



September 3, 2015

EMERGING MARKET TURMOIL SKEWS RISKS TOWARDS DELAYED FED LIFT-OFF

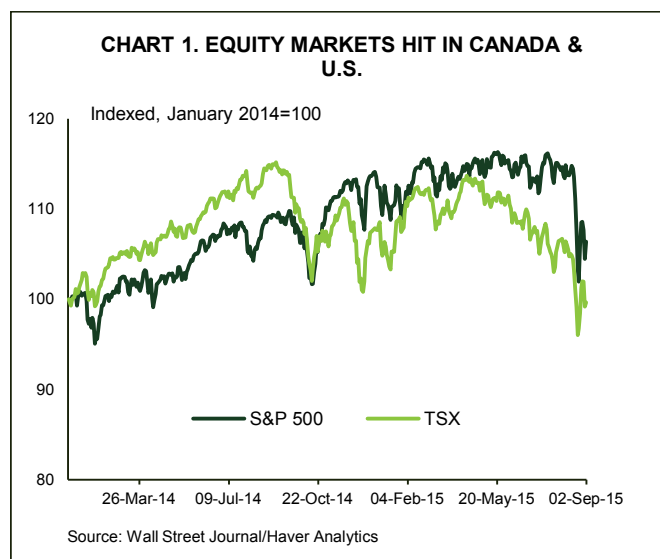
Highlights

- For the second straight month global financial market moves were dominated by troubles in emerging markets, and Canada's commodity-heavy TSX was not immune.
- While we remain confident that better U.S. growth will be largely domestically driven, the risks emanating from abroad have increased. As a result, we have pushed back our forecast for the first rate hike by the Fed until Q1 2016, resulting in adjustments to other financial forecasts.
- Forecast increases in Treasury yields have been reduced, with corresponding downward adjustments made to Canadian government bond yields. A more modest increase in interest rates has also led us to pare back the general appreciation in the U.S. dollar. We have also downgraded our forecast for the price of oil further.

For the second straight month global financial market moves were dominated by troubles in emerging markets, and Canada's commodity-heavy TSX was not immune. Investor pessimism had its roots in Chinese equity market declines once again. Concerns that the Chinese economy may slow more than investors expect have increased. Markets have also been preoccupied with when the U.S. Federal Reserve will raise interest rates, and we have pushed back our forecast for the first rate hike by the Fed until early in 2016.

While we remain confident that better U.S. growth will be largely domestically driven, the risks emanating from abroad have increased. Worsening in conditions in emerging markets and knock-on effects in commodity markets will likely lead to greater disinflationary pressures in the U.S., through both lower import prices and demand for U.S. exports. The Fed can afford to be more patient in engineering its lift-off from the zero lower interest rate bound as the cost of withdrawing stimulus too soon is likely perceived to be larger than waiting too long.

This expected delay to Fed rate hikes has sent ripples through most of our financial market forecasts (see tables pages 3-4). Forecast increases in Treasury yields have been reduced, with corresponding downward adjustments made to Canadian government bond yields. A more modest increase in interest rates has led us to pare back the appreciation in the U.S. dollar. We have also downgraded our forecast for the price of oil further. A prolonged period of low prices is clearly needed to reduce drilling activity and bring global oil production in line with demand. This process is taking time, and we expect WTI to remain below \$60 per barrel until the second half of 2016, which has negative consequences for Canada's economic outlook. We continue to expect that the Bank will keep the overnight rate at its current stimulative setting until at least the latter half of 2017. However, the risk profile continues to be tilted towards a further cut.



Fed likely to delay hikes to 2016

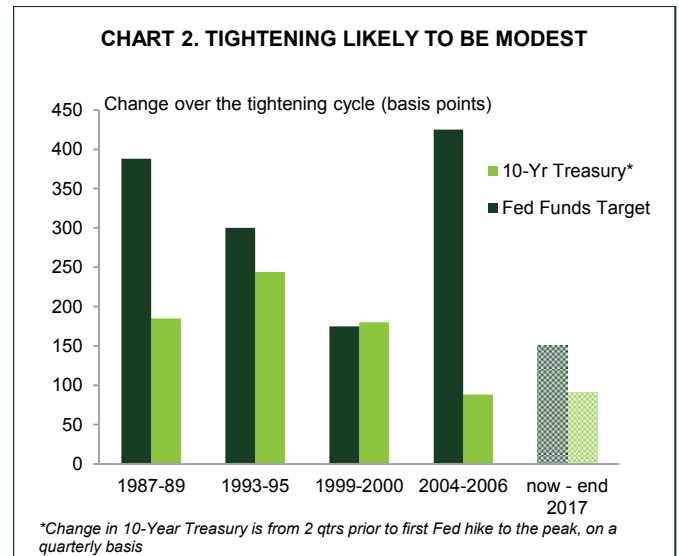
Volatility in financial markets doesn't always correspond to changes in the economic fundamentals, but in the current environment the likelihood of another global growth disappointment this year has increased. Our outlook for the global economy has been downgraded, with growth tracking a very modest 3% for 2015, a deceleration from 3.4% in 2014. Growth is still improving in advanced economies, but the slowdown in emerging markets has been more pronounced.

