ELECTRIC GENERAL RATE APPLICATION 2015

Manitoba Hydro Undertaking #39

Manitoba Hydro to provide the most recent updates of the financial institutions who contribute to the consensus forecast.

Response:

The publically available sources of forecasts for May or June 2015 used by Manitoba Hydro in its consensus forecasting are attached.

Also included in this exhibit is an update to MH Exhibit #58 that includes a consensus forecast of the publically available sources from May/June 2015. The updated tables provided below compare forecasts of Manitoba Hydro Canadian Short-term and Long-term interest rates as well as CAD/USD exchange rates from four different forecast times – Fall 2014, January 2015, Spring 2015 and May/June 2015. As in the interest rate forecasts provided in MH Exhibit #58, the forecast of interest rates in the tables below includes the 1.0% Manitoba provincial guarantee fee as well as any associated borrowing spreads.

Depending on the timing of the preparation of a consensus forecast – Fall 2014 Update, January 2015 Update, Spring 2015 Economic Outlook, May/June 2015 Update – not all sources have an updated forecast to be used in the consensus and should therefore be compared with caution. The timing of Manitoba Hydro's annual Spring Economic Outlook coincides with the preparation of the outlooks from all of the sources used by Manitoba Hydro. Forecasts prepared at other times of the year by Manitoba Hydro result in one or more sources not being included as they do not prepare an updated forecast. Most of the short-term forecasting sources provide updated forecasts quarterly or more often while the longer term forecasting sources tend to prepare forecasts annually or semi-annually.

The consensus forecasts from the **Spring 2015 Economic Outlook** include forecasts from the full suite of sources used by Manitoba Hydro which include the following:

Financial Institutions	Private Sector Sources
BMO Capital Markets	IHS Global
CIBC World Markets	Conference Board of Canada
National Bank of Canada	Spatial Economics
Royal Bank of Canada	
Scotiabank	
TD Economics	
Desjardins Bank	
Laurentian Bank of Canada	

The consensus forecasts from the **Fall 2014 Update, which were used in IFF14**, include forecasts from all but one from the full suite of sources used by Manitoba Hydro and include the following (Spatial Economics is not included):

Financial Institutions	Private Sector Sources
BMO Capital Markets	IHS Global
CIBC World Markets	Conference Board of Canada
National Bank of Canada	
Royal Bank of Canada	
Scotiabank	
TD Economics	
Desjardins Bank	
Laurentian Bank of Canada	

The consensus forecasts from the **January 2015 Update**, which were used in Manitoba Hydro's response to PUB/MH I-10b, exclude updates from Laurentian Bank of Canada, Conference Board of Canada and Spatial Economics but include forecasts from the following sources:

Financial Institutions	Private Sector Sources
BMO Capital Markets	IHS Global
CIBC World Markets	
National Bank of Canada	
Royal Bank of Canada	
Scotiabank	
TD Economics	
Desjardins Bank	

The consensus forecasts from the **May/June 2015 Update**, which were used in response to this Undertaking #39, exclude updates from Laurentian Bank of Canada, IHS Global, Conference Board of Canada and Spatial Economics but include forecasts from the following sources:

Financial Institutions	Private Sector Sources
BMO Capital Markets	
CIBC World Markets	
National Bank of Canada	
Royal Bank of Canada	
Scotiabank	
TD Economics	
Desjardins Bank	

The following tables compare the consensus forecasts of interest rates and exchange rates as provided in MH Exhibit #58 with the addition of consensus forecasts from the publically available sources from May/June 2015.

Manitoba Hydro Canadian Short-term Rate - %

	Fall Update EO 2014 (IFF14)	January 2015 Update	Δ from Fall 2014	Spring EO 2015	Δ from Jan 2015	May/June 2015 Update	Δ from Spring EO 2015
2014/15	1.95%	1.85%	-0.10%	-	-	-	-
2015/16	2.30%	1.50%	-0.80%	1.70%	0.20%	1.65%	-0.05%
2016/17	3.40%	1.95%	-1.45%	2.25%	0.30%	1.90%	-0.35%
2017/18	4.10%	3.30%	-0.80%	3.75%	0.45%	-	-
2018/19	4.45%	3.95%	-0.50%	4.25%	0.30%	-	-
2019/20	4.90%	4.50%	-0.40%	4.50%	0.00%	-	-
2020/21	4.90%	4.50%	-0.40%	4.55%	0.05%	-	-
2021/22	4.90%	4.50%	-0.40%	4.60%	0.10%	-	-
2022/23	4.90%	4.50%	-0.40%	4.60%	0.10%	-	-
2023/24	4.90%	4.50%	-0.40%	4.60%	0.10%	-	-

Manitoba Hydro Canadian Long-term Rate - %

	Fall Update EO 2014 (IFF14)	January 2015 Update	Δ from Fall 2014	Spring EO 2015	Δ from Jan 2015	May/June 2015 Update	Δ from Spring EO 2015
2014/15	4.50%	4.20%	-0.30%	-	-	-	-
2015/16	5.10%	4.00%	-1.10%	4.00%	0.00%	3.95%	-0.05%
2016/17	5.50%	4.55%	-0.95%	4.70%	0.15%	4.40%	-0.30%
2017/18	5.80%	5.70%	-0.10%	5.80%	0.10%	-	-
2018/19	6.00%	5.75%	-0.25%	6.00%	0.25%	-	-
2019/20	6.20%	5.75%	-0.45%	6.10%*	0.40%	-	-
2020/21	6.20%	5.75%	-0.45%	6.25%	0.50%	-	-
2021/22	6.20%	5.75%	-0.45%	6.35%	0.60%	-	-
2022/23	6.20%	5.75%	-0.45%	6.35%	0.60%	-	-
2023/24	6.20%	5.75%	-0.45%	6.35%	0.60%	-	-

* The rate for fiscal year 2019/20 was reported incorrectly in MH Exhibit #58. The rate of 6.10% is the correct rate.

CAD/USD Exchange Rate

	Fall Update EO 2014 (IFF14)	January 2015 Update	Δ from Fall 2014	Spring EO 2015	Δ from Jan 2015	May/June 2015 Update	Δ from Spring EO 2015
2014/15	1.10	1.13	+0.03	-	-	-	-
2015/16	1.12	1.29	+0.17	1.27	-0.02	1.26	-0.01
2016/17	1.12	1.25	+0.13	1.23	-0.02	1.24	+0.01
2017/18	1.12	1.13	+0.01	1.16	+0.03	-	-
2018/19	1.12	1.11	-0.01	1.15	+0.04	-	-
2019/20	1.10	1.10	-	1.14	+0.04	-	-
2020/21	1.10	1.09	-0.01	1.13	+0.04	-	-
2021/22	1.10	1.09	-0.01	1.13	+0.04	-	-
2022/23	1.10	1.09	-0.01	1.13	+0.04	-	-
2023/24	1.10	1.10	-	1.13	+0.03	-	-

Canadian Economic Outlook

BMO Capital Markets Economics

May 29, 2015

	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2013	2014	2015	2016
PRODUCTION	(quarter/quarter % change : a.r.)															
Real GDP (chain-weighted)	1.0	3.4	3.2	2.2	-0.6	0.5	3.5	2.2	2.2	2.3	2.0	2.1	2.0	2.4	1.5	2.2
Final Sales	1.9	5.5	3.9	0.7	-1.4	0.9	3.5	2.3	2.3	2.4	2.1	2.1	1.8	2.7	1.3	2.3
Final Domestic Demand	0.3	2.8	2.6	1.6	-1.6	-0.9	2.2	1.6	2.0	2.1	2.0	2.1	1.5	1.6	0.6	1.8
Consumer Spending	1.3	4.3	2.7	2.1	0.4	1.3	3.5	2.3	2.2	2.0	2.0	2.0	2.5	2.7	1.9	2.3
Durables	1.9	14.3	8.5	1.6	-5.5	3.0	3.0	2.0	2.0	1.5	1.8	1.5	3.8	5.1	1.8	2.0
Non-Durables	2.7	-0.5	-0.1	2.2	3.0	1.6	3.5	2.3	2.3	2.2	2.0	2.0	2.3	2.4	2.0	2.3
Services	1.5	3.9	2.7	2.1	0.5	0.8	3.6	2.4	2.2	2.0	2.0	2.1	2.3	2.3	1.8	2.3
Government Spending	-1.1	1.3	-0.9	1.7	0.5	0.2	0.7	1.1	1.1	1.5	1.3	1.5	0.1	-0.3	0.6	1.1
Business Investment	-0.7	1.4	4.1	-2.0	-15.5	-13.4	0.2	0.4	4.0	5.7	5.6	6.1	2.6	0.2	-6.4	2.3
Non-Residential Construction	-1.5	0.6	0.9	-1.7	-19.7	-16.0	0.0	0.0	4.0	5.8	6.0	6.5	5.0	-0.1	-8.5	2.1
Machinery and Equipment	0.8	3.1	10.2	-2.5	-7.4	-9.0	0.5	1.0	4.0	5.5	5.0	5.5	-1.7	1.0	-2.6	2.6
Residential Construction	-2.4	10.2	11.8	0.3	4.0	-2.0	0.5	0.0	0.0	-0.5	-1.0	-1.0	-0.4	2.7	2.7	-0.3
Exports	0.5	19.6	8.4	-1.7	-1.1	2.1	5.4	5.3	5.1	4.6	4.4	4.1	2.0	5.4	2.9	4.7
Imports	-4.5	9.8	4.2	1.6	-1.5	-3.5	1.3	3.0	4.1	3.7	4.0	3.9	1.3	1.8	0.7	3.0
	(billions of chained 2007 dollars : a.r.)															
Inventory Change	14.8	5.7	1.2	8.5	11.5	9.7	9.8	9.4	9.1	8.8	8.6	8.6	12.4	7.5	10.1	8.8
Contribution to GDP Growth	-0.6	-2.2	-1.1	1.9	0.8	-0.4	0.0	-0.1	-0.1	-0.1	-0.1	0.0	0.2	-0.3	0.2	-0.1
Net Exports	-30.7	-19.8	-14.5	-19.3	-18.6	-10.6	-5.0	-1.8	-0.5	0.8	1.4	1.6	-39.6	-21.1	-9.0	0.8
Contribution to GDP Growth	1.6	3.0	1.3	-1.1	0.2	1.8	1.3	0.7	0.3	0.2	0.1	0.0	0.2	1.1	0.7	0.5
	(billions of dollars : a.r.)															
Nominal GDP	1,950	1,968	1,990	1,992	1,977	1,989	2,014	2,038	2,066	2,093	2,119	2,145	1,894	1,975	2,005	2,106
(% chng : a.r.)	6.6	3.8	4.4	0.4	-2.9	2.5	5.1	4.9	5.6	5.3	5.0	5.1	3.4	4.3	1.5	5.0
INFLATION	(quarter/quarter % change : a.r.)															
GDP Price Index	5.5	0.4	1.1	-1.8	-2.1	1.9	1.5	2.6	3.3	3.0	2.9	3.0	1.4	1.8	-0.0	2.7
CPI All Items	3.2	3.3	1.2	-0.0	-0.2	1.9	2.5	1.8	1.8	2.1	2.2	2.4	0.9	1.9	1.1	2.0
Excl. Food & Energy	2.3	2.0	2.2	1.5	1.9	2.3	2.3	1.5	1.6	1.9	2.0	2.4	0.8	1.6	1.9	1.9
Food Prices	1.4	5.5	2.1	3.9	4.9	2.6	2.6	2.5	1.7	2.0	1.6	2.1	1.2	2.3	3.5	2.1
Energy Prices	12.4	10.9	-6.8	-17.3	-27.8	-0.2	4.5	3.1	3.5	5.0	5.2	3.4	1.5	3.5	-10.6	3.8
Services	1.6	3.6	3.3	0.2	1.9	1.7	2.0	2.1	2.1	2.3	2.0	2.2	1.4	2.1	1.9	2.1
	(year/year % change)															
CPI All Items	1.4	2.2	2.1	1.9	1.1	0.7	1.1	1.5	2.0	2.0	2.0	2.1				
BoC Core	1.3	1.7	2.0	2.2	2.2	2.2	2.3	2.3	2.1	2.0	2.0	2.1	1.2	1.8	2.3	2.1
FINANCIAL	(average for the quarter : %)															
Overnight Rate	1.00	1.00	1.00	1.00	0.75	0.75	0.75	0.75	0.75	0.75	1.00	1.25	1.00	1.00	0.75	0.95
3-Month T-Bill	0.87	0.93	0.94	0.90	0.62	0.64	0.65	0.65	0.65	0.65	0.90	1.14	0.97	0.91	0.64	0.84
90-Day BAs	1.26	1.27	1.28	1.28	1.03	0.99	0.99	0.99	0.99	0.99	1.23	1.46	1.20	1.27	1.00	1.17
10 Year Bond Yield	2.47	2.35	2.14	1.95	1.44	1.63	1.76	1.82	1.90	1.98	2.07	2.17	2.26	2.23	1.66	2.03
Canada/US spread: (bps)																
90 day	82	90	91	87	60	62	56	31	7	-17	-17	-17	91	88	52	-11
10 year	-30	-27	-36	-33	-52	-48	-47	-49	-51	-54	-55	-55	-9	-31	-49	-54
FOREIGN TRADE	(billions of dollars : a.r.)															
Current Account Balance	-41.2	-36.5	-36.1	-52.2	-69.9	-59.8	-53.6	-48.5	-43.1	-39.6	-36.1	-33.2	-56.3	-41.5	-58.0	-38.0
(% of GDP)	-2.1	-1.9	-1.8	-2.6	-3.5	-3.0	-2.7	-2.4	-2.1	-1.9	-1.7	-1.5	-3.0	-2.1	-2.9	-1.8
Merchandise Balance	7.5	10.2	10.4	-8.1	-29.0	-18.9	-14.0	-10.8	-7.5	-4.9	-2.4	-0.4	-7.2	5.0	-18.2	-3.8
Non-Merchandise Balance	-48.7	-46.7	-46.5	-44.1	-40.9	-40.9	-39.6	-37.8	-35.6	-34.7	-33.7	-32.9	-49.0	-46.5	-39.8	-34.2
	(average for the quarter)															
Exchange Rate (US¢/C$)	90.6	91.7	91.8	88.1	80.6	81.9	80.6	79.8	80.9	82.1	83.4	84.7	97.1	90.6	80.7	82.8
Exchange Rate (C$/US$)	1.103	1.090	1.089	1.135	1.241	1.221	1.240	1.254	1.236	1.217	1.199	1.181	1.030	1.105	1.239	1.208
Exchange Rate (¥/C$)	93.1	93.6	95.5	100.8	96.0	98.4	98.6	99.1	101.8	104.4	107.0	109.7	94.7	95.8	98.0	105.7
Exchange Rate (C$/Euro)	1.51	1.50	1.44	1.42	1.40	1.35	1.37	1.36	1.31	1.27	1.23	1.19	1.37	1.47	1.37	1.25
INCOMES	(year/year % change)															
Corporate Profits Before Tax	10.4	18.9	10.7	3.9	-18.8	-22.5	-22.9	-17.9	2.3	8.2	9.7	11.2	0.7	10.8	-20.5	7.9
Corporate Profits After Tax	3.3	9.1	8.8	9.2	-6.7	-10.3	-12.8	-13.4	1.8	4.9	5.7	6.6	7.3	7.6	-10.9	4.7
Personal Income	3.2	3.5	3.6	3.2	3.5	2.6	3.3	3.7	3.8	5.1	4.8	4.8	3.7	3.4	3.3	4.6
Real Disposable Income	1.5	1.4	1.7	1.2	2.5	2.1	2.6	2.6	1.8	2.8	2.2	2.0	2.5	1.5	2.5	2.2
	(average for the quarter : %)															
Savings Rate	4.8	3.8	3.7	3.6	5.0	4.2	4.5	4.4	4.5	4.6	4.5	4.4	5.2	4.0	4.5	4.5
OTHER INDICATORS	(quarter average)															
Unemployment Rate (%)	7.0	7.0	7.0	6.7	6.7	6.9	6.9	6.8	6.7	6.6	6.5	6.5	7.1	6.9	6.8	6.6
Housing Starts (000s, a.r.)	176	196	199	184	175	178	176	183	178	179	181	183	188	189	178	180
Existing Home Sales (y/y % ch)	1.7	6.5	6.0	6.2	5.6	1.5	-4.5	-2.0	2.8	0.4	3.0	1.8	0.7	5.1	0.0	2.0
MLS Home Price Index (y/y % ch)	5.1	5.1	5.3	5.4	5.0	4.3	2.3	0.6	-0.2	-0.5	0.3	0.4	2.7	5.2	3.0	0.0
Motor Vehicle Sales (mlns, a.r.)	1.77	1.85	1.98	1.95	1.83	1.88	1.84	1.83	1.84	1.85	1.86	1.87	1.77	1.89	1.85	1.86
	(quarter/quarter % change : a.r.)															
Employment Growth	0.6	-0.0	0.7	1.6	0.7	-0.0	0.3	0.7	1.4	1.2	1.2	1.2	1.4	0.6	0.6	1.0
Industrial Production	6.1	5.3	0.7	3.6	-4.5	-3.8	1.1	2.1	3.6	3.8	3.5	3.2	1.8	4.1	-0.5	2.5
Federal Budget Balance (% of FY GDP)													-0.3	-0.1	0.1	0.1

Note: Outlined areas represent forecast periods

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Divergence and Convergence

by Avery Shenfeld

Half Steam Ahead

Since the start of the year, we've cut our global growth forecast by nearly a half point to 2.9%, the softest since the recession. That owes to a divergence between an improving developed world and a deterioration in emerging markets.

US fundamentals still look healthy despite the poor Q1 outturn. Unless America's business leaders are totally out of touch, their brisk hiring points to solid demand growth ahead. Political risks in Greece (and Spain later this year) won't be enough to take the Eurozone off a clear recovery path, with lots of headroom for non-inflationary growth. But a downshifting in China and recessions in Russia and Brazil are contributing to a much less impressive overall pace.

Like Toronto Maple Leafs fans, we are once again holding onto hopes that next year can only be better. Stimulus efforts today should boost EM results next year. But there are also secular forces, including slower trend growth in an aging west, that will limit the bounce to about 3½% in 2016, well below the nearly 5% global growth pace seen in the five years leading up to the last recession.

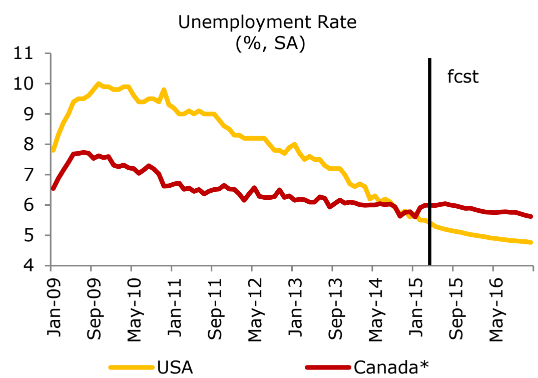
For financial markets, increased volatility could be the name of the game in the next six quarters. Diverging economic performance will mean mixed messages for investors, and will drive swings that could temporarily shake the equity market's complacency.

Canada in a Not-So-Super Cycle

We're slashing our 2015 growth forecast for Canada by more than a quarter point

Chart 1

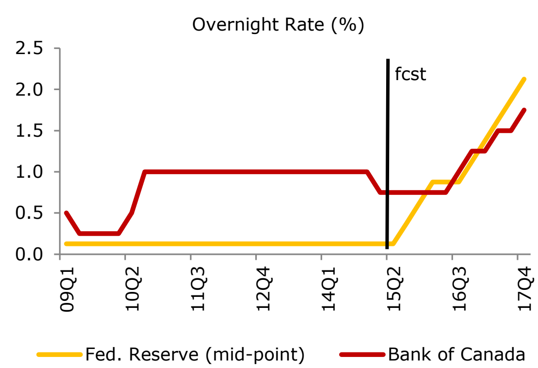
Labour Markets Have Converged ...



** Measured using US methodology for comparability*
Source: Statistics Canada, BLS, CIBC

Chart 2

... And So Will Policy Rates



Source: BoC, Federal Reserve, CIBC

Table 1

FORECAST SUMMARY
(% Change Except Where Noted)

CANADA	15Q1A	15Q2F	15Q3F	15Q4F	16Q1F	2014A	2015F	2016F
Real GDP Growth (AR)	-0.6	0.7	1.7	3.0	3.2	2.4	1.4	2.7
Real Final Domestic Demand (AR)	-1.6	1.4	0.7	1.4	1.5	1.6	0.8	1.4
Household Consumption (AR)	0.4	3.1	1.9	1.9	1.6	2.7	2.0	1.7
All Items CPI Inflation (Y/Y)	1.1	0.5	0.6	1.2	2.1	1.9	0.8	2.2
Core CPI Ex Indirect Taxes (Y/Y)	2.2	2.1	2.0	2.0	2.0	1.8	2.1	2.0
Unemployment Rate (%)	6.7	6.9	7.0	6.9	6.8	6.9	6.9	6.7

U.S.	15Q1A	15Q2F	15Q3F	15Q4F	16Q1F	2014A	2015F	2016F
Real GDP Growth (AR)	-0.7	3.0	4.2	2.5	1.8	2.4	2.4	2.5
Real Final Sales (AR)	-1.1	3.4	4.0	3.0	2.4	2.3	2.3	2.8
All Items CPI Inflation (Y/Y)	-0.1	-0.1	0.5	1.8	3.1	1.6	0.5	2.6
Core CPI Inflation (Y/Y)	1.7	1.8	2.0	2.2	2.4	1.7	1.9	2.3
Unemployment Rate (%)	5.6	5.3	5.2	5.1	5.0	6.2	5.3	4.9

Table 2

INTEREST AND EXCHANGE RATE FORECAST

		2015			2016			
END OF PERIOD:		**2-Jun**	**Sep**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**
CDA	Overnight target rate	0.75	0.75	0.75	0.75	0.75	1.00	1.25
	98-Day Treasury Bills	0.60	0.70	0.70	0.70	0.70	1.00	1.20
	2-Year Gov't Bond	0.58	0.70	0.90	1.20	1.35	1.50	1.70
	10-Year Gov't Bond	1.68	1.90	2.10	2.00	2.15	2.55	2.65
	30-Year Gov't Bond	2.28	2.50	2.60	2.50	2.65	2.85	3.05
U.S.	Federal Funds Rate	0.125	0.375	0.625	0.875	0.875	0.875	1.125
	91-Day Treasury Bills	0.01	0.30	0.55	0.75	0.75	0.80	1.00
	2-Year Gov't Note	0.66	1.00	1.05	1.30	1.40	1.50	1.55
	10-Year Gov't Note	2.26	2.60	2.85	2.70	2.75	2.95	3.10
	30-Year Gov't Bond	3.02	3.15	3.35	3.25	3.40	3.50	3.60
Canada - US T-Bill Spread		0.59	0.40	0.15	-0.05	-0.05	0.20	0.20
Canada - US 10-Year Bond Spread		-0.58	-0.70	-0.75	-0.70	-0.60	-0.40	-0.45
Canada Yield Curve (30-Year — 2-Year)		1.70	1.80	1.70	1.30	1.30	1.35	1.35
US Yield Curve (30-Year — 2-Year)		2.35	2.15	2.30	1.95	2.00	2.00	2.05
EXCHANGE RATES	CADUSD	0.80	0.79	0.79	0.81	0.81	0.82	0.81
	USDCAD	1.24	1.27	1.26	1.24	1.23	1.22	1.24
	USDJPY	124	126	126	125	122	120	118
	EURUSD	1.11	1.05	1.08	1.12	1.15	1.18	1.21
	GBPUSD	1.53	1.52	1.57	1.61	1.60	1.61	1.61
	AUDUSD	0.77	0.74	0.75	0.77	0.79	0.82	0.85
	USDCHF	0.93	1.00	0.99	0.96	0.94	0.92	0.90
	USDBRL	3.14	3.02	3.13	3.18	3.22	3.21	3.21
	USDMXN	15.42	14.93	14.85	14.80	14.79	14.80	14.83

to only 1.4%, stung by a downside miss in Q1, and an end-of-quarter picture that depressed the Q2 outlook. Even thereafter, a not-so-super cycle will see a recovery in commodities that will leave them well below prior peaks. A less-globally-exposed US, with much more pent-up demand in its less-indebted household sector, will jump to the lead over Canada in growth after a virtual tie in the last two quarters (Table 1).

Since Canada outpaced the US during the recession and early recovery, divergence in growth has already generated a convergence in economic slack (Chart 1), necessitating a parallel convergence in short term rates (Chart 2). The Fed will carry through on Yellen's clear intention to hike rates this year. But a soft Q1, and tame core PCE, will see the Fed wait until September to pull the trigger, needing more assurance that growth has rebounded.

Even with the Fed on hold, longer-dated Treasuries have been on a roller coaster this year, taking Canadian bonds along for the ride. North American yields nosedived as investors fell under the spell of ECB QE bond buying. In May, the market simply came to its senses, and realized the risk of locking in money for long dates at negative nominal yields in Europe and negative real rates in North America.

But more of a shake-up lies ahead. The first nudge in the funds rate will likely see the market overshoot rate hike expectations until the Fed pauses in early 2016 (Table 2).

Despite all that volatility, slower trend growth and reduced incentives for capital spending at any given interest rate will see central banks and bond markets settle at what by historical standards will still be unusually low yields. That's just the next chapter in a story dating back to the 1980s, in which successive cycles have required lower average real interest rates to reach and stay at full employment.

In Canada, it's easier to forecast where the currency is going (a few cents weaker after the first Fed hike, then recovering only modestly), than to project the interest rate settings that will make it so. Governor Poloz's optimistic forecast for the next six quarters repeatedly cites the underpinning of a softer exchange rate. While another ease is very much on the table, if the Fed actually hikes by September, the BoC will be relieved of the burden to cut again as the loonie weakens. Keeping the C$ range bound as oil recovers will see the Bank of Canada stay on hold right through the first half of 2016.

Choppy Waters for Equities

Equities should outperform bonds next year, but could be more volatile in the next couple of quarters. Our top-down leading indicator model, which translates trends in Canadian and US GDP growth, oil prices and other key variables into forward earnings, projects a modest 6% growth rate for year-on-year earnings in the coming four quarters, well below the double-digit Bloomberg consensus.

That would put the Composite index at a lofty 20 times forward multiple if you substitute our model's earnings projection for the bottom up consensus. While that's heavily tilted towards huge multiples on energy stocks, the market's path could still see-saw as earnings downgrades for 2015 trade off against economic hopes for the following year.

But closer to year-end, the picture for 2016 will take centre stage. Our macro model looks for a heady 18% bounce in calendar 2016 earnings, lifted by improved global growth, firmer prices for oil and lumber, and improved Canadian economic performance. The denominator for discounting future earnings and dividends will be a bit higher, which will eat into the multiple. But as we've seen in the past, that can be more than offset by a bright picture for earnings and dividends growth during a gentle and early stage of a tightening cycle.

The US Economy: Back to the New Norm

Andrew Grantham

It's déjà vu all over again for the US economy, with 2015 following much the same path as 2014. We're not even halfway through the calendar, and elevated expectations for GDP growth at the start of the year are already hanging by a thread, following a soft first quarter.

In part, the disappointment is due to overly optimistic expectations of what kind of growth rate the US economy can achieve these days, given productivity and demographic challenges (see *"Two is the New Three: The US Economic Speed Limit"*). But it's also because growth hasn't responded as expected to the slide in oil prices.

Re-oiling the Wheel

Surging production in US shale was one of the major causes of global oversupply in the oil market and the sharp decline in benchmark prices. While it did reduce the US dependence on imported oil by roughly two-thirds, even in mid-2014, the US was still a significant net importer. As a result, it should still be a net beneficiary of lower crude prices.

But so far we seem to have seen more negatives than positives. Investment in the oil industry has taken a big hit, weighing on GDP through capital spending. However, rig counts are stabilizing, suggesting the worst of the cutbacks could be over, and slightly higher oil prices come 2016 should see some of that spending come back. The same could be true of another recent source of investment weakness—machinery orders in manufacturing—now that the rapid appreciation of the US$ has stalled (Chart 1).

Table 1

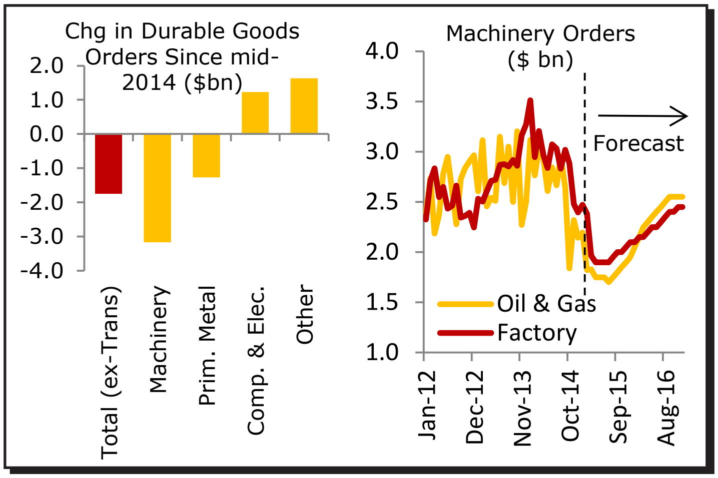
US FORECAST DETAIL

(real % change, s.a.a.r., unless otherwise noted)

	15:1A	15:2F	15:3F	15:4F	16:1F	16:2F	16:3F	2014A	2015F	2016F
GDP At Market Prices ($Bn)	17,665	17,898	18,196	18,416	18,602	18,796	19,009	17,419	18,044	18,908
% change	-0.9	5.4	6.8	4.9	4.1	4.2	4.6	3.9	3.6	4.8
Real GDP ($2009 Bn)	16,264	16,385	16,556	16,656	16,730	16,820	16,927	16,086	16,465	16,878
% change	-0.7	3.0	4.2	2.5	1.8	2.2	2.6	2.4	2.4	2.5
Final Sales	-1.1	3.4	4.0	3.0	2.4	2.4	2.4	2.3	2.3	2.8
Personal Consumption	1.8	2.4	3.9	2.9	3.0	2.0	2.3	2.5	3.0	2.8
Total Govt. Expenditures	-1.1	2.2	1.4	0.5	-1.0	1.1	1.2	-0.2	0.6	0.6
Residential Construction	4.9	17.5	17.5	8.0	6.0	9.6	9.5	1.6	8.8	9.7
Business Fixed Investment	-2.8	4.7	6.2	5.2	6.7	7.3	5.4	6.3	3.8	6.0
Inventory Change ($2009 Bn)	95.0	79.3	89.6	69.4	44.6	36.7	43.6	70.6	83.3	41.2
Exports	-7.6	7.0	6.0	5.0	4.0	5.0	4.1	3.2	2.4	4.8
Imports	5.6	4.0	7.0	4.6	6.8	7.0	6.0	4.0	5.8	6.0
GDP Deflator	-0.1	2.3	2.5	2.4	2.3	2.0	2.0	1.5	1.2	2.2
CPI (yr/yr % chg)	-0.1	-0.1	0.5	1.8	3.1	2.7	2.4	1.6	0.5	2.6
Core CPI (yr/yr % chg)	1.7	1.8	2.0	2.2	2.4	2.3	2.2	1.7	1.9	2.3
Unemployment Rate (%)	5.6	5.3	5.2	5.1	5.0	4.9	4.8	6.2	5.3	4.9
Housing Starts (AR, K)	975	1,118	1,160	1,220	1,280	1,340	1,400	1,001	1,118	1,370

Chart 1

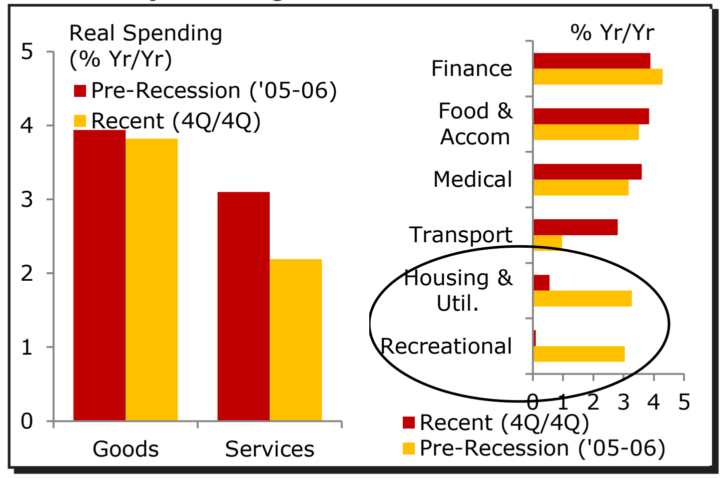
Machinery Orders Slump (L), Should Recover in 2016 (R)



Source: BEA, CIBC

Chart 2

Spending Lagging in Services, Not Goods (L), Particularly Housing and Recreation (R)



Source: BEA, CIBC

Spending Rather than Saving

The weakness in investment was expected, however, to have been eclipsed by a pick-up in real consumer spending with households having to spend less every time they fill up their cars. True, gasoline prices have risen quite a way off their previous lows. But compared to what they were paying in mid-2014, US households are still racking up meaningful savings at the pumps. Yet that hasn't translated into higher spending. Indeed, the three-month annualized rate of core retail sales has been the weakest since the recession.

In part, the recent soft consumption figures are a pay-back for spending getting ahead of income growth in the second half of 2014. With savings now replenished and gasoline prices still lower than a year ago, spending prospects should improve in the coming months. In particular, compared with growth rates prior to the recession, it's spending on services, not goods, where there's the most room to make up (Chart 2).

Recent weakness in spending growth on leisure/recreation already appears at odds with higher consumer confidence (Chart 3, left) and rising spending on eating out. With US job gains over the past year more tilted towards younger Americans than they were in the early stages of the recovery, that's one area of spending that should benefit.

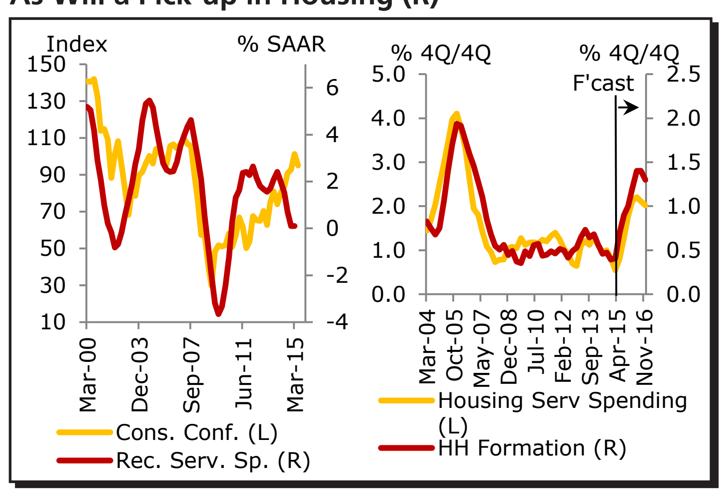
Housing: The Bricks and Mortar for Growth

But for another area of service spending to pick up, we're going to have to see a turnaround in the housing market (Chart 3, right). Spending growth on housing-related services, as well as household furnishing and refurbishment, remains well below pre-recession rates. Yet adding these areas to residential construction, it is easy to see that housing remains a very important determinant of the US economy (Chart 4, left). We've previously argued that the improved employment prospects for young people should help household formation, which does appear to have perked up recently.

Initially there will continue to be a greater leaning towards renting rather than home ownership. But if finances continue to improve as we expect, that should also turn around. The headline home-ownership rate in the US has fallen sharply to its lowest since the mid-1990s. And controlling for the older population reveals an even

Chart 3

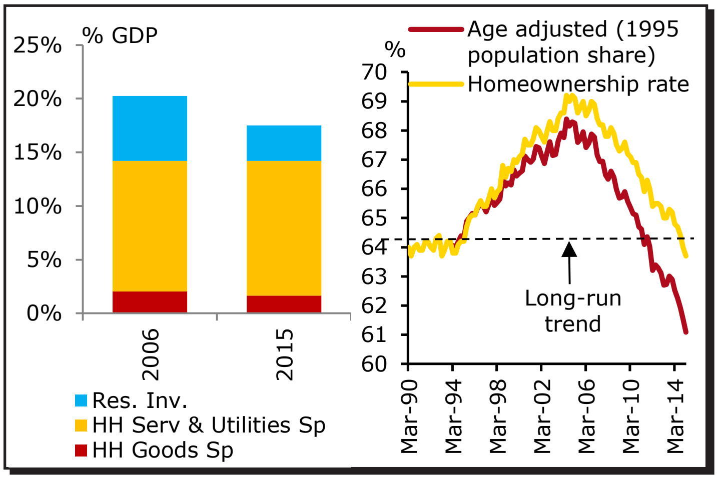
Consumer Confidence to Aid Spending (L), As Will a Pick-up in Housing (R)



Source: Conference Board, BEA, CIBC

Chart 4

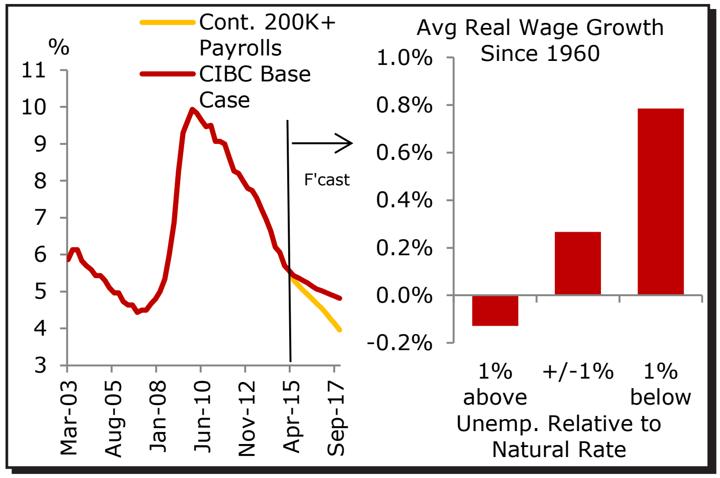
Housing Importance Goes Further Than Construction (L), Home Ownership Very Low (R)



Source: Census Bureau, NAR, BEA, CIBC

Chart 5

Moderate Payroll Growth Would See Historic Low Jobless Rate (L), Possibly Wage Pressures (R)



Source: BLS, CIBC

sharper decline, and plenty of pent-up demand to be unleashed in the coming years (Chart 4, right), particularly if, as we expect, mortgage rates rise only gradually.

Early Hike to Avoid Rate Mountain

To have the luxury of employing an only gradual climb in rates, the Fed will have to start hiking sooner rather than later. If the economy keeps growing at even the modest rate it has since the recession ended, and keeps adding 200K or so jobs to payrolls every month, we would be at decade-low levels of unemployment before the end of 2017 (Chart 5, left)—levels of unemployment that would typically result in significant real wage gains (Chart 5, right), and other inflationary pressures.

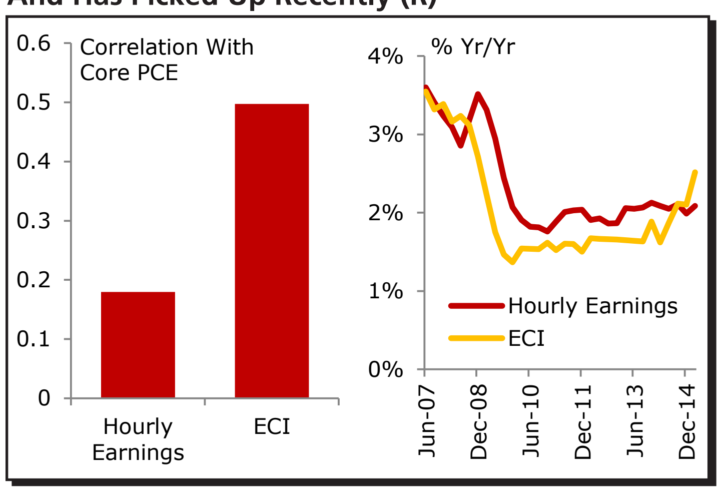
And we're starting to see signs that wages are picking up. Sure, average hourly earnings (AHE) have been a source of serial disappointment in the latest payroll releases. But that series doesn't account for changes in the composition of the economy or the characteristics of the workforce. The average age of a US worker, for example, has edged down a little recently after rising for years, which would depress the AHE figures. The Employment Cost Index accounts for such changes, is a measure preferred by the Fed, and has a better correlation with core inflation. Of note, it has been on a definite uptrend recently (Chart 6).

Core inflation has also firmed a bit, despite the fact that a strong US$ is weighing on imported content. And were it not for one important area—medical care services—it would be looking a little firmer still. An area where prices historically have risen quickly, medical inflation has recently been more subdued, and its weight has grown within the CPI basket. Its even higher weighting within core PCE could account for the recent divergence between that indicator and the CPI.

