Economic Monitor

October 26, 2011

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

DUNDEEWEALTH®

FINANCIAL MARKETS OVERVIEW

by William Tharp

Improving economic growth in North America means that a dip back into recession is becoming less likely. However growth will be relatively sluggish and somewhat below potential. A modest degree of fiscal stimulus is assumed next year in the US, following another major round of wrangling and disagreement in November. Inflation is expected to slow. Europe has probably entered recession; progress on financial issues will continue at a halting pace but even a speed-up wouldn't resolve all problems. Greece will default and will likely leave the Euro in time. A further slowdown in Asian growth appears likely, although some Chinese numbers show improvement.

1.► The **BANK OF CANADA** is unlikely to raise interest rates for the foreseeable future. A rate cut is off the table for now, although the Bank has trimmed both its growth and inflation forecasts significantly for 2012. Should Europe's banking problems get out of hand, the knock on effect could trigger a rate cut in Canada as global credit could be seriously constricted.

2.► The **FED** funds target rate is expected to remain in the range of 0% to 0.25% until at least mid-2013, according to the Fed. The potential end of some fiscal stimulus measures in December and the possibility of some fiscal tightening as early as next year mean that monetary policy needs to remain stimulative and we could see further loosening measures by the Fed (buying more mortgage debt) late this year or early next year, especially if the payroll tax holiday is not extended into 2012.

3.► **BOND YIELDS** have probably seen their lows for this year but may drift lower in 2012 along with inflation. Should the Fed become concerned about deflation again it could attempt to cap 30-year yields near 2%. This would not necessarily involve much buying by the Fed.

4.► The **CANADIAN DOLLAR** has been pushed back up, closer to parity, as investors have pushed oil and copper prices higher, hoping that the slowdown in Chinese growth is over. In our view this is overly optimistic as an oil price near $80, let alone $90, will not allow global growth to regain significant traction anytime soon. Expect the dollar to fall back, along with commodity prices.

5.► The **U.S. DOLLAR** is expected to lose ground against the Renminbi and Yen but gain further ground against the Indian Rupee. (It still appears too early to resume buying Indian stocks). With Europe likely in recession, the Dollar will probably rise further against the European currencies but the pattern will be irregular as occasional progress on coming to grips with Europe's financial problems boosts the Euro from time to time.