While we expect the heightened risks emanating from emerging markets will lead the U.S. Federal Reserve to hold off raising interest rates in September, they won't delay hikes indefinitely. The U.S. economy continues to strengthen, driven by domestic forces. These forces are unlikely to be derailed by a slowdown in China or other emerging markets. Our base case is for the first rate hike to occur in the first quarter of 2016, with the funds rate rising to 1.00% by the end of 2016 and 1.75% by the end of 2017, only very slightly below our previous forecast.

Evidence that the U.S. economy shook of its Q1 weakness was loud and clear in the hearty 3.7% pace of real economic growth in the second quarter. Even with the soft patch in Q1, the U.S. economy expanded at a respectable 2.2% pace in the first half of the year, which is impressive given the sizeable declines in energy-related investment and a strengthening U.S. dollar.

Looking ahead, the U.S. economy is likely to experience some further drag from energy investment and a higher U.S. dollar. The decline in equity markets may also dent consumer confidence and household wealth. However, lower gasoline prices, rising employment and income, and improved household wealth should enable the U.S. consumer to carry the economy forward, with additional strength sourced from residential investment. Consumer confidence remains strong. The housing market continued to set a blistering pace in July and vehicle sales set another cycle high in August. Real consumer spending is tracking another solid 3% advance in Q3. The consumer is expected to be key in driving U.S. economic growth to settle into a very comfortable 2.5% to 3% pace over the coming quarters, resulting in continued reduction in economic slack and increased inflationary pressures, eventually.

The labor market continues to churn out new jobs at an impressive pace, and the unemployment rate has fallen to 5.3%, very close to the Federal Reserve's long-run projection of 5.0-5.2%. That argues for rate hikes from the employment side of the Fed's dual mandate of targeting full



employment and stable inflation. The fly in the ointment is the persistently low level of inflation and risk it could weaken further given forces from abroad.

Our analysis indicates that much of the dampening effect of a stronger dollar on inflation has occurred. A smaller degree of appreciation in the U.S. dollar in our forecast should also limit its further dampening influence. However, weakness in emerging markets could result in lower prices for the many goods Americans consume from abroad, irrespective of the effects of the currency. This risk is expected to contribute to the delay in the Fed tightening.

While it is easy to get overly pessimistic in the face of recent equity market downturn, it is important to remember there is upside risk to our current forecast. If it becomes clearer in the months ahead that the worst fears of an abrupt slowdown in China aren't coming to pass, and wage inflation in the U.S. picks up, the Fed could opt to raise rates this year. Moreover, whenever the Fed does start to raise rates, the pace of interest rate increases is expected to be more modest than in the past (see Chart 2). We expect the fed funds rate to reach 1.75% by the end of 2017, amounting to 150 basis points of tightening over a two year period. That is very modest when compared to past Fed tightening cycles over the past 30 years. Similarly, the rise in yields, as measured by the 10-Year Treasury is also modest when compared to past fed tightening cycles.

Canadian bond yields are expected to be pulled higher by rising U.S. rates. However, Canada's relatively weaker economic performance versus the United States means that Canadian yields are expected to rise relatively less. This will contribute to a further depreciation in the loonie in the first half of 2016 to around 73 U.S. cents.