Residential investment and related consumer spending should be the bricks and mortar that support US GDP growth this year, with business investment building on better recent trends to also become a driver again in 2016. Yet even with that support, GDP growth will remain on the same 2½% growth track next year. While that's unimpressive by historic standards, it would be enough in today's environment to result in inflation down the road if the Fed doesn't start gently tapping the brakes soon.

Chart 6

ECI More Correlated With Inflation (L), And Has Picked Up Recently (R)



Source: BLS, BEA, CIBC

Canadian Outlook: Waiting for the Rotation

Benjamin Tal and Nick Exarhos

Households and the energy sector have carried the Canadian economy on their shoulders to 2014. But the oil patch will continue to suffer as prices for crude establish a lower and more volatile equilibrium, while consumer spending has less room to respond to low interest rates. As a result, the Bank of Canada understandably is counting on a "natural sequence" of stronger non-energy exports and increased investment to save the day. But the reality is that it will take time for the most meaningful benefits of a more competitive exchange rate to arrive.

No Silver Bullets for Labour Market

The Canadian consumer has had ample time to take full advantage of low borrowing costs. After that earlier shopping spree, consumption has now less room to be a growth catalyst on its own, without support from job creation sparked elsewhere. The benefit from lower federal taxes and cheaper gas prices might provide a temporary lift, but some of those windfalls may be stashed away for rainy days, or used to cover provincial tax hikes.

Consumers had held down savings at extremely low levels in 2014. In fact, by Q4 the decline in the savings rate to 3.6% had contributed roughly 1.5 percentage points to year-on-year consumer spending growth. The start of 2015 saw that trend break. While the 5% Q1 rate can retreat slightly in the quarters ahead, employment and salary gains will have to be the primary driver of continued momentum in consumption.

Given the growth composition of today's labour market and the fiscal situation in many of Canada's largest provinces, it's difficult to see how job creation will take off in the short to medium term. Payrolls in the oil patch have been slashed, with more pain likely ahead. And there are other headwinds elsewhere.

Table 1

CANADA FORECAST DETAIL

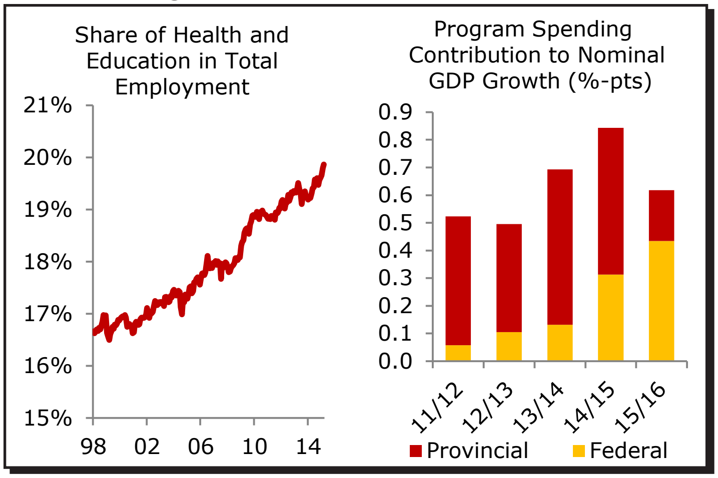
(real % change, s.a.a.r., unless otherwise noted)

	15:1A	15:2F	15:3F	15:4F	16:1F	16:2F	16:3F	16:4F	2014A	2015F	2016F
GDP At Market Prices ($Bn)	1,977	1,993	2,020	2,053	2,079	2,104	2,132	2,158	1,975	2,011	2,118
% change	-2.9	3.2	5.7	6.7	5.0	5.0	5.4	5.0	4.3	1.8	5.3
Real GDP ($2007 Bn)	1,762	1,765	1,773	1,786	1,800	1,814	1,827	1,839	1,747	1,772	1,820
% change	-0.6	0.7	1.7	3.0	3.2	3.0	2.9	2.6	2.4	1.4	2.7
Final Domestic Demand	-1.6	1.4	0.7	1.4	1.5	1.7	1.6	1.5	1.6	0.8	1.4
Household Consumption	0.4	3.1	1.9	1.9	1.6	1.6	1.3	1.2	2.7	2.0	1.7
Total Govt. Expenditures	0.5	-1.3	-1.1	0.6	0.4	0.6	0.5	0.4	-0.3	0.1	0.2
Residential Construction	4.0	2.0	-3.2	-2.2	-1.2	0.8	1.0	0.2	2.7	2.9	-0.7
Business Fixed Investment*	-16.1	-0.9	0.9	3.0	4.0	4.6	5.7	5.2	-0.2	-3.9	3.5
Inventory Change ($2007 Bn)	11.5	3.0	2.3	4.0	6.4	8.3	9.9	11.0	7.5	5.2	8.9
Exports	-1.1	6.9	5.2	5.1	5.6	5.1	5.2	5.0	5.4	3.8	5.4
Imports	-1.5	3.0	1.4	1.6	1.9	2.5	2.3	2.2	1.8	1.9	2.0
GDP Deflator	-2.1	2.4	3.9	3.6	1.7	2.0	2.4	2.3	1.8	0.4	2.6
CPI (yr/yr % chg)	1.1	0.5	0.6	1.2	2.1	2.2	2.2	2.2	1.9	0.8	2.2
Core CPI (yr/yr % chg)	2.2	2.1	2.0	2.0	2.0	2.0	2.0	2.1	1.8	2.1	2.0
Unemployment Rate (%)	6.7	6.9	7.0	6.9	6.8	6.7	6.7	6.6	6.9	6.9	6.7
Employment Change (K)	31	-1	35	53	55	53	49	54	111	130	191
Goods Trade Balance (AR, $bn)	-29.0	-24.8	-17.8	-9.1	-1.4	2.7	8.1	15.4	5.0	-20.2	6.2
Housing Starts (AR, K)	175	189	192	189	190	186	186	188	189	186	187

* M&E plus Non-Res Structures and Intellectual Property and NPISH

Chart 1

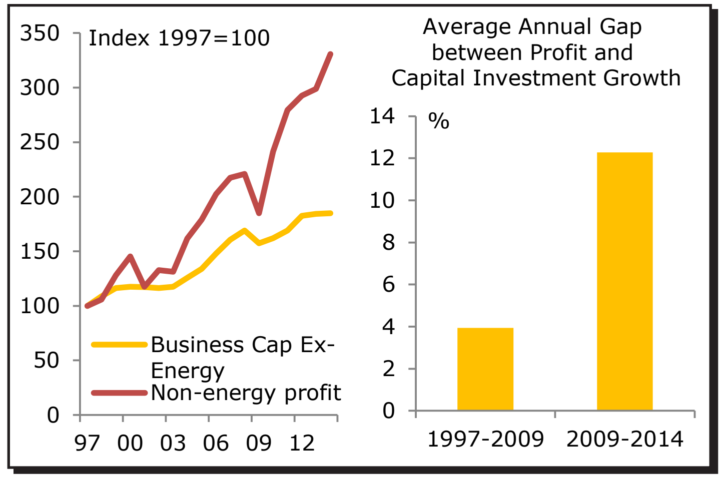
CDN Employment Leans on Public Sector (L); Provinces Tighten Belts (R)



Source: Statistics Canada, Provincial & Federal Budgets, CIBC

Chart 2

Non-Energy Business Investment Sluggish Versus Profit Growth



Source: Statistics Canada, CIBC

The share of employment taken up by the public sector has been steadily trending higher over the past several years (Chart 1, left), with gains in education and health (127K) through the year ending April making up most of the gains of the broader labour market (139K). Although the federal government is using its position of strength to loosen fiscal policy in the coming year, provinces are generally undertaking measures to constrain spending (Chart 1, right).

Searching For A Cap-Ex Leader

Capital spending will be the biggest blow to the Canadian economy this year. Energy firms will likely end up shaving some 30% from their expenditure plans. While crude prices have rebounded smartly off the lows, and have the potential to rally slightly more next year, the increased volatility due to the absence of a price manager in the market—formerly the role of Saudi Arabia—will weaken the correlation between prices and investment. The substantial upfront costs faced by Canadian oil sands projects may influence a preference toward production that can be more reactive to prices, such as US shale.

Can an upturn in non-energy business investment in Canada fill the void? Non-energy corporations are still in a very good position to invest with abundant room for capital expenditures to catch up with corporate profits (Chart 2, left). While the divergence in growth rates has stood at extended levels so far in the recovery (Chart 2, right), greater profitability should foster an environment in which management finds projects with higher internal rates of return.

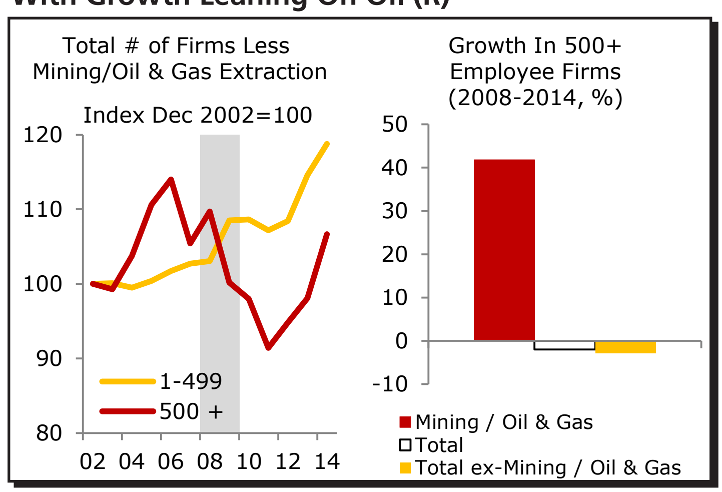
Buyback activity has been flagged as a culprit for lacklustre cap-ex growth, but the level of share repurchases mostly reflects the market's overall higher capitalization. Even gauged against profits, the total amount returned to shareholders through dividends and buybacks on the TSX isn't completely out of line with what we saw in 2007, a year in which non-residential business investment grew by over 2.5%. Furthermore, today's lower tax rates mean that corporations can return more to shareholders without impinging upon capital spending.

Larger Firms Gone, But Will They Return?

It's not buybacks, but the sharp loss in the number of large, often capital-intensive companies in Canada in the Great Recession and its aftermath that appears to account for the lacklustre trend in business investment.

Chart 3

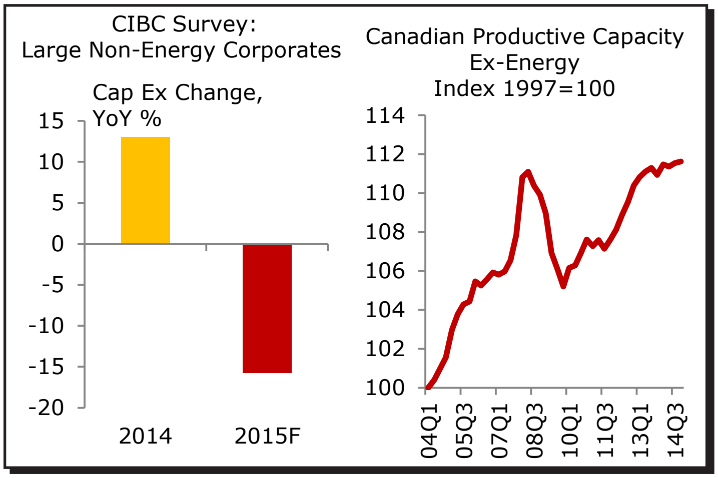
Recession Saw "Big" Firm Losses (L); With Growth Leaning On Oil (R)



Source: Statistics Canada, CIBC

Chart 4

Non-Energy Firms Planning to Cut Spending (L); Capacity Bumping Against Pre-Recession Ceiling (R)



Source: Statistics Canada, CIBC

Although firms employing over 500 people were on an upward trajectory before 2008-09, the recession saw many corporate giants head for the exit (Chart 3, left). The trend in the recovery has seen their numbers rebound more slowly than the population of smaller firms. Even that was tilted towards the oil patch, driven by booming conditions in that sector until mid-2014 (Chart 3, right).

While big business never represented the lion's share of entities, their large project capital spending can be of disproportionate impact, and they support a constellation of spending by smaller firms that rely on them. Not only have we not repopulated their ranks back to previous levels, but the ones we do have don't plan on making significant expansions just yet. Our survey of large corporates outside the energy sector suggests that firms were expecting to reduce capital expenditures by 16% this year (Chart 4, left).

A failure to attract entrants, and soft investment from incumbent firms, has meant that the growth in overall Canadian productive capacity outside of the energy sector has slowed dramatically in recent quarters (Chart 4, right). Because such firms are harder to attract, their earlier disappearance helps explain why the non-energy capital spending recovery may take longer to materialize.

Looking ahead, a more constructive environment for larger firms, which have more flexibility in location decisions, should see an eventual turn higher in investment. As the Canadian dollar trades at a discount for a longer period, and remains rangebound even as oil prices rally further, business leaders may see Canada as a more competitive location to increase capacity for the longer term.

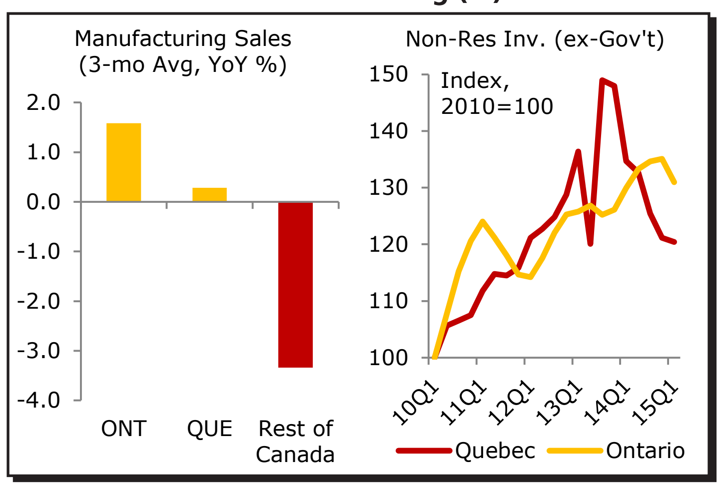
Fine Tuning the Provincial Picture

We continue to expect central Canada to outpace the national average in the soft energy environment of 2015. That's already visible in some of Ontario's numbers, but Québec's manufacturing sector doesn't seem to be gaining much momentum just yet (Chart 5, left). Tamer-than-expected output from the factory sector is perhaps a reason why signs of business investment continues to be weak (Chart 5, right).

A more delayed firming in activity is a reason why we've trimmed our outlook for Québec by over 0.5% in 2015. We lifted Alberta's outlook slightly, as less-than-expected fiscal restraint reduced the damage we previously anticipated. Still, the outlook for Canada is an anaemic 1.4% this year (Table 1), and we moved provincial forecasts somewhat lower to capture our downscaling of the national first half pace. Look for a more balanced and firmer growth profile next year, as the hit from oil sector downsizing passes.

Chart 5

Québec Factories Not Perking Back Up (L); Private Investment Still Slowing (R)



Source: Statistics Canada, Bank of Canada, CIBC

Table 1

Provincial Outlook

Y/Y % Chg	Real GDP Growth 2014F	Real GDP Growth 2015F	Real GDP Growth 2016F	Nominal GDP Growth 2014F	Nominal GDP Growth 2015F	Nominal GDP Growth 2016F
BC	2.6	1.8	2.8	4.4	3.4	5.3
Alta	4.4	0.0	2.7	7.9	-4.8	6.5
Sask	1.4	0.3	2.6	2.0	-3.3	6.1
Man	1.6	1.9	2.6	3.4	3.5	5.0
Ont	2.3	2.2	2.9	4.0	4.4	5.2
Qué	1.5	1.7	2.6	3.0	3.7	4.8
NB	0.5	1.2	1.9	1.9	3.0	4.0
NS	1.6	1.3	2.2	3.5	2.8	4.3
PEI	1.3	1.7	1.8	3.0	2.5	3.9
N&L	-2.5	-1.4	-1.0	-2.0	-5.9	4.1
Cda	**2.4**	**1.4**	**2.7**	**4.3**	**1.8**	**5.3**

Global Growth: Reslicing the Pie

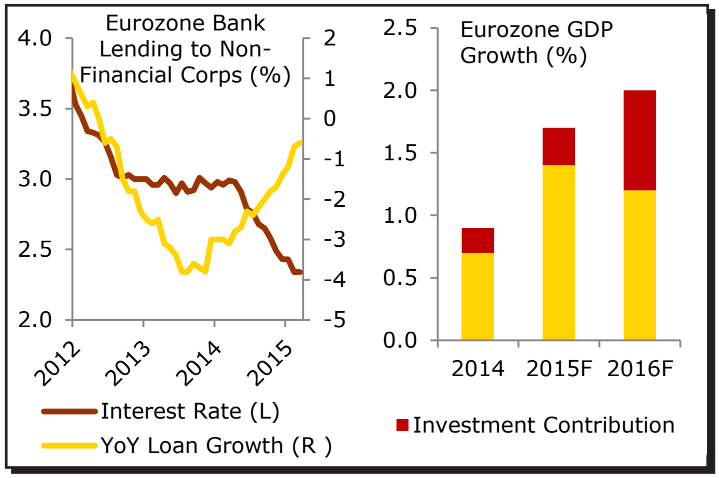
Andrew Grantham and Royce Mendes

Reslicing rather than expanding the global growth pie has been the recipe for the world's economy in 2015. The decline in commodity prices has meant that growth has rotated away from major producers and towards users. But there's also been another shift towards current proponents of QE—Japan and the Eurozone. Thus far, much of the upturn in these countries has been the result of weakening currencies. Consequently, they've come at the expense of countries whose currencies have been on the other side of those moves.

Indeed, global growth in 2015 is set to be the weakest since the recession (Table 1). But there could be better news on the horizon in 2016. By then monetary stimulus measures should be supporting domestic demand in those regions undertaking QE, resulting in spillover effects for their major trading partners.

Chart 1

Borrowing Costs Continue to Fall (L); Investment Will be an Important Part of Growth in 2016 (R)



Source: ECB, CIBC

Eurozone: Responding to Medicine

The ECB is administering its first round of QE, but is Draghi's prescription enough to revive the economy? As mentioned above, much of QE's positive effects have come via a weaker currency. The euro has depreciated almost 10% on a trade-weighted basis since rumours of the program started circulating. That could add as much as 1% to growth. Credit conditions have also continued to ease, and the decline in interest rates for both households and corporations to record lows have been seen for core and peripheral countries alike (Chart 1, left).

Green shoots, including stronger consumer demand, export growth and a reduction of government fiscal drags, are supporting our call for 1.7% growth in 2015. Importantly, recent growth has been more balanced across countries. Spain and France were both major contributors to Q1's solid pace, while Italy grew for the first quarter in over a year. That means that less of the heavy lifting had to be done by Germany, where less economic slack remains. Even Greece grew—in spite of the harsh austerity being forced upon it by creditors.

High corporate leverage and uncertainty surrounding Greece and Ukraine have held investment back in prior years, but a strong rebound could be in the cards for

Table 1

REAL GDP GROWTH RATES

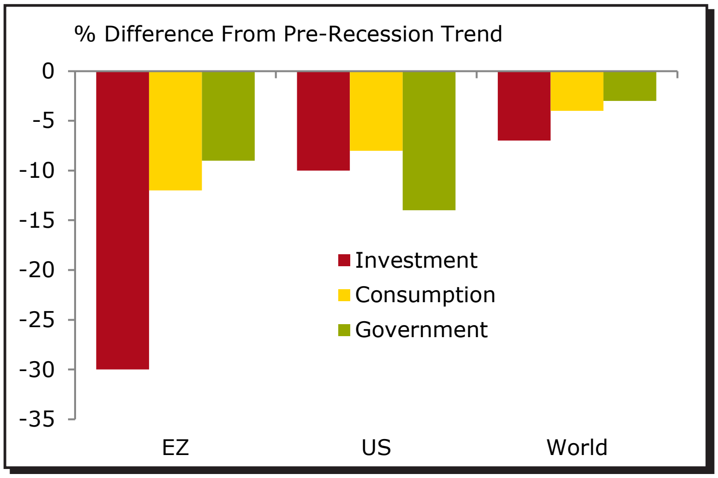
	5 yrs before recession, avg	2011A	2012A	2013A	2014E	2015F	2016F
World*	4.8	4.1	3.4	3.3	3.3	2.9	3.6
US	2.9	1.6	2.3	2.2	2.4	2.4	2.5
Canada	2.6	3.0	1.9	2.0	2.5	1.4	2.7
Euroland	2.2	1.6	-0.8	-0.5	0.9	1.7	2.2
UK	3.3	1.6	0.7	1.7	2.6	2.0	2.4
Japan	1.8	-0.5	1.8	1.6	-0.1	0.5	1.2
Brazil	4.0	4.0	1.8	2.8	0.2	-1.6	3.1
Russia	7.5	4.3	3.4	1.3	0.6	-4.0	0.5
India	8.9	7.7	4.8	4.7	7.5	7.5	8.0
China	11.6	9.3	7.7	7.7	7.4	6.5	6.8

** at Purchasing Power Parity*

Source: National statistical agencies, IMF, CIBC

Chart 2

Lack of EZ Investment a Key Source of Global Weakness



Source: World Bank, CIBC

that component of GDP. Business sentiment is already recovering from last year's Russian-induced weakness and, as growth picks up and fixed assets become overdue for replacement, investment is expected to post a strong recovery. With borrowing costs also forecast to stay very low, investment should lead the charge in 2016 (Chart 1, right).

That could have positive repercussions for growth globally. Investment in the Eurozone has been a notable laggard of the global recovery (Chart 2). And its high import content means an acceleration would be positive for major trading partners, including the UK, China and India.

True, uncertainty surrounding Greece's future could weigh on confidence. A Greek exit would bring unwelcome financial market volatility, but is unlikely to leave much of an imprint on the region's medium term health. Heightened tensions in the Ukraine, or political risks tied to Spain's upcoming elections, are more meaningful risks. But should neither of those materialize, the Eurozone looks well placed for stronger growth of 2.2% in 2016.

In the UK, elections have given the Conservative party a majority and a mandate to seek further spending cuts in an upcoming budget. Additional austerity could push back rate hikes by the BoE. And while the central bank has already been forced to reduce its growth forecasts, it could still be a bit too optimistic for GDP this year. Nevertheless, as the UK labour market continues to strengthen and with the Fed raising rates later this year, a minority on the MPC will call for earlier rate hikes. But it will take a re-acceleration in growth in 2016, aided by ties to an accelerating Eurozone and a stronger consumer, for the BoE to finally start raising rates.

China: Riding the Stimulus Wave

Official GDP data may not be showing a severe downturn. But trends in imports and on-the-ground indicators such as electricity use tell a different story, as does the willingness of policymakers to add stimulus. The PBoC has slashed interest rates to an all-time low of 5.1% and further cut the reserve requirement it imposes on banks. With inflation remaining low, the PBoC is still in a position to add more stimulus going forward (Chart 3, left).

There's also been fiscal support. Infrastructure investment has been used to stimulate growth, with projects in key areas already being sped up. China's Premier has also promised to provide additional money to the China Development Bank. As a result of the increase in spending, the general government fiscal deficit is now projected to be much larger than was first expected (Chart 3, right).

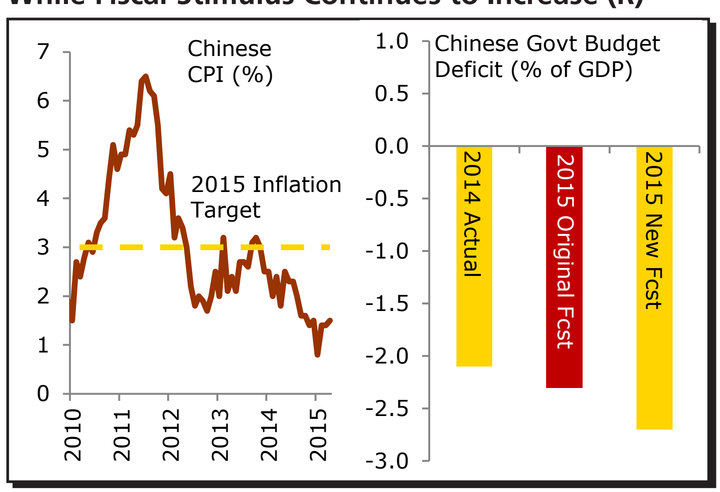
In spite of all this stimulus, demographic changes will still result in underlying growth slowing. While softer trend growth is a natural part of China's maturation, Beijing authorities will try to engineer a gentle path to that deceleration. We expect growth to slow to 6.5% this year—even if the official numbers don't show it—and, as the stimulus filters through the economy, growth may accelerate to 6.8% in 2016.

India: Moving into the Fast Lane

Although Indian Prime Minister Narendra Modi's progress on reshaping the economy has been less radical than some would like, reforms and a welcome slide in oil prices have positioned India for solid growth in the coming years. Modi has made progress by opening the economy

Chart 3

China Has Room for More Monetary Stimulus (L), While Fiscal Stimulus Continues to Increase (R)



Source: Bloomberg, China Ministry of Finance, WSJ to more foreign direct investment and his government is slowly privatizing public entities. In addition, cheaper oil has both boosted growth and caused inflation to fall far enough that RBI Governor Rajan can add stimulus to the economy without fearing surging prices.

We see this positive backdrop leading to a rebound in growth to 7.5% in 2015 and 8.0% in 2016. Even though the economy still requires major reforms, our forecast will be enough for India to overtake China as the frontrunner in growth among large economies. India should be able to maintain this lead for some time due to its more favourable demographics (Chart 4, left). While the Indian economy is still small relative to other large economies, it will also be a major contributor to global growth going forward (Chart 4, right).

Japan: Back and Forth Policies

BoJ Governor Kuroda has had success in conquering deflation, but current policies won't likely be enough to hit the 2% inflation target over the medium term. As a result, the BoJ will need to expand its QE program later this year to regain the market's confidence.

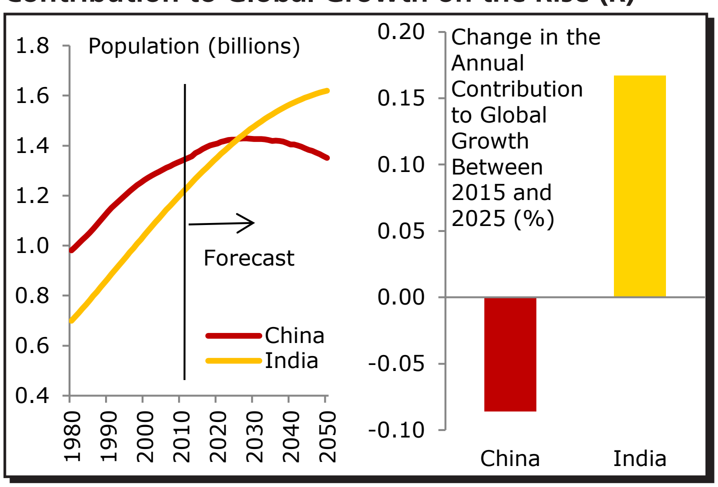
Even so, Japanese growth is expected to be soft going forward, and we've lowered our forecast for 2015 GDP growth to 0.5%. We're allowing for a further leg of yen depreciation, capturing the potential disappointments in growth and the need to lever off even greater support for net exports.

Although early 2015 saw exports surge, they've recently given back some of that move. In addition, private consumption is still suffering from a hangover that started with the April 2014 tax hike. And, while tax revenues are increasing, government expenditures are being restrained in an attempt to prove that the country's bloated debt load can be controlled (Chart 5).

Our forecast for 2016 is slightly higher at 1.2%, as we expect pro-growth policies, in conjunction with the further depreciation in the yen and the ongoing global recovery, to boost GDP. But another consumption tax hike is looming in April 2017. As a result, Abe's longer-term growth and inflation goals may prove more elusive.

Chart 4

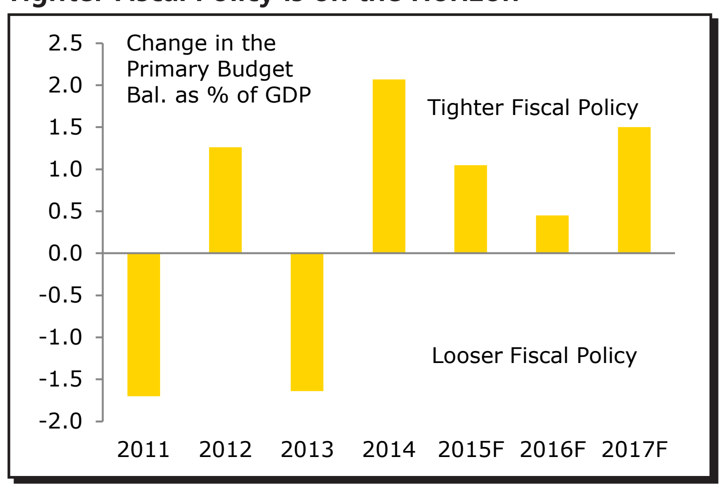
India's Population is Set to Overtake China (L), Contribution to Global Growth on the Rise (R)



Source: UN, CIBC

Chart 5

Although There Have Been Ebbs and Flows, Tighter Fiscal Policy is on the Horizon



Source: Bloomberg, OECD, CIBC

UPDATE

HIGHLIGHTS

- The upwards trend in long-term bond yields continued until mid-May, and the U.S. 10-year yield temporarily surpassed 2.35%, a peak since last November. This trend subsequently reversed course somewhat, taking that yield to around 2.15%. Bond yields in other countries followed a similar trend, with the German 10-year yield reaching 0.75% before dropping back to around 0.55%.
- The recent change in bond market trends occurred at the same time as oil prices softened and the U.S. dollar rallied. Currencies appear to be having an especially strong influence on the financial markets at the moment. Somewhat better U.S. data, promoting appreciation of the dollar, are tending to put downwards pressure on both oil prices and bond yields, which might seem counter-intuitive.
- The minutes of the latest Federal Reserve (Fed) meeting show that the officials are still expecting an acceleration of the U.S. economy after a disappointing start to the year. But they seemed a bit more worried, and noted some downside risks for the U.S. economy, relating to the strength of the dollar and less robust consumption than expected, among other things. Therefore, a key interest rate hike at the June meeting is increasingly improbable.
- After several disappointments, a few U.S. data have recently painted a somewhat rosier picture. In particular, job growth returned to a decent level in April, and housing starts surged to their highest point since November 2007.
- The Bank of Canada (BoC) left its target for the overnight rate at 0.75% at its May 27 meeting. After a weak first quarter, the BoC is still optimistic that the return to solid growth in the United States will soon support exports and business investment in Canada. It also notes that consumption is still relatively firm. However, The BoC points out that a lasting appreciation of the Canadian dollar could force it to re-assess the situation.
- Comments by an official that the European Central Bank (ECB) would temporarily accelerate its asset purchases before the summer slack period helped to reverse several financial market trends in the middle of May. The ECB subsequently exacerbated the euro's decline by dissipating speculations of a possible early halt to its bond purchases. The continued risk of default by the Greek government also contributed to the common currency's slump.
- Higher-than-expected economic growth in Japan in the first quarter reduced the likelihood of the Bank of Japan intensifying its quantitative measures in the near future. In the United Kingdom, the strength of the pound and the crossing of inflation into negative territory provide confirmation that the Bank of England will bide its time before embarking on monetary tightening.

INTEREST RATE FORECASTS

- We are still predicting that the Fed will start very gradual monetary tightening when it meets this September. This scenario is however based on the assumption that U.S. economic data will keep improving, confirming that the weakness at the beginning of the year was only a temporary rough patch. In Canada, the key interest rate status quo will likely continue until the spring of 2016.
- The recent decline in long-term bond yields is bolstering our belief that the earlier upwards movement was a bit too fast, like that of oil prices. Bond yields will probably fluctuate close to their current levels in the months to come, and then start heading up more sustainably towards the end of the summer. We are maintaining our year-end targets.

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Table 1
Key interest rates

End of period in %	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2f	2015 Q3f	2015 Q4f	2016 Q1f	2016 Q2f	2016 Q3f	2016 Q4f
United States												
Federal funds	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	0.75	1.00	1.25	1.50
Canada												
Overnight funds	1.00	1.00	1.00	1.00	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.25
Euro zone												
Refinancing rate	0.25	0.15	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
United Kingdom												
Base rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25
Japan												
Overnight funds	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10

f: forecasts
Sources: Datastream and Desjardins, Economic Studies

Table 2
Schedule and key rates

Date	*Central Bank*	*Decision*	*Rate*
March 2015			
11	Bank of Korea	-25 b.p.	1.75
11	Reserve Bank of New Zealand	s.q.	3.50
16-17	Bank of Japan	---	---
18	Bank of Sweden	-15 b.p.	-0.25
18	Federal Reserve	s.q.	0,00 / 0,25
19	Bank of Norway	s.q.	1.25
19	Swiss National Bank	s.q.	-0.75
26	Bank of Mexico	s.q.	3.00
April 2015			
7	Reserve Bank of Australia	s.q.	2.25
7-8	Bank of Japan	---	---
9	Bank of England	s.q.	0.50
9	Bank of Korea	s.q.	1.75
15	European Central Bank	s.q.	0.05
15	Bank of Canada	s.q.	0.75
29	Reserve Bank of New Zealand	s.q.	3.50
29	Bank of Sweden	s.q.	-0.25
29	Bank of Brazil	+50 b.p.	13.25
29	Federal Reserve	s.q.	0,00 / 0,25
30	Bank of Japan	---	---
30	Bank of Mexico	s.q.	3.00
May 2015			
5	Reserve Bank of Australia	-25 b.p.	2.00
7	Bank of Norway	s.q.	1.25
11	Bank of England	s.q.	0.50
15	Bank of Korea	s.q.	1.75
21-22	Bank of Japan	---	---
27	Bank of Canada	s.q.	0.75

s.q.: status quo; b.p. : basis points
Source: Desjardins, Economic Studies

Table 3
Coming soon

Date	*Central Bank*
June 2015	
2	Reserve Bank of Australia
3	European Central Bank
3	Bank of Brazil
4	Bank of England
4	Bank of Mexico
10	Reserve Bank of New Zealand
11	Bank of Korea
17	Federal Reserve
18	Bank of Norway
18	Swiss National Bank
18-19	Bank of Japan
July 2015	
2	Bank of Sweden
7	Reserve Bank of Australia
9	Bank of England
9	Bank of Korea
14-15	Bank of Japan
15	Bank of Canada
16	European Central Bank
22	Reserve Bank of New Zealand
23	Bank of Mexico
29	Bank of Brazil
29	Federal Reserve
August 2015	
4	Reserve Bank of Australia
6	Bank of England
6-7	Bank of Japan
12	Bank of Korea

Source: Desjardins, Economic Studies

Table 4
United States: fixed income market

End of period in %	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2f	2015 Q3f	2015 Q4f	2016 Q1f	2016 Q2f	2016 Q3f	2016 Q4f
Key rate												
Federal funds	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	0.75	1.00	1.25	1.50
Treasury bills												
3-month	0.05	0.04	0.02	0.04	0.03	0.05	0.50	0.65	0.70	1.00	1.20	1.50
Federal bonds												
2-year	0.39	0.42	0.56	0.63	0.54	0.70	1.00	1.20	1.30	1.55	1.70	1.80
5-year	1.71	1.60	1.77	1.64	1.37	1.60	1.75	1.90	2.00	2.15	2.30	2.40
10-year	2.73	2.52	2.51	2.17	1.93	2.15	2.30	2.45	2.50	2.65	2.80	3.00
30-year	3.56	3.34	3.21	2.75	2.54	2.85	2.90	2.95	3.00	3.10	3.20	3.35
Yield curve												
5-year - 3-month	1.66	1.56	1.75	1.60	1.34	1.55	1.25	1.25	1.30	1.15	1.10	0.90
10-year - 2-year	2.34	2.09	1.95	1.54	1.39	1.45	1.30	1.25	1.20	1.10	1.10	1.20
30-year - 3-month	3.51	3.30	3.19	2.71	2.51	2.80	2.40	2.30	2.30	2.10	2.00	1.85

f: forecasts
Sources: Datastream and Desjardins, Economic Studies

Table 5
Canada: fixed income market

End of period in %	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2f	2015 Q3f	2015 Q4f	2016 Q1f	2016 Q2f	2016 Q3f	2016 Q4f
Key rate												
Federal funds	1.00	1.00	1.00	1.00	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.25
Treasury bills												
3-month	0.89	0.94	0.92	0.92	0.56	0.65	0.65	0.65	0.70	1.00	1.10	1.40
Federal bonds												
2-year	1.07	1.10	1.12	1.01	0.50	0.70	0.85	0.95	1.05	1.30	1.45	1.55
5-year	1.71	1.53	1.63	1.34	0.76	1.05	1.20	1.35	1.50	1.70	1.80	1.90
10-year	2.46	2.24	2.15	1.79	1.36	1.70	1.75	1.85	1.95	2.20	2.30	2.40
30-year	2.96	2.78	2.67	2.34	1.98	2.30	2.35	2.40	2.45	2.60	2.65	2.80
Yield curve												
5-year - 3-month	0.82	0.59	0.71	0.42	0.20	0.40	0.55	0.70	0.80	0.70	0.70	0.50
10-year - 2-year	1.39	1.14	1.03	0.78	0.86	1.00	0.90	0.90	0.90	0.90	0.85	0.85
30-year - 3-month	2.07	1.84	1.75	1.42	1.42	1.65	1.70	1.75	1.75	1.60	1.55	1.40
Spreads (Canada - U.S.)												
3-month	0.84	0.90	0.90	0.88	0.53	0.60	0.15	0.00	0.00	0.00	-0.10	-0.10
2-year	0.68	0.68	0.56	0.38	-0.04	0.00	-0.15	-0.25	-0.25	-0.25	-0.25	-0.25
5-year	-0.00	-0.07	-0.14	-0.30	-0.61	-0.55	-0.55	-0.55	-0.50	-0.45	-0.50	-0.50
10-year	-0.27	-0.28	-0.36	-0.38	-0.57	-0.45	-0.55	-0.60	-0.55	-0.45	-0.50	-0.60
30-year	-0.60	-0.56	-0.54	-0.41	-0.56	-0.55	-0.55	-0.55	-0.55	-0.50	-0.55	-0.55

f: forecasts
Sources: Datastream and Desjardins, Economic Studies

FX Forecasts

Desjardins Economic Studies
www.desjardins.com/economics

May 26, 2015

The U.S. dollar is poised to rebound—it only needs good data...

HIGHLIGHTS

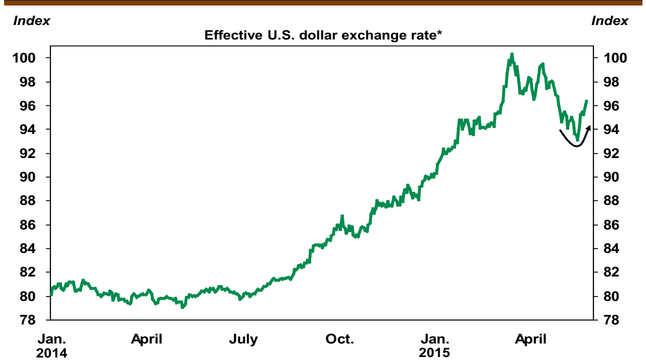
- We remain optimistic for the second quarter in the United States and in our eyes, the most probable scenario remains a first key interest rate increase in September. In this context, we still think the U.S. dollar will rise in the coming months, perhaps hitting new cyclical peaks against several currencies.
- It is too early to look for a lasting rise by the Canadian dollar. The factors that helped weaken it in the last few quarters persist. The Canadian dollar could well drop back below US$0.80 in the coming months.
- Beyond the Greek issue, which is a major downside risk in the near term, our expectation for the U.S. economy and monetary policy suggest that the euro could test its March lows.
- The Bank of Japan is confident it can reach its 2% inflation target in 2016 with the current degree of monetary stimulus. We are cautious about the yen's potential to depreciate for the rest of the year; our target is ¥124/US$.

Contents

Editorial

The foreign exchange markets remain very volatile. The big drops against the greenback recorded by many currencies were followed by a short rise from mid-March to mid-May. This trend could reverse again as the U.S. dollar is showing signs of life (graph 1). One factor is needed however to support a sustained rebound in the U.S. dollar: better economic numbers in the United States.

Graph 1 – The U.S. dollar has strengthened a little since mid-May



* Weighted U.S. dollar average against the euro, yen, pound, Canadian dollar, Swedish krona and Swiss franc.
Sources: Bloomberg and Desjardins, Economic Studies

THE DISAPPOINTMENT IS MOUNTING

U.S. economic growth was very weak in the first quarter, at just 0.2% (annualized), hard hit by the weather, sharp drop in oil sector investment and labour dispute at West Coast ports. This growth could also be downgraded, likely into negative territory. Among other things, the data on international trade was weaker than the assumption used in the first estimate of real GDP.