INTEREST RATE OUTLOOK													
	Spot Rate Sep-03	2014				2015F				2016F			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
CANADA													
Overnight Target Rate	0.50	1.00	1.00	1.00	1.00	0.75	0.75	0.50	0.50	0.50	0.50	0.50	0.50
3-mth T-Bill Rate	0.37	0.90	0.94	0.92	0.91	0.55	0.58	0.45	0.45	0.45	0.45	0.45	0.50
2-yr Govt. Bond Yield	0.41	1.07	1.10	1.13	1.01	0.51	0.49	0.35	0.50	0.65	0.75	0.80	0.90
5-yr Govt. Bond Yield	0.74	1.71	1.53	1.63	1.34	0.77	0.81	0.75	0.90	1.05	1.30	1.40	1.60
10-yr Govt. Bond Yield	1.45	2.46	2.24	2.15	1.79	1.36	1.68	1.50	1.60	1.75	1.90	2.00	2.15
30-yr Govt. Bond Yield	2.21	2.96	2.78	2.67	2.33	1.99	2.31	2.20	2.30	2.40	2.50	2.60	2.70
10-yr-2-yr Govt Spread	1.04	1.39	1.14	1.02	0.78	0.85	1.19	1.15	1.10	1.10	1.15	1.20	1.25
U.S.													
Fed Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.00
3-mth T-Bill Rate	0.01	0.05	0.04	0.02	0.04	0.03	0.01	0.10	0.20	0.40	0.65	0.80	0.85
2-yr Govt. Bond Yield	0.70	0.44	0.47	0.58	0.67	0.56	0.64	0.70	0.85	1.05	1.35	1.50	1.60
5-yr Govt. Bond Yield	1.49	1.73	1.62	1.78	1.65	1.37	1.63	1.50	1.60	1.75	2.00	2.15	2.25
10-yr Govt. Bond Yield	2.17	2.73	2.53	2.52	2.17	1.94	2.35	2.20	2.30	2.45	2.60	2.70	2.75
30-yr Govt. Bond Yield	2.95	3.56	3.34	3.21	2.75	2.54	3.11	3.00	3.15	3.20	3.30	3.40	3.45
10-yr-2-yr Govt Spread	1.48	2.29	2.06	1.94	1.50	1.38	1.71	1.50	1.45	1.40	1.25	1.20	1.15
CANADA - U.S SPREADS													
Can - U.S. T-Bill Spread	0.36	0.85	0.90	0.90	0.87	0.52	0.57	0.35	0.25	0.05	-0.20	-0.35	-0.35
Can - U.S. 10-Year Bond Spread	-0.72	-0.27	-0.29	-0.37	-0.38	-0.58	-0.67	-0.70	-0.70	-0.70	-0.70	-0.70	-0.60

F: Forecast by TD Bank Group as at September 2015; All forecasts are end-of-period; Source: Bloomberg, Bank of Canada, Federal Reserve.

GLOBAL STOCK MARKETS					
	Price Sep-03	30-Day % Chg.	YTD % Chg.	52-Week High	52-Week Low
S&P 500	1,949	-7.1	-5.3	2,131	1,862
S&P/TSX Composite	13,545	-6.4	-7.4	15,577	13,053
DAX	10,289	-10.1	4.9	12,375	8,572
FTSE 100	6,181	-7.6	-5.9	7,104	5,899
Nikkei	18,182	-11.5	4.2	20,868	14,533
MSCI AC World Index*	389	-8.5	-6.7	443	382

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

COMMODITY PRICE FORECASTS																		
	Price Sep-03	52-Week High	52-Week Low	2014				2015F				2016F				Annual Average		
				Q1	Q2	Q3	Q4	Q1	Q2	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	2014	2015F	2016F
Crude Oil (WTI, \$US/bbl)	47	95	38	99	103	98	73	49	59	46	44	50	55	63	68	93	49	59
Natural Gas (\$US/MMBtu)	2.72	4.41	2.48	5.17	4.59	3.94	3.75	2.87	2.78	2.80	3.30	3.20	2.95	2.90	3.40	4.36	2.94	3.11
Gold (\$US/troy oz.)	1126	1302	1085	1294	1289	1282	1199	1218	1191	1125	1075	1050	1125	1175	1210	1266	1152	1140
Silver (US\$/troy oz.)	14.7	19.2	14.1	20.5	19.7	19.71	16.47	16.74	16.44	14.90	14.75	14.00	15.75	16.25	16.75	19.1	15.7	15.69
Copper (cents/lb)	233	318	225	319	308	317	300	264	275	236	238	230	230	240	240	311	253	235
Nickel (US\$/lb)	4.48	9.04	4.32	6.64	8.38	8.42	7.15	6.51	5.94	4.85	6.00	6.80	7.50	8.00	9.00	7.65	5.83	7.83
Aluminum (Cents/lb)	73	95	69	77	82	90	89	82	79	73	78	80	82	86	86	85	78	84
Wheat (\$US/bu)*	5.93	10.18	5.82	9.32	8.90	8.43	8.10	7.45	7.34	6.50	6.90	7.15	7.50	8.00	8.25	8.69	7.05	7.73

F: Forecast by TD Bank Group as at September 2015; All forecasts are period averages; E: Estimate; Source: Bloomberg, USDA (Haver). *As at September 2, 2015.