Expectations are high for the second quarter but, to date, most of the data released for April was disappointing. This includes a dip in industrial output and stagnating retail sales, although they had rebounded in March after a 3-month slide. The carryover for retail sales does not

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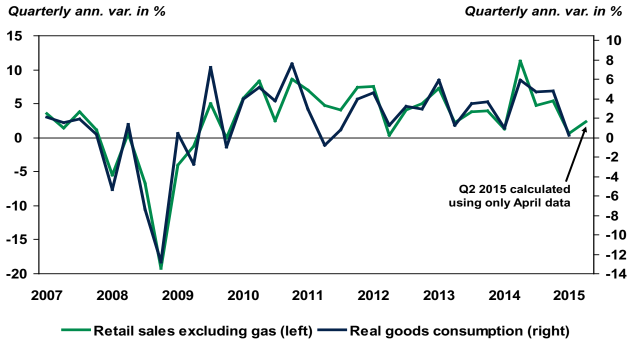
point to any big acceleration by consumption in the second quarter (graph 2). To achieve real GDP growth above 3%, however, consumers will have to make a big contribution. The data for May and June will have to be strong. April's rebound by housing starts and employment helps us to remain optimistic about what's to come.

Graph 2 – U.S. real consumption only looks a little better for the second quarter



Sources: U.S. Census Bureau, Bureau of Economic Analysis and Desjardins, Economic Studies

THE FEDERAL RESERVE COULD WAIT LONGER

Of course, if economic growth advances more slowly than anticipated in the second quarter, that would compromise the scenario of a first Federal Reserve (Fed) key interest rate increase in September. The Fed could decide to wait a few more months, especially if inflation were subdued; this would have a big impact on the greenback's movement. Although it is currently showing signs of renewed life, it could quickly give up ground in the near term.

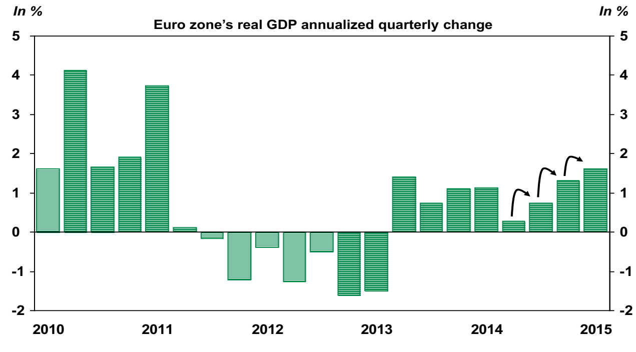
That being said, because we remain optimistic for the second quarter in the United States, in our eyes, the most probable scenario remains a first rate increase in September. In this context, we still think the U.S. dollar will rise in the coming months, perhaps hitting new cyclical peaks against several currencies.

A FEW FLASHES IN THE PAN

The U.S. dollar's weakness between mid-March and mid-May cannot only be chalked up to disappointing data in the United States. For example, the U.S. dollar was hit by the rebounding euro, buoyed by better economic numbers across the pond (graph 3). However, the optimism was probably exaggerated. It seems unlikely that growth will keep accelerating the way it has recently; the first-quarter slowdown in Germany is one sign of that.

As the European figures improved, some started to expect an early end to the European Central Bank's easing measures. Once again, this is likely to be a flash in the pan, as the euro zone's economy is nowhere near full capacity and, accordingly, underlying inflation pressures will be weak for several more quarters. We also remain pessimistic about the euro; other currencies in the region should follow the same downtrend, at least somewhat.

Graph 3 – The euro zone's economy has been gaining speed for the last three quarters



Sources: Eurostat and Desjardins, Economic Studies

Lastly, there is reason to wonder about whether the upswing by oil prices will last—it has boosted some currencies, including the Canadian dollar. West Texas Intermediate (WTI), the benchmark oil price, went from about US$45/barrel in March to over US$60/barrel in early May. For this upswing to persist, however, the imbalance between oil production and demand would have to adjust further. We are therefore pessimistic about crude-sensitive currencies for the near future.

François Dupuis
Vice-President and Chief Economist

Hendrix Vachon
Senior Economist

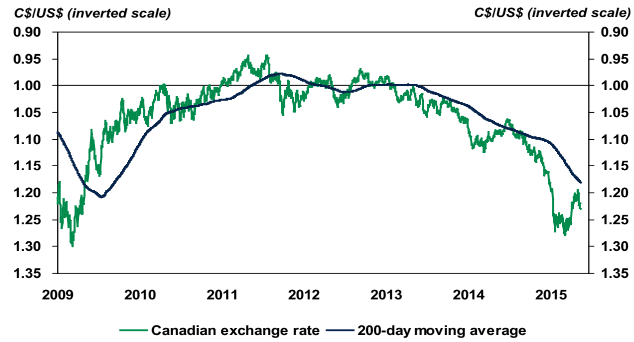
CANADIAN DOLLAR (CAD)

Too soon for a lasting rise

- The main drivers behind the recent rebound by the Canadian exchange rate were the rise by oil prices and weak U.S. dollar. The rebound took the loonie to a 4-month peak at US$0.8389 (C$1.1920/US$) on May 14. The loonie has since then dropped back below US$0.82, as crude prices lost some ground and the greenback seems to be showing new signs of life.
- Technically, the 3-month momentum is back in positive territory, but it is still too early to talk about a Canadian dollar uptrend. The 200-day moving average is still solidly tilted to the downside and has not been tested despite the loonie's upswing. Investors are a lot less pessimistic, however, as net speculative positions are back at neutral.
- Fundamentally, the chances of further depreciation seem stronger than the chances of lasting appreciation. The key factor is still the movement by oil prices, which does not promise to be good in the near term. Firstly, global oil output continues to rise faster than demand. Among other things, oil producing countries responded to the drop in revenue by increasing their export volumes. Also, a possible final agreement on Iran's nuclear program in June and relaxation of sanctions could intensify the oil surplus and delay the much awaited adjustment between supply and demand. In this context, oil prices could relapse close to recent lows before starting a real uptrend.
- The energy sector is vital to Canada's economy and the data acquired to date points to nearly zero real GDP growth in the first quarter. Subsequent quarters are expected to see a rebound, but this scenario will be highly dependent on the ability of other sectors to take up the slack. Investment and exports will have to do well, arguing for an ongoing low dollar. The Bank of Canada (BoC) is less open to another key interest rate cut, but it could rapidly change its stance if the economy is not up to par.

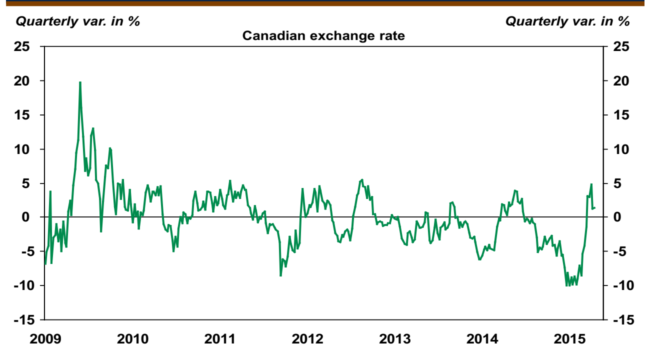
Forecasts: It is too early to look for a lasting rise by the Canadian dollar. The factors that helped weaken it in the last few quarters persist. Oil prices could tumble, the U.S. dollar should go up, and the BoC could still change its mind. In this context, the Canadian dollar could well drop back below US$0.80 in the coming months.

Canadian dollar and trend



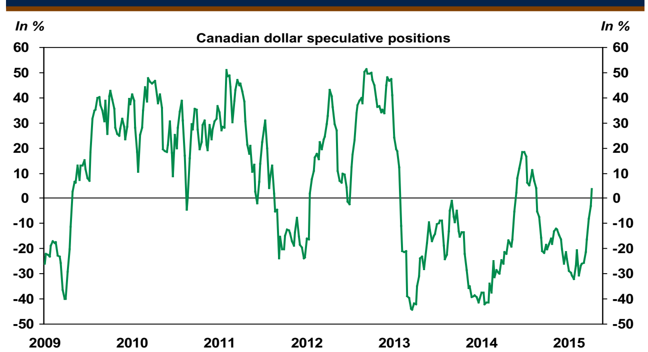
Sources: Datastream and Desjardins, Economic Studies

Canadian dollar: momentum



Sources: Datastream and Desjardins, Economic Studies

Canadian dollar: net speculative positions



Sources: Chicago Mercantile Exchange and Desjardins, Economic Studies

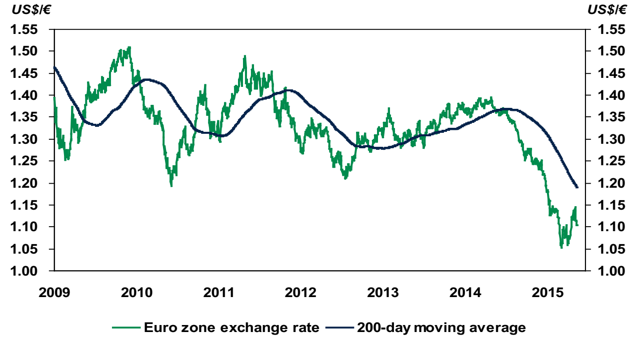
EURO (EUR)

Volatility could remain strong

- After falling to US$1.06 in mid-April, the euro started to trend up sharply, going above US$1.145 in mid-May. The news that the European Central Bank (ECB) will temporarily pick up the pace on its financial securities purchases before the summer lull recently took the euro back to around US$1.10.
- The big rebound of the euro largely seems to reflect the U.S. dollar correction—it had shot up too quickly in early 2015. The euro's rise also came during a particularly volatile period in the markets, in which we also saw sharp upswings by oil prices and bond yields that did not seem to be based on better economic statistics. On the contrary, U.S. economic figures have generally been disappointing in the last few months, prompting investors to push back the forecast timing for the onset of U.S. monetary firming.
- The euro also seems to have benefited from the fact that Europe's economic numbers have recently been better. The euro zone's real GDP is showing annualized 1.6% growth for the first quarter. That, combined with an uptick of inflation, is making some analysts think that the ECB could halt its securities purchases prior to the scheduled September 2016 cut-off date. Changing expectations for monetary policy on both sides of the Atlantic has certainly been one factor in the euro's recent upswing. However, there are good reasons to think this factor will not be a major support for the euro in the months to come. An early halt to the ECB's purchases seems unlikely, as the ECB knows that the improvement to the euro zone's economy is heavily reliant on its stimulus policy. Conversely, the Federal Reserve could surprise investors by kicking off monetary firming toward the end of this summer.
- The euro's recent rebound seems particularly fragile given that nothing has yet been settled with Greece. The negotiations between the Greek government and its European partners seem to have taken a more positive turn lately, but the International Monetary Fund (IMF) is taking a harder line. It seems increasingly likely that Greece will see a partial default or reschedule its debt and the risks of major political and financial crises remain high.

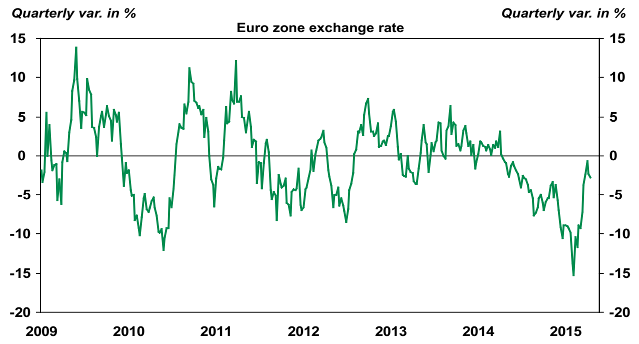
Forecasts: Beyond the Greek issue, which is a major downside risk in the near term, we expect the U.S. economy to rebound and U.S. key rates to rise in the second half of 2015, suggesting that the euro could test its March lows.

Euro and trend



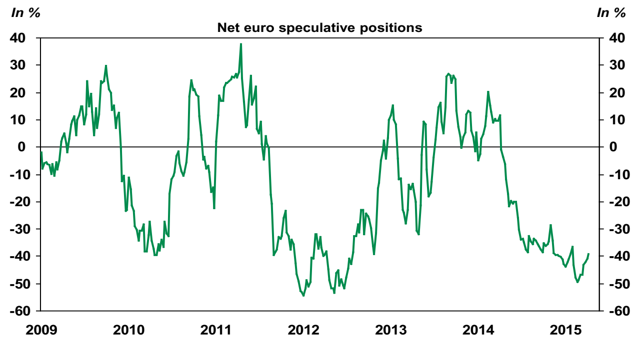
Sources: Datastream and Desjardins, Economic Studies

Euro: momentum



Sources: Datastream and Desjardins, Economic Studies

Euro: net speculative positions



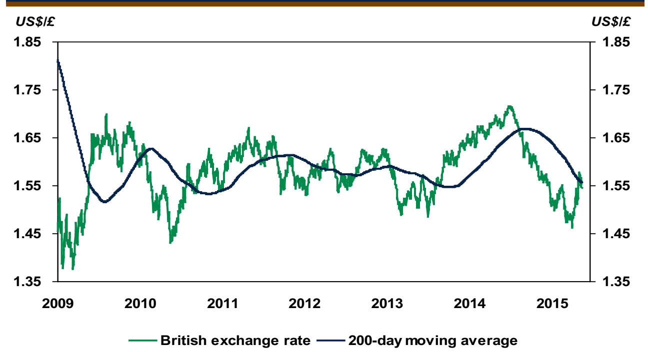
Sources: Chicago Mercantile Exchange and Desjardins, Economic Studies

BRITISH POUND (GBP)

An overdone upswing

- Like the euro, the pound sterling shot up as of mid-April, rising from about US$1.46 to US$1.54 at the end of the month. The pound did not go up as much as the euro, however, and the EUR/GBP pair hit £0.74 in early May. The Conservative government's surprise victory in the May 7 election gave the pound an extra push, taking it to US$1.58 and wiping out its retreat against the euro. The election of a majority government is especially good for the pound, as numerous surveys had suggested an impasse that would quickly take the United Kingdom back to the polls. Political risks could start to hamper the pound once again in a few quarters, however, with Prime Minister Cameron pledging to hold a referendum by 2017 on whether to keep the United Kingdom in the European Union. Scottish nationalists also made some spectacular gains, raising the spectre of another referendum on Scottish independence. Although the first quarter was a little softer than expected, the economic outlook for the United Kingdom remains relatively good. Weak inflation, which recently slid into negative territory, and the strong pound argue for a long monetary policy status quo, however. **Like most currencies, the pound should slide against the U.S. dollar in the months to come.**

British pound and trend



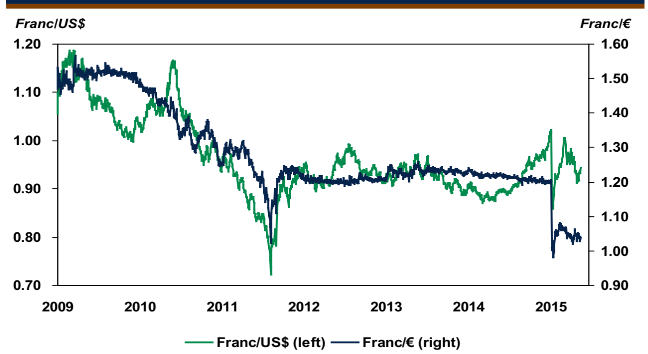
Sources: Datastream and Desjardins, Economic Studies

SWISS FRANC (CHF)

The Swiss National Bank managed to curb another rise by the franc

- A month ago, we remarked that the Swiss National Bank (SNB) would have trouble tolerating persisting upside pressure on the franc against the euro. The SNB did not sit on its hands: on April 22, it announced that it was slashing the number of accounts not subject to negative interest rates. Although this decision's real impact seems limited, it was read as a signal that the SNB would not allow the franc to rise further. The EUR/CHF pair immediately went from 1.025 francs to 1.040 francs on the news. After that, the strong euro and rumoured SNB intervention took the pair close to 1.050 francs, a level that seems acceptable to the SNB. A leader recently remarked that SNB was satisfied with the effect of negative rates, but could expand its balance sheet further. **Save for a financial shock due to the Greek problem, the franc should be relatively stable against the euro in the months to come.**

Swiss franc



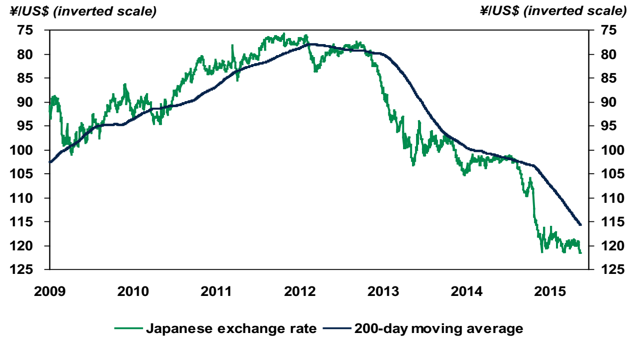
Sources: Datastream and Desjardins, Economic Studies

YEN (JPY)

The Bank of Japan thinks it will reach its inflation target in 2016

- Japan's exchange rate has been among the least volatile rates in the last few months. Incursions above ¥120/US$ are always short-lived, with no factors that could support another depreciation movement like a lasting U.S. dollar rebound or signs that the Bank of Japan (BoJ) would relax its monetary policy more.
- While the U.S. dollar should show a persistent rebound in the next few months, further action from the BoJ seems much less likely. The BoJ is confident it can reach its 2% inflation target in 2016 with the current degree of monetary stimulus. Moreover, for the last few meetings, one leader has been voting to cut its securities purchases. We cannot overlook the improvement in some fundamentals, such as the more than ¥2,000B surplus in March's current account, a high that dates back to October 2007. Real GDP growth was also a strong 2.4% in the first quarter. **We are cautious about the yen's potential to depreciate for the rest of the year; our target is ¥124/US$.**

Yen and trend



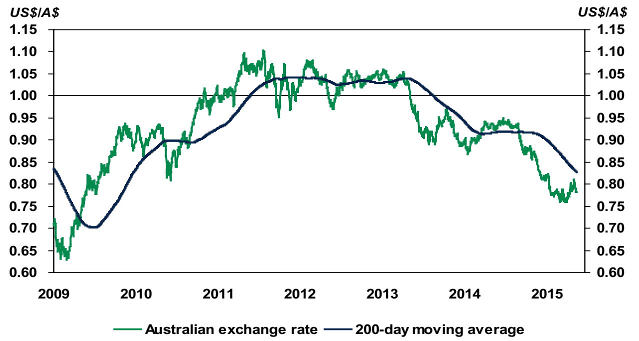
Sources: Datastream and Desjardins, Economic Studies

AUSTRALIAN DOLLAR (AUD)

The Reserve Bank of Australia carries on with its easing cycle

- The Australian dollar rose in the second half of April and early May, taking it back above US$0.80. The release of a few better than anticipated statistics last month, including employment, certainly had something to do with the currency's rebound. Stronger prices for commodities also played in favour of the Australia's dollar, along with the U.S. dollar's weakness. However, the aussie's rise is already running out of steam. One of the factors against it is the Reserve Bank of Australia's recent key rate cut, ordered in May, and the suggestion that the easing cycle is not over yet.
- Australia's economic situation remains uncertain due to the sharp drop by mining investment and mixed data from China. At 1.3%, inflation is also well below its target range (2% to 3%). **We expect Australia's dollar to slide back to around US$0.75 in the coming months**, consistent with the evolution of the Australian economy's fundamentals and anticipated U.S. dollar rebound.

Australian dollar and trend



Sources: Datastream and Desjardins, Economic Studies

EMERGING CURRENCIES

Emerging currencies did not respond as strongly to the new jump by bond yields

CHINESE YUAN (CNY)

- Chinese monetary authorities capitalized on the greenback's weakness as of mid-March to revalue the yuan to 6.20 yuan/US$. The rebound by advanced nations' bond yields did not trigger another wave of emerging currency depreciation, which may also have bolstered Chinese authorities in revaluing their currency. However, **it would be surprising to see the yuan surge against the greenback this year**. Firstly, the greenback should rise, as China's economic numbers remained mixed. This could result in further monetary easing measures to try to speed up credit. The People's Bank of China also ordered another interest rate cut on May 10.

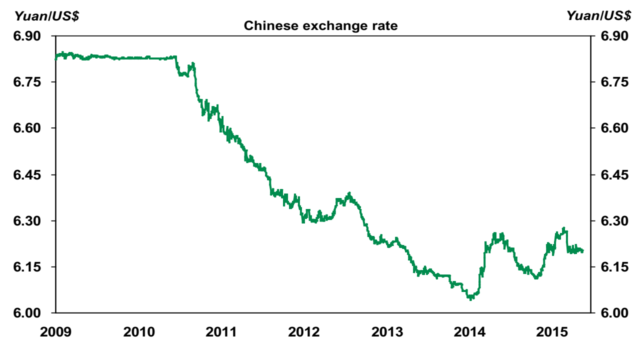
MEXICAN PESO (MXN)

- The Mexican peso has been fairly stable against the U.S. dollar since mid-April, with the USD/MXN pair generally fluctuating between 15.0 pesos and 15.5 pesos. The peso's resilience despite the upswing by bond yields could be due to the fact that the rise in yields does not reflect a change in expectations for U.S. monetary policy. The Bank of Mexico recently downgraded its growth outlooks for 2015 and 2016, as Mexican oil production has declined. It is keeping the door open to a key rate increase this year, however, especially if the Federal Reserve initiates monetary firming. In this context, **a key rate increase in the United States in response to a rebound of the U.S. economy would probably hurt the peso less than other emerging currencies**.

BRAZILIAN REAL (BRL)

- The Brazilian real has been less volatile since April and is currently trading at close to 3.05 reales/US$. The 2013 rebound by bond yields had hit the real hard and we could have expected it to depreciate recently. Brazil's exchange rate is much higher than it was in 2013, however. Now, it is mainly affected by commodity prices and economic indicators. Here, the outlook remains gloomy, with runaway inflation (8.2% in April) and a central bank that must pursue monetary firming in order to subdue inflation. **It will be hard for Brazil's economic growth to pick up speed and the exchange rate could climb over 3.25 reales/US$.**

Chinese yuan and trend



Sources: Datastream and Desjardins, Economic Studies

Mexican peso and trend

Sources: Datastream and Desjardins, Economic Studies

Brazilian real and trend

Sources: Datastream and Desjardins, Economic Studies

Table 1
Currency market

Country – Currency*	Spot price May 25	Percentage return since 1 month	3 months	6 months	1 year	Last 52 weeks Higher	Average	Lower
Americas								
Argentina – peso	8.9699	0.9283	2.8806	5.3300	11.2201	8.9699	8.5158	8.0638
Brazil – real	3.0645	3.1315	6.6100	20.8832	38.0974	3.2926	2.5983	2.1959
Canada – dollar	1.2286	0.9532	-1.2340	9.1846	12.9280	1.2803	1.1572	1.0632
Canada – (CAD/USD)	0.8139	-0.9442	1.2494	-8.4120	-11.4480	0.9406	0.8642	0.7811
Mexico – peso	15.2824	-0.6394	2.4101	12.0842	18.7859	15.5843	14.0583	12.8363
Asia and South Pacific								
Australia – (AUD/USD)	0.7825	0.0861	-0.7786	-8.2786	-15.2347	0.9498	0.8483	0.7590
China – yuan renminbi	6.2020	0.1372	-0.9162	1.0674	-0.5540	6.2744	6.1908	6.1112
Hong Kong – dollar	7.7519	0.0219	-0.0677	-0.0335	-0.0161	7.7708	7.7536	7.7500
India – rupee	63.4960	-0.2611	2.6417	2.6364	8.4938	64.1470	61.5996	58.5250
Japan – yen	121.5600	2.1641	2.2716	3.0388	19.2115	121.5600	112.5166	101.1750
New Zeland – (NZD/USD)	0.7310	-3.9108	-3.2529	-6.4181	-14.4225	0.8821	0.7912	0.7262
South Korea – won	1,090	0.9913	-0.8143	-1.7264	6.3979	1,132	1,068	1,008
Europe								
Denmark – krona	6.7926	-1.0171	3.3315	13.8915	24.0295	7.1086	6.1129	5.4452
Euro zone – (EUR/USD)	1.1023	1.4541	-2.9409	-11.7096	-19.1322	1.3691	1.2276	1.0522
Norway – kroner	7.6437	-1.5438	1.3162	12.3323	28.2363	8.3125	6.9755	5.9455
Russia – ruble	49.8950	-2.6377	-19.8731	8.9042	46.1133	72.4500	47.8725	33.6595
Sweden – krona	8.4163	-2.5214	1.3988	13.3486	26.6495	8.8229	7.6116	6.6218
Switzerland – swiss franc	0.9428	-1.0600	-0.6691	-2.1638	5.2470	1.0194	0.9394	0.8533
United Kingdom – (GBP/USD)	1.5503	2.2255	0.0742	-1.4149	-7.9506	1.7170	1.5894	1.4642

* In comparison with the U.S. dollar, unless otherwise indicated.
Note: Currency table base on previous day closure.

Table 2
Currency market: history and forecasts

End of period		2014 Q3	Q4	2015 Q1	Q2f	Q3f	Q4f	2016 Q1f	Q2f	Q3f	Q4f
American dollar											
Canadian dollar	(USD/CAD)	1.1199	1.1621	1.2688	1.2500	1.2821	1.2500	1.2346	1.2195	1.2048	1.1905
Euro	(EUR/USD)	1.2632	1.2101	1.0740	1.0800	1.0400	1.0500	1.0600	1.0900	1.1100	1.1300
British pound	(GBP/USD)	1.6212	1.5593	1.4845	1.5200	1.4800	1.4900	1.5100	1.5500	1.5600	1.5500
Swiss franc	(USD/CHF)	0.9534	0.9894	0.9744	0.9700	1.0000	1.0000	1.0000	0.9800	0.9700	0.9600
Yen	(USD/JPY)	109.66	119.70	120.14	121.00	122.00	124.00	124.00	125.00	126.00	127.00
Australian dollar	(AUD/USD)	0.8746	0.8170	0.7607	0.7700	0.7300	0.7500	0.7600	0.7800	0.7900	0.8000
Chinese yuan	(USD/CNY)	6.1385	6.2061	6.1995	6.2000	6.2500	6.2000	6.2000	6.1900	6.1700	6.1500
Mexican peso	(USD/MXN)	13.43	14.75	15.26	15.40	15.60	14.80	14.60	14.50	14.25	14.00
Brazilian real	(USD/BRL)	2.4507	2.6559	3.2077	3.1000	3.3500	3.3000	3.2500	3.1000	3.0000	2.9500
Effective dollar*	(1973 = 100)	81.30	85.13	92.06	91.00	94.40	93.40	92.30	90.70	90.10	89.00
Canadian dollar											
American dollar	(CAD/USD)	0.8929	0.8605	0.7882	0.8000	0.7800	0.8000	0.8100	0.8200	0.8300	0.8400
Euro	(EUR/CAD)	1.4147	1.4061	1.3626	1.3500	1.3333	1.3125	1.3086	1.3293	1.3373	1.3452
British pound	(GBP/CAD)	1.8155	1.8119	1.8835	1.9000	1.8974	1.8625	1.8642	1.8902	1.8795	1.8452
Swiss franc	(CAD/CHF)	0.8513	0.8514	0.7680	0.7760	0.7800	0.8000	0.8100	0.8036	0.8051	0.8064
Yen	(CAD/JPY)	97.91	103.00	94.69	96.80	95.16	99.20	100.44	102.50	104.58	106.68
Australian dollar	(AUD/CAD)	0.9795	0.9494	0.9651	0.9625	0.9359	0.9375	0.9383	0.9512	0.9518	0.9524
Chinese yuan	(CAD/CNY)	5.4813	5.3406	4.8863	4.9600	4.8750	4.9600	5.0220	5.0758	5.1211	5.1660
Mexican peso	(CAD/MXN)	11.99	12.69	12.03	12.32	12.17	11.84	11.83	11.89	11.83	11.76
Brazilian real	(CAD/BRL)	2.1883	2.2855	2.5282	2.4800	2.6130	2.6400	2.6325	2.5420	2.4900	2.4780

f: forecasts; * Trade-weighted against major U.S. partners.
Sources: Datastream, Federal Reserve Board and Desjardins, Economic Studies

NATIONAL BANK
FINANCIAL MARKETS
A division of National Bank of Canada

MONTHLY ECONOMIC MONITOR

Economics and Strategy

June 2015

Highlights

- *Global manufacturing took a breather in the first quarter of 2015 due to weaker trade flows, the latter impacted partly by temporary factors. As those factors dissipate, export-centric emerging economies should bounce back and together with a strengthening OECD will help support global growth. However, downside risks to the world economy should not be underestimated, including elevated USD-denominated debt outside of the US and the impact of Fed rate hikes in emerging economies.*

- *A worse-than-expected start to the year for the world's largest economy had us lower our US GDP growth forecast for 2015 by three ticks to 2.6%. That said, fundamentals for domestic demand remain strong with a solid labour market helping lift consumption, the main engine of growth. The Fed remains on track to hike interest rates later this year, but don't expect it to get aggressive when it starts tightening. The strong U.S. dollar is not only hindering exports, but is also making it more difficult for the PCE annual inflation rate to reach the Fed's 2% target.*

- *After an awful Q1, Canada should bounce back as exports recover in synch with better US growth. That said, the second half of the year may not be as good as assumed by the Bank of Canada considering some of the impacts of the oil shock may be back-loaded e.g. investment spending. A likely moderation in housing and consumption won't help either. Given how overall growth will be dependent on trade, the central bank will do what it can to keep the Canadian dollar grounded.*

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				Change from Previous Forecast	
	2014	2015	2016	2015	2016
United States					
GDP	2.4%	2.6%	2.7%	-0.3 pp	unch
CPI inflation	1.6%	0.4%	2.3%	unch	unch
Fed Fund Target Rate*	0.25%	0.75%	1.50%	unch	unch
Ten-year bond yield*	2.14%	2.62%	2.92%	+28 bp	+25 bp
Canada					
GDP	2.5%	2.0%	2.0%	unch	unch
CPI inflation	1.9%	1.0%	2.2%	unch	unch
Overnight rate*	1.00%	0.75%	1.00%	unch	unch
Ten-year bond yield*	1.81%	2.08%	2.42%	+19 bp	+22 bp

* end of period

World: Manufacturing woes

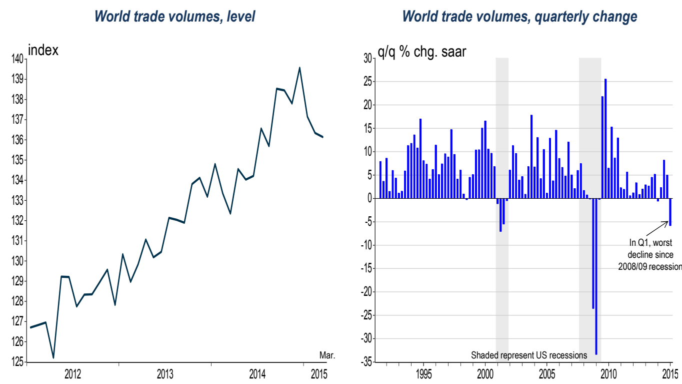
Global manufacturing took a breather in the first quarter of 2015 due to weaker trade flows, the latter impacted partly by temporary factors. As those factors dissipate, export-centric emerging economies should bounce back and together with a strengthening OECD will help support global growth. However, downside risks to the world economy should not be underestimated, including elevated USD-denominated debt outside of the US and the impact of Fed rate hikes in emerging economies.

Global economic activity continues to be powered by the services sector as manufacturing woes persist. The latter is largely due to trade volumes which took a dive in the first quarter of 2015. The near-6% annualized drop suggested by latest CPB data is the worst since 2009 when the world economy was in recession. So what exactly happened in Q1? Put simply, there were two major factors restraining factories in the first quarter, one temporary and one more structural in nature.

Atypically bad weather and port strikes on the US west coast hurt global trade flows, and hence manufacturing, and a rebound can therefore be expected as those temporary factors dissipate. Less encouraging, however, is the deceleration in China's GDP growth which is more structural in nature. Emerging economies with supply chain linkages to the world's second largest economy are not surprisingly also seeing a moderation in growth. Weakness extended to early Q2 according to Markit whose emerging markets index expanded further in April, but at a slower pace than in Q1. While the services sector continued to grow, the manufacturing sector in countries like Taiwan, South Korea, and Indonesia contracted further.

Adding to problems in some emerging economies is debt. The greenback's surge has tightened domestic financial conditions particularly for USD borrowers. According to the Bank for International Settlements, the stock of dollar-denominated debt held by non-financial entities outside the US has grown from around $6 trillion in 2008 to about $9 trillion, with 40% of that accounted by emerging markets. More generally, emerging market economies have seen a faster increase in credit but smaller gains in output than in the past, i.e. rising higher credit intensity. That contrasts sharply with the decline in credit intensity seen in advanced economies. This growing dependence on debt is concerning, particularly with interest rates likely to rise in synch with tighter Fed policy. Recall the "taper tantrum" of 2013 which caused large outflows from emerging markets, causing the latter's bond yields to spike. For now, the situation seems to be under control, with continuing net inflows and relatively stable bond yields. But as we've seen in the past, flows can reverse very quickly.

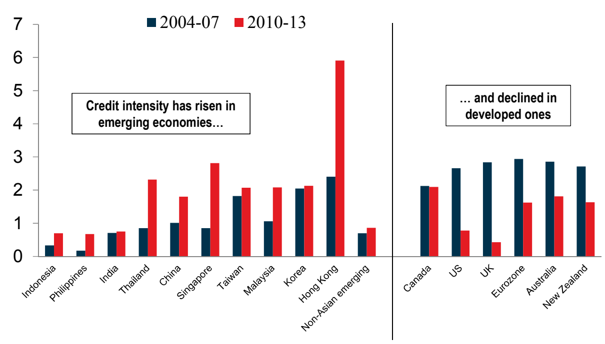
World: Trade volumes sank in Q1



NBF Economics and Strategy (data via CPB)

World: Credit intensity has risen in emerging markets

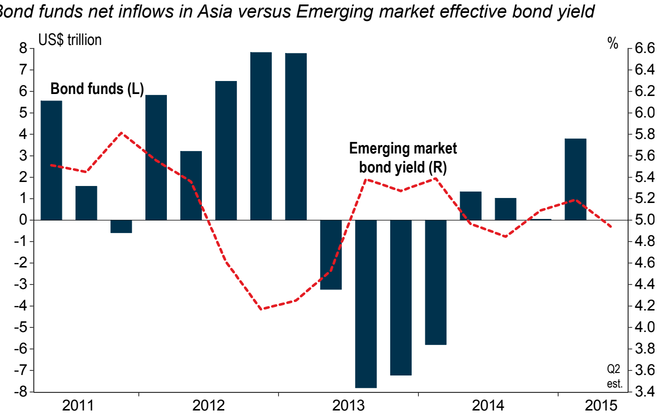
Credit intensity of GDP, i.e. the change in credit-per-unit increase in GDP



NBF Economics and Strategy (data via IMF)

World: Emerging market bonds holding firm

Bond funds net inflows in Asia versus Emerging market effective bond yield



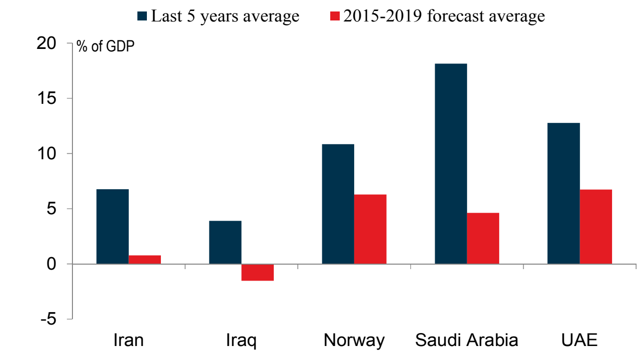
NBF Economics and Strategy (data via IMF, Bloomberg)

World Economic Outlook

	Forecast		
	2014	**2015**	**2016**
Advanced countries	***1.8***	***2.1***	***2.2***
United States	2.4	2.6	2.7
Euroland	0.9	1.5	1.5
Japan	-0.1	1.0	0.8
UK	2.6	2.6	2.5
Canada	2.5	2.0	2.0
Australia	2.7	2.6	3.1
New Zealand	3.2	2.9	2.7
Hong Kong	2.3	2.5	2.7
Korea	3.3	3.1	3.6
Taiwan	3.7	3.7	3.6
Singapore	2.9	2.9	3.4
Emerging Asia	***6.7***	***6.7***	***6.9***
China	7.4	6.8	7.1
India	7.2	7.7	8.0
Indonesia	5.0	5.4	5.7
Malaysia	6.0	4.8	5.0
Philippines	6.1	6.4	6.2
Thailand	0.7	3.7	3.9
Latin America	***1.3***	***0.8***	***2.3***
Mexico	2.1	2.9	3.4
Brazil	0.1	-1.1	1.2
Argentina	0.5	-0.5	1.9
Venezuela	-4.0	-6.0	-2.3
Colombia	4.6	2.8	3.5
Eastern Europe and CIS	***1.7***	***-0.1***	***2.1***
Russia	0.6	-4.0	0.2
Czech Rep.	2.0	2.5	2.7
Poland	3.3	3.5	3.5
Turkey	2.9	3.1	3.7
Middle East and N. Africa	***2.4***	***2.8***	***3.0***
Sub-Saharan Africa	***5.0***	***4.6***	***5.0***
Advanced economies	***1.8***	***2.1***	***2.2***
Emerging economies	***4.6***	***4.3***	***5.0***
World	***3.4***	***3.3***	***3.8***

Source: NBF Economics and Strategy

World: Oil collapse has helped rebalance global savings
Current account balance

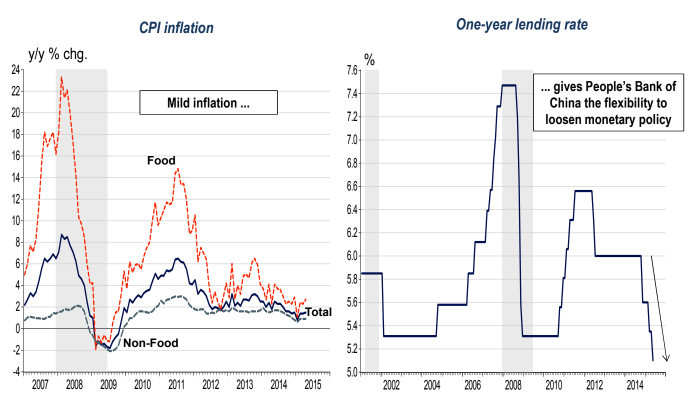


NBF Economics and Strategy (data via IMF)

Fortunately, there are also tailwinds helping the global economy. Brent oil prices are on track to average roughly $60/barrel this year, 40% lower than the 2014 average. That's a stimulus of around 1.5% of GDP assuming everything else remains constant. Cheaper oil has also helped in rebalancing global savings by improving the current account balance of oil importing countries, which are often in deficit territory, at the expense of big oil exporters which usually enjoy large surpluses. For instance, Saudi Arabia's current account surplus is now expected to shrink from an outsized 18% to roughly 5% on average over the coming five years.

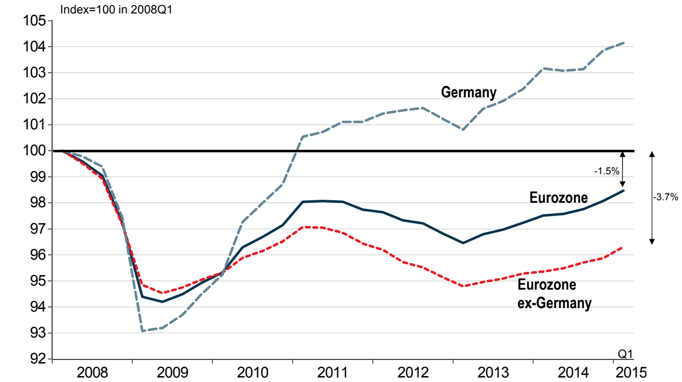
Highly accommodative monetary policy stimulus around the globe should also help support growth. In China for example, the one-year lending rate was cut to 5.1% in May, the lowest since the country joined the World Trade Organisation back in 2001. Mild inflation made it easier for the People's Bank of China to stimulate the economy, the latest rate cut intended to rekindle loan growth in the formal banking sector.

China: Monetary Policy stimulus



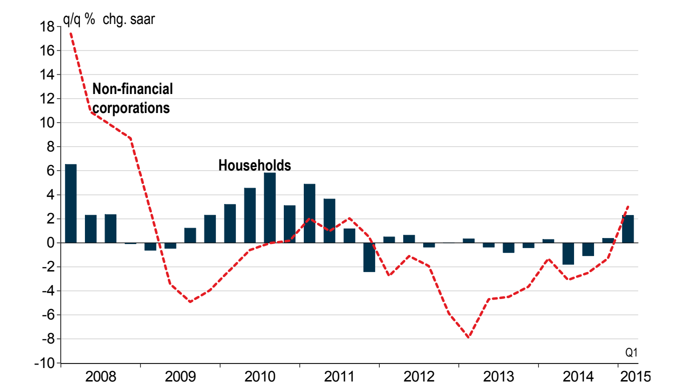
NBF Economics and Strategy (data via Datastream)

Eurozone: Recovery continued in Q1



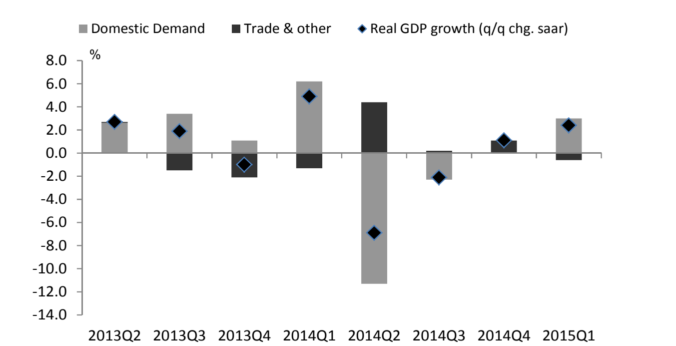
NBF Economics and Strategy (data via Eurostat)

Eurozone: Has deleveraging finally come to an end?
MFI loans to Non-financial corporations and Households



NBF Economics and Strategy (data via Datastream)

Japan: Domestic demand lifts Q1 GDP
Contributions to real GDP



NBF Economics and Strategy (data via Datastream)

China's government also announced fiscal stimulus back in March with the budget deficit slated to widen to roughly 2.3% of GDP. In our view, the combined stimulus should be enough to offset ongoing headwinds in the real estate market, and allow GDP growth to average close to Beijing's 7% target this year and next.

Unlike emerging markets, the OECD should perform much better than last year buoyed by the US, Japan and even the Eurozone, all three set to grow synchronously for the first time in five years. The eurozone recovery extended to the first quarter of 2015 as GDP grew 1.6% annualized thanks to gains in most member countries including powerhouses Germany and France. That's the fastest pace of expansion in four years in the eurozone. True, recent gains haven't made up for the deep slump during the recession — GDP is still 1.5% below its pre-recession peak, or 3.7% below peak excluding Germany. But there are signs the common currency area is moving in the right direction. Thanks to unprecedented stimulus by the European Central Bank monetary policy seems to be working again as evidenced by household and business loans which both grew in Q1 at the fastest pace in years. The cheaper euro resulting from the ECB's ultra-loose policies is also giving a lift to exports, and helping support imported inflation and hence inflation expectations.

That said a relapse cannot be ruled out. Despite recent progress, it's much too soon to discard the threat of deflation, more so considering poor demographics, i.e. contracting working age population. A Greek debt default could also jeopardise the zone's recovery. At this point, markets seem largely unfazed, inured perhaps by repeated exposure to such a recurring theme. May be investors are expecting the troika (IMF, ECB, European Union) to bail out Greece for the third time in five years, or perhaps they expect any default (if it does happen) to be orderly and not significantly impact financial markets. But in truth, repercussions on confidence and economic activity are highly uncertain. That remains the major downside risk to our forecast for the zone to grow 1.5% this year and next.

Like the eurozone, Japan is on the ascendency. GDP expanded for the second straight quarter in Q1 with a +2.4% annualized print, the biggest jump since 2013. Domestic demand, helped by a solid performance from consumers and to a lesser extent housing and investment, more than offset the drag from trade in the first quarter. That's not to say the Bank of Japan will pull back on monetary policy stimulus. With the annual inflation rate remaining stubbornly below the central bank's 2% target, odds are that QE will be expanded. The ramp up of asset purchases should take the yen closer to 130 against the USD. The more competitive currency and a smaller fiscal drag than last year should help GDP growth pick up to roughly 1% this year.

U.S.: Better than it looks

A worse-than-expected start to the year for the US had us lower our GDP growth forecast for 2015 by three ticks to 2.6%. That said, fundamentals for domestic demand remain strong with a solid labour market helping lift consumption, the main engine of growth. The Fed remains on track to hike interest rates later this year, but don't expect it to get aggressive when it starts tightening. The strong U.S. dollar is not only hindering exports, but is also making it more difficult for the PCE inflation rate to reach the Fed's 2% target.

Likely downward revisions to already-disappointing first quarter GDP results would mean the US economy contracted for the first time in a year. Not only was trade a drag on the economy, but domestic demand was also very soft in Q1 due to weak growth for consumption and residential investment (both worst since the first quarter last year), a sharp contraction of business investment in structures (the worst since Q1 of 2011), and another quarterly drag from government. There was further bad news considering the massive inventory build during the quarter, which could restrain production later.

But the US economy is stronger than what's depicted by Q1 results. The latter were weak largely due to temporary factors such as bad weather (which affected consumption and construction) and port strikes on the West Coast (which hurt exports). So, growth should bounce back as those factors dissipate. Note that outside of recessions, a weak performance such as in Q1 is followed, often with a lag, by solid growth sometimes with a 4-5% handle. Given the inventory build in the prior quarter, it is unlikely Q2 growth will hit those heights. But such a growth spurt is possible in the second half of the year after inventories have been downsized. Indeed, economic fundamentals remain very strong particularly for consumption.

True, April's retail results were weaker than expected. But those have to be looked at in context given that the flat sales came after healthy gains in the prior month. Our optimism for consumption for the balance of the year rests on solid fundamentals. Consumer confidence is high and so is the savings rate. Re-leveraging should also help boost spending. Latest data from the New York Fed show household debt rising in Q1 for the sixth time in the last seven quarters thanks in part to auto loans, the latter reaching a new record. Re-leveraging is arguably more effective in lifting consumption spending if it is broad based, i.e. if more households can have access to borrowing. We are encouraged by the fact that the lowest quartile (i.e. those with the lowest credit scores) has seen the fastest improvement in the last five years. In other words, many who had previously been shut out of credit markets due to low credit scores may now be eligible to borrow and spend. Pent-up demand from such a group should not be underestimated.

U.S.: Q1 GDP results were awful …

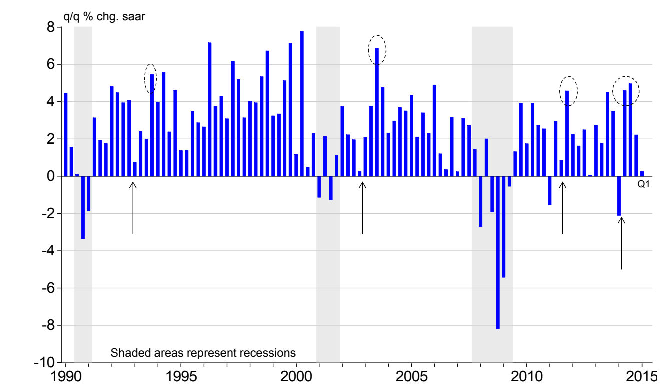
Real GDP contributions

	2015Q1	2014Q4	2014Q3
GDP	**0.2**	**2.2**	**5.0**
Consumption	1.3	3.0	2.2
Business investm. Equip./Intell.	0.3	0.4	1.0
Business investm. Struct.	-0.8	0.2	0.1
Residential investm.	0.0	0.1	0.1
Government	-0.2	-0.4	0.8
Domestic Demand	**0.8**	**3.4**	**4.2**
Exports	-1.0	0.6	0.6
Imports	-0.3	-1.6	0.2
Trade	**-1.3**	**-1.0**	**0.8**
Final sales	**-0.5**	**2.3**	**5.0**
Inventories	0.7	-0.1	0.0

NBF Economics and Strategy (data via Datastream)

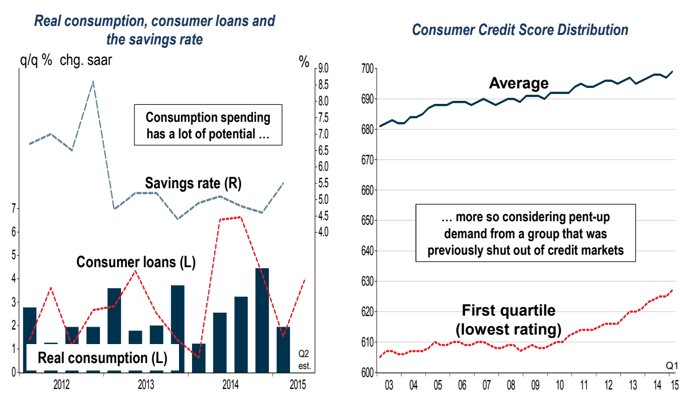
… but sharp rebound is coming

Real GDP



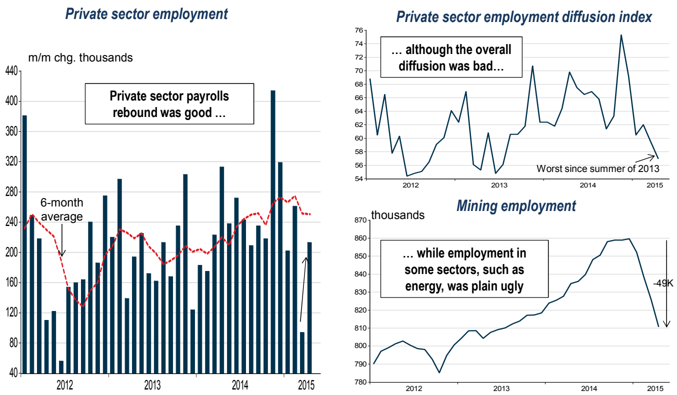
NBF Economics and Strategy (data via Datastream)

U.S.: Consumption will bounce back



NBF Economics and Strategy (data via Datastream, New York Fed)

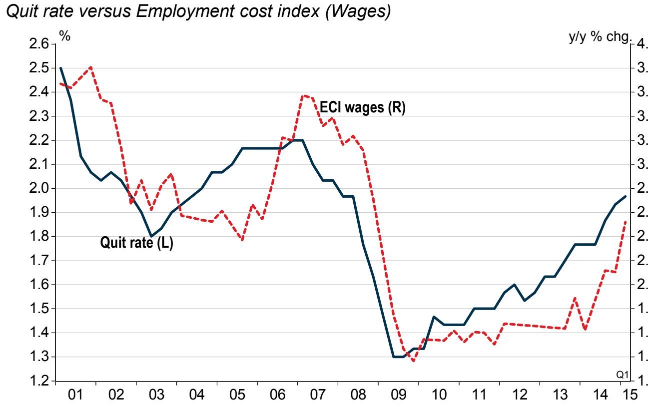
U.S.: April employment — The good, the bad and the ugly



NBF Economics and Strategy (data via Datastream)

U.S.: Wages slowly coming up

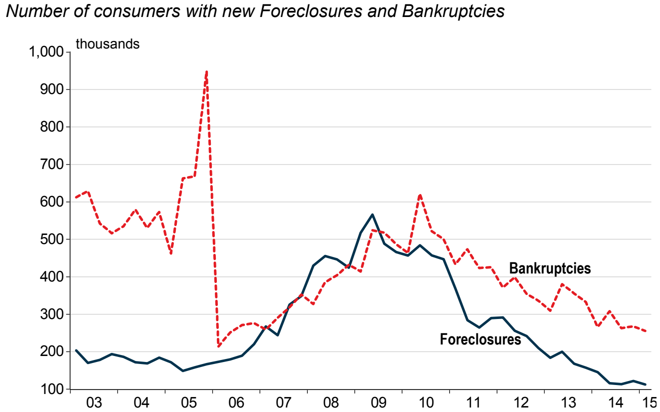
Quit rate versus Employment cost index (Wages)



NBF Economics and Strategy (data via Datastream)

U.S.: Foreclosures and bankruptcies at multi-year lows

Number of consumers with new Foreclosures and Bankruptcies



NBF Economics and Strategy (data via New York Fed)

Crucially for consumers, the labour market remains resilient as evidenced by a low rate of layoffs (initial jobless claims are at a 15-year low) and high number of job openings (5 million according to the latest JOLTS report). So, it wasn't surprising to us the pace of employment creation bounced back after a disappointing March. The increase in non-farm payrolls swiftly returned to 200K+ territory in April buoyed by the private sector. Employment in the goods sector got a lift thanks to gains in cyclical sectors such as manufacturing and construction. Private services sector employment was also strong. That said, not all is rosy in the US labour market. Mining employment continues to struggle in the aftermath of the oil price collapse, and the private sector employment diffusion index is the lowest since the summer of 2013, i.e. job creation is not exactly widespread.

Wage inflation also remains mild, although it's encouraging to see it heading in the right direction based on employment cost indices. The uptick in wages should become more pronounced if, as we expect, the quit rate rises further as other job opportunities become available. True, in the goods sector the quit rate and hence wages are capped somewhat. But in the services sector where businesses have less room to automate or even outsource, employees have some flexibility. That explains why the quit rate has risen in the past year significantly faster in services sectors such as health care, education, leisure, hospitality, accommodation, food services, and even retail, compared to say manufacturing.

Consumers, at least those who own homes, should also benefit from housing wealth effects as home prices continue to climb. A program launched by the federal government late last year allows under strict underwriting standards a down payment that is as low as 3% for first time home buyers. That, together with low mortgage rates, has helped support demand. On the supply side, inventories have been shrinking thanks in part to fewer foreclosures. Those have helped boost home prices nearly 13% annualized over January-March according to the 20-city Case-Shiller index, the biggest three-month increase since 2013.

While the Q1 disappointment prompted us to trim by three ticks our 2015 growth forecast to 2.6%, we remain positive on the US economy, expecting its main engine i.e. consumers to drive growth. Record corporate profits and the earlier USD surge (which has made it cheaper for firms to import machinery from say Germany or Japan) should help boost business investment. So, domestic demand should strengthen further and offset any drag from trade, the latter remaining under pressure from the strong dollar. Despite seeing above-potential growth, the Fed won't get aggressive when it starts its tightening cycle late this year largely due to tepid inflation, the annual PCE deflator remaining stuck well below its 2% target.

MONTHLY ECONOMIC MONITOR

Canada: Weak Q1

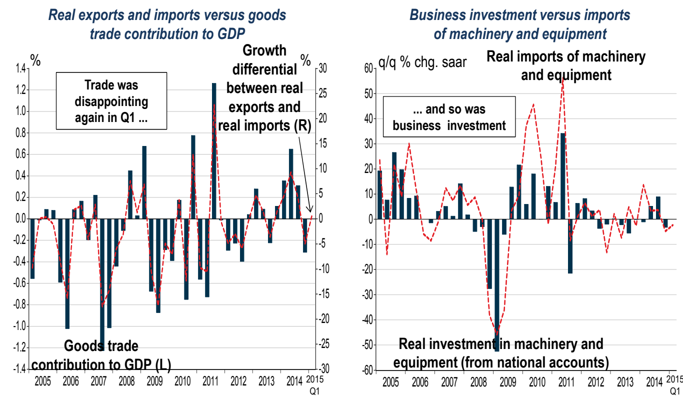
After an awful Q1, Canada should bounce back as exports recover in synch with better US growth. That said, the second half of the year may not be as good as assumed by the Bank of Canada considering some of the impacts of the oil shock may be back-loaded rather than front-loaded e.g. investment spending. A likely moderation in housing and consumption won't help either. Given how overall growth will be dependent on trade, the central bank will do what it can to keep the Canadian dollar grounded.

Canadian GDP data for Q1 wasn't yet available at this writing, but monthly readings to date suggest economic growth decelerated sharply after three strong quarters. Trade may not have contributed much to the economy in the quarter based on nearly matching contractions for export and import volumes. Domestic demand probably softened as well with weak performances for business investment (based on imports of industrial machinery) and residential construction (based on slumping housing starts) offsetting tepid growth in consumption spending. All told, GDP growth was probably no better than 0.5% annualized in the first quarter of 2015. On a positive note, however, the handoff to Q2 was probably good, with March GDP growth well supported by healthy volumes reported in the month by both the manufacturing and wholesale sectors.

The Q1 weakness was partly due to extraordinary circumstances such as atypically bad weather which disrupted overall economic activity and closures of auto assembly lines in Ontario for retooling which curtailed manufacturing output. So, expect a rebound in Q2 as those temporary factors dissipate.

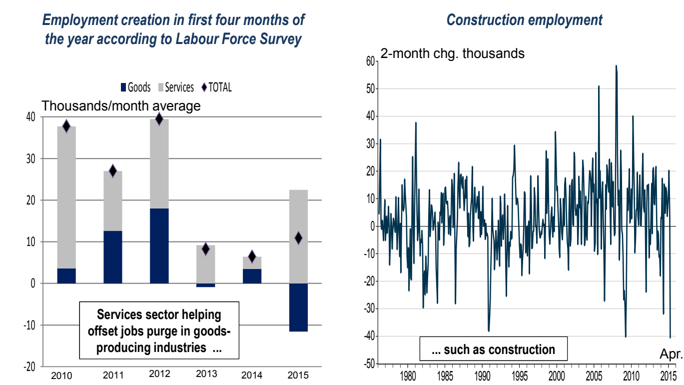
As we showed last month, the impact of the oil shock on the labour market has not been as bad as feared. In fact, job creation in the first four months this year, i.e. 11K/month on average according to the Labour Force Survey, was the best since 2012. That's not to say the labour market has been unaffected by the oil shock. The goods sector has lost about 11K jobs/month on average this year, about half of which was in construction. The headcount in the construction industry fell 41K over March and April alone, the worst two-month drop ever, the slump likely related to infrastructure projects in the energy patch. Fortunately, a resilient services sector is providing an offset for now. It's also encouraging that the private sector created jobs for the second straight month in April, and that full time employment is bouncing back — the share of full-time employment in total employment is now the highest in months. We nonetheless remain cautious about the overall Canadian jobs outlook given that the negative impact of the oil shock on the economy is highly uncertain with regards to both extent and timing.

Canada: A weak Q1 in the cards



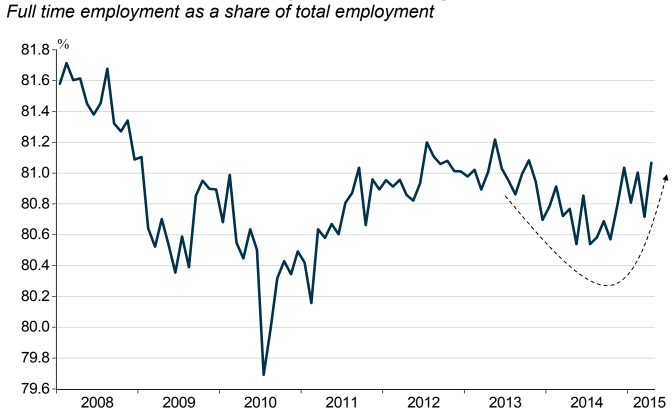
NBF Economics and Strategy (data via Statistics Canada)

Canada: Employment holding firm thanks to services



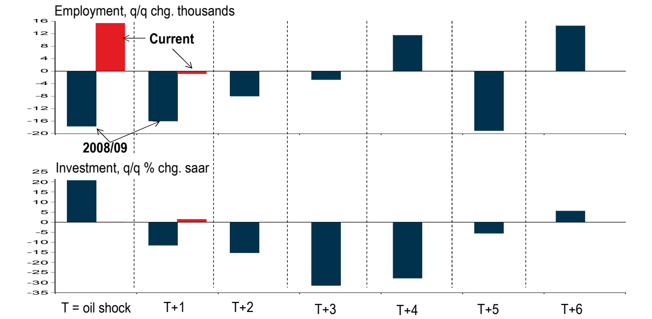
NBF Economics and Strategy (data via Statistics Canada)

Canada: Full time employment making a comeback
Full time employment as a share of total employment



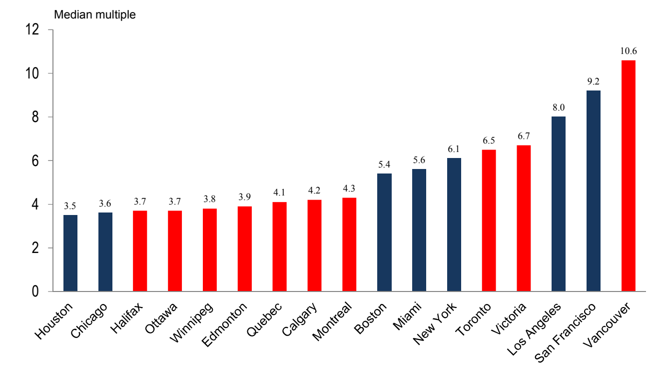
NBF Economics and Strategy (data via Statistics Canada)

Impact of oil shock: Not so "front loaded" this time
Employment and Real commercial & industrial non-residential building investment in Alberta and Saskatchewan after oil shock: 2008/09 versus Current shock



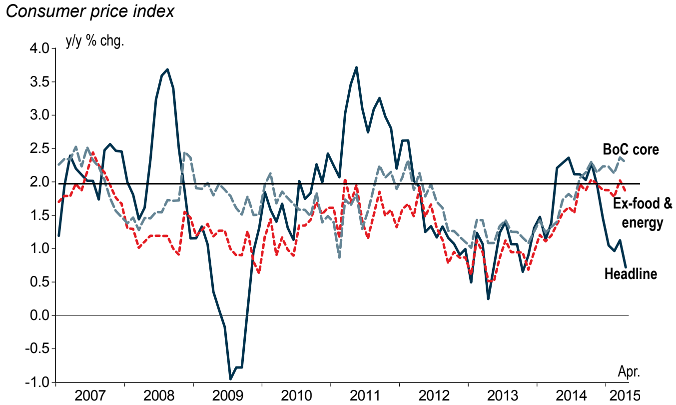
NBF Economics and Strategy (data via Statistics Canada)

Canada: The most overvalued housing market in the world?
Median home price divided by median household income for CA-US metropolitan areas



NBF Economics and Strategy (data via OECD and Demographia)

Canada: Inflation remains mild
Consumer price index



NBF Economics and Strategy (data via Statistics Canada)

The same applies to the investment outlook. For now, Alberta and Saskatchewan are showing resilience not only on the employment front but also in terms of investment spending. But if the oil collapse of 2008 is any guide, one can expect investment to eventually taper down. So, there may be some downside risks to the BoC's call for above-potential growth of 2.7% on average in the second half of the year.

The housing market also presents some risks, after solid gains in recent years. Home prices are up more than 4% year-on-year according to the latest Teranet-National Bank house price index with the overall index being driven by outperformance in cities blessed by strong immigration such as Vancouver and Toronto, which are offsetting softness elsewhere. While a moderation in price gains is likely in synch with a slower moving economy, we're not as pessimistic as some.

A famous magazine with worldwide circulation labelled Canada as one of the most overvalued housing market in the world based on the deviation from historical average of price-to-income-per-person. That measure, however, is far from ideal because it doesn't say anything about the relative valuation against other countries. What if a country is just in catch up mode? A comparison between large metropolitan areas with similar characteristics suggests things are not as bad as advertised. While the ratio of median home prices relative to household income is the highest in Vancouver, that's not off the charts when compared to San Francisco. Similarly, Toronto is much in line with New York City. More generally, analysts bashing Canada's housing market have been so wrong for so many years not only because of reliance on such ratios, but also perhaps because of the fundamental error of ignoring demographics. Canada's population growth for people aged 20-44 is one of the fastest in the OECD due to an immigration policy that has spurred demand for housing in major cities.

With domestic demand restrained by the curtailment of investment in the oil patch, and a likely moderation in growth in housing and consumption, trade will remain the driver of Canadian growth in 2015. Strengthening U.S. demand, coupled with lagged impacts of a cheaper Canadian dollar will give a boost to exporters, allowing GDP to grow roughly 2.0% in 2015, the third consecutive year of above potential growth. That's not to say the Bank of Canada will quickly abandon its dovish stance on monetary policy. Given how overall growth will be dependent on trade, the central bank will do what it can to keep the Canadian dollar grounded. Soft inflation gives it the flexibility to be patient — the annual headline inflation rate was just 0.8% in April, the lowest since October 2013. And given its concerns about the global economy and domestic risks, the central bank will likely continue to err on the side of caution and delay interest rate hikes to next year.

United States
Economic Forecast

(Annual % change)*	2012	2013	2014	2015	2016	Q4/Q4 2014	Q4/Q4 2015	Q4/Q4 2016
Gross domestic product (2009 $)	2.3	2.2	2.4	2.6	2.7	2.4	2.7	2.1
Consumption	1.8	2.4	2.5	3.3	2.9	2.9	3.4	2.3
Residential construction	13.5	11.9	1.6	4.5	4.5	2.5	5.5	3.2
Business investment	7.2	3.0	6.3	3.4	3.5	6.2	2.8	2.6
Government expenditures	(1.4)	(2.0)	(0.2)	0.1	0.3	0.8	(0.1)	0.2
Exports	3.3	3.0	3.2	2.4	2.2	2.4	1.8	1.2
Imports	2.3	1.1	4.0	4.0	3.4	5.6	2.7	3.7
Change in inventories (bil. $)	57.1	63.6	70.6	87.3	77.0	80.0	79.0	75.0
Domestic demand	2.1	1.9	2.5	2.8	2.5	2.9	2.7	2.0
Real disposable income	3.0	(0.2)	2.5	3.6	2.5	3.1	3.3	2.6
Household employment	1.8	1.0	1.6	2.1	1.7	2.2	2.1	1.4
Unemployment rate	8.1	7.4	6.2	5.3	5.0	5.7	5.1	4.9
Inflation	2.1	1.5	1.6	0.4	2.3	1.2	1.3	2.2
Before-tax profits	11.4	4.2	(0.8)	6.2	5.1	-0.2	6.0	4.5
Federal balance (unified budget, bil. $)	(1,089.2)	(680.2)	(483.3)	(469.0)	(536.0)	...	...	...
Current account (bil. $)	(460.8)	(400.3)	(410.6)	(448.8)	(440.8)	...	...	...

** or as noted*

Financial Forecast**

	Current 5/25/15	Q3 2015	Q4 2015	Q1 2016	Q2 2016	2015	2016
Fed Fund Target Rate	0.25	0.50	0.75	1.00	1.25	0.75	1.50
3 month Treasury bills	0.02	0.52	0.69	0.88	1.22	0.69	1.49
Treasury yield curve							
2-Year	0.64	1.15	1.48	1.65	1.80	1.48	2.26
5-Year	1.57	1.99	2.08	2.19	2.28	2.08	2.62
10-Year	2.21	2.52	2.62	2.70	2.77	2.62	2.92
30-Year	2.99	3.21	3.26	3.31	3.34	3.26	3.39
Exchange rates							
U.S.$/Euro	1.10	1.08	1.05	1.04	1.04	1.05	1.00
YEN/U.S.$	121	123	124	125	126	124	130

National Bank Financial

*** end of period*

Canada
Economic Forecast

*(Annual % change)**	*2012*	*2013*	*2014*	*2015*	*2016*	*Q4/Q4 2014*	*Q4/Q4 2015*	*Q4/Q4 2016*
Gross domestic product (2007 $)	1.9	2.0	2.5	2.0	2.0	2.6	1.7	1.9
Consumption	1.9	2.5	2.8	2.2	1.9	2.6	2.0	1.8
Residential construction	5.7	(0.4)	2.8	1.3	(0.1)	5.2	(1.3)	0.0
Business investment	9.0	2.6	0.1	(1.7)	(0.3)	0.5	(2.2)	0.5
Government expenditures	0.2	0.1	(0.1)	0.3	(0.0)	0.6	(0.3)	0.2
Exports	2.6	2.0	5.4	4.8	7.0	6.5	5.9	5.7
Imports	3.7	1.3	1.7	2.3	3.2	2.6	2.0	3.0
Change in inventories (millions $)	7,437	12,368	7,433	5,461	3,577	8,017	3,202	2,794
Domestic demand	2.5	1.5	1.6	1.4	1.1	2.0	0.9	1.1
Real disposable income	2.8	2.5	1.5	1.7	1.9	1.2	1.9	1.9
Employment	1.3	1.4	0.6	0.8	1.0	0.7	0.7	1.0
Unemployment rate	7.3	7.1	6.9	6.8	6.7	6.7	6.8	6.6
Inflation	1.5	0.9	1.9	1.0	2.2	1.9	1.5	2.5
Before-tax profits	(4.2)	(0.6)	9.0	(2.0)	4.2	6.7	(0.7)	5.0
Current account (bil. $)	(59.9)	(56.3)	(43.5)	(52.6)	(44.5)	....	....	....

** or as noted*

Financial Forecast**

	Current 5/25/15	*Q3 2015*	*Q4 2015*	*Q1 2016*	*Q2 2016*	*2015*	*2016*
Overnight rate	0.75	0.75	0.75	0.75	0.75	0.75	1.00
3 month T-Bills	0.65	0.63	0.63	0.68	0.68	0.63	1.02
Treasury yield curve							
2-Year	0.67	0.93	1.01	1.12	1.24	1.01	1.62
5-Year	1.05	1.51	1.59	1.67	1.75	1.59	2.00
10-Year	1.78	2.02	2.08	2.14	2.20	2.08	2.42
30-Year	2.36	2.59	2.63	2.66	2.70	2.63	2.86
CAD per USD	1.23	1.25	1.27	1.28	1.26	1.27	1.23
Oil price (WTI), U.S.$	59	58	60	62	64	60	70

National Bank Financial

*** end of period*

MONTHLY ECONOMIC MONITOR

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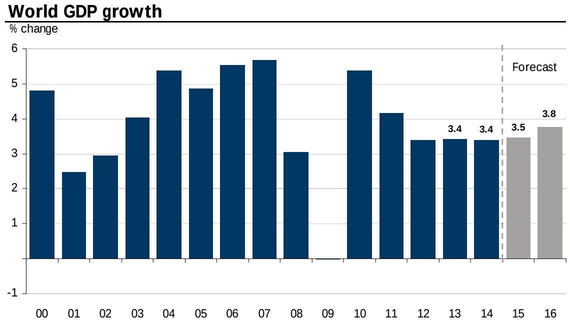
NATIONAL BANK
FINANCIAL MARKETS
A division of National Bank of Canada

ECONOMIC AND FINANCIAL MARKET OUTLOOK

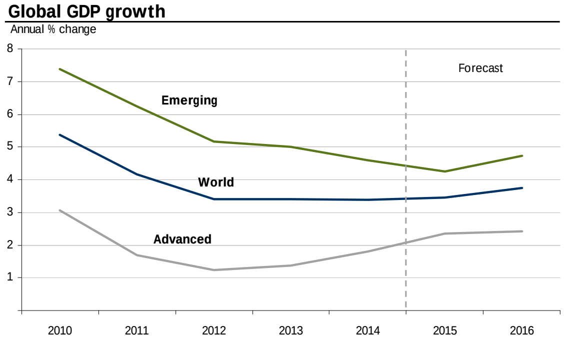
June 2015

World GDP growth



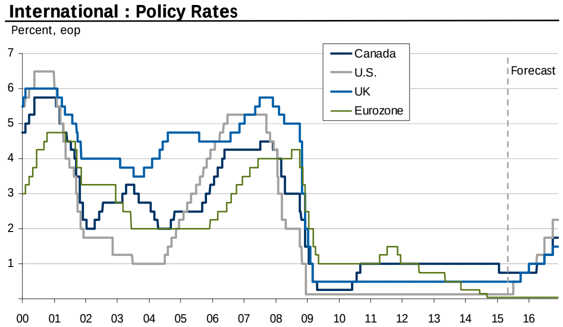
Source: International Monetary Fund, RBC Economics Research

Global GDP growth



Source: International Monetary Fund, RBC Economics Research

International : Policy Rates



Source: Bank of England, European Central Bank, Federal Reserve, Bank of Canada, RBC Economics Research

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Patience being tested

A full-fledged pickup in global economic growth proved elusive in the first quarter of 2015, although supportive conditions augur well for a strong bounce-back in the current quarter. Our assessment is that the underpinnings for this recovery are sturdier than in previous years given the decline in oil prices and global central banks providing even greater stimulus. Therefore, even with the global economy staggering in early 2015, this slowing is unlikely to be sufficient to push 2015's growth rate below the 3.5% range that has been maintained for the past three years.

Disappointing data from Canada, the US, the UK, and China dominated recently and eclipsed an impressive gain in the euro area in the first quarter. The details showed that the pullback in the energy sector played a role in the weakening, although one-off factors, ranging from severe winter weather in the US and Canada to election-related jitters in the UK, also dampened activity. To some extent, the sharp slowing in global growth in the first quarter was reminiscent of 2014 when one-off factors weighed on activity in a number of economies. This resulted in the global growth rate slipping and then recovering in subsequent quarters such that world gross domestic product (GDP) growth averaged 3.4% that year.

Trading places

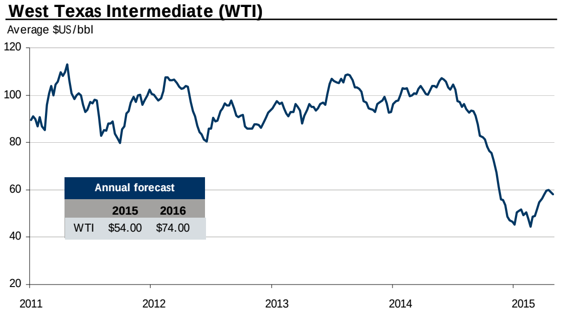
After several years of global growth driven by incremental gains from the emerging market economies, we expect advanced economies to make a larger contribution in 2015. The purchasing managers' indices illustrate this divergence in momentum with the advanced economies showing a sharp acceleration while the momentum in the emerging economies has slowed.

Showing the money

Acceleration in activity in advanced economies was underpinned by central banks flooding the financial system with liquidity, with the relative underperformance in emerging market economies prompting some of the major central banks among these economies to follow suit and ease monetary policy recently. Chinese real GDP growth was the slowest in six years in the first quarter, and April reports point to only mild acceleration in the second quarter. The weaker outturn led the People's Banks of China (PBoC) to ease policy aggressively, and we expect additional stimulus to be implemented to ensure that the government's targets of 7% real GDP growth and 3% inflation are achieved. The Reserve Bank of India also cut its policy rate three times this year.

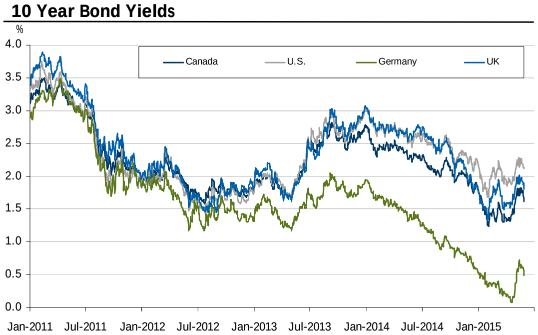
Within the advanced economies, the Bank of Canada and Reserve Bank of Australia cut their policy rates this year from already very accommodative levels while the Bank of England talked down expectations about the timing of

West Texas Intermediate (WTI)



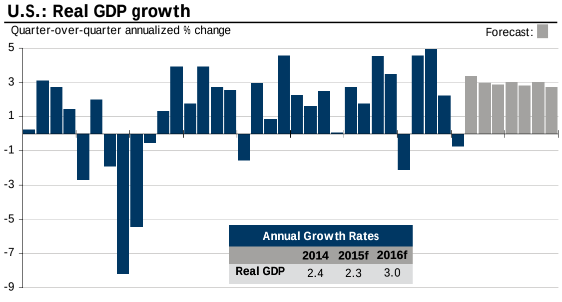
Source: Haver Analytics, RBC Economics Research

10 Year Bond Yields



Source: Bank of Canada, Financial Times, Reuters, U.S. Treasury, RBC Economics Research

U.S.: Real GDP growth



Source: Bureau of Economic Analysis, RBC Economics Research

its first rate hike on the back of low inflation and the absence of wage pressures. The European Central Bank's (ECB) aggressive quantitative easing program and maintenance of an extremely low policy rate contributed to firmer growth in the euro area in the first quarter despite ongoing concerns about Greece. Even the US Federal Reserve, which is in position to unwind some monetary policy stimulus, remained on the sidelines. A rebound in US growth in the second quarter and persistent improvement in labour market conditions will likely see the Fed raise the fed funds target this autumn, although monetary policy will remain accommodative in 2015 and 2016.

Oil prices – not out of the woods yet

The 40% jump in West Texas Intermediate (WTI) oil prices from the mid-March low reflected a correction after an eight-month period of relatively steady decline. Concerns about Middle Eastern supply making its way to market and a mild reduction in North American inventories combined with a weaker US dollar to prop up oil prices. The six-week rally in prices petered out in mid-May. Despite these gyrations, we maintain our forecast that prices will average $54.00 per barrel on a WTI basis in 2015 and rise in 2016 to average $74.00 per barrel. With the number of active oil and gas rigs running at less than half the pace that they were a year earlier and energy companies aggressively reducing investment, the supply adjustment needed for prices to recover on a sustained basis is underway.

Bond yields rise as tail risks diminish

The recovery in oil prices helped to dispel concerns that the global economy was heading into a period of deflation. Negative headline inflation rates in the US, the UK, and euro area translated into declines in inflation expectations, as investors worried that the combination of energy-induced declines and excess capacity would see households and businesses delay purchases until prices fell further. This view was challenged by developments in the euro area where growth accelerated in the first quarter, and the headline inflation rate rebounded to 0.0% in April from a low of -0.6% in January. Similarly, the turnaround in energy prices and firming in US growth indicators in April resulted in inflation expectations recovering. The easing in the risk of a deflation-driven pullback in economic activity saw investors reduce their holdings of government securities resulting in bond yields shifting significantly higher. The yield on the 10-year German bund moved from a low of 7 basis points on April 20 to 64 basis points a month later. In that period, 10-year US Treasury yields and Canadian government bonds rose 35 and 37 basis points, respectively. We expect that strengthening growth and rising inflation late in the year will keep modest upward pressure on long-term interest rates, although the pace of increase is likely to be less pronounced than in the recent month.

US growth slowdown to be short-lived...

The US economy slipped in the first quarter, hampered by severe weather that weighed on household spending and non-energy investment and the west coast port strike that held back trade activity. A pullback in investment activity by energy companies due to sharply lower oil prices sealed the case for real GDP to contract at a 0.7% annualized pace in the first quarter. Despite the disappointing growth performance, the US labour market managed to generate more than half a million new jobs during the three-month period, with only the March report showing any flow through from the softening in output growth. In April, the pace of job creation recovered with employment rising 223,000. The unemployment rate showed no ill effects from the growth slowdown averaging 5.6% in the first quarter and starting the second quarter at 5.4%.

…rebound likely à la 2014

Other reports on April activity were mixed, with strength in housing starts and the composite purchasing managers' index but disappointing prints on retail sales and industrial production. The mixed results were not sufficient to derail our forecast that real GDP will rise at an above-potential pace in the quarter. We expect the persistence of very accommodative financial conditions, the windfall accruing to households from lower gasoline prices, and steady improvement in labour market conditions to result in a reacceleration in spending following a lacklustre first quarter. Business investment is also forecasted to recover following the 21% annualized drop in investment in non-residential structures in the first quarter. Much of this decline was due to a sharp drop in spending on mining exploration, shafts, and wells, as the number of active drilling rigs plunged. That said, poor weather conditions also appeared to be a factor delaying building in other sectors. Further declines in drilling activity are likely to weigh against a strong recovery in non-residential investment in structures in the second quarter; however, a rebound in spending on machinery and equipment is forecasted to skate total business spending back on-side.

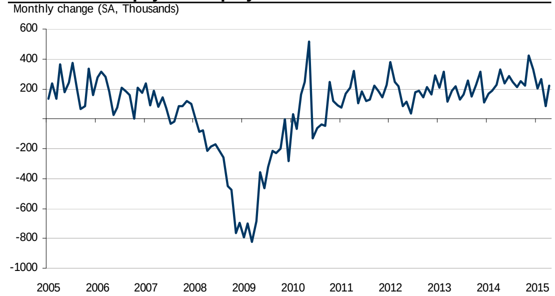
US economy to regain its stride in H2

We expect volatility in the first half of 2015 to be followed by a stable period of growth in the second half, as support from lower energy costs underpin spending by consumers and non-energy companies. Healthy balance sheets and tighter labour market conditions should see financial institutions keep credit available. Import demand is forecasted to strengthen as firms and consumers take advantage of the strong US dollar while exports should benefit from gradual acceleration in global growth. Net trade is likely to weigh on the economy's growth rate this year as imports grow more rapidly than exports. Following four years of fiscal restraint weighing on growth, the government sector is forecasted to provide a small lift in 2015 and 2016.