FOREIGN EXCHANGE OUTLOOK														
Currency	Exchange rate	Spot Price Sep-03	2014				2015				2016			
			Q1	Q2	Q3	Q4	Q1	Q2	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Exchange rate to U.S. dollar														
Japanese yen	JPY per USD	119.8	103.0	101.3	109.7	119.9	120.0	122.1	120.0	124.0	130.0	132.0	127.0	124.0
Euro	USD per EUR	1.11	1.38	1.37	1.26	1.21	1.07	1.12	1.11	1.10	1.08	1.06	1.10	1.12
U.K. pound	USD per GBP	1.53	1.67	1.71	1.62	1.56	1.49	1.57	1.52	1.55	1.57	1.58	1.62	1.65
Swiss franc	CHF per USD	0.97	0.88	0.89	0.96	0.99	0.97	0.94	0.97	0.98	0.96	0.96	0.93	0.92
Canadian dollar	CAD per USD	1.32	1.11	1.07	1.12	1.16	1.27	1.25	1.32	1.33	1.37	1.37	1.35	1.33
Australian dollar	USD per AUD	0.70	0.93	0.94	0.87	0.82	0.76	0.77	0.70	0.68	0.68	0.67	0.67	0.69
NZ dollar	USD per NZD	0.64	0.87	0.88	0.78	0.78	0.75	0.68	0.63	0.62	0.62	0.61	0.59	0.59
Exchange rate to Euro														
U.S. dollar	USD per EUR	1.11	1.38	1.37	1.26	1.21	1.07	1.12	1.11	1.10	1.08	1.06	1.10	1.12
Japanese yen	JPY per EUR	133	142	139	138	145	129	136	133	136	140	140	140	139
U.K. pound	GBP per EUR	0.73	0.83	0.80	0.78	0.78	0.72	0.71	0.73	0.71	0.69	0.67	0.68	0.68
Swiss franc	CHF per EUR	1.09	1.22	1.21	1.21	1.20	1.04	1.04	1.08	1.08	1.04	1.02	1.02	1.03
Canadian dollar	CAD per EUR	1.48	1.52	1.46	1.42	1.40	1.36	1.39	1.47	1.46	1.48	1.45	1.49	1.49
Australian dollar	AUD per EUR	1.59	1.49	1.45	1.45	1.48	1.41	1.45	1.59	1.62	1.59	1.58	1.64	1.62
NZ dollar	NZD per EUR	1.75	1.59	1.56	1.62	1.55	1.44	1.65	1.76	1.77	1.74	1.74	1.86	1.90
Exchange rate to Japanese yen														
U.S. dollar	JPY per USD	119.8	103.0	101.3	109.7	119.9	120.0	122.1	120.0	124.0	130.0	132.0	127.0	124.0
Euro	JPY per EUR	133	142	139	138	145	129	136	133	136	140	140	140	139
U.K. pound	JPY per GBP	183	172	173	178	187	178	192	182	192	203	209	205	204
Swiss franc	JPY per CHF	123.0	116.5	114.2	114.8	120.6	123.5	130.6	123.3	126.3	135.0	137.2	137.0	134.8
Canadian dollar	JPY per CAD	90.5	93.2	94.9	97.9	103.3	94.6	97.9	90.9	93.2	94.9	96.4	94.1	93.2
Australian dollar	JPY per AUD	84.0	95.5	95.5	95.8	98.0	91.5	94.1	84.0	84.3	88.4	88.4	85.1	85.6
NZ dollar	JPY per NZD	76.3	89.4	88.7	85.4	93.4	89.8	82.8	75.6	76.9	80.6	80.5	74.9	73.2
Exchange rate to Canadian dollar														
U.S. dollar	USD per CAD	0.75	0.91	0.94	0.89	0.86	0.79	0.80	0.76	0.75	0.73	0.73	0.74	0.75
Japanese yen	JPY per CAD	90.5	93.2	94.9	97.9	103.3	94.6	97.9	90.9	93.2	94.9	96.4	94.1	93.2
Euro	CAD per EUR	1.48	1.52	1.46	1.42	1.40	1.36	1.39	1.47	1.46	1.48	1.45	1.49	1.49
U.K. pound	CAD per GBP	2.02	1.84	1.83	1.82	1.81	1.88	1.96	2.01	2.06	2.14	2.17	2.18	2.19
Swiss franc	CHF per CAD	0.74	0.80	0.83	0.85	0.86	0.77	0.75	0.74	0.74	0.70	0.70	0.69	0.69
Australian dollar	AUD per CAD	1.08	0.98	0.99	1.02	1.05	1.03	1.04	1.08	1.11	1.07	1.09	1.10	1.09
NZ dollar	NZD per CAD	1.18	1.04	1.07	1.15	1.11	1.05	1.18	1.20	1.21	1.18	1.20	1.25	1.27

F: Forecast by TD Bank Group as at September 2015; All forecasts are end-of-period; Source: Federal Reserve, Bloomberg, TDBG.

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