The prospect of stronger growth, tightening labour market conditions, and a gradual recovery in inflation as the effect of the fall in energy prices subsides supports our view that the Federal Reserve will raise the policy rate in the third quarter of 2015. Statements by Fed officials have been clear about the drivers of policy, and although a steady hand has been maintained so far this year, if the data play out as we expect, then it will clear the way for the Fed funds rate to be lifted from the zero lower bound.

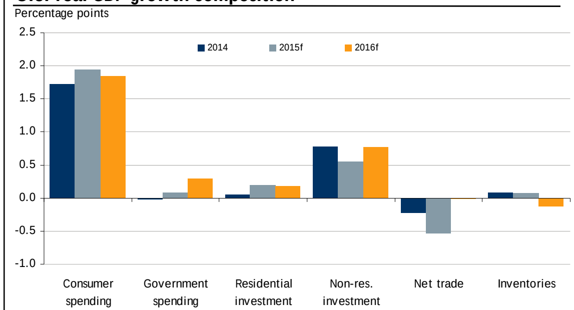
Given the risks associated with reducing policy stimulus for the first time in nine years, policymakers are likely to move slowly, with the funds target band forecasted to end 2015 in the range of 0.50% to 0.75% from 0.00% to 0.25% today. Persistent growth and inflation rising above 2% in 2016 should keep the Fed on course to continue to normalize policy gradually with the fed funds target expected to finish 2016 in the range of 2.00% to 2.25%. Longer-term yields are also forecasted to move higher as the Fed implements its tightening

U.S.: Nonfarm payroll employment



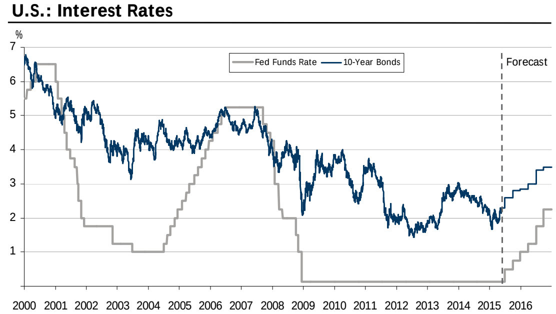
Source: Bureau of Labor Statistics, RBC Economics Research

U.S. real GDP growth composition



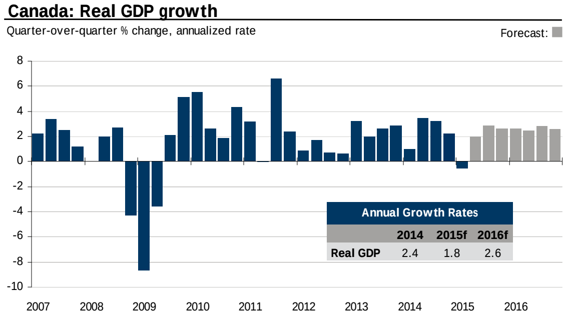
Source: Bureau of Economics Analysis, RBC Economics Research

U.S.: Interest Rates



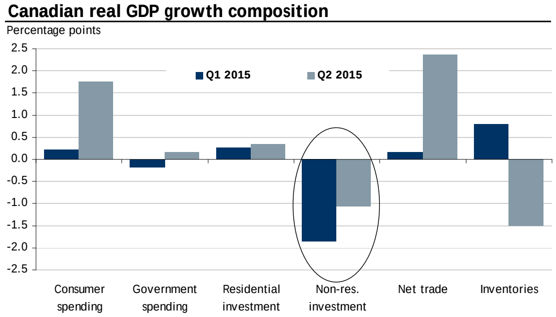
Source: Federal Reserve Board, U.S. Treasury, RBC Economics Research

Canada: Real GDP growth



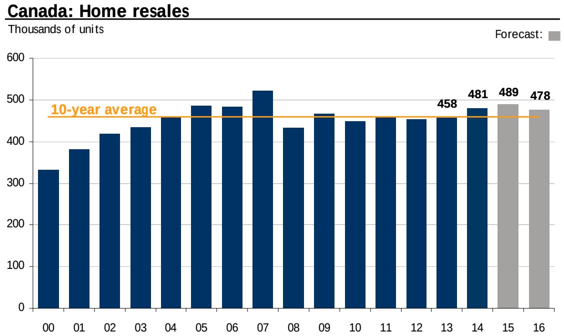
Source: Statistics Canada, RBC Economics Research

Canadian real GDP growth composition



Source: Statistics Canada, RBC Economics Research

Canada: Home resales



Source: Canadian Real Estate Association, RBC Economics Research

program and inflation, both realized and expected, rises. The rapid increase in 10-year yields between mid-April and mid-May reflected not only a reassessment of the risks to the outlook for the global economy and inflation but also the repositioning of investors, which exaggerated the move. Looking forward, we anticipate a more muted pace of increase with the 10-year yield forecasted to end 2015 at 2.8% and 2016 at 3.5%.

Canada weathering the storm(s)

Early 2015 proved challenging for Canada's economy, as severe winter weather cut into domestic and external demand, auto sector retooling took the wind out of manufacturing, and low oil prices sapped investment activity in the energy sector. The combination resulted in the economy contracting at a 0.6% annualized pace in the first quarter. The weakness in the quarter highlighted the effect of the oil price drop on Canada's economy with non-residential investment taking 1.8 percentage points off the quarter's growth rate. This downward pressure was exacerbated by severe weather conditions that dampened consumer spending activity. Weather conditions also reduced US demand for Canadian exports, which fell in the first quarter marking the second consecutive quarterly decline. Investment by energy companies likely weakened further in the second quarter, albeit more modestly, as the rig count continued to fall, and we anticipate another drop in non-residential investment to be reported. Conversely, the storm-affected pullback in consumption of goods and services is forecasted to be reversed.

Pullback not in the cards for housing market this year

Recent data showed housing starts and sales in April running solidly above the first-quarter average pace. Home re-sales recovered in March and April following three months of weaker activity. The Bank of Canada's decision to cut interest rates in late January led to mortgage rates being notched downward and likely contributed to the revival in activity. Markets in Alberta and Saskatchewan tumbled in January and February as oil prices plumbed recent lows, and although sales firmed in March and April, they remained at levels that were significantly lower than in 2014. The recent rise in sales activity hints that the oil-producing provinces may have hit their lows early in the year; however, given the uncertainty surrounding the near-term outlook for the price for oil, another round of selling cannot be ruled out. In the oil-consuming provinces, the rebound in sales activity in March and April is likely to be maintained resulting in sales nationally rising by 1.5% in 2015 and prices posting an average gain of 3.8%. Another annual rise in average home prices would exert pressure on affordability; however, the deterioration will likely be limited by historically low interest rates. In 2016, the combination of price gains and rising rates will likely put sufficient stress on affordability levels that re-sale activity will begin to soften.

Housing starts activity recorded a weather-related easing in December to February followed by firmer levels in March and April. Unlike the resale market, construction activity in Alberta and Saskatchewan failed to snap back in April. With energy-producing provinces headed for a weak year for growth, we expect starts will be subdued in 2015 in these regions. However, strength in Ontario and BC should limit the decline in overall starts in 2015, such that the pace of building is broadly consistent with the pace of household formation.

Positives outweigh negatives for consumer

Canada's consumer is in a good spot with labour market conditions gradually firming, wage growth starting to accelerate, and lower gasoline prices providing a lift to disposable incomes. The slowing in consumer spending and jump in disposable income in the first quarter resulted in the savings rate recovering to 5% following three quarters of sub-4% readings. While debt levels are high so are asset values, with overall net worth suggesting that the strains on household finances are limited at the current time. Furthermore, the persistence of low interest rates means that the cost to service this debt continues to be manageable. To be sure, the dogged increase in debt accumulation is creating concerns about the damage that will be done if the economy hits a speed bump; however, this remains a risk to the outlook not a *fait accompli*. Even when we apply our forecast for interest rates to rise during the next six quarters, debt service costs remain historically low.

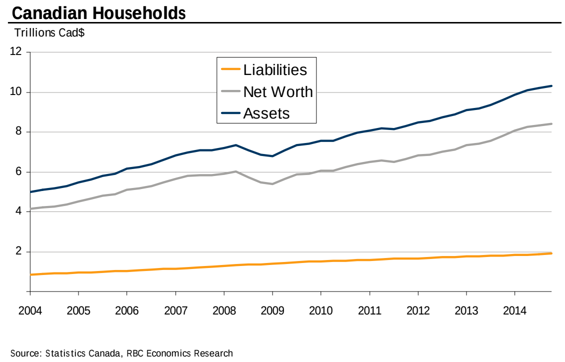
Monthly reports point to a pickup in spending after the first quarter's weather-related slowing in consumer activity. Motor vehicle sales came in close to a record pace in April, setting up for a bounce-back in spending on durable goods following a decline in the first quarter. On balance, consumer spending is forecasted to provide a solid contribution to growth in 2015 despite the weak start to the year. There were 43,000 jobs created in the first four months of 2015, with a whopping 95% being full-time positions. Other indicators show the improvement in the health of the labour market continues with a mild reduction in both the number who are working part-time because they cannot find full-time employment and the number of discouraged workers. Furthermore, wage data indicate a rising proportion of jobs are higher-wage positions. Thus, even after accounting for the effect of the cutbacks in the energy sector, Canada's labour market continues to plod along.

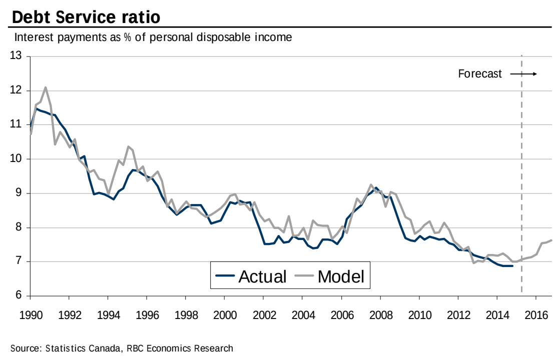
Business outlook murky; 2016 should be better

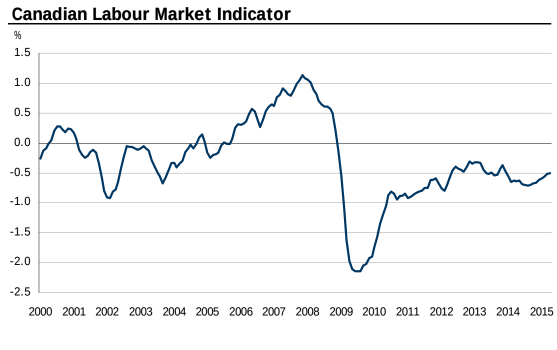
Canadian business investment is headed for a weak year with energy companies aggressively scaling back spending. Our forecast assumes that investment by the energy industry will fall by 30% this year. Even with a pickup in spending by industries outside this sector, overall investment in non-residential structures and machinery and equipment will fall in 2015. For companies outside the energy patch, the combination of easy financial conditions and firmer domestic and foreign demand should see a pickup in investment activity that should partially mitigate the hit to the economy this year. In 2016, as oil prices recover, the weight from the pullback by energy companies will lessen while non-energy companies continue their expansion plans in order to meet demand resulting in investment providing a lift to growth.

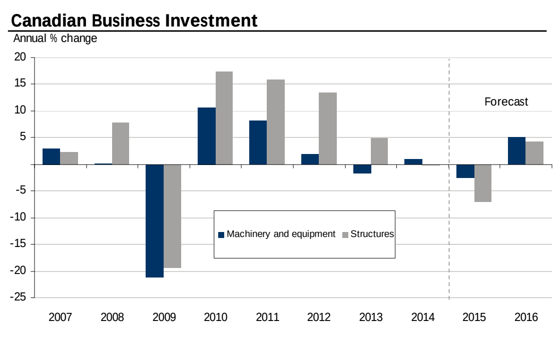
Exports to act as a factor lifting economy's growth rate

Our outlook that Canada's economy will withstand the energy price-driven hit to energy sector investment and employment reflects not only a positive read on the outlook for consumption and housing but also an assumption that the strengthening US economy and recent weakening in the currency will fuel a persistent increase in demand for Canadian exports. Export growth faded in late 2014 and the first quarter of 2015, with the recent weakening due to se-

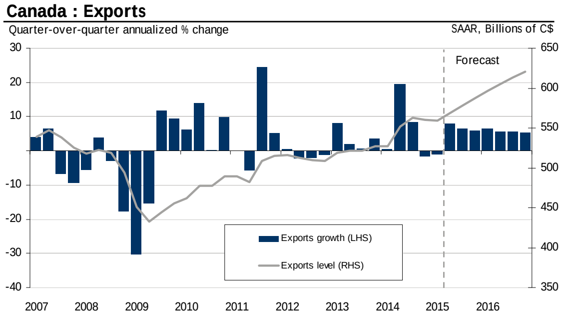






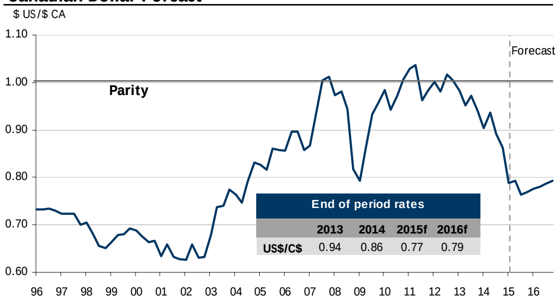


Canada : Exports



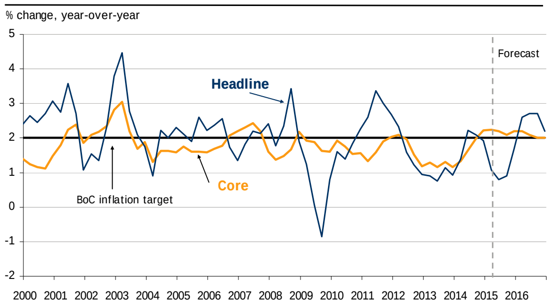
Source: Statistics Canada, RBC Economics Research

Canadian Dollar Forcast



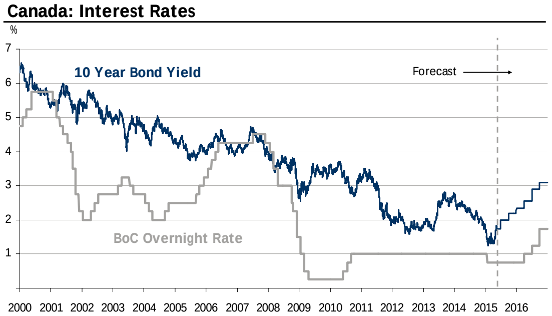
Source: Bank of Canada, RBC Economics Research

Canada : Inflation



Source: Statistics Canada, RBC Economics Research

Canada: Interest Rates



Source: Bank of Canada, RBC Economics

vere winter weather reducing US demand and dampening Canadian exporters' ability to transport their merchandise. A retooling in the auto sector also reduced exports of motor vehicles. The return of normal weather conditions and a revival in US economic activity augur well for a rebound in export growth as Canadian producers work to satisfy pent-up US demand.

We anticipate Canadian exporters to benefit from stable US demand in the second half of 2015. The Canadian dollar is also likely to provide support with the currency forecasted to weaken against the US dollar once the US Federal Reserve raises the policy rate. Our forecast assumes that even with oil prices having recovered some of its lost ground, the divergence in monetary policy between Canada and the US will see investors increase US dollar positions resulting in depreciation in Canada's currency to US$0.77 from US$0.81 on average so far this year. The currency is likely to remain below US$0.80 in 2016 as the Bank of Canada's policy rate stays below its US counterpart.

Bank of Canada forecasts growth recovery

The Bank of Canada provided a relatively upbeat assessment of the economy's prospects in 2015 with the April forecast showing a quicker and deeper drop in activity in the first quarter to be followed by a stronger rebound in the next three quarters. The Bank stressed that it did not expect the hit from the oil sector to be bigger than in their earlier projections but that its effect would affect growth more quickly. The basic tenets of the Bank's forecast were unchanged, with the economy expected to grow at an above-potential pace starting in the third quarter and the output gap to close by the end of 2016. The forecast assumes that energy prices will hold steady, meaning that the downward pressure from the declines in prices in the past year will dissipate in 2016 and both the headline and core measures of inflation will converge around 2% as the economy reaches its capacity limits.

Our forecast is broadly in line with the Bank's outlook, although we are assuming a stronger growth profile. This raises the prospect that inflation will rise beyond the 2% target unless the Bank starts to remove some policy stimulus. We expect Canada's headline inflation rate to bottom in the second quarter of 2015, as the effects of the drop in energy prices start to abate. In 2016, the combination of rising energy prices and a sustained run of above-potential growth reducing the economy's spare capacity should underpin stronger increases in the headline rate, which we expect will remain above the Bank's 2% target. Given that some of the increase reflects a swing in energy prices, the Bank is unlikely to react immediately, because the ex-energy and core measure (which does not include various energy components) will remain only slightly above target.

With the economy expanding at an above-trend pace, labour market conditions will tighten generating upward pressure on wages and creating the conditions for the Bank to shift policy toward a less highly stimulative position. We maintain our call that the first increase in the overnight rate will be announced in the second quarter of 2016. By the end of 2016, we forecast the overnight rate will be 1.75%, 100 basis points above today's rate. Longer-term yields will increase with the 10-year yield expected to end 2016 at just above 3.0%.

Economic forecast detail — Canada

Real growth in the economy

Quarter-over-quarter annualized % change unless otherwise indicated

	Actual					Forecast							Actual		Forecast	
	2014				2015				2016				year-over-year % change			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2013	2014	2015	2016
Household Consumption	1.3	4.3	2.7	2.1	0.4	3.2	2.5	2.6	2.7	2.6	2.1	2.1	2.5	2.7	2.2	2.6
Durables	1.9	14.3	8.5	1.6	-5.5	5.5	2.1	1.7	2.8	2.1	1.5	1.5	3.8	5.1	2.1	2.3
Semi-Durables	-5.4	8.0	3.4	2.9	1.3	3.0	2.8	2.5	3.1	3.8	3.1	3.1	2.8	3.1	2.8	3.1
Non-durables	2.7	-0.5	-0.1	2.2	3.0	3.0	2.8	2.8	3.1	3.8	2.2	2.2	2.3	2.4	2.2	3.0
Services	1.5	3.9	2.7	2.1	0.5	2.8	2.4	2.7	2.5	2.1	2.1	2.1	2.3	2.3	2.1	2.4
NPISH consumption	3.1	-0.1	1.9	0.6	1.5	3.2	2.6	2.5	2.7	2.6	2.1	2.1	1.6	0.8	1.8	2.6
Government expenditures	-0.7	2.2	-0.9	1.0	-0.8	0.8	1.0	1.0	1.5	2.0	2.5	2.5	0.4	0.2	0.3	1.6
Government fixed investment	-2.9	-3.5	-0.7	5.9	8.0	1.2	1.5	1.5	2.5	3.0	3.5	3.5	-1.6	-2.7	3.2	2.4
Residential investment	-2.4	10.2	11.8	0.3	4.0	4.9	2.3	3.1	-1.2	-2.5	0.9	0.8	-0.4	2.7	4.5	0.5
Non-residential investment	-0.7	1.4	4.1	-2.0	-15.5	-9.7	-0.1	6.3	7.9	5.8	5.8	4.3	2.6	0.2	-5.4	4.5
Non-residential structures	-1.5	0.6	0.9	-1.7	-19.7	-9.8	-0.5	7.0	7.5	5.0	5.0	3.8	5.0	-0.1	-7.0	4.2
Machinery & equipment	0.8	3.1	10.2	-2.5	-7.4	-9.5	0.5	5.2	8.5	7.3	7.3	5.1	-1.7	1.0	-2.5	5.1
Intellectual property	1.0	-25.6	7.1	13.1	-21.2	-9.7	0.0	5.3	6.0	5.5	5.5	3.0	-4.6	-2.7	-6.1	3.7
Final domestic demand	0.3	2.8	2.6	1.6	-1.6	1.1	1.8	2.7	2.8	2.6	2.6	2.4	1.5	1.6	1.0	2.5
Exports	0.5	19.6	8.4	-1.7	-1.1	8.0	6.5	6.1	6.6	5.6	5.5	5.4	2.0	5.4	4.2	6.2
Imports	-4.5	9.8	4.2	1.6	-1.5	0.4	3.6	5.4	6.9	6.1	4.0	4.6	1.3	1.8	1.9	5.1
Inventories (change in $b)	14.8	5.7	1.2	8.5	11.5	4.8	5.7	5.1	5.5	6.3	5.2	5.2	12.4	7.5	6.8	5.5
Real gross domestic product	**1.0**	**3.4**	**3.2**	**2.2**	**-0.6**	**2.0**	**2.9**	**2.7**	**2.7**	**2.5**	**2.8**	**2.6**	**2.0**	**2.4**	**1.8**	**2.6**

Other indicators

Year-over-year % change unless otherwise indicated

	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2013	2014	2015	2016
Business and labour																
Productivity	1.7	2.8	2.4	1.6	1.3	0.2	0.3	0.7	1.5	1.5	1.7	1.7	1.1	2.1	0.6	1.6
Pre-tax corporate profits	7.5	12.0	9.7	6.2	-10.8	-10.2	-10.9	-5.4	12.0	10.2	10.5	8.8	-0.6	8.8	-9.4	10.3
Unemployment rate (%)*	7.0	7.0	7.0	6.7	6.7	6.7	6.5	6.4	6.3	6.3	6.2	6.2	7.1	6.9	6.6	6.3
Inflation																
Headline CPI	1.4	2.2	2.1	1.9	1.1	0.8	0.9	1.7	2.6	2.7	2.7	2.2	0.9	2.0	1.1	2.5
Core CPI	1.3	1.7	2.0	2.2	2.2	2.2	2.1	2.2	2.2	2.1	2.0	2.0	1.3	1.8	2.2	2.1
External trade																
Current account balance ($b)	-41.2	-36.5	-36.1	-52.2	-69.9	-52.5	-48.7	-35.0	-26.2	-25.9	-22.1	-19.4	-56.3	-41.5	-51.5	-23.4
% of GDP	-2.1	-1.9	-1.8	-2.6	-3.5	-2.6	-2.4	-1.7	-1.3	-1.2	-1.0	-0.9	-3.0	-2.1	-2.6	-1.1
Housing starts (000s)*	176	196	199	184	175	182	181	181	182	180	178	177	188	189	180	179
Motor vehicle sales (mill., saar)*	1.77	1.86	1.98	1.94	1.83	1.88	1.86	1.85	1.85	1.85	1.84	1.84	1.78	1.89	1.86	1.85

*Period average

Source: Statistics Canada, RBC Economics Research forecasts

Economic forecast detail — United States

Real growth in the economy

Quarter-over-quarter annualized % change unless otherwise indicated

	Actual					Forecast							Actual		Forecast	
	2014				2015				2016				year-over-year % change			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2013	2014	2015	2016
Consumer spending	1.2	2.5	3.2	4.4	1.8	2.5	2.9	2.7	2.7	2.7	2.6	2.5	2.4	2.5	2.8	2.7
Durables	3.2	14.1	9.2	6.2	1.1	5.4	6.4	6.1	5.8	5.5	5.2	4.8	6.7	6.9	5.6	5.7
Non-durables	0.0	2.2	2.5	4.1	0.1	2.5	2.8	2.5	2.5	2.4	2.3	2.1	1.9	1.8	2.2	2.5
Services	1.3	0.9	2.5	4.3	2.5	2.1	2.3	2.2	2.3	2.4	2.3	2.3	1.9	2.1	2.6	2.3
Government spending	-0.8	1.7	4.4	-1.9	-1.1	1.0	1.3	1.5	1.7	1.8	2.0	2.2	-2.0	-0.2	0.5	1.7
Residential investment	-5.3	8.8	3.3	3.8	4.9	10.1	7.0	5.0	4.3	4.8	5.5	5.5	11.9	1.6	6.0	5.4
Non-residential investment	1.6	9.7	8.9	4.7	-2.8	6.7	7.7	6.2	5.9	5.7	5.5	5.4	3.0	6.3	4.4	6.1
Non-residential structures	2.9	12.6	4.8	5.9	-20.8	2.0	8.8	5.5	4.8	4.1	3.6	3.1	-0.5	8.2	-1.7	4.9
Equipment & software	-1.0	11.2	11.0	0.6	2.7	9.4	9.0	7.7	7.4	7.3	7.1	7.1	4.6	6.4	6.2	7.7
Intellectual property	4.7	5.5	8.8	10.3	3.6	6.0	5.1	4.3	4.4	4.5	4.5	4.4	3.4	4.8	6.3	4.6
Final domestic demand	0.7	3.4	4.1	3.3	0.8	3.0	3.3	3.0	3.0	3.0	3.0	2.9	1.9	2.5	2.7	3.0
Exports	-9.2	11.0	4.6	4.5	-7.6	9.0	6.4	6.9	7.6	7.6	7.4	7.7	3.0	3.2	2.9	7.4
Imports	2.2	11.3	-0.9	10.4	5.6	4.0	5.2	6.4	6.2	7.0	5.4	5.9	1.1	4.0	5.7	6.0
Inventories (change in $b)	35.2	84.8	82.2	80.0	95.0	84.7	68.6	66.6	65.6	59.6	55.5	42.5	63.6	70.6	78.7	55.8
Real gross domestic product	**-2.1**	**4.6**	**5.0**	**2.2**	**-0.7**	**3.4**	**3.0**	**2.9**	**3.0**	**2.8**	**3.0**	**2.7**	**2.2**	**2.4**	**2.3**	**3.0**

Other indicators

Year-over-year % change unless otherwise indicated

	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2013	2014	2015	2016
Business and labour																
Productivity	0.5	0.9	0.9	-0.4	0.5	0.2	-0.3	0.6	1.5	1.4	1.5	1.6	1.2	0.5	0.2	1.5
Pre-tax corporate profits	-4.8	0.1	1.4	-0.2	3.7	-3.4	-5.5	-3.0	4.1	4.1	4.6	4.7	4.2	-0.8	-2.2	4.4
Unemployment rate (%)*	6.6	6.2	6.1	5.7	5.6	5.4	5.4	5.3	5.3	5.3	5.3	5.2	7.4	6.2	5.4	5.3
Inflation																
Headline CPI	1.4	2.1	1.8	1.2	-0.1	0.0	0.2	1.2	2.7	2.5	2.7	2.6	1.5	1.6	0.3	2.6
Core CPI	1.6	1.9	1.8	1.7	1.7	1.8	2.0	2.1	2.2	2.0	2.0	2.1	1.8	1.7	1.9	2.1
External trade																
Current account balance ($b)	-404	-389	-396	-454	-507	-433	-400	-415	-432	-438	-434	-432	-400	-411	-439	-434
% of GDP	-2.4	-2.3	-2.3	-2.6	-2.9	-2.4	-2.2	-2.3	-2.3	-2.3	-2.3	-2.3	-2.4	-2.4	-2.4	-2.3
Housing starts (000s)*	934	984	1029	1055	975	1100	1237	1293	1322	1350	1376	1400	928	1001	1151	1362
Motor vehicle sales (millions, saar)*	15.7	16.5	16.7	16.7	16.6	17.0	17.1	17.1	17.2	17.4	17.6	17.8	15.5	16.4	17.0	17.5

*Period average

Source: Bureau of Economic Analysis, RBC Economics Research forecasts

Financial market forecast detail

Interest rates—North America

%, end of period

	Actual					Forecast							Actual	Forecast	
	14Q1	14Q2	14Q3	14Q4	15Q1	15Q2	15Q3	15Q4	16Q1	16Q2	16Q3	16Q4	2014	2015	2016
Canada															
Overnight	1.00	1.00	1.00	1.00	0.75	0.75	0.75	0.75	0.75	1.00	1.25	1.75	1.00	0.75	1.75
Three-month	0.90	0.94	0.92	0.91	0.55	0.75	0.75	0.75	0.85	1.15	1.40	1.85	0.91	0.75	1.85
Two-year	1.07	1.10	1.13	1.01	0.51	0.65	0.75	0.90	1.15	1.50	1.75	2.05	1.01	0.90	2.05
Five-year	1.71	1.53	1.63	1.34	0.77	1.05	1.25	1.55	1.85	2.10	2.35	2.55	1.34	1.55	2.55
10-year	2.46	2.24	2.15	1.79	1.35	1.75	2.00	2.20	2.35	2.55	2.90	3.10	1.79	2.20	3.10
30-year	2.96	2.78	2.67	2.34	1.98	2.45	2.65	2.80	2.90	3.00	3.35	3.50	2.34	2.80	3.50
Yield curve (10s-2s)	139	114	102	78	84	110	125	130	120	105	115	105	78	130	105
United States															
Fed funds	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.25	1.75	2.25	0.25	0.75	2.25
Three-month	0.05	0.04	0.02	0.04	0.03	0.15	0.35	0.50	0.70	0.90	1.45	1.95	0.04	0.50	1.95
Two-year	0.45	0.47	0.58	0.67	0.56	0.75	1.05	1.30	1.65	1.90	2.25	2.40	0.67	1.30	2.40
Five-year	1.74	1.62	1.78	1.65	1.37	1.65	1.85	2.05	2.20	2.30	2.65	2.75	1.65	2.05	2.75
10-year	2.73	2.53	2.52	2.17	1.94	2.30	2.60	2.80	2.85	3.00	3.40	3.50	2.17	2.80	3.50
30-year	3.55	3.34	3.21	2.75	2.54	3.05	3.30	3.50	3.50	3.70	4.15	4.25	2.75	3.50	4.25
Yield curve (10s-2s)	228	206	194	150	138	155	155	150	120	110	115	110	150	150	110
Yield spreads															
Three-month T-bills	0.85	0.90	0.90	0.87	0.52	0.60	0.40	0.25	0.15	0.25	-0.05	-0.10	0.87	0.25	-0.10
Two-year	0.62	0.63	0.55	0.34	-0.05	-0.10	-0.30	-0.40	-0.50	-0.40	-0.50	-0.35	0.34	-0.40	-0.35
Five-year	-0.03	-0.09	-0.15	-0.31	-0.60	-0.60	-0.60	-0.50	-0.35	-0.20	-0.30	-0.20	-0.31	-0.50	-0.20
10-year	-0.27	-0.29	-0.37	-0.38	-0.59	-0.55	-0.60	-0.60	-0.50	-0.45	-0.50	-0.40	-0.38	-0.60	-0.40
30-year	-0.59	-0.56	-0.54	-0.41	-0.56	-0.60	-0.65	-0.70	-0.60	-0.70	-0.80	-0.75	-0.41	-0.70	-0.75

Interest rates—International

%, end of period

	Actual					Forecast							Actual	Forecast	
	14Q1	14Q2	14Q3	14Q4	15Q1	15Q2	15Q3	15Q4	16Q1	16Q2	16Q3	16Q4	2014	2015	2016
United Kingdom															
Repo	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.00	1.25	1.50	0.50	0.75	1.50
Two-year	0.71	0.87	0.84	0.45	0.43	0.65	0.90	1.25	1.40	1.60	1.95	2.15	0.45	1.25	2.15
10-year	2.73	2.68	2.43	1.76	1.58	2.10	2.40	2.50	2.75	2.90	3.10	3.30	1.76	2.50	3.30
Euro Area															
Refinancing rate	0.25	0.15	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Two-year	0.17	0.03	-0.07	-0.11	-0.25	-0.20	-0.20	-0.20	-0.15	-0.15	-0.15	-0.15	-0.11	-0.20	-0.15
10-year	1.57	1.25	0.95	0.54	0.18	0.70	0.80	1.00	1.10	1.25	1.40	1.55	0.54	1.00	1.55

Growth outlook

% change, quarter-over-quarter in real GDP

	14Q1	14Q2	14Q3	14Q4	15Q1	15Q2	15Q3	15Q4	16Q1	16Q2	16Q3	16Q4	2014	2015F	2016F
Canada*	1.0	3.4	3.2	2.2	-0.6	2.0	2.9	2.7	2.7	2.5	2.8	2.6	2.4	1.8	2.6
United States*	-2.1	4.6	5.0	2.2	-0.7	3.4	3.0	2.9	3.0	2.8	3.0	2.7	2.4	2.3	3.0
United Kingdom	0.7	0.8	0.7	0.6	0.3	0.5	0.7	0.6	0.6	0.5	0.5	0.4	2.8	2.5	2.4
Euro Area	0.3	0.1	0.2	0.3	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.9	1.5	1.8
Australia	1.1	0.5	0.4	0.5	0.9	0.6	0.7	0.8	0.7	0.8	0.7	0.7	2.7	2.4	2.8
New Zealand	1.0	0.7	0.9	0.8	0.6**	0.6	0.6	0.6	0.6	0.6	0.5	0.5	3.3	2.8	2.3

*Seasonally adjusted annualized rates;**Forecast

Inflation outlook

% change, year-over-year

	14Q1	14Q2	14Q3	14Q4	15Q1	15Q2	15Q3	15Q4	16Q1	16Q2	16Q3	16Q4	2014	2015F	2016F
Canada	1.4	2.2	2.1	1.9	1.1	0.8	0.9	1.7	2.6	2.7	2.7	2.2	2.0	1.1	2.5
United States	1.4	2.1	1.8	1.2	-0.1	0.0	0.2	1.2	2.7	2.5	2.7	2.6	1.6	0.3	2.6
United Kingdom	1.7	1.7	1.5	0.9	0.1	0.3	0.3	0.7	1.6	1.8	2.0	2.0	1.5	0.4	1.8
Eurozone	0.7	0.6	0.4	0.2	-0.3	0.2	0.3	0.5	0.9	1.0	1.0	1.0	0.4	0.2	1.0
Australia	2.9	3.0	2.3	1.7	1.3	2.1	2.3	2.9	3.0	2.9	2.8	2.6	2.5	2.3	2.9
New Zealand	1.5	1.6	1.0	0.8	0.1	-0.1	-0.3	-0.1	0.6	0.9	1.2	1.5	1.2	-0.1	1.1

Exchange rates

%, end of period

	Actual					Forecast							Actual	Forecast	
	14Q1	**14Q2**	**14Q3**	**14Q4**	**15Q1**	**15Q2**	**15Q3**	**15Q4**	**16Q1**	**16Q2**	**16Q3**	**16Q4**	**2014**	**2015**	**2016**
AUD/USD	0.93	0.94	0.87	0.82	0.76	0.78	0.76	0.75	0.74	0.74	0.73	0.73	0.82	0.75	0.73
USD/CAD	1.11	1.07	1.12	1.16	1.27	1.26	1.31	1.30	1.29	1.28	1.27	1.26	1.16	1.30	1.26
EUR/USD	1.38	1.37	1.26	1.21	1.07	1.07	1.07	1.11	1.15	1.16	1.16	1.17	1.21	1.11	1.17
USD/JPY	103.2	101.3	109.7	119.7	120.1	124.0	128.0	132.0	129.0	126.0	123.0	120.0	119.7	132.0	120.0
NZD/USD	0.87	0.88	0.78	0.78	0.75	0.73	0.71	0.69	0.68	0.67	0.66	0.66	0.78	0.69	0.66
USD/CHF	0.89	0.89	0.96	0.99	0.97	0.98	1.03	1.01	0.98	0.97	0.98	0.98	0.99	1.01	0.98
GBP/USD	1.67	1.71	1.62	1.56	1.48	1.49	1.51	1.59	1.64	1.63	1.63	1.63	1.56	1.59	1.63

Note: Exchange rates are expressed in units per USD, with the exception of the euro, GBP, AUD, and NZD, which are expressed in USD per local currency unit.
Source: Reuters, RBC Economics Research forecasts

Global Economics

June 1, 2015

Global Forecast Update

Another Slow Start For The Global Economy

A recurring theme is that the global economy is still struggling to generate increased traction. Particularly worrisome is the chronic underperformance of the U.S. and the continuing slowdown in China, the world's two largest economies, and the multiple headwinds still affecting the global economy. Increasingly, a prolonged period of above-trend growth appears less likely.

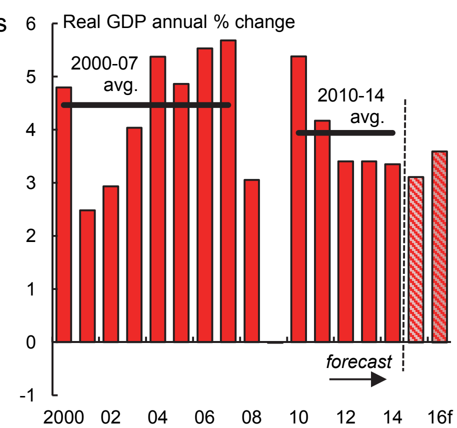
The U.S. has been slow to recover even as most of the early-year headwinds have dissipated. The West Coast dock strike has been settled and two-way trade is moving again. The delays and disruptions to travel and shipments triggered by a prolonged stretch of severe winter weather are long gone, though the spring has been repeatedly punctuated with periodic bouts of adverse wet, dry and windy conditions. Ford's shutdown to retool two of its largest truck assembly plants is over, and motor vehicle production is gearing up. There are new concerns that seasonality issues could be exaggerating the recent stream of worse-than-expected economic news out of the U.S., but the recent spate of weakness appears more fundamental and global in scope because the problems are proving to be more durable.

Many of the world's major oil-producing countries, including the U.S., Canada and Mexico, are experiencing a significant retrenchment in investment, jobs and output associated with the collapse in international crude oil prices, notwithstanding the relatively modest rebound in prices. Even with some recent giveback, the close to 20% appreciation in the U.S. dollar over the past year is taking a large bite out of American exports and foreign earnings. Importantly, there is an absence of synchronized growth, especially among the larger emerging market economies (EMEs) which provided important support during and after the recession. Some EMEs are implementing much needed structural reforms. China's slowdown reflects a number of policy-induced measures to help transition from export- and investment-dependent growth, a credit-fuelled real estate boom, and government corruption, though recently enacted stimulus should help slow the deceleration in output growth. Others EMEs are in severe recession, most notably Brazil, Venezuela, Argentina, and Russia, as well as Greece where large public sector debt burdens remain incompatible with a near-term revival in growth. In the countries hardest hit by the financial crisis internationally, increased regulatory oversight is reinforcing bank lending caution. And recurring geopolitical troubles, particularly in the Middle East and southern Mediterranean areas, are an added source of instability and uncertainty that continues to undermine confidence and growth.

Chronic economic underperformance is one reason why businesses have been slow to invest and consumers slow to spend. In the first quarter, world trade volumes, which combine both exports and imports, contracted at a seasonally adjusted rate of 1.5%. The slide came on the heels of a weakening trend in the second half of last year, when world trade volumes posted moderating gains of 2.0% and 1.2% in the third and fourth quarters respectively. Export volumes declined in the first three months of the year in both advanced and emerging economies, paced by slides in the U.S. and Asia/Pacific. While import volumes remained positive but quite

Contents

Global Output Growth: Lower For Longer



Source: Scotiabank Economics, IMF.

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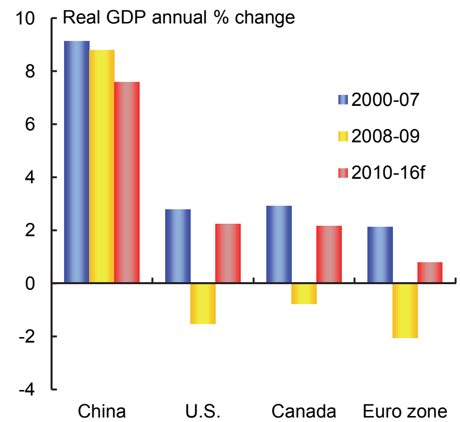
modest in the advanced economies, they dropped sharply in most emerging market regions outside of Latin America. China's Lunar Holidays may account for some, but not all, of the retrenchment.

Chronic Underperformance



Source: Scotiabank Economics, National Bureau of Statistics of China, BEA, Statistics Canada, Eurostat.

More recent data indicate that the weakening trend in the world's economic momentum has yet to reverse course. The Markit Purchasing Managers' composite index for global manufacturing edged lower in May, with the smoothed six-month growth trend contracting at a 3% annualized rate. U.S. manufacturing activity edged higher in May, but is 9% below its peak in August 2014, while China's PMI has been below the 50 level that separates expansion from contraction for five out of the last six months. Similarly, the global composite index for industrial production also declined, pulling the six-month growth trend down to an annualized rate of just under 2%. And while U.S. 'core' durable goods orders — non-defense capital goods orders excluding aircraft — increased modestly in April for the second month in a row, the smoothed six-month growth trend has dropped at an annualized rate of just 5¼%. Canada's new orders data for manufactured goods are significantly lagged, with the smoothed six-month growth trend slumping to an annualized rate of only 0.7% in March as the downturn in oil-related activity increasingly offset prior gains attributable to reviving U.S. activity. North American rail shipments are still moderating in response to less-than-buoyant industrial activity, and reduced demand for coal and crude oil.

On the plus side, U.S. housing-related activity is showing signs of reviving. New home sales, construction starts and building permits rebounded in April. There is a glimmer of hope that this important sector is rebuilding momentum on the back of a much improved job market, after sharply higher mortgage rates in 2013 short-circuited the sector's recovery. Auto sales appear poised to move steadily higher against the backdrop of continuing job gains, comparatively low prices at the pump, and historically low borrowing costs. Tourism flows appear to be improving as well, with U.S. and Chinese travel expenditures gradually increasing alongside cheaper fuel prices.

The current mix of economic and financial market conditions should be very supportive of stronger and more sustainable activity throughout the NAFTA region, and internationally as well. The list includes historically low borrowing costs in most countries around the world, increasing monetary stimulus in many advanced and emerging market economies, significant foreign exchange revaluations that should boost the export competitiveness of most countries, sharply lower prices for gasoline, cash-rich corporations, a lengthy period of outsized job gains in the U.S., the increasing wealth generated by rising asset prices (equities, real estate and collectibles, for example), and increased fiscal initiatives and infrastructure expenditures in a number of nations.

That these highly stimulative factors have yet to reinvigorate U.S. and global growth suggests that the underlying problems are more structural than cyclical. There is still too much supply relative to demand internationally. Key commodity markets are a case in point. While crude oil prices have begun to firm on expectations that the sharp decline in U.S. rig counts is leading to reduced output, the potential for sizeable oversupply conditions still endures around the world. Excess capacity persists in most labour markets and many industrial sectors, highlighting the weakness in investment spending. And the continuing rise in private and public sector indebtedness leaves less flexibility for households and governments to finance sharply higher expenditures. The Bank for International Settlements calculates that outstanding debt in the globe's twelve largest economies has essentially doubled to around US$125 trillion since 2007, with emerging market economies accounting for the largest increase through this period. Even though many Americans have successfully deleveraged their balance sheets, the demographic profile of potential borrowers — students and newly formed households — is collectively constrained by existing high levels of debt, and an underwhelming job market for higher-paying and more permanent positions.

Persistent structural deficiencies increase the odds that potential output gains around the world are likely to be on the 'softer side', although pent-up consumer and business demand in some countries and regions still could temporarily provide a stronger boost to activity. Growth should be led by the U.K. and the U.S. in the advanced nations, and India and China among the emerging market countries. In this environment, the U.S. dollar and sterling should strengthen further among the advanced nations, with the continuing improvement in U.S. job conditions and a modest upward bias in wages and prices enabling the Fed to begin raising the funds rate gradually in the second half of the year. While U.S. bond yields are biased higher, the extent of the rise will be limited by the differential economic performances and policy settings among the advanced nations.

International

Real GDP	2000-13	2014	2015f	2016f
	(annual % change)			
World (based on purchasing power parity)	3.9	3.3	3.1	3.6
Canada	2.2	2.4	1.6	2.0
United States	1.9	2.4	2.2	2.8
Mexico	2.4	2.1	2.6	3.1
United Kingdom	1.8	2.8	2.5	2.3
Euro zone	1.2	0.9	1.5	1.7
Germany	1.2	1.6	1.9	2.0
France	1.4	0.2	1.1	1.4
Italy	0.2	-0.4	0.5	1.0
Spain	1.7	1.4	2.6	2.3
Russia	4.9	0.6	-4.9	0.5
Turkey	4.4	2.9	3.2	3.9
China	9.1	7.4	7.0	6.5
India	7.0	7.4	7.5	7.7
Japan	0.9	-0.1	0.7	1.2
South Korea	4.4	3.3	3.0	3.5
Indonesia	5.8	5.0	5.1	5.7
Australia	3.0	2.7	2.5	2.8
Thailand	4.4	0.9	3.7	4.0
Brazil	3.5	0.1	-1.4	1.0
Colombia	4.2	4.6	3.0	3.4
Peru	5.6	2.4	3.1	4.1
Chile	4.5	1.9	2.6	3.7

Consumer Prices	2000-13	2014	2015f	2016f
	(y/y % change, year-end)			
Canada	2.0	1.9	1.8	2.1
United States	2.4	1.2	1.0	2.2
Mexico	4.7	4.1	3.2	3.9
United Kingdom	2.3	0.5	0.6	2.3
Euro zone	2.0	-0.2	0.8	1.4
Germany	1.7	0.1	1.0	1.5
France	1.8	0.1	0.7	1.2
Italy	2.3	-0.1	0.5	1.0
Spain	2.7	-1.0	0.5	1.2
Russia	11.4	11.4	12.9	7.9
Turkey	16.6	8.2	7.0	5.9
China	2.4	1.5	1.7	2.1
India*	10.2	4.3	5.8	6.2
Japan	-0.1	2.4	0.7	1.0
South Korea	2.9	0.8	1.2	2.4
Indonesia	5.6	8.4	4.4	5.4
Australia	3.0	1.7	1.8	2.2
Thailand	2.6	0.6	1.0	2.2
Brazil	6.5	6.4	8.4	6.0
Colombia	5.1	3.7	3.8	3.5
Peru	2.6	3.2	2.9	2.9
Chile	3.2	4.6	2.8	3.0

* Wholesale Price Index used prior to 2012.

Forecast Changes

International

- Signs of a moderate recovery are emerging in the Japanese economy, though substantial challenges remain in place. Real GDP increased by 0.6% q/q in the first quarter of 2015, following a 0.3% gain in the final three months of 2014. Nevertheless, year-over-year growth remained in contractionary territory given the strong expansion a year earlier ahead of the consumption tax rate increase in April 2014. We have made a small upward revision to our 2015 real GDP growth forecast, and now expect the Japanese economy to expand by 0.7% this year (0.6% previously).
- First-quarter real GDP growth in Germany surprised on the downside, given weaker export sector performance. Output expanded by only 0.3% q/q following a 0.7% gain in the prior three months. Accordingly, we have revised our growth forecasts for Germany, and now expect 1.9% and 2.0% expansion in 2015 and 2016, respectively (earlier 2.0% and 1.9%, respectively).
- Meanwhile, France and Italy posted stronger-than-anticipated momentum in the first quarter, advancing by 0.6% q/q and 0.3% q/q, respectively. This resulted in upward revisions to the 2015 real GDP growth forecasts: we expect French output to grow by 1.1% in 2015 (earlier 1.0%) while the Italian economy is forecast to advance by 0.5% (0.4% earlier). Our euro zone aggregate real GDP growth projections remain unchanged at 1.5% for 2015 and 1.7% for 2016.
- The collapse in oil prices has taken a larger-than-expected toll on the Colombian economy. Accordingly, we have revised our real GDP forecasts downward for 2015 (to 3.0% from 3.5%) and 2016 (to 3.4% from 3.8%).

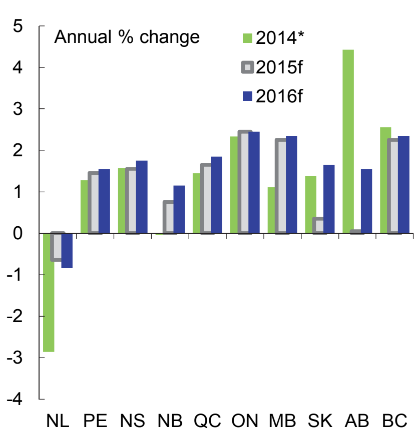
International

Current Account Balance	2000-13	2014	2015f	2016f
	(% of GDP)			
Canada	-0.1	-2.1	-3.2	-2.5
United States	-4.0	-2.4	-2.6	-2.8
Mexico	-1.4	-2.0	-2.8	-2.6
United Kingdom	-2.5	-5.5	-4.6	-4.5
Euro zone	-0.1	2.1	2.2	2.1
Germany	4.1	7.5	6.6	6.2
France	-0.4	-1.0	-0.8	-0.6
Italy	-1.1	1.9	2.3	2.1
Spain	-5.0	0.8	0.6	0.5
Russia	5.7	3.5	4.5	5.0
Turkey	-4.5	-5.9	-4.9	-5.1
China	4.3	2.1	2.1	2.0
India	-1.5	-1.5	-1.4	-1.8
Japan	2.9	0.5	2.0	2.2
South Korea	2.1	6.3	6.9	6.0
Indonesia	1.4	-2.9	-2.4	-2.2
Australia	-4.5	-2.9	-3.1	-2.7
Thailand	2.5	3.2	3.7	3.3
Brazil	-1.2	-4.0	-4.6	-3.8
Colombia	-1.9	-5.4	-5.8	-5.4
Peru	-1.3	-4.0	-4.0	-2.2
Chile	0.3	-1.2	-0.6	-0.4

Commodities

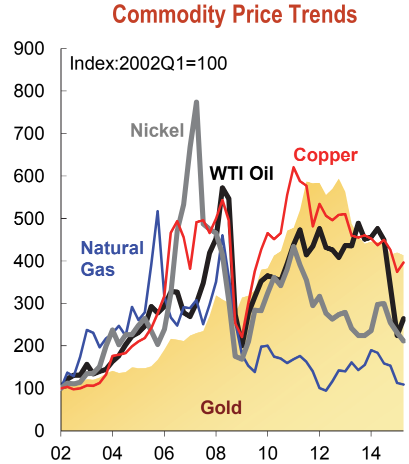
	2000-13	2014	2015f	2016f
	(annual average)			
WTI Oil (US$/bbl)	63	93	58	65
Brent Oil (US$/bbl)	65	99	63	70
Nymex Natural Gas (US$/mmbtu)	5.32	4.28	2.95	3.25
Copper (US$/lb)	2.30	3.11	2.75	2.75
Zinc (US$/lb)	0.79	0.98	1.00	1.50
Nickel (US$/lb)	7.58	7.65	6.38	8.75
Gold, London PM Fix (US$/oz)	792	1,266	1,185	1,185
Pulp (US$/tonne)	745	1,025	968	975
Newsprint (US$/tonne)	587	604	558	550
Lumber (US$/mfbm)	280	349	320	360

Provincial GDP



* 2014 data are preliminary GDP by industry estimates.
Source: Statistics Canada, Scotiabank Economics.

Commodity Price Trends



Source: Bloomberg, Scotiabank Economics.

Forecast Changes

Commodities

- WTI oil prices have rallied on expectations of a production slowdown in the U.S. shales and a strong spring and summer driving season in the United States (underway on the Memorial Day weekend). U.S. drilling activity continues to drop (-57.9% y/y), suggesting that U.S. 'light, tight' oil output is on the cusp of a decline. Equally important, U.S. petroleum demand (as measured by products supplied) has climbed by 3.5% in the four weeks to May 22 — up 662,000 b/d y/y to 19.766 mb/d. U.S. refineries are running at a high 93.6% operating rate in mid-May — 3.7 percentage points above the 89.9% of a year ago. High U.S. commercial oil inventories have edged down in the past four weeks.
- Global oil industry investment will drop by more than 20% in 2015. However, Persian Gulf countries are ramping up drilling activity in a bid for increased market share vis-a-vis the U.S. shales and Russia. Saudi Arabia, the main architect of OPEC's strategy of allowing market forces to shake out higher-cost non-OPEC supply, is not expected to change policy at the June 5 OPEC meeting. However, internal wrangling may eventually emerge, with Iran signalling that it wants other OPEC producers to make room for an increase in its oil exports, assuming it secures a nuclear deal with U.N. Security Council members plus Germany by June 30.
- Western Canada's coking coal production will drop in 2015Q3 alongside significant output cuts linked to weak global supply and demand conditions.

North America

Canada	2000-13	2014	2015f	2016f
		(annual % change)		
Real GDP	2.2	2.4	1.6	2.0
Consumer Spending	3.0	2.7	2.0	2.2
Residential Investment	3.8	2.7	3.4	-1.0
Business Investment	3.7	-0.1	-4.0	2.4
Government	2.7	-0.3	0.6	0.3
Exports	0.8	5.4	3.1	4.8
Imports	3.3	1.8	1.6	3.1
Nominal GDP	4.7	4.3	1.4	4.3
GDP Deflator	2.4	1.8	-0.2	2.3
Consumer Price Index	2.0	1.9	1.2	2.1
Core CPI	1.8	1.8	2.2	2.0
Pre-Tax Corporate Profits	5.1	8.8	-7.0	9.0
Employment	1.5	0.6	0.7	0.8
thousands of jobs	235	111	132	146
Unemployment Rate (%)	7.1	6.9	6.8	6.7
Current Account Balance (C$ bn.)	-6.5	-41.5	-64.0	-52.0
Merchandise Trade Balance (C$ bn.)	33.9	5.0	-23.1	-11.0
Federal Budget Balance (C$ bn.)	-4.5	0.8	1.5	2.0
per cent of GDP	-0.3	0.0	0.1	0.1
Housing Starts (thousands)	200	188	180	178
Motor Vehicle Sales (thousands)	1,606	1,851	1,855	1,855
Motor Vehicle Production (thousands)	2,421	2,390	2,430	2,490
Industrial Production	0.5	4.1	0.5	2.6
United States				
Real GDP	1.9	2.4	2.2	2.8
Consumer Spending	2.3	2.5	3.0	3.1
Residential Investment	-1.8	1.6	6.3	7.6
Business Investment	2.0	6.3	3.1	5.0
Government	1.2	-0.2	0.6	0.7
Exports	4.0	3.2	1.7	4.0
Imports	3.4	4.0	5.5	5.3
Nominal GDP	4.0	3.9	3.0	4.6
GDP Deflator	2.1	1.5	0.8	1.7
Consumer Price Index	2.4	1.6	0.4	2.1
Core CPI	2.0	1.7	1.8	2.0
Pre-Tax Corporate Profits	6.9	-0.8	-1.0	5.0
Employment	0.4	1.9	2.1	1.5
millions of jobs	0.51	2.63	2.88	2.17
Unemployment Rate (%)	6.4	6.2	5.3	5.0
Current Account Balance (US$ bn.)	-537	-411	-473	-526
Merchandise Trade Balance (US$ bn.)	-655	-736	-770	-835
Federal Budget Balance (US$ bn.)	-539	-485	-480	-495
per cent of GDP	-4.0	-2.8	-2.7	-2.6
Housing Starts (millions)	1.31	1.00	1.12	1.30
Motor Vehicle Sales (millions)	15.2	16.4	17.0	17.3
Motor Vehicle Production (millions)	10.5	11.7	12.1	12.3
Industrial Production	0.9	4.2	2.2	3.2
Mexico				
Real GDP	2.4	2.1	2.6	3.1
Consumer Price Index (year-end)	4.7	4.1	3.2	3.9
Current Account Balance (US$ bn.)	-13.7	-26.5	-33.4	-33.5
Merchandise Trade Balance (US$ bn.)	-6.5	-2.4	-11.6	-10.1

Forecast Changes

Canada & United States

- We have again lowered our forecast of U.S. GDP growth this year, from 2.6% to 2.2%, following the sharp downward revision to first-quarter growth and a weaker-than-anticipated handoff to Q2. We continue to expect activity to gain momentum over the remainder of the year, underpinned by solid consumer fundamentals (strengthening job and income gains, lower gasoline prices, rising stock market pricing and home values) and pent-up housing demand.
- A sharper-than-expected Q1 slowdown fuelled by oil sector cutbacks combined with a somewhat softer U.S. growth profile have also prompted us to revise lower our forecast for Canadian output growth this year, from 1.8% to 1.6%. Strengthening U.S. demand alongside a more competitive currency is expected to support an export-led pickup in industrial activity later in the year. At the same time, lacklustre employment and wage gains will likely restrain retail and housing activity.
- After a strong final month for fiscal 2014-15 (FY15), easing in Canada's federal austerity this fiscal year will be largely delivered through family tax relief and an expanded child/youth benefit. In the U.S., buoyant federal monthly revenues, underpinned by taxes owing for 2014, are expected to leave the fiscal 2015 deficit virtually unchanged from fiscal 2014.

Mexico

- We have revised our expectations for Mexican real GDP growth in 2015 downward to 2.6% from 2.8%. This reflects recent data releases, weakness in certain sectors of the Mexican economy (i.e. mining, which includes oil and gas activity), and downward revisions to our U.S. forecast.

Provincial

	2000-13	2014	2015f	2016f	2000-13	2014	2015f	2016f
	Real GDP* (annual % change)				Budget Balances*, FY March 31 ($millions)			
Canada	2.2	2.4	1.6	2.0	-3,102	-5,150	800	1,500
Newfoundland & Labrador	3.1	-2.9	-0.6	-0.8	167	-389	-924	-1,093
Prince Edward Island	1.9	1.3	1.5	1.6	-40	-46	-35	n.a.
Nova Scotia	1.5	1.6	1.6	1.8	23	-679	-102	-98
New Brunswick	1.3	0.0	0.8	1.2	-97	-499	-255	-477
Quebec	1.8	1.4	1.7	1.9	-836	-2,824	-2,350	0
Ontario	1.9	2.3	2.5	2.5	0	-10,453	-10,933	-8,512
Manitoba	2.4	1.1	2.3	2.4	-6 **	-522	-424	-422
Saskatchewan	2.4	1.4	0.4	1.7	n.a.	n.a.	41	107
Alberta	3.3	4.4	0.1	1.6	n.a.	-302	248	n.a.
British Columbia	2.6	2.6	2.3	2.4	198	353	879	284

* 2014 data are preliminary estimates of GDP by industry at basic prices.

* FY15 and FY16: Provinces' estimates; ** FY04-FY13.

	2000-13	2014	2015f	2016f	2000-13	2014	2015f	2016f
	Employment (annual % change)				Unemployment Rate (annual average, %)			
Canada	1.5	0.6	0.7	0.8	7.1	6.9	6.8	6.7
Newfoundland & Labrador	1.3	-1.7	-0.8	-0.9	14.6	11.9	12.4	12.8
Prince Edward Island	1.5	-0.1	0.3	0.6	11.3	10.6	10.6	10.6
Nova Scotia	0.8	-1.1	0.4	0.6	8.9	9.0	8.9	8.7
New Brunswick	0.6	-0.2	0.1	0.4	9.5	9.9	10.0	9.9
Quebec	1.4	0.0	0.8	0.8	8.1	7.7	7.3	7.2
Ontario	1.4	0.8	0.9	1.0	7.2	7.3	6.9	6.9
Manitoba	1.0	0.1	0.9	0.8	5.0	5.4	5.3	5.1
Saskatchewan	1.3	1.0	0.3	0.7	4.9	3.8	4.4	4.2
Alberta	2.7	2.2	0.1	0.8	4.8	4.7	5.6	5.5
British Columbia	1.3	0.6	0.7	0.9	6.7	6.1	5.9	5.9

	2000-13	2014	2015f	2016f	2000-13	2014	2015f	2016f
	Housing Starts (annual, thousands of units)				Motor Vehicle Sales (annual, thousands of units)			
Canada	200	189	180	178	1,606	1,851	1,855	1,855
Atlantic	12	8	8	8	117	137	137	135
Quebec	45	39	35	37	407	420	426	427
Ontario	72	59	59	59	607	719	726	729
Manitoba	5	6	6	6	45	56	56	56
Saskatchewan	5	8	6	7	44	56	53	52
Alberta	34	41	37	34	211	269	258	256
British Columbia	27	28	29	27	175	194	199	200

Forecast Changes

Provinces

- With a slower-than-expected start to 2015, real GDP growth for the year is trimmed for most provinces, mirroring less buoyant U.S. growth and, in several instances, further softness in residential construction. For Atlantic Canada through April, the lack of significant job creation from a year earlier leaves projected 2015 employment lower and the region's annual unemployment rate slightly higher.
- Alberta early in 2015 performed relatively strongly on several indicators, such as housing starts and job creation. However, the slowdown expected over the rest of the year is expected to dampen the province's annual averages. Consequently, we continue to look for positive, but very modest real GDP growth for Alberta, with its new government's preference for avoiding program spending cuts limiting some of the near-term downside risk.
- Headline CPI inflation from January to April has been roughly zero in Atlantic Canada on a year-over-year (y/y) basis, compared with the 1.0% national rise. In part this reflects modest y/y price hikes, excluding food and energy, of just over 1.0% in each Atlantic province except Nova Scotia, where a stronger 1.6% y/y gain is reported.
- To date in 2015, the average price on residential home sales has surged from a year earlier in British Columbia and Ontario. Conversely, in five provinces, average home sale prices are unchanged from a year earlier or lower.
- The spring *Budgets* signalled fiscal restraint for the majority of Provinces during fiscal 2015-16 (FY16), aside from substantial infrastructure investment in several regions. Over the next few years, the expected rise in provincial and municipal service fees towards full cost recovery will likely impact both households and businesses.

Quarterly Forecasts

Canada	2014 Q3	2014 Q4	2015 Q1	2015 Q2f	2015 Q3f	2015 Q4f	2016 Q1f	2016 Q2f	2016 Q3f	2016 Q4f
Real GDP (q/q, ann. % change)	3.2	2.2	-0.6	1.7	2.0	2.0	2.0	2.1	2.1	2.2
Real GDP (y/y, % change)	2.6	2.5	2.1	1.6	1.3	1.3	1.9	2.0	2.1	2.1
Consumer Prices (y/y, % change)	2.1	1.9	1.1	0.9	1.2	1.8	2.1	2.1	2.1	2.1
Core CPI (y/y % change)	2.0	2.2	2.2	2.2	2.1	2.1	2.0	2.0	2.0	2.0
United States										
Real GDP (q/q, ann. % change)	5.0	2.2	-0.7	2.4	3.1	3.2	2.8	2.7	2.5	2.5
Real GDP (y/y, % change)	2.7	2.4	2.7	2.2	1.7	2.0	2.9	2.9	2.8	2.6
Consumer Prices (y/y, % change)	1.8	1.2	-0.1	0.1	0.3	1.0	2.1	2.0	2.1	2.2
Core CPI (y/y % change)	1.8	1.7	1.7	1.7	1.8	1.9	1.9	1.9	2.0	2.1

Financial Markets

Central Bank Rates

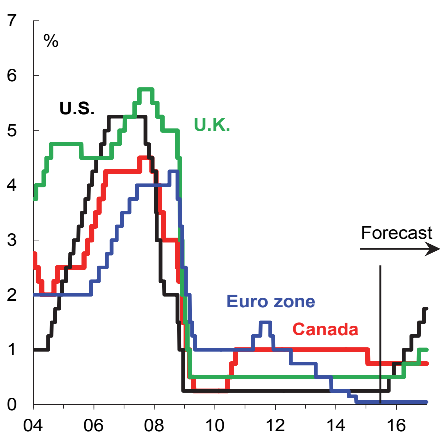
(%, end of period)

Americas	2014 Q3	2014 Q4	2015 Q1	2015 Q2f	2015 Q3f	2015 Q4f	2016 Q1f	2016 Q2f	2016 Q3f	2016 Q4f
Bank of Canada	1.00	1.00	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
U.S. Federal Reserve	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.25	1.50	1.75
Bank of Mexico	3.00	3.00	3.00	3.02	3.50	3.75	4.00	4.25	4.50	4.75
Central Bank of Brazil	11.00	11.75	12.75	13.25	13.25	13.25	13.25	12.75	12.50	12.00
Bank of the Republic of Colombia	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.75	5.00
Central Reserve Bank of Peru	3.50	3.50	3.25	3.25	3.25	3.25	3.25	3.25	3.50	3.50
Central Bank of Chile	3.25	3.00	3.00	3.00	3.00	3.00	3.25	3.50	3.75	4.00
Europe										
European Central Bank	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Bank of England	0.50	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Swiss National Bank	0.00	-0.25	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.50
Asia/Oceania										
Reserve Bank of Australia	2.50	2.50	2.25	2.00	2.00	2.00	2.00	2.00	2.25	2.50
People's Bank of China	6.00	5.60	5.35	5.10	5.00	4.90	4.90	4.90	4.90	4.90
Reserve Bank of India	8.00	8.00	7.50	7.25	7.00	7.00	7.00	7.00	7.00	7.00
Bank of Korea	2.25	2.00	1.75	1.75	1.75	1.75	1.75	2.00	2.25	2.50
Bank Indonesia	7.50	7.75	7.50	7.50	7.25	7.25	7.25	7.25	7.50	7.50
Bank of Thailand	2.00	2.00	1.75	1.50	1.50	1.50	1.50	1.75	2.00	2.25
Canada										
3-month T-bill	0.92	0.92	0.55	0.65	0.70	0.75	0.75	0.75	0.75	0.75
2-year Canada	1.12	1.01	0.51	0.60	0.75	0.90	1.25	1.50	1.80	2.00
5-year Canada	1.63	1.34	0.76	0.90	1.25	1.50	1.75	1.95	2.10	2.30
10-year Canada	2.15	1.79	1.36	1.60	1.80	1.85	2.10	2.20	2.35	2.50
30-year Canada	2.67	2.34	1.98	2.20	2.40	2.50	2.60	2.70	2.85	3.00
United States										
3-month T-bill	0.02	0.04	0.02	0.05	0.30	1.05	1.30	1.55	1.80	2.10
2-year Treasury	0.57	0.66	0.56	0.60	0.95	1.45	1.70	2.00	2.30	2.60
5-year Treasury	1.76	1.65	1.37	1.45	1.65	1.90	2.15	2.35	2.50	2.80
10-year Treasury	2.49	2.17	1.92	2.10	2.30	2.40	2.65	2.75	2.90	3.00
30-year Treasury	3.20	2.75	2.54	2.85	3.00	3.00	3.10	3.20	3.35	3.50
Canada-U.S. Spreads										
3-month T-bill	0.90	0.88	0.53	0.60	0.40	-0.30	-0.55	-0.80	-1.05	-1.35
2-year	0.56	0.35	-0.05	0.00	-0.20	-0.55	-0.45	-0.50	-0.50	-0.60
5-year	-0.13	-0.31	-0.61	-0.55	-0.40	-0.40	-0.40	-0.40	-0.40	-0.50
10-year	-0.34	-0.38	-0.56	-0.50	-0.50	-0.55	-0.55	-0.55	-0.55	-0.50
30-year	-0.53	-0.41	-0.56	-0.65	-0.60	-0.50	-0.50	-0.50	-0.50	-0.50

Financial Markets

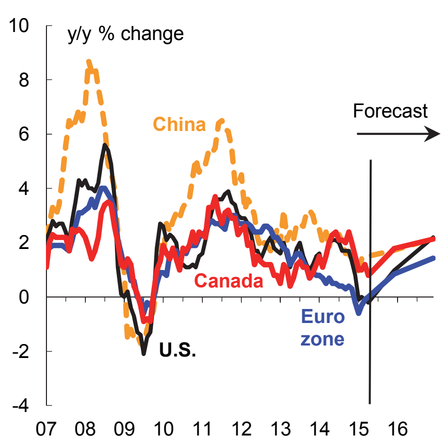
Exchange Rates	2014 Q3	2014 Q4	2015 Q1	2015 Q2f	2015 Q3f	2015 Q4f	2016 Q1f	2016 Q2f	2016 Q3f	2016 Q4f
Americas				(end of period)						
Canadian Dollar (USDCAD)	1.12	1.16	1.27	1.22	1.23	1.26	1.26	1.25	1.25	1.24
Canadian Dollar (CADUSD)	0.89	0.86	0.79	0.82	0.81	0.79	0.79	0.80	0.80	0.81
Mexican Peso (USDMXN)	13.43	14.75	15.26	15.40	15.67	15.50	15.37	15.10	15.04	15.13
Brazilian Real (USDBRL)	2.45	2.66	3.20	3.15	3.20	3.25	3.10	3.10	3.15	3.35
Colombian Peso (USDCOP)	2025	2377	2600	2500	2550	2575	2625	2650	2675	2700
Peruvian Nuevo Sol (USDPEN)	2.89	2.98	3.10	3.18	3.20	3.20	3.30	3.28	3.25	3.25
Chilean Peso (USDCLP)	598	606	625	610	619	625	624	624	624	623
Canadian Dollar Cross Rates										
Euro (EURCAD)	1.41	1.41	1.36	1.34	1.33	1.32	1.32	1.30	1.28	1.24
U.K. Pound (GBPCAD)	1.82	1.81	1.88	1.83	1.85	1.90	1.90	1.89	1.90	1.88
Japanese Yen (CADJPY)	98	103	95	100	100	99	102	103	104	106
Australian Dollar (AUDCAD)	0.98	0.95	0.97	0.95	0.93	0.92	0.92	0.93	0.94	0.93
Mexican Peso (CADMXN)	11.99	12.69	12.03	12.62	12.74	12.30	12.20	12.08	12.03	12.20
Europe										
Euro (EURUSD)	1.26	1.21	1.07	1.10	1.08	1.05	1.05	1.04	1.02	1.00
U.K. Pound (GBPUSD)	1.62	1.56	1.48	1.50	1.50	1.51	1.51	1.51	1.52	1.52
Swiss Franc (USDCHF)	0.96	0.99	0.97	0.95	0.98	1.02	1.03	1.05	1.08	1.10
Swedish Krona (USDSEK)	7.21	7.81	8.63	8.50	8.55	8.60	8.60	8.60	8.60	8.60
Norwegian Krone (USDNOK)	6.43	7.45	8.06	7.80	7.85	7.90	7.90	7.85	7.75	7.70
Russian Ruble (USDRUB)	39.6	60.7	58.2	55.5	56.5	56.0	55.5	55.0	54.0	53.0
Turkish Lira (USDTRY)	2.28	2.34	2.60	2.73	2.77	2.80	2.78	2.75	2.69	2.65
Asia/Oceania										
Japanese Yen (USDJPY)	110	120	120	122	123	125	128	129	130	131
Australian Dollar (AUDUSD)	0.87	0.82	0.76	0.78	0.76	0.73	0.73	0.74	0.75	0.75
Chinese Yuan (USDCNY)	6.14	6.21	6.20	6.17	6.13	6.10	6.08	6.05	6.03	6.00
Indian Rupee (USDINR)	61.8	63.0	62.5	64.0	65.0	66.0	66.4	66.8	67.1	67.5
South Korean Won (USDKRW)	1055	1091	1110	1100	1135	1170	1165	1160	1155	1150
Indonesian Rupiah (USDIDR)	12188	12388	13074	13300	13650	14000	13975	13950	13925	13900
Thai Baht (USDTHB)	32.4	32.9	32.5	33.8	34.2	34.5	34.4	34.3	34.1	34.0

Central Bank Rates



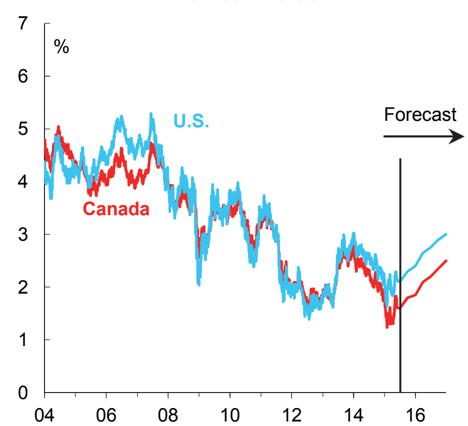
Source: Bloomberg, Scotiabank Economics.

Global Inflation



Source: Bloomberg, Scotiabank Economics.

10-Year Yields



Source: Bloomberg, Scotiabank Economics.

TD Securities

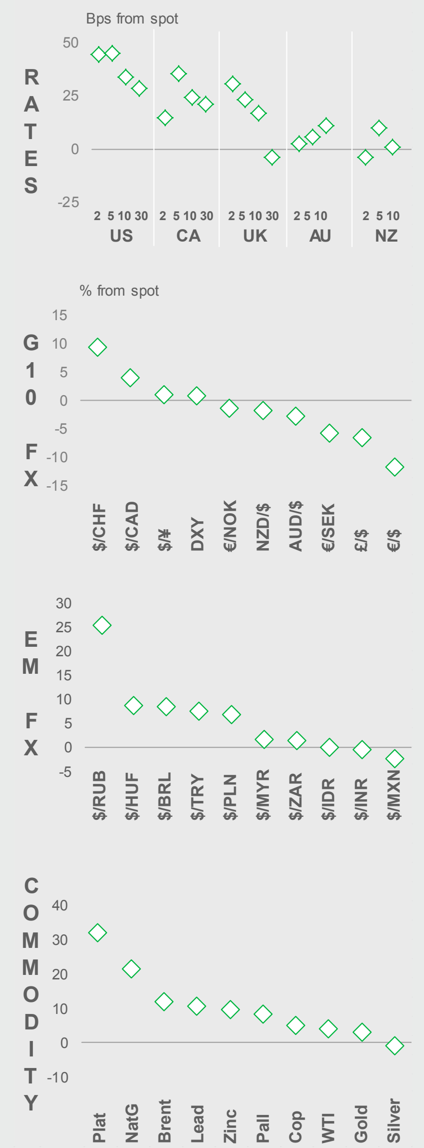
Global Markets

Rates, FX and Commodities Strategy

28 May 2015 | **TD Securities**

Highlights

TD 15Q4 FORECASTS



THE VIEW FROM 10,000 FEET

G10 MACRO

US growth heading into Q2 is underwhelming but it is too soon to abandon the recovery narrative. While negative spillovers from the US introduce a new short-term headwind to global growth, momentum is expected to build in the Eurozone over 2015H2. Policy-makers conditioned to disappointment will keep the theme of reflation alive and well.

G10 RATES

Fixed income markets have pulled back from extremely rich valuations, but yields remain low. From here bond markets are waiting for more clarity on Fed hikes.

G10 FX

Resumption of USD bull trend looks intact with the Fed still expected to lift policy later this year.

EMFX & RATES

EMs to continue suffering from early Fed lift-off expectations. In H2 2015, EMFX vol is set to increase, while curves are at risk of corrections.

COMMODITIES

Oil prices have stabilized recently, but global oversupply continues to weigh on prices. USD strength will be an ongoing challenge for precious metals.

	What Has Changed	What We've Changed
Higher Yields	Yields have moved higher across the G10 after the ECB QE trade crumbled under its own weight.	We have moved most of our year-end yield forecasts higher, though North American yields are only expected to increase modestly by 2015Q4.
RBNZ Goes Dovish	The RBNZ is expected to adopt an explicitly dovish bias following soft labour market data.	Lower forecasts for the NZD and NZ yields: NZDUSD to 0.71 and 10yr yields almost unchanged for 2015Q4.

Global Markets

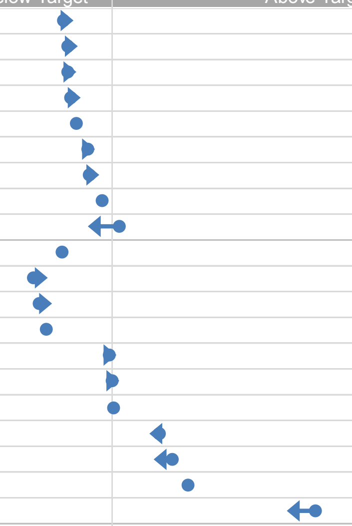
28 May 2015 | **TD Securities**

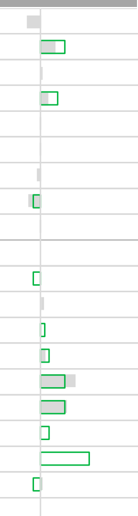
THE TD VIEW

		Macro Outlook	Trading Bias: Rates	Trading Bias: FX	Key Risks
G10	US	US economic momentum is expected to rebound meaningfully during the second half of the year, setting the stage for liftoff.	Front-end yields are expected begin edging higher with the curve bear flattening into the first Fed hikes later this year.	USD strength persists unless Fed tightening delayed.	The liftoff in rates will be contingent on a rebound in growth momentum, and a relapse will keep the Fed on the sidelines.
G10	Canada	Q1 weakness to be crystalized in a flat GDP print. Q2 rebound determined by the rebound in the US and currently looks soft.	On-hold BoC to anchor 2-year segment and pressure Canada-US spreads lower. Curve to steepen as US yields rise.	Onwards and upwards for USDCAD, we still eye 1.30 in H2-2015. Buy on dips.	Positive growth offsets will not emerge if US weakness proves to be more serious than a Q1 soft patch or oil tumbles further.
G10	Europe	Wary of spillovers from the poor Q1 in the US, but so far, growth seems resilient as inflation bottoms.	Likely scope for bunds to continue to rally further in the next few weeks as CPI and ECB unlikely push against that.	EURUSD's primary trend remains down, unless the Fed rate tune changes. Riksbank still biased to ease with EURSEK near 9.20.	US disappointment tends to enter Eurozone with one month lag. We believe Riksbank eyeing 9.20 as threshold to cut rates.
G10	Asia-Pac	Australia just managing 2% GDP growth, while New Zealand grows at a 3+% pace; inflation is likely at the low for both countries	Global reflation trade is steepening curves; short end bonds underpriced for fresh RBA/RBNZ easing biases in June	A new RBNZ easing bias (June 11) is more convincing than the RBA, hence expect a AUDNZD breach back towards 1.10 soon	Weak Chinese Q2 activity data weighing down regional sentiment. Commodity price risks are for another leg lower.
EM	Latam	Brazil's economy still in dire straits, with fiscal consolidation likely insufficient. Mexico's activity gaining traction.	Hikes to continue in Brazil with at least one more +50bp to regain control of CPI expectations. Banxico to follow the Fed.	USDBRL around 3.15 in Q1, but higher towards 3.50 by year-end. MXN may suffer vs USD: we prefer TRYMXN shorts.	Slower US growth for Mexico. European jitters around a Greek default. Fiscal consolidation and longer recession in Brazil.
EM	EMEA	Diverging trends in EMEA with stronger activity in CEE, disappointing in Turkey and S. Africa. Russia likely in recession.	Hungary and Russia to continue easing, Poland on hold, Turkey could hike after the election, S. Africa likely to hike in Q3.	Risks of short-term corrections in EMEA FX. TRY is most at risk, with ZAR coming in second. USDRUB in the 51-55 range.	A Greek default, early start of Fed lift-off, oil price rebound except for Russia. Geopolitical risks in Ukraine.
EM	Asia	India gaining traction, while Indonesia not yet showing signs of economic turnaround. Malaysia slowing on low oil prices.	India and Indonesia to cut at the next meeting. Possibly more cuts than just 25bp in the former. Steady rates in Malaysia.	USDINR to test 65 and likely 67, before retreating to below 64 by yearend. USDMYR around FV at 3.60/3.65. IDR weak for now.	Mostly political in India and Indonesia, especially for the latter. China slowdown and excessive leverage. Fed lift-off.
COMMODITY	Energy	Changing US dynamics on reduced capacity constraints conflicts with OPEC oversupply as demand is bottoming	Short Brent		OPEC meeting in June and unplanned production outages in the MENA
COMMODITY	Precious metals	Weaker data in the US not enough to suggest that a slightly more dovish FOMC pushes rate hike materially into the future	Long Pt/Pd ratio		US economy suddenly gains traction and Fed hikes rates earlier, ECB QE fails to stoke increased inflation expectations
COMMODITY	Other metals	Weak Chinese growth exhibiting seeds of green shoots, while GDP is at target; additional stimulus likely to boost demand	Long Ni, Long Zn		Chinese housing and activity takes another leg lower, despite increased stimulus

CENTRAL BANK MONITOR

		Inflation: Deviation from target* (% points) -6 -4 -2 0 2 4 6 8 10 12 Below Target / Above Target	Inflation: Y/Y%	Inflation: As of	Inflation: Next Print	Last Mtg: Date	Last Mtg: Change	Current %	Next Mtg: Date	Next Mtg: TD	12m Fcast (bps∆ from spot) -75 0 75 150225	12m Fcast: Mkt	12m Fcast: TD
G10	NZ		0.1	Mar	16 Jul	30 Apr	+0bp	3.50	10 Jun	+0		-43	+0
G10	US		-0.2	Apr	18 Jun	29 Apr	+0bp	0.25	17 Jun	+0		+46	+75
G10	Sweden		-0.2	Apr	11 Jun	29 Apr	+0bp	-0.25	2 Jul	+0		+7	+0
G10	UK		-0.1	Apr	16 Jun	11 May	+0bp	0.50	4 Jun	+0		+22	+50
G10	EZ		0.0	Apr	2 Jun	15 Apr	+0bp	0.05	3 Jun	+0		-1	+0
G10	Canada		0.8	Apr	19 Jun	27 May	+0bp	0.75	15 Jul	+0		-3	+0
G10	Australia		1.4	Apr	31 May	5 May	-25bp	2.00	2 Jun	+0		-14	+0
G10	Norway		2.0	Apr	10 Jun	7 May	+0bp	1.25	18 Jun	-25		-38	-25
G10	Japan		2.3	Mar	28 May	22 May	+0bp	0.10	19 Jun	+0		-5	+0
Emerging Markets	China		1.5	Apr	8 Jun								
Emerging Markets	India		4.9	Apr	12 Jun	7 Apr	+0bp	7.50	2 Jun	-25		n.a.	-25
Emerging Markets	Poland		-1.1	Apr	15 Jun	6 May	+0bp	1.50	3 Jun	+0		+9	+0
Emerging Markets	Hungary		-0.3	Apr	9 Jun	26 May	-15bp	1.65	23 Jun	-15		-1	+10
Emerging Markets	Malaysia		1.8	Apr	17 Jun	7 May	+0bp	3.25	9 Jul	+0		+14	+25
Emerging Markets	S Africa		4.5	Apr	17 Jun	21 May	+0bp	5.75	23 Jul	+0		+108	+75
Emerging Markets	Mexico		3.1	Apr	9 Jun	30 Apr	+0bp	3.00	4 Jun	+0		+80	+75
Emerging Markets	Indonesia		6.8	Apr	1 Jun	19 May	+0bp	7.50	18 Jun	-25		n.a.	+25
Emerging Markets	Turkey		7.9	Apr	3 Jun	20 May	+0bp	7.50	23 Jun	+0		n.a.	+150
Emerging Markets	Brazil		8.2	Apr	10 Jun	29 Apr	+50bp	13.25	3 Jun	+50		+2	-25
Emerging Markets	Russia		16.4	Apr	4 Jun	30 Apr	-150bp	12.50	15 Jun	-100		n.a.	+0





Current → Fcast for 2015

*Deviation from avg since 2007 for India, which does not have an inflation target.

View from the Top

David Tulk

The dominant macro theme for 2015 of an economic outperformance in the United States that sets the stage for the Federal Reserve to begin withdrawing stimulus is looking a little frayed. The set of temporary shocks that restrained growth early in the year have not faded as quickly as many had hoped while the relative maturation of the recovery in the United States exposes additional cyclical vulnerabilities. This comes at a difficult time for the global recovery when uncertainty in the US can leak into a still fragile Eurozone economy and slow the manufacturing supply chain, further exacerbating the structural deceleration across many emerging market economies. Without the US, the global growth cupboard is looking a little bare.

With just a smattering of Q2 data, we feel it is too soon to abandon the US recovery narrative. Financial markets have wavered on this point and the response across asset classes has not been uniform. Over the last month, the synchronized move one would expect between higher Treasury yields and the USD consistent with stronger US growth and Fed hikes appeared to be breaking down (see chart on the following page). While there was no definitive explanation for the push higher in global yields, the weakness in the USD seemed to be more cleanly aligned with the growing view that the Fed will not hike until 2016. Resolving this apparent contradiction will either reveal further value in long USD positions or create renewed demand for US Treasuries. We reiterate our longstanding view that the former will win out but acknowledge a lower level of conviction than in the past.

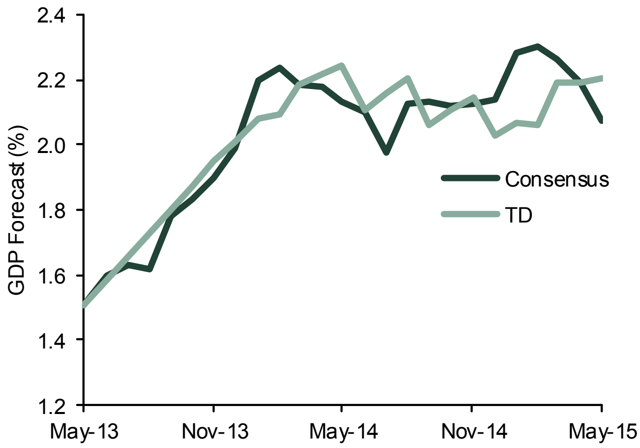
The Patient Revival of Reflation

As we outlined earlier this month, we expect that the adjustment higher in global yields will be sustained. Starting points matter and it may very well have been the case that market positioning prior to the selloff was simply too pessimistic. Fears of deflation are expected to fade as Q2 will mark what will be a very prolonged trough for energy prices. Underlying inflation across most major economies will then start to drift higher over the second half of the year. The positive growth impulse from ECB QE and additional stimulus from China will further curtail downside risks to global growth and ultimately contribute to a more balanced global recovery.

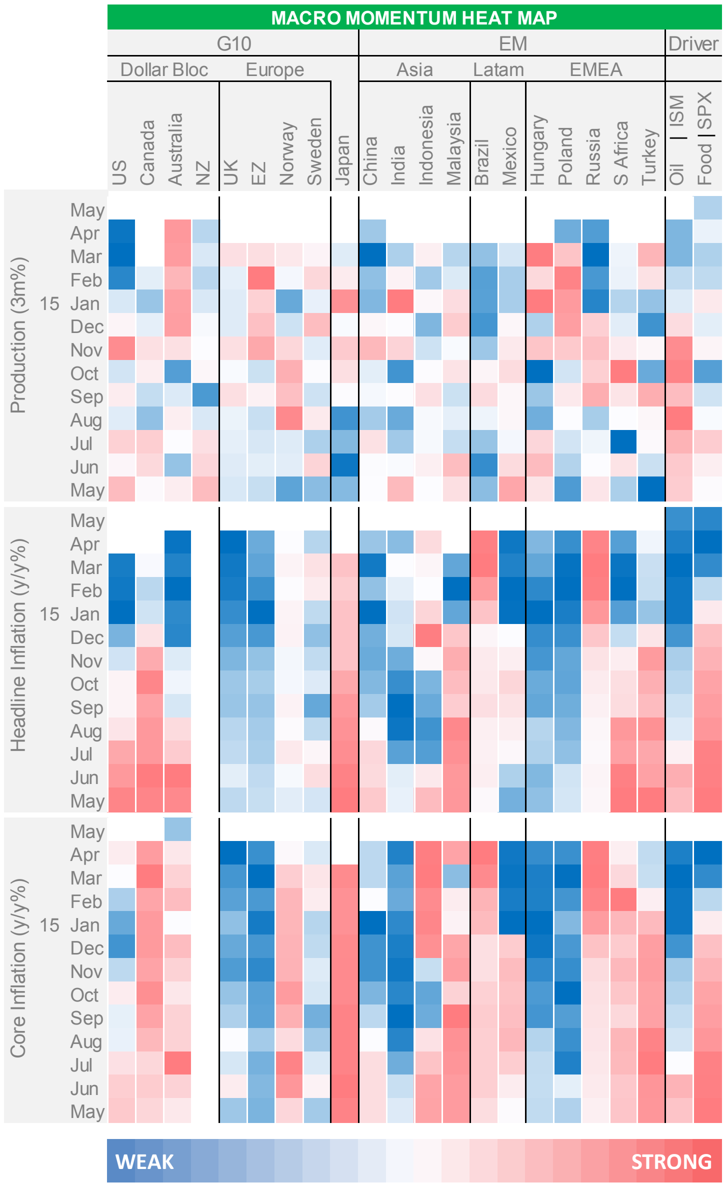
The Q1 Question

The fly in the ointment—and one that had a disproportionate impact on the FX market—is degree to which the sluggish start to the year in the United States is transitory or a sign of something more severe. The transitory shock camp would

Year Ahead G7 GDP Forecasts



* Weighted average of current and next year
Source: Consensus Economics, TD Economics



*For relative shading, monthly figure is compared with the last three years worth of data for that country. For Production, the two columns of drivers on the right show the US ISM Manufacturing and S&P500. For Inflation, it shows oil and food prices.

point to the well understood weather and supply chain disruption story to explain some of the early weakness in Q1. If proven correct and growth does rebound through Q2, the optics look better for the Fed to hike in September amid accelerating growth and firming inflation.

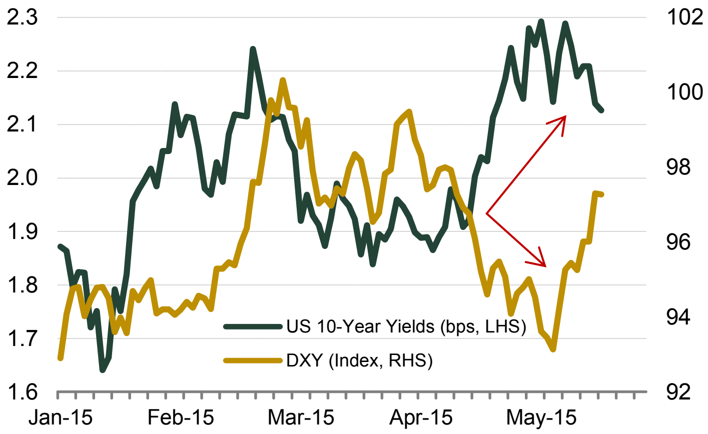
A more nuanced view of the data reveals a greater cause for concern, affirmed by our own calculations that place the probability of a US recession in the next 6 months at 20% (the highest probability since 2012). In tracing the origin, one of the distinguishing features of the start of 2015 versus 2014 is a sharp tightening in financial conditions that can be traced to the steady appreciation in the USD since the middle of 2014. As a result, there has been a dichotomy between domestically focused data experiencing weather-related gyrations such as housing and consumer spending and manufacturing data that has yet to show convincing signs of rebounding from Q1 weakness. This may be the currency equivalent of the taper tantrum in the rates market that ultimately delayed (but did not stop) the Fed transitioning away from unbridled accommodation.

In weighing the competing economic narratives, it simply remains too soon to know if 2015 growth will dovetail 2014. The data remains in the driver's seat and the Fed's flexible reaction function will slow the pace of normalization if the market gets ahead of itself to the extent that the underlying recovery is imperiled. This leaves us holding onto our call for the first rate hike to occur in September, though this increasingly feels like the soonest the Fed could hike than the most likely outcome. In the event that the data rebounds to reinforce this expectation, we see 5s as especially vulnerable on the curve. By contrast the selloff in 30s since the middle of April looks like an overreaction to the snippets of positive economic data, making a bear flattening in 5s30s a compelling tactical trade.

Elsewhere in the G10, reverberations of Q1 weakness in the United States will keep activity subdued over a slightly longer horizon until either a more positive US-led dynamic reemerges or global activity stalls completely. While we expect the former scenario to play out, the risk of the latter could easily drive market sentiment over the next month or two and creates several opportunities:

- If the US recovery stumbles in Q2 or if Canadian export capacity lags stronger external demand, the Bank of Canada may be forced to pare back its recent optimism that in turn will restore market pricing for at least some chance of a cut later this year and allow the belly of curve to outperform on Treasury weakness. The CAD is expected to weaken in either scenario with GBP as the better cross in the event that the US rebound fails to materialize. Indeed, expecting GBP strength against all commodity currencies is appealing to those looking to avoid the USD.

USD and Treasury Yields Were Sending a Conflicting Message



Source: Bloomberg, TD Securities

- We do not expect the RBA or the RBNZ to cut rates but both central banks are expected to adopt increasingly dovish rhetoric. We anticipate that the RBNZ will sound more convincing of the pair, which creates a risk for AUDNZD to push higher towards 1.10 by the middle of June.

- Separating the macro outlook from shorter term market moves, we would wait for at least one last widening in Bund-Treasury spreads based on US data supporting a September hike by the Fed before positioning for a trend compression in Bund-Treasury spreads. Over a longer horizon, we expect growth in the Eurozone to outperform the US.

EMFX continues to be held hostage by broader USD moves but several more idiosyncratic elements have since emerged. An election upset in Poland has added to greater uncertainty that could translate to additional PLN weakness whereas the upcoming election in Turkey stands as a clear risk event translating to higher volatility with downside risk in the TRY. Versus the USD, the ZAR outlook is also bleak amid headwinds but there is more upside versus EUR.

Despite the uncertainty caused by a stumbling start the prevailing macro themes for 2015 have not disappeared entirely. Instead, the Q1 weakness story will extend the horizon over which the recovery will broaden from the United States to other regions that have thus far lagged. Policymakers conditioned to disappointment will continue to nurture this process, keeping the theme of reflation alive and well. Financial markets will continue to oscillate around this narrative and after ebbing away from optimism in the spring, the arrival of summer will see the corresponding flow.

Snapshot: US

MACRO

After the sluggish growth performance Q1, US economic momentum is beginning to show signs of reacceleration with the recent wave of economic reports pointing to a rebound in activity. Nevertheless, we expect Q2 GDP growth to remain fairly subdued, rising at an unspectacular 1.5% to 2.0% pace. However, with underlying fundamentals remaining favorable growth is expected to rebound more meaningfully during the second half of the year.

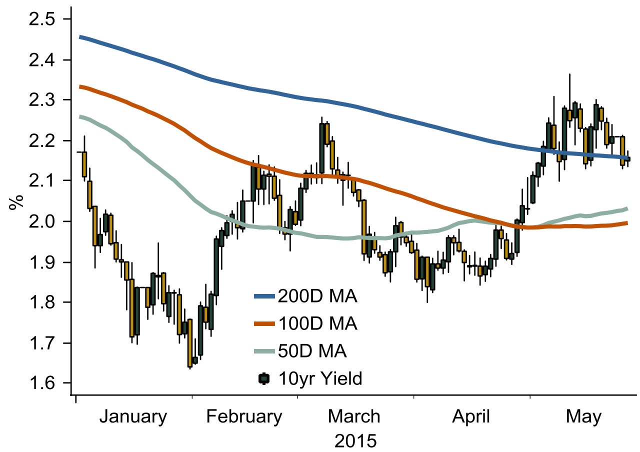
RATES

Despite the downgrade to the economic outlook and the dimming prospects for near term Fed hikes, Treasury yields have reset dramatically higher in sympathy with the retracement in Bunds. Notwithstanding this, we continue to see more potential for yields to grind higher as the curve bear-flattens into the first rate hike in September.

FX

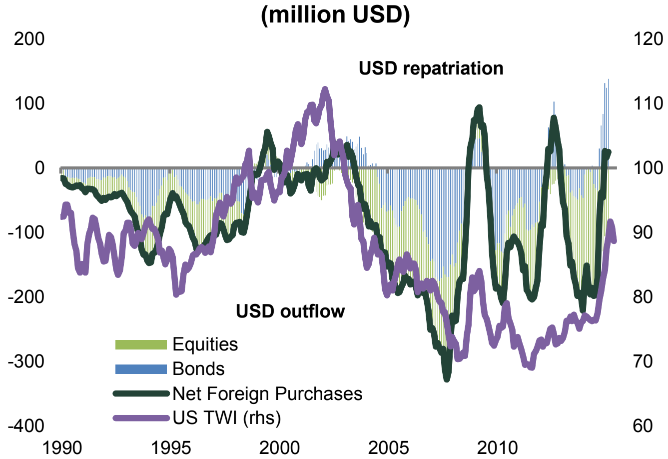
After an extended retrenchment that extended through most of May, the USD seems to have found its footing again. The USD bull-trend is back in business if 2015 rate hike expectations are firmed up at the June FOMC meeting – September is still our base case scenario.

US Treasury Yields Reset Higher



Source: Macrobond, TD Securities

Net Portfolio Flows Supportive for USD Bull Trend (million USD)



Source: TIC

TD FORECASTS - United States

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16	9/16	12/16
O/N			0.25	0.25	0.50	0.75	1.00	1.00	1.00	1.25
3m			0.01	0.20	0.50	0.65	0.85	0.85	0.95	1.15
2y			0.64	0.60	0.90	1.10	1.35	1.60	1.75	2.00
5y			1.53	1.65	1.85	2.00	2.15	2.35	2.50	2.70
10y			2.13	2.25	2.45	2.50	2.60	2.70	2.80	3.00
30y			2.87	3.05	3.20	3.20	3.30	3.35	3.40	3.60
USD/JPY			124	121	123	125	125	125	127	127
EUR/USD			1.09	1.05	1.00	0.96	1.00	1.00	1.05	1.05
GBP/USD			1.54	1.46	1.45	1.43	1.45	1.49	1.50	1.52
USD/CHF			0.95	0.95	1.00	1.04	1.00	1.00	0.95	0.95

Spread to Germany

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16
O/N			20	20	45	70	95	95
3m			34	45	75	85	100	95
2y			87	75	95	115	140	160
5y			151	155	155	160	165	170
10y			157	150	145	135	120	100
30y			167	155	150	110	95	85

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Global Markets

28 May 2015 | **TD Securities**

Snapshot: Canada

MACRO

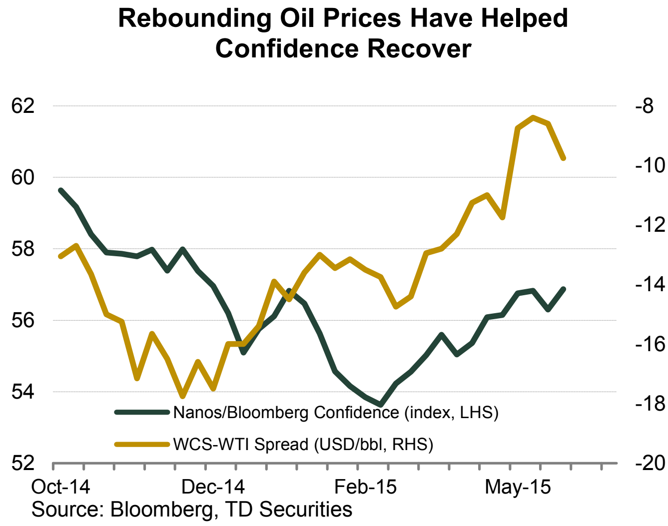
The rebound in the price of oil, especially WCS, has helped lift consumer confidence and the housing market but energy-related business investment is expected to remain weak. The health of non-energy exports is closely tied to a prospective rebound in the US economy following a Q1 soft patch. The Bank of Canada is expected to remain on the sidelines but may sound more cautious in the event growth does not accelerate as expected.

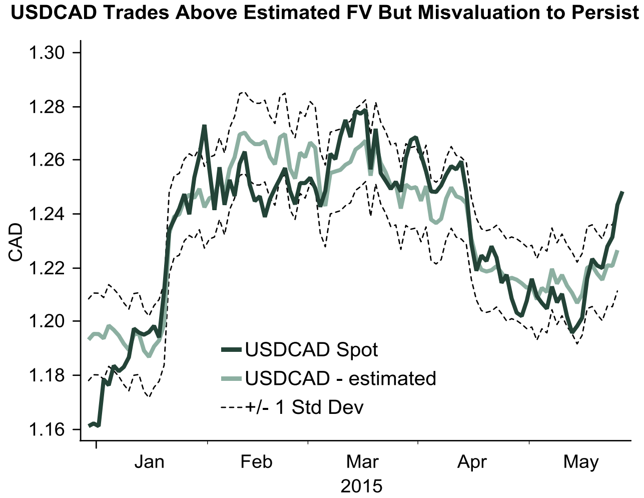
RATES

We had been looking for higher yields in 2015 reflecting a more stable global backdrop-so while the timing of the bond sell-off was a surprise, the direction and size of the swing fit our narrative. Barring a disorderly end to the Greek crisis, yields should be rangebound until we have more clarity on the FOMC. The BoC should stay on hold, pressuring Canada-US spreads lower while 2s10s should steepen as we close in on Fed hikes

FX

After staging an impressive rally in April (which saw our tactical target of 1.1950 relalized), the CAD was among the weakest performing majors in May. We have been long USDCAD above 1.22 and we eye 1.28 in the near future as we think the BoC is too optimistic on growth in H2-2015 and the Fed begins to lift policy in Q3 of this year.





Source: Macrobond, TD Securities

TD FORECASTS - Canada

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16	9/16	12/16	Spread to US: 100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16
O/N			0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00			50	50	25	0	-25	-25
3m			0.64	0.65	0.70	0.70	0.70	0.75	0.80	0.95			63	45	20	5	-15	-10
2y			0.63	0.60	0.75	0.80	1.00	1.15	1.35	1.65			-1	0	-15	-30	-35	-45
5y			0.96	1.05	1.20	1.35	1.55	1.75	1.90	2.10			-57	-60	-65	-65	-60	-60
10y			1.67	1.80	1.90	1.95	2.05	2.20	2.30	2.40			-46	-45	-55	-55	-55	-50
30y			2.25	2.40	2.45	2.50	2.60	2.70	2.75	2.80			-62	-65	-75	-70	-70	-65
USD/CAD			1.24	1.25	1.27	1.30	1.33	1.27	1.22	1.18								
CAD/JPY			99	97	97	96	94	99	104	108								
EUR/CAD			1.36	1.31	1.27	1.25	1.33	1.27	1.28	1.24								
GBP/CAD			1.91	1.82	1.83	1.86	1.93	1.89	1.83	1.79								

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Snapshot: Australia

MACRO

Data reports were mixed over the past month, with strong home sales, house prices and building approvals mitigated by softer retail sales, capex, and employment. While iron ore prices have stabilised, the 25% fall over Dec-April will see a repeat of falling terms of trade dragging GDP growth lower, risking a repeat of the 2014 "income recession" theme. We downgraded this year's GDP growth from 2½% to 2¼% earlier this month.

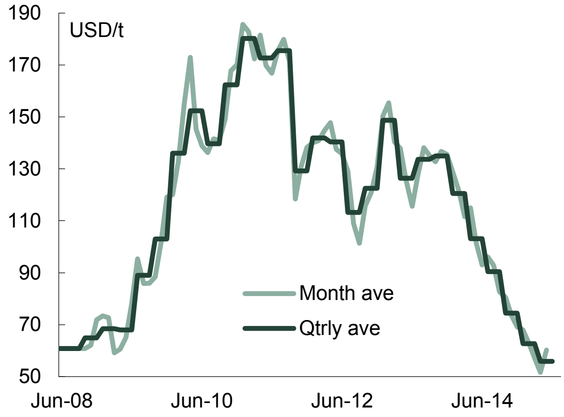
RATES

The RBA delivered the anticipated -25bp to 2% on May 5, but extinguished market goodwill by dropping any forward guidance. The Board minutes claimed that this was normal practice, but the market remains skeptical. OIS is 65% priced for another cut by year end. We expect an explicit easing bias to be (re) introduced on June 2, along with a pause at 2%, but weak data is required to get the bond market to rally much from here.

FX

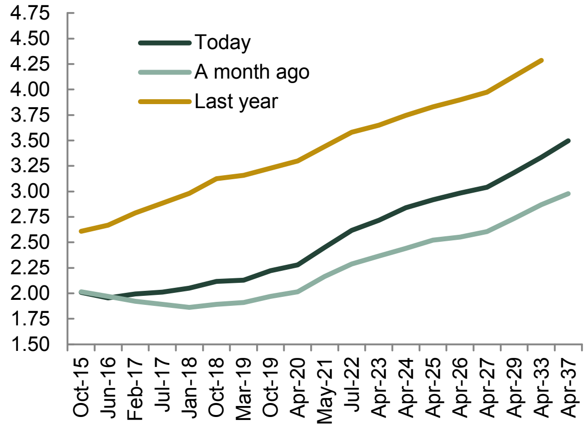
The AUD is at the lows of the past month ($US0.777), no doubt welcomed by the RBA but this time the stronger USD is entirely at work as the local data flow has not been overwhelmingly negative. The RBA dropping its easing bias on May 5 trimmed short positions and kept the AUD trading over $US0.80 for some time, hence why we expect an explicit easing bias to return on June 2. We target $US0.77 month-end and $US0.75 by year end.

Iron ore spot price has bounced but quarterly averages still in a downtrend



Source: Bloomberg; Haver; TD Securities

ACGB curve steepens on reflation trade



Source: Bloomberg; TD Securities

TD FORECASTS - Australia

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16	9/16	12/16	Spread to US: 100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16
O/N			2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.50			175	175	150	125	100	100
3m			2.01	2.05	2.05	2.10	2.15	2.25	2.50	2.75			200	185	155	145	130	140
3y			1.94	2.00	1.95	2.05	2.10	2.20	2.35	2.60			130	140	105	95	75	60
5y			2.17	2.25	2.20	2.30	2.50	2.65	2.75	2.90			63	60	35	30	35	30
10y			2.77	2.95	2.85	2.95	3.05	3.10	3.20	3.45			65	70	40	45	45	40
AUD/USD			0.77	0.77	0.76	0.75	0.75	0.74	0.72	0.70								
AUD/NZD			1.06	1.05	1.06	1.06	1.07	1.10	1.13	1.13								
AUD/JPY			95	93	93	94	94	93	91	89								
EUR/AUD			1.42	1.36	1.32	1.28	1.33	1.35	1.46	1.50								

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Snapshot: New Zealand

MACRO

Softer Q1 employment and wages growth started a "June cut" conversation, however, inflation expectations have stopped falling, Q1 retail sales volumes were twice expectations, and housing continues to surge. The Budget announced taxing profits on house-selling, also supporting the June cut view, but most measures are actually already in place (reinforcement merely being stepped up).

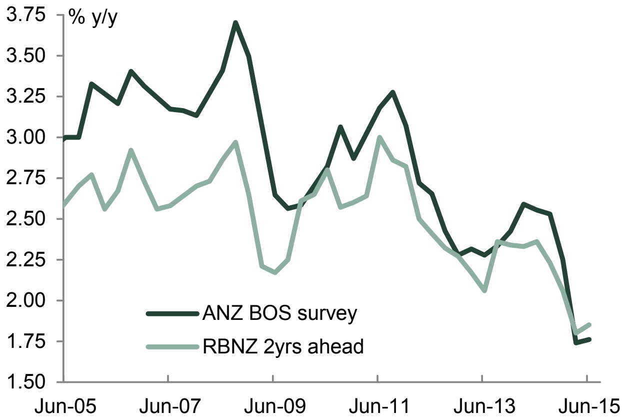
RATES

The RBNZ shift to a conditional easing bias on 30 April encouraged OIS to price -25bp by July and 50% priced for 3% by year end. While this pricing is consistent with our expectation for a downward sloping RBNZ bank bill profile on June 11, we need activity data to materially disappoint to pull the trigger, so Sep/Oct is the earliest opportunity. If the global reflation trade continues, expect even steeper yield curves.

FX

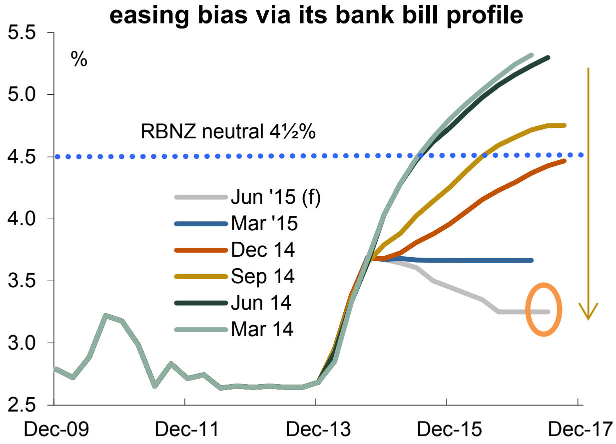
The softer RBNZ tone at the 30 April OCR Review was a key driver behind NZD underperformance, reaching $US0.733 after two weeks, until weaker U.S. data pushed up all USD-cross rates. While stronger U.S. inflation and a hawkish Yellen saw the NZD sink below $US0.73 this week, the TWI at 76 is much lower compared with a month ago (79.5 pre-OCR Review) and downside lies ahead.

New Zealand: inflation expectations remain low



Source: RBNZ; ANZ Business Outlook Survey; TD Securities

RBNZ 'should' express an outright easing bias via its bank bill profile



Source: RBNZ; TD Securities

TD FORECASTS - New Zealand

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16	9/16	12/16
O/N			3.50	3.50	3.50	3.50	3.50	3.50	3.75	4.00
3m			3.48	3.45	3.45	3.50	3.50	3.65	3.85	4.10
3y			3.10	3.00	3.00	3.05	3.10	3.25	3.40	3.60
4y			3.16	3.15	3.20	3.25	3.35	3.45	3.50	3.75
10y			3.45	3.40	3.40	3.50	3.55	3.60	3.80	4.05
NZD/USD			0.73	0.73	0.72	0.71	0.70	0.67	0.64	0.62
AUD/NZD			1.06	1.05	1.06	1.06	1.07	1.10	1.13	1.13
NZD/JPY			90	88	89	89	88	84	81	79
EUR/NZD			1.50	1.44	1.39	1.35	1.43	1.49	1.64	1.69

Spread to Australia

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16
O/N			150	150	150	150	150	150
3m			147	140	140	140	135	140
3y			116	100	105	100	100	105
4y			99	90	100	95	85	80
10y			68	45	55	55	50	50

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Snapshot: Eurozone

MACRO

While May surveys suggested some more mixed results, we still see the Eurozone set up well for acceleration. Q2 GDP growth was 1.6% SAAR even with a terrible Q1 in the US. So as US growth firms and external demand improves, we easily see potential for the pace of annualized growth run around 2.5%. But it will take years of that to get the unemployment rate to fall back to more normal levels, so inflation is still not a worry.

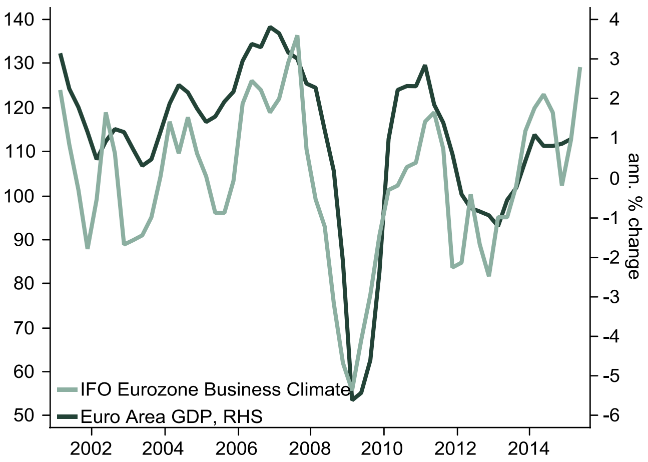
RATES

Eurozone CPI for May and the June ECB meeting will likely to little to support higher rates. This means there is scope for bunds to rally further, but it seems unlikely that we will return to the previously rich levels, especially with the ECB having announced tapered summer buying. Eventual US data strength that reaffirms a September hike will see some period of UST underperformance, but bund-UST spreads should trend tighter.

FX

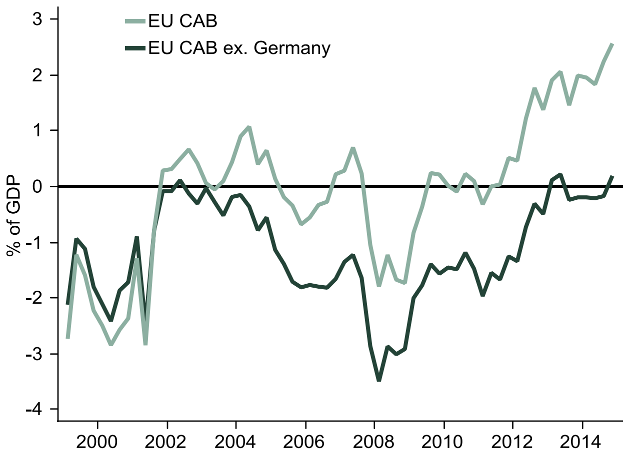
A reversal of fortune in the EUR after an unexplained selloff in German bunds and repricing of EZ macro risks (better growth than initially expected) drove EUR strength. The realization that QE will remain in place for the long-run should keep the primary trend in EURUSD lower (a delay in the Fed hike is a risk to this view). Positive basic balance is mostly German driven so a low EUR is needed to redistribute wealth in EZ.

EZ Growth & Sentiment Is Improving



Source: Macrobond, TD Securities

Lower EUR Needed to Redistribute Wealth Within the EZ



Source: Macrobond, TD Securities

TD FORECASTS - German Rates and Euro	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16	9/16	12/16	Spread to US: 100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16
O/N			0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05			-20	-20	-45	-70	-95	-95
3m			-0.33	-0.25	-0.25	-0.20	-0.15	-0.10	-0.10	-0.10			-34	-45	-75	-85	-100	-95
2y			-0.23	-0.15	-0.05	-0.05	-0.05	0.00	0.05	0.10			-87	-75	-95	-115	-140	-160
5y			0.02	0.10	0.30	0.40	0.50	0.65	0.80	1.05			-151	-155	-155	-160	-165	-170
10y			0.55	0.75	1.00	1.15	1.40	1.70	1.85	2.10			-157	-150	-145	-135	-120	-100
30y			1.20	1.50	1.70	2.10	2.35	2.50	2.65	2.80			-167	-155	-150	-110	-95	-85
EUR/USD			1.09	1.05	1.00	0.96	1.00	1.00	1.05	1.05								
EUR/GBP			0.71	0.72	0.69	0.67	0.69	0.67	0.70	0.69								
EUR/CHF			1.04	1.00	1.00	1.00	1.00	1.00	1.00	1.00								
EUR/JPY			135	127	123	120	125	125	133	133								

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Snapshot: United Kingdom

MACRO

The elections have come and gone and there is much more certainty than expected. Conservatives are moving faster than expected to deliver a new budget focused on spending cuts rather than tax hikes, and life seems to be returning to London property markets with risks of the mansion tax gone. This provides Q2/Q3 upside risks to growth, but inflation should still only slowly move back to target.

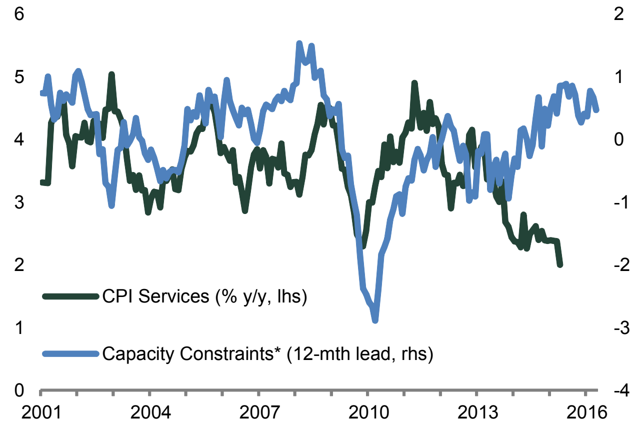
RATES

We continue to see the risks skewed higher for UK rates and the risk that with stronger growth, inflation moving higher, and dissents for tightening likely to come within the next 3-4 months, short sterling is likely price in more hikes. If US growth continues to disappoint, the UK economy should still outperform and gilts underperforman. But we continue to look for a September hike, so for now, not a trade we like.

FX

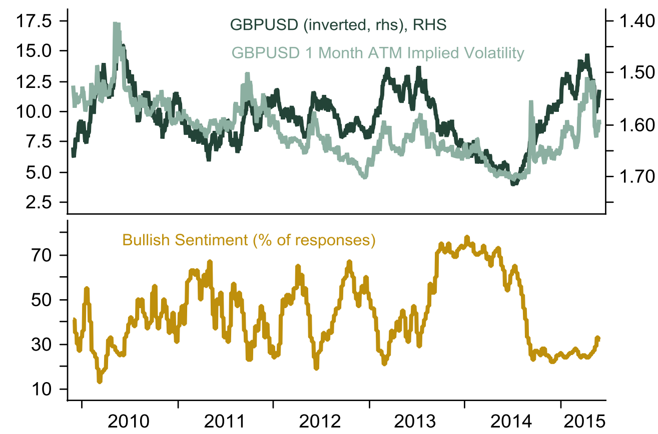
Now that the UK election uncertainty has cleared with a surprising Conservative majority, strengthening macro fundamentals and a prospective BoE rate hike in early 2016 will dominate currency performance. Thus, we have pulled forward our forecast for GBP strength; cable may correct the GBP is still a compelling buy on the crosses, especially versus CAD and EUR. "Brexit" risks are overstated and at least a year away.

UK Inflation Subdued Near-term, But Capacity Constraints Eventually to Push Services CPI Higher



Source: BoE Agents Survey, CBI, ONS
*Z-score, average of CBI new orders & Services Constraints in Agents survey

Cable Vulnerable to Correct, But Sentiment is Firming & GBP is a Compelling Buy on the Cross



Source: Macrobond, TD Securities

TD FORECASTS - United Kingdom

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16	9/16	12/16	Spread to US: 100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16
O/N			0.50	0.50	0.50	0.50	0.75	1.00	1.00	1.00			25	25	0	-25	-25	0
3m			0.47	0.45	0.50	0.65	0.90	1.00	1.00	1.10			46	25	0	0	5	15
2y			0.54	0.45	0.60	0.85	1.10	1.40	1.50	1.65			-10	-15	-30	-25	-25	-20
5y			1.42	1.15	1.35	1.65	1.90	2.05	2.15	2.30			-11	-50	-50	-35	-25	-30
10y			1.88	1.85	1.90	2.05	2.25	2.40	2.50	2.65			-24	-40	-55	-45	-35	-30
30y			2.59	2.40	2.50	2.55	2.65	2.75	2.75	2.75			-27	-65	-70	-65	-65	-60
GBP/USD			1.54	1.46	1.45	1.43	1.45	1.49	1.50	1.52								
EUR/GBP			0.71	0.72	0.69	0.67	0.69	0.67	0.70	0.69								
GBP/CHF			1.46	1.39	1.45	1.49	1.45	1.49	1.43	1.45								
GBP/JPY			190	176	178	179	181	187	191	193								

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Global Markets

28 May 2015 | **TD Securities**

Snapshot: Scandies

MACRO

The big picture remains largely unchanged that Swedish activity and growth has remained quite resilient but that has still not fed into consistent inflation. In Norway, the economy has clearly outperformed out expectations for more pain on the back of the oil price shock, and most impressive so far has been the resiliency of consumers. If there is to be more than one more rate cut, consumer confidence data likely needs to weaken.

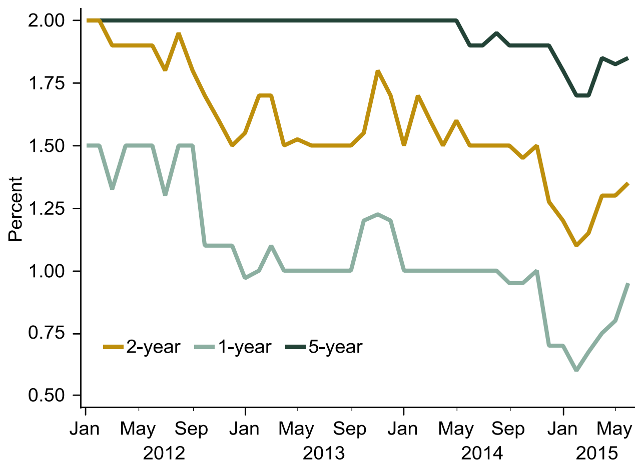
RATES

Interest rates in Sweden are at the mercy of FX and ad hoc inflation surprises. In Norway, they are at the mercy of oil prices and the lags into domestic investment. With the market almost 50/50 priced for a rate cut the Norges Bank assumes in June in their forecast, receiving rates seems advantageous. Similarly for Sweden, while we do not forecast another rate cut, other measures like QE or FLS-style easing still bias rates lower.

FX

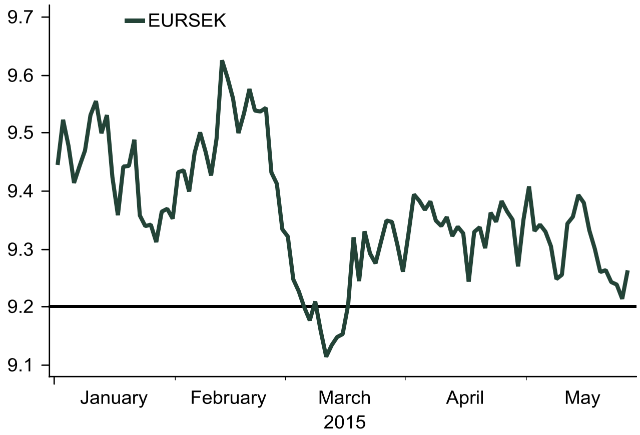
We are closely monitoring EURSEK and view 9.20 as the Riksbank's line in the sand to tolerate currency strength. The evolution of inflation expectations is also key and has thus far shows little improvement, leaving us bias to look for additional easing by the central bank and a rebound in EURSEK. Norges Bank is still expected to ease but only marginally.

Inflation Expectations...



Source: Macrobond, TNS Prospera (median shown), TD Securities

...and Sub-9.20 on EURSEK Are Key Triggers for Riksbank Easing



Source: Macrobond, Bloomberg, TD Securities

TD FORECASTS - Norwegian Rates and Scandie FX

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16	9/16	12/16
O/N			1.25	1.00	1.00	1.00	1.00	1.00	1.00	1.00
3m			0.91	0.95	0.95	1.00	1.00	1.00	1.00	1.00
2y			0.72	0.90	1.00	1.20	1.35	1.45	1.55	1.65
4y			0.92	1.10	1.40	1.55	1.70	1.80	1.95	2.05
9y			1.51	1.60	1.95	2.20	2.30	2.45	2.60	2.70
EUR/NOK			8.46	8.70	8.55	8.35	8.25	8.40	8.60	8.60
USD/NOK			7.75	8.29	8.55	8.70	8.25	8.40	8.19	8.19
NOK/SEK			1.10	1.06	1.05	1.05	1.04	1.01	0.97	0.96
EUR/SEK			9.27	9.25	9.00	8.75	8.60	8.50	8.35	8.25
USD/SEK			8.49	8.81	9.00	9.11	8.60	8.50	7.95	7.86

Spread to US

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16
O/N			100	75	50	25	0	0
3m			90	75	45	35	15	15
2y			7	30	10	10	0	-15
4y			-61	-55	-45	-45	-45	-55
9y			-61	-65	-50	-30	-30	-25

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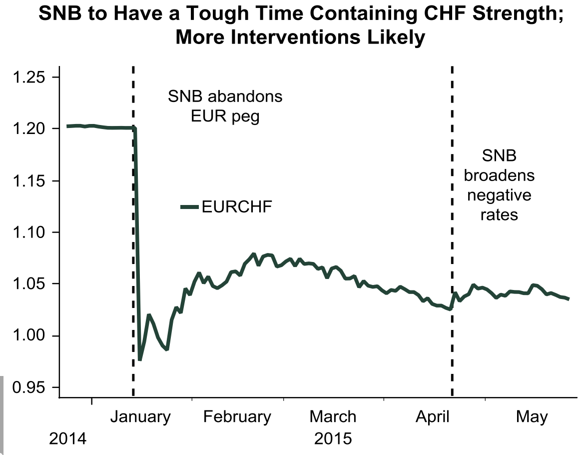
Snapshot: CHF

FX

Swiss fundamentals still augur for a weaker exchange rate but CHF remains well supported and prone to appreciation pressures. As such, we expect the SNB to try to restrain the glide lower in EURCHF that remains probable given that the EURUSD's primary trend is down.



Source: Macrobond, TD Securities

TD FORECASTS - Switzerland

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16	9/16	12/16
EUR/CHF			1.04	1.00	1.00	1.00	1.00	1.00	1.00	1.00
USD/CHF			0.95	0.95	1.00	1.04	1.00	1.00	0.95	0.95
CHF/JPY			131	127	123	120	125	125	133	133
GBP/CHF			1.46	1.39	1.45	1.49	1.45	1.49	1.43	1.45

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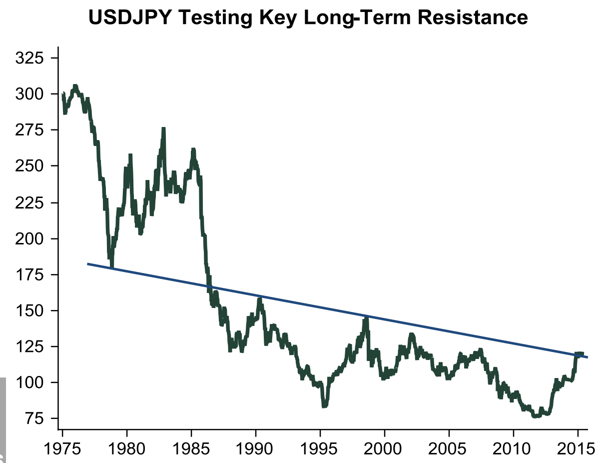
Snapshot: JPY

FX

USDJPY has punched above a key long-term resistance level, but we think sustained gains over the medium are required to significantly push the pair higher from here (with 135 lurking on the radar). We do not think this is an imminent risk but it does ultimately hinge on Fed/BoJ policy; we concede the balance of risk is growing that JPY weakness could persist for much longer.



Source: Macrobond, TD Securities

TD FORECASTS - Japan

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16	9/16	12/16
USD/JPY			124	121	123	125	125	125	127	127
EUR/JPY			135	127	123	120	125	125	133	133
AUD/JPY			95	93	93	94	94	93	91	89
GBP/JPY			190	176	178	179	181	187	191	193

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Snapshot: EMEA

MACRO

We see increasing differentiation in EMEA growth trends. While Poland and Hungary continue to exhibit robust economic activity data (though CPI remains negative in both countries), Turkey and South Africa continue to exhibit lacklustre macro performance. Russia is likely in recession as a result of sanctions, weak underlying fundamentals and low crude oil prices. Inflation is reaccelerating in both Turkey and S. Africa.

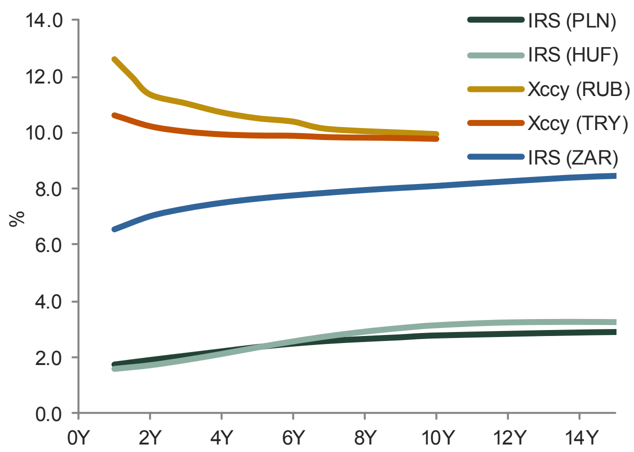
RATES

In Hungary, we expect the NBH to cut another 15bp to 1.50%, but as the MPC sees space for further easing, the Bank could cut more. In S. Africa, we expect the SARB to hike 25bp in Q3 in response to faster CPI (September more likely than July). While pre-emptive moves remain unlikely, Turkey's CBRT could resume tightening after the election if the AKP fails to win an outright majority. Russia to continue easing for now.

FX

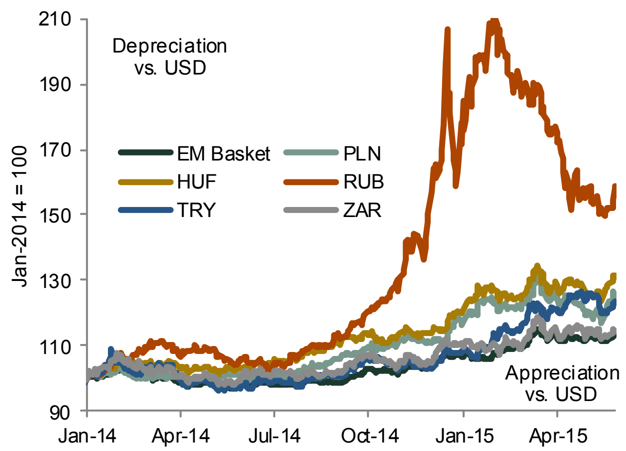
Our EMEA forecasts continue to envisage EURHUF and EURPLN in the 297/298 and 3.90/3.95 ranges, respectively, until year end. We like to see PLNHUF higher towards 75.44 by end-Q2 with NBH easing the major risk. TRY and ZAR are amongst the most vulnerable currencies in the region; TRY because of the election, ZAR on the possibility of SARB hikes in spite of the weak fundamentals. USDRUB to trade near-term in 50-55 range.

Term structure of major EMEA swap rates



Source: Bloomberg, TD Securities

EM FX vs. EMEA FX in 2014



Source: Bloomberg, TD Securities

TD FORECASTS - EMEA Policy Rates and FX

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16	9/16	12/16
Poland			1.50	1.50	1.50	1.50	1.50	1.75	2.00	2.25
Hungary			1.65	1.50	1.50	1.50	1.50	1.75	2.00	2.25
Russia			12.50	11.50	10.50	12.50	12.50	12.50	12.50	12.50
Turkey			7.50	7.50	8.00	8.00	8.50	9.00	9.50	9.50
S. Africa			5.75	5.75	6.00	6.00	6.25	6.50	6.75	6.75
EUR/PLN			4.13	3.95	3.92	3.90	3.85	3.85	3.89	3.89
EUR/HUF			309	298	297	297	295	295	295	295
EUR/RUB			56.7	57.8	65.0	62.4	63.0	62.0	65.1	64.1
EUR/TRY			2.89	2.78	2.75	2.74	2.73	2.75	2.90	2.89
EUR/ZAR			13.15	12.50	12.25	11.81	12.20	12.15	12.71	12.71

Spread to Germany

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16
Poland			145	145	145	145	145	170
Hungary			160	145	145	145	145	170
Russia			1245	1145	1045	1245	1245	1245
Turkey			745	745	795	795	845	895
S. Africa			570	570	595	595	620	645

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Snapshot: LATAM

MACRO

Brazil is still trying to rebalance from the excesses of the past. Monetary tightening is likely to cause extra damage to the economy in the effort to put inflation expectations under control, but with CPI above 8% and rising, it will be hard for the BCB to regain market trust. Definitely in better shape, Mexico's industrial and consumer activity is gaining traction. The labour market is solid, with mild inflationary pressures.

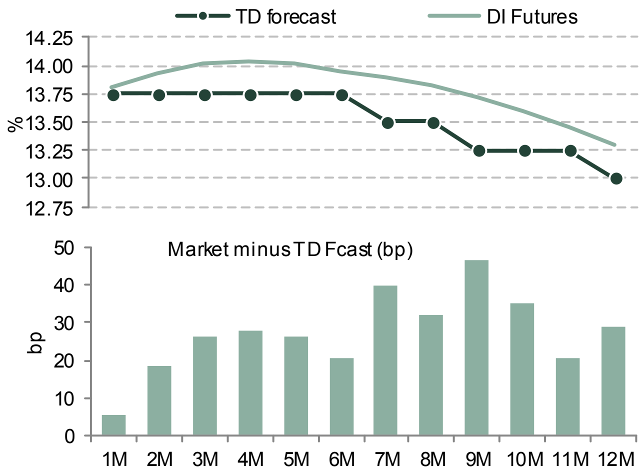
RATES

With inflation on a steady rise in Brazil, the BCB has a very limited set of options at its disposal. Hiking rates is the primary tool to regain control of expectations. However, the higher they push nominal rates, the sooner and faster they will be cut when CPI is under control. We think this could be as soon as Q4. In Mexico, Banxico will mimic the Fed, which means we do not expect hikes until Q3.

FX

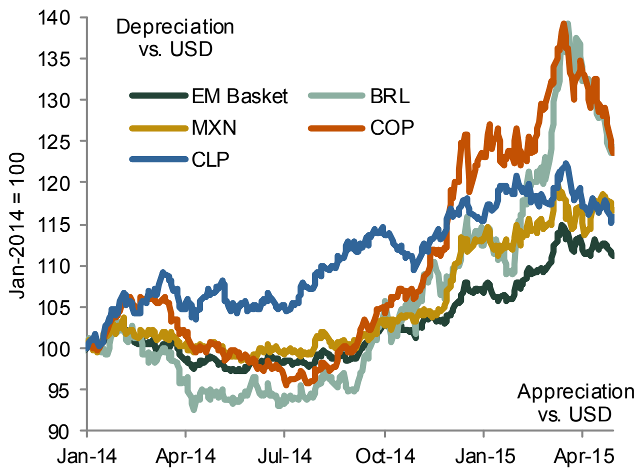
The April BRL momentum, supported by the fiscal consolidation plan and the disclosure of the Petrobras statements, reversed in May on the realization that the economy will be in dire straits for a long time. We continue to forecast USDBRL at 3.15 in Q1, and higher to 3.50 by year-end. In Mexico, better economic data may not suffice to support a significant fall of USDMXN, so we prefer TRYMXN shorts as a hedge against USD strength.

BCB Implied Rate Expectations



Source: Bloomberg, TD Securities

EM FX vs. LATAM FX in 2014



Source: Bloomberg, TD Securities

TD FORECASTS - Latam Policy Rates and FX

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16	9/16	12/16
Brazil			13.25	13.75	13.75	13.50	13.25	12.75	12.50	12.25
Mexico			3.00	3.00	3.25	3.50	3.75	4.00	4.00	4.25
USD/BRL			3.14	3.15	3.35	3.45	3.50	3.40	3.35	3.30
USD/MXN			15.30	15.15	15.30	15.00	14.80	14.70	14.60	14.50
BRL/MXN			4.87	4.81	4.57	4.35	4.23	4.32	4.36	4.39
EUR/BRL			3.42	3.31	3.35	3.31	3.50	3.40	3.52	3.47
EUR/MXN			16.70	15.91	15.30	14.40	14.80	14.70	15.33	15.23

Spread to US

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16
Brazil			1300	1350	1325	1275	1225	1175
Mexico			275	275	275	275	275	300

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Snapshot: EM ASIA

MACRO

Our conviction on India's outlook has been strengthened by our recent trip there. Economic activity is slowly gaining traction, while inflation remains tame and in line with the target for next year. In Indonesia, politics continues to represent a major market concern, though we think risks are overstated. Inflation is temporarily rising on seasonal factors. Malaysia's growth keeps decelerating, while CPI is picking up.

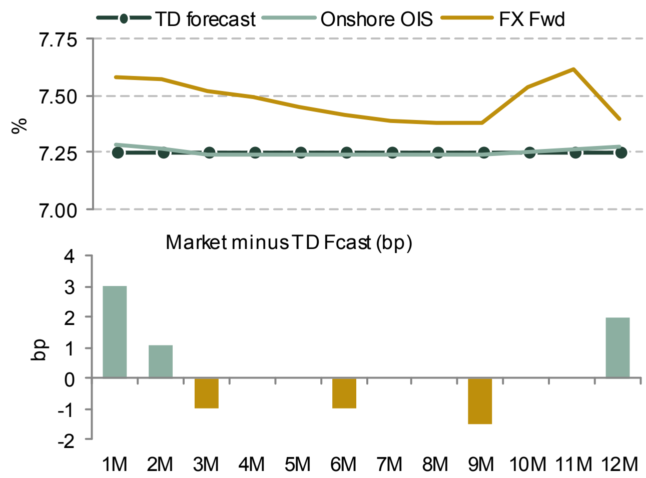
RATES

The RBI was clear saying that India is growing below potential; hence rate cuts are very likely in the near future. We expect 25bp of easing at the next June meeting and perhaps more later. A monsoon alert is the major short-term risk against this view. In Indonesia, we continue to forecast a 25bp cut in June or early Q3. Risks to this forecast are further CPI acceleration and a rally in USDIDR. Steady rates in Malaysia in 2015.

FX

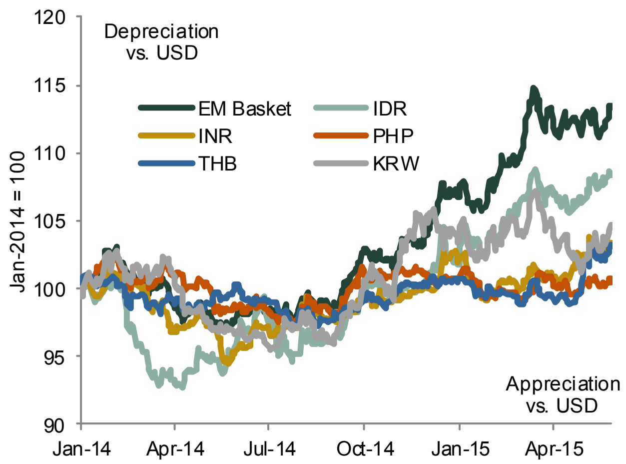
We remain INR positive long-term, with risks of short-term corrections. Tactically, we position for USDINR above 64 and headed to 65, possibly testing 67 before correcting to levels just shy of 64 by year-end. The RBI does not target any specific level, but likely to smooth vol if need be. The IDR to remain under moderate pressure for now, especially with a dollar rebound. MYR should trade in the 3.60/3.64 range where we see FV.

RBI Implied Rate Expectations



Source: Bloomberg, TD Securities

EM FX vs. ASIA FX in 2014



Source: Bloomberg, TD Securities

TD FORECASTS - Asian Policy Rates and FX

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16	9/16	12/16
India			7.50	7.25	7.25	7.25	7.25	7.50	7.75	8.00
Indonesia			7.50	7.25	7.25	7.50	7.75	7.75	7.75	7.75
Malaysia			3.25	3.25	3.25	3.25	3.50	3.50	3.75	3.75
USD/INR			63.9	63.0	64.0	63.8	63.1	63.2	63.0	63.0
USD/IDR			13213	13000	13100	13200	13200	13300	13400	13400
USD/MYR			3.64	3.60	3.65	3.70	3.62	3.60	3.55	3.55

Spread to US

	100d history	Spot+4q fcast	Spot	6/15	9/15	12/15	3/16	6/16
India			725	700	675	650	625	650
Indonesia			725	700	675	675	675	675
Malaysia			300	300	275	250	250	250

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Analytics at a Glance

G10 RATES AT A GLANCE

	2y	5y	10y	30y	Tenor	WTI	SPX	DXY	Eco (US)	Eco° (Dom)	Largest 3mΔ		Strongest Rate Corr		UST	ASW	Δm	Δy	Δytd	Consensus	TD
						1-Month Correlation									Spreads (bps)		History and Forecasts			Fcast Δ to Q415 (bps)	
US	0.66	1.55	2.16	2.91	2	-0.3	-0.3	0.3	0.1	0.1	CRB	-0.5	SW5	0.6	…	-24	8	28	-2	58	46
					5	-0.2	-0.2	0.1	0.0	0.0	CRB	-0.4	CA5	0.9	…	-13	13	5	-12	…	47
					10	0.0	-0.1	0.0	0.0	0.0	DXY	-0.3	CA30	1.0	…	-8	12	-32	-4	34	37
					30	0.1	0.0	-0.1	0.0	0.0	VIX	0.2	CA30	1.0	…	25	16	-43	11	…	33
CAD	0.65	0.99	1.71	2.29	2	-0.2	0.0	0.1	0.3	-0.1	CRB	-0.6	US5	0.8	-1	-42	-2	-43	-38	30	17
					5	-0.1	0.0	0.0	0.2	0.0	CRB	-0.4	US5	0.9	-57	-46	6	-61	-38	…	39
					10	-0.1	-0.1	-0.1	0.2	0.0	DXY	-0.3	US30	1.0	-46	-45	20	-64	-12	24	29
					30	0.0	-0.1	-0.2	0.1	0.0	DXY	-0.3	US30	1.0	-62	-43	17	-59	-9	…	25
AUD	2.02	2.24	2.84		3	0.2	-0.5	-0.2	0.0	-0.3	US10	0.5	CA10	0.8	130	-28	2	-83	-18	2	11
					5	0.2	-0.5	-0.2	0.0	-0.2	US10	0.5	CA10	0.9	63	-36	9	-97	-10	…	14
					10	0.1	-0.4	-0.2	0.1	-0.1	US10	0.3	NZ10	0.9	65	-26	22	-94	3	3	18
NZD	3.09	3.15	3.49		2	-0.1	-0.2	0.0	0.2	-0.1	SPX	-0.3	AU10	0.8	98	-39	-6	-74	-43	…	-5
					5	-0.1	-0.2	0.0	0.2	-0.3	Eco°	-0.5	AU10	0.9	103	-45	4	-80	-38	…	9
					10	0.0	-0.3	-0.2	0.2	-0.3	Eco°	-0.4	AU10	0.9	133	-47	20	-81	-20	12	5
EUR	-0.23	0.02	0.55	1.19	2	0.3	0.0	-0.4	-0.1	0.0	WTI	0.4	CA10	-0.6	-87	-34	4	-28	-13	7	18
					5	0.6	-0.3	-0.6	-0.3	-0.1	WTI	0.7	NO5	0.8	-151	-34	13	-41	1	…	38
					10	0.6	-0.4	-0.5	-0.2	-0.1	WTI	0.8	NO10	0.9	-157	-33	39	-84	1	2	60
					30	0.6	-0.3	-0.6	-0.2	-0.2	WTI	0.7	CA10	0.9	-167	-18	57	-108	-19	…	90
UK	0.54	1.42	1.88	2.59	2	0.4	-0.3	0.0	-0.2	-0.1	WTI	0.5	US30	0.8	-10	-40	3	-15	10	53	31
					5	0.5	-0.3	-0.2	-0.2	0.0	WTI	0.5	US30	0.8	-11	-18	12	-51	25	…	23
					10	0.5	-0.4	-0.3	-0.4	0.0	WTI	0.5	US30	0.9	-24	-7	19	-76	13	22	17
					30	0.5	-0.3	-0.2	-0.3	-0.1	WTI	0.5	CA10	0.9	-27	38	17	-84	9	…	-4
NOK	0.74	0.93	1.51		2	-0.2	0.0	-0.1	0.2	-0.3	US10	-0.5	SW2	0.9	-141	-69	-2	-92	-5	…	48
					4	0.1	0.2	-0.3	0.0	-0.1	DXY	-0.4	SW5	0.9	-120	-69	1	-103	0	…	63
					9	0.3	-0.3	-0.4	-0.2	-0.4	DXY	-0.4	GE10	0.9	-61	-63	13	-114	-3	0	69

Strongest ← Sorted by average G10 correlation → Weakest

(1m-3m) correlation

-50 0 50 100
Forecasted bps from spot

Analytics at a Glance

G10 FX AT A GLANCE

	100d history	Tech Bias	DXY	WTI	CRB	US data	VIX	SPX	US10	Largest 3mΔ	Δm	Δy	Δytd	Mkt	TD
DXY	200 1050	Bullish	…	-0.7	-0.6	0.6	0.0	0.2	0.0	SPX +0.5	1	21	8	3	1
USD/JPY	200 150	Neutral	0.8	-0.5	-0.4	0.5	0.2	-0.1	0.0	US10 -0.6	4	22	3	1	1
USD/CHF	1200	Bullish	0.8	-0.6	-0.5	0.5	-0.2	0.3	-0.1	US10 -0.5	-1	6	-5	5	10
EUR/SEK	2900	Neutral	-0.2	0.2	0.0	0.1	-0.1	-0.1	0.0	SPX -0.3	-1	3	-2	-1	-6
EUR/NOK	5000	Neutral	0.3	-0.1	-0.2	0.3	0.2	-0.2	0.2	DXY +0.4	1	4	-6	-1	-1
GBP/USD	150 200	Bearish	-0.6	0.5	0.6	-0.4	-0.1	0.0	-0.1	CRB +0.5	0	-8	-1	-2	-7
EUR/USD	50100 200	Bearish	-0.9	0.6	0.6	-0.6	0.1	-0.2	0.0	SPX -0.6	-1	-20	-10	-4	-12
USD/CAD	200 500	Neutral	0.7	-0.6	-0.6	0.3	0.2	0.0	0.0	SPX +0.4	3	14	7	1	4
NZD/USD	150 200	Neutral	-0.5	0.3	0.3	-0.3	-0.4	0.2	-0.2	US data -0.2	-6	-15	-7	-1	-2
AUD/USD	500 200	Neutral	-0.6	0.4	0.4	-0.5	-0.2	0.0	0.2	US10 +0.4	-4	-17	-6	-5	-3

Column groups: 1-Month Correlation (DXY to US10, Largest 3mΔ); Mkt Positioning (Rate differential, IMM, Risk Reversals); History and Forecasts (Δm, Δy, Δytd; Fcast Δ to Q415 (%): Mkt, TD)

-9 -6 -3 0 3 6 9 12

% from spot

50/100/200 day moving average

Strong support/resistance

(1m - 3m) correlation

Strongest — Weakest

Sorted by average G10 correlation

-3 -2 -1 0 1 2 3

Short — Long

3m z-score

-20-10 0 10 20

Forecasted %Δ from spot

EMFX AT A GLANCE

	100d history	Tech Bias	DXY	US data	CRB	VIX	WTI	SPX	US10	Largest 3mΔ	Δm	Δy	Δytd	Mkt	TD
USD/TRY	200 10050	Bullish	0.6	0.3	-0.2	0.0	-0.2	0.0	0.2	SPX +0.4	-1	26	13	4	8
USD/ZAR	200 150	Neutral	0.6	0.5	-0.4	0.3	-0.3	-0.2	0.2	US data +0.2	2	15	4	3	2
USD/RUB	2050 100	Neutral	0.4	0.6	0.0	-0.2	-0.3	0.3	-0.1	US data +0.6	1	50	-15	8	25
USD/HUF	200 150	Neutral	0.8	0.5	-0.5	0.2	-0.3	-0.1	0.2	SPX +0.4	3	27	8	2	9
USD/PLN	200 500	Neutral	0.8	0.5	-0.5	0.1	-0.3	-0.1	0.1	SPX +0.4	4	24	7	4	7
USD/BRL	200 100 50	Bullish	0.2	0.4	-0.3	0.4	-0.3	-0.3	0.3	US data +0.4	8	40	18	4	10
USD/MXN	200 150	Neutral	0.4	0.4	-0.4	0.3	-0.1	-0.2	0.5	DXY -0.3	0	19	4	-1	-2
USD/INR	2000	Bullish	0.3	0.2	-0.1	0.5	-0.2	-0.4	-0.2	VIX +0.4	1	8	1	0	0
USD/IDR	200 50	Bullish	0.3	0.1	-0.2	0.3	-0.1	-0.3	-0.1	SPX -0.4	2	14	7	1	0
USD/MYR	200 150	Bullish	0.5	0.4	-0.2	0.1	-0.2	0.0	-0.1	US data +0.6	2	13	4	2	2

Column groups: 1-Month Correlation (DXY to US10, Largest 3mΔ); Mkt Positioning (Rate differential, Risk Reversals); History and Forecasts (Δm, Δy, Δytd; Fcast Δ to Q415 (%): Mkt, TD)

-20 -10 0 10 20

% from spot

50/100/200 day moving average

Strong support/resistance

(1m - 3m) correlation

Strongest — Weakest

Sorted by average G10 correlation

-2 0 2

Short — Long

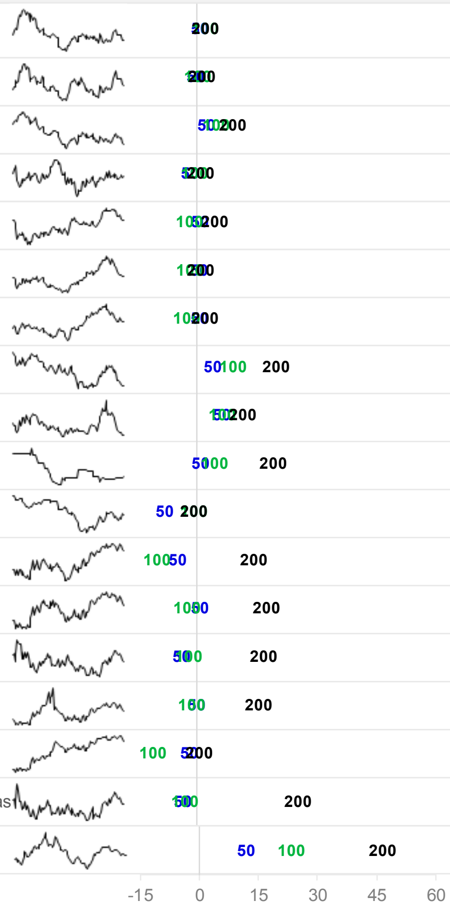
3m z-score

-10 0 10 20 30

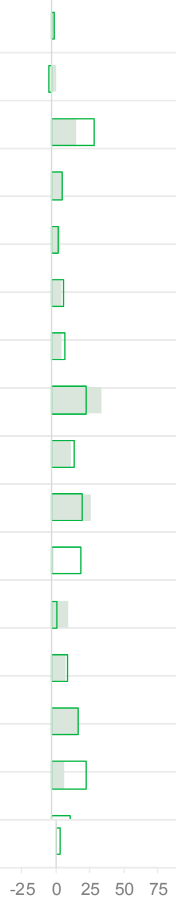
Forecasted % from spot

Analytics at a Glance

COMMODITIES AT A GLANCE



	1-Month correlation								History and Forecasts			Fcast Δ to Q415 (%)	
	WTI	DXY	CRB	SPX	US data	US10	VIX	Largest 3mΔ	Δm	Δy	Δytd	Consensus	TD
Gold	0.1	0.0	0.1	0.0	-0.1	0.0	0.0	US10 +0.5	-2	-6	0	3	3
Silver	0.0	-0.2	0.2	0.0	-0.1	0.1	0.0	US10 +0.4	0	-12	6	4	-1
Platinum	0.1	-0.3	0.3	-0.1	0.0	-0.2	0.0	WTI -0.2	-3	-23	-7	18	32
Palladium	0.4	-0.4	0.5	-0.1	-0.5	-0.4	0.0	US data -0.4	1	-6	-1	9	8
Copper	0.3	-0.2	0.2	-0.3	0.0	-0.2	0.2	SPX -0.5	0	-13	-5	7	5
Zinc	0.3	-0.3	0.2	-0.4	-0.1	-0.2	0.3	SPX -0.5	-5	5	1	7	9
Lead	0.2	0.0	0.0	-0.4	-0.1	-0.2	0.3	SPX -0.4	-8	-9	5	7	11
Nickel	0.3	-0.3	0.4	-0.4	-0.2	-0.4	0.3	SPX -0.4	-5	-35	-15	38	26
Aluminum	0.3	-0.3	0.3	-0.4	-0.2	0.0	0.2	SPX -0.4	-8	-5	-7	14	17
Molybdenum	0.3	-0.2	0.1	-0.2	-0.3	-0.1	0.1	US data -0.5	2	-46	-16	29	23
Iron Ore	0.1	0.1	0.1	-0.3	-0.1	0.2	0.3	SPX -0.3	6	-35	-11	2	22
WTI	1.0	-0.6	0.4	-0.2	-0.5	0.0	0.0	SPX -0.3	1	-44	8	13	4
Brent	1.0	-0.7	0.4	-0.2	-0.5	-0.1	0.0	SPX -0.4	-4	-40	1	11	12
NatGas	0.5	-0.5	0.7	0.3	-0.1	-0.2	-0.3	CRB +0.9	13	-39	-2	20	20
Heating Oil	0.9	-0.7	0.4	-0.2	-0.5	0.0	0.0	DXY -0.5	-3	-36	1	10	26
Gasoline	0.8	-0.5	0.3	-0.1	-0.4	-0.2	-0.1	DXY -0.3	-2	-35	37	…	15
AECO Nat Gas	0.5	-0.5	0.7	0.3	-0.1	-0.2	-0.4	CRB +0.8	12	-46	-4	…	50
Thermal coal	0.6	-0.4	0.3	-0.2	-0.3	0.1	0.0	WTI +0.3	-1	-25	-2	…	4



% from spot

50/100/200 day moving average

(1m-3m) correlation

Strongest Weakest

Sorted by average commodity correlation

Forecasted % from spot

Forecasts

			Spot	2015				2016			
			May 28, 2015	Q1 A	Q2 F	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
DOLLAR BLOC	United States	Fed Funds Rate	0.25	0.25	0.25	0.50	0.75	1.00	1.00	1.00	1.25
		3m	0.01	0.02	0.20	0.50	0.65	0.85	0.85	0.95	1.15
		2y	0.64	0.56	0.60	0.90	1.10	1.35	1.60	1.75	2.00
		5y	1.53	1.37	1.65	1.85	2.00	2.15	2.35	2.50	2.70
		10y	2.13	1.92	2.25	2.45	2.50	2.60	2.70	2.80	3.00
		30y	2.87	2.54	3.05	3.20	3.20	3.30	3.35	3.40	3.60
	Canada	Overnight Rate	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	1.00
		3m	0.64	0.55	0.65	0.70	0.70	0.70	0.75	0.80	0.95
		2y	0.63	0.51	0.60	0.75	0.80	1.00	1.15	1.35	1.65
		5y	0.96	0.76	1.05	1.20	1.35	1.55	1.75	1.90	2.10
		10y	1.67	1.36	1.80	1.90	1.95	2.05	2.20	2.30	2.40
		30y	2.25	1.98	2.40	2.45	2.50	2.60	2.70	2.75	2.80
	Australia	Cash Target Rate	2.00	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.50
		3m	2.14	2.23	2.05	2.05	2.10	2.15	2.25	2.50	2.75
		3y	1.94	1.70	2.00	1.95	2.05	2.10	2.20	2.35	2.60
		5y	2.17	1.80	2.25	2.20	2.30	2.50	2.65	2.75	2.90
		10y	2.77	2.32	2.95	2.85	2.95	3.05	3.10	3.20	3.45
	New Zealand	Cash Target Rate	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.75	4.00
		3m	3.48	3.63	3.45	3.45	3.50	3.50	3.65	3.85	4.10
		3y	3.10	3.10	3.00	3.00	3.05	3.10	3.25	3.40	3.60
		4y	3.16	3.11	3.15	3.20	3.25	3.35	3.45	3.50	3.75
		10y	3.45	3.22	3.40	3.40	3.50	3.55	3.60	3.80	4.05
EUROPE	Germany	ECB Refi Rate	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
		3m	-0.33	-0.31	-0.25	-0.25	-0.20	-0.15	-0.10	-0.10	-0.10
		2y	-0.23	-0.25	-0.15	-0.05	-0.05	-0.05	0.00	0.05	0.10
		5y	0.02	-0.10	0.10	0.30	0.40	0.50	0.65	0.80	1.05
		10y	0.55	0.18	0.75	1.00	1.15	1.40	1.70	1.85	2.10
		30y	1.20	0.61	1.50	1.70	2.10	2.35	2.50	2.65	2.80
	UK	Bank Rate	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.00	1.00
		3m	0.47	0.45	0.45	0.50	0.65	0.90	1.00	1.00	1.10
		2y	0.54	0.42	0.45	0.60	0.85	1.10	1.40	1.50	1.65
		5y	1.42	1.19	1.15	1.35	1.65	1.90	2.05	2.15	2.30
		10y	1.88	1.58	1.85	1.90	2.05	2.25	2.40	2.50	2.65
		30y	2.59	2.33	2.40	2.50	2.55	2.65	2.75	2.75	2.75
	Norway	Deposit Rate	1.25	1.25	1.00	1.00	1.00	1.00	1.00	1.00	1.00
		3m	0.91	0.92	0.95	0.95	1.00	1.00	1.00	1.00	1.00
		2y	0.72	0.83	0.90	1.00	1.20	1.35	1.45	1.55	1.65
		4y	0.92	1.00	1.10	1.40	1.55	1.70	1.80	1.95	2.05
		10y	1.51	1.39	1.60	1.95	2.20	2.30	2.45	2.60	2.70

Table title: SUMMARY G10 RATES FORECASTS

Forecasts

SUMMARY G10 FX FORECASTS	Spot	2015				2016			
	May 28, 2015	Q1 A	Q2 F	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
USD/JPY	123.8	120.1	121.0	123.0	125.0	125.0	125.0	127.0	127.0
EUR/USD	1.09	1.07	1.05	1.00	0.96	1.00	1.00	1.05	1.05
GBP/USD	1.54	1.48	1.46	1.45	1.43	1.45	1.49	1.50	1.52
USD/CHF	0.95	0.97	0.95	1.00	1.04	1.00	1.00	0.95	0.95
USD/CAD	1.24	1.27	1.25	1.27	1.30	1.33	1.27	1.22	1.18
AUD/USD	0.77	0.76	0.77	0.76	0.75	0.75	0.74	0.72	0.70
NZD/USD	0.73	0.75	0.73	0.72	0.71	0.70	0.67	0.64	0.62
EUR/NOK	8.46	8.65	8.70	8.55	8.35	8.25	8.40	8.60	8.60
EUR/SEK	9.27	9.26	9.25	9.00	8.75	8.60	8.50	8.35	8.25
DXY	97.1	98.4	85.9	90.3	98.4	103.8	103.0	99.5	99.0

SUMMARY COMMODITIES FORECASTS		Spot	2015				2016			
		May 28, 2015	Q1 A	Q2 F	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
Precious metals	Gold *	1189	1184	1195	1180	1200	1250	1250	1275	1300
	Silver *	16.70	16.66	16.50	15.90	16.25	17.50	17.50	19.00	19.75
	Platinum *	1121	1143	1150	1225	1375	1450	1500	1550	1700
	Palladium *	787	736	785	800	825	850	875	900	900
Other metals	Copper **	2.76	2.75	2.81	2.88	2.85	2.80	2.84	2.80	2.80
	Zinc **	0.99	0.94	1.02	1.06	1.08	1.20	1.20	1.25	1.40
	Lead **	0.88	0.83	0.91	0.96	0.97	1.02	1.04	1.05	1.10
	Nickel **	5.80	5.60	5.95	7.00	8.00	8.00	9.00	9.50	10.00
	Aluminum **	0.77	0.81	0.82	0.84	0.86	0.88	0.90	0.94	0.94
	Molybdenum +	7.73	8.40	7.85	8.50	9.00	10.00	10.00	11.00	11.00
	Iron Ore *+	62	55	58	64	64	64	64	68	68
Energy	Nymex Crude Oil +-	58	48	58	59	62	65	70	70	75
	Brent Crude Oil +-	63	57	64	65	70	75	80	80	85
	Heating Oil -+	1.87	1.72	1.90	1.95	2.10	2.20	2.30	2.30	2.45
	Gasoline -+	1.97	1.78	1.95	1.90	1.95	2.00	2.20	2.20	2.25
	Natural Gas --	2.84	2.64	2.65	2.90	3.40	3.50	3.00	3.20	3.50
	AECO Natural Gas --	2.27	2.09	2.10	2.20	2.70	2.80	2.40	2.60	3.00
	Newcastle Thermal Coal-	62	62	55	60	65	75	75	80	80

Commodity forecasts are period averages
**London PM Fix $/oz.*
+ Molybdenum equivalent to moly oxide, FOB USA
+- $/bbl

Forecasts

		SUMMARY EMERGING MARKET FORECASTS								
		Spot	2015				2016			
		May 28, 2015	Q1 A	Q2 F	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F
Cantral Bank Rates	Brazil	13.25	12.75	13.75	13.75	13.50	13.25	12.75	12.50	12.25
	Mexico	3.00	3.00	3.00	3.25	3.50	3.75	4.00	4.00	4.25
	India	7.50	7.50	7.25	7.25	7.25	7.25	7.50	7.75	8.00
	Indonesia	7.50	7.50	7.25	7.25	7.50	7.75	7.75	7.75	7.75
	Malaysia	3.25	3.25	3.25	3.25	3.25	3.50	3.50	3.75	3.75
	Poland	1.50	1.50	1.50	1.50	1.50	1.50	1.75	2.00	2.25
	Hungary	1.65	1.95	1.50	1.50	1.50	1.50	1.75	2.00	2.25
	Russia	12.50	14.00	11.50	10.50	12.50	12.50	12.50	12.50	12.50
	Turkey	7.50	7.50	7.50	8.00	8.00	8.50	9.00	9.50	9.50
	South Africa	5.75	5.75	5.75	6.00	6.00	6.25	6.50	6.75	6.75
EM vs USD	USD/BRL	3.14	3.20	3.15	3.35	3.45	3.50	3.40	3.35	3.30
	USD/MXN	15.30	15.26	15.15	15.30	15.00	14.80	14.70	14.60	14.50
	USD/INR	63.90	62.50	62.95	64.00	63.75	63.10	63.20	63.00	63.00
	USD/IDR	13213	13074	13000	13100	13200	13200	13300	13400	13400
	USD/MYR	3.64	3.70	3.60	3.65	3.70	3.62	3.60	3.55	3.55
	USD/PLN	3.78	3.80	3.76	3.92	4.06	3.85	3.85	3.70	3.70
	USD/HUF	283	280	284	297	309	295	295	281	281
	USD/RUB	51.87	58.19	55.00	65.00	65.00	63.00	62.00	62.00	61.00
	USD/TRY	2.64	2.60	2.65	2.75	2.85	2.73	2.75	2.76	2.75
	USD/ZAR	12.04	12.13	11.90	12.25	12.30	12.20	12.15	12.10	12.10
EM vs EUR	EUR/BRL	3.42	3.43	3.31	3.35	3.31	3.50	3.40	3.52	3.47
	EUR/MXN	16.70	16.38	15.91	15.30	14.40	14.80	14.70	15.33	15.23
	EUR/INR	69.77	67.20	66.10	64.00	61.20	63.10	63.20	66.15	66.15
	EUR/IDR	14427	14022	13650	13100	12672	13200	13300	14070	14070
	EUR/MYR	3.98	3.97	3.78	3.65	3.55	3.62	3.60	3.73	3.73
	EUR/PLN	4.13	4.07	3.95	3.92	3.90	3.85	3.85	3.89	3.89
	EUR/HUF	309	300	298	297	297	295	295	295	295
	EUR/RUB	56.68	62.52	57.75	65.00	62.40	63.00	62.00	65.10	64.05
	EUR/TRY	2.89	2.79	2.78	2.75	2.74	2.73	2.75	2.90	2.89
	EUR/ZAR	13.15	13.02	12.50	12.25	11.81	12.20	12.15	12.71	12.71

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Global Strategy

USA

Canada

Australia

New Zealand

UK

Europe

Emerging Markets

FX & Commodities

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