

QUARTERLY ECONOMIC FORECAST

TD Economics



June 18, 2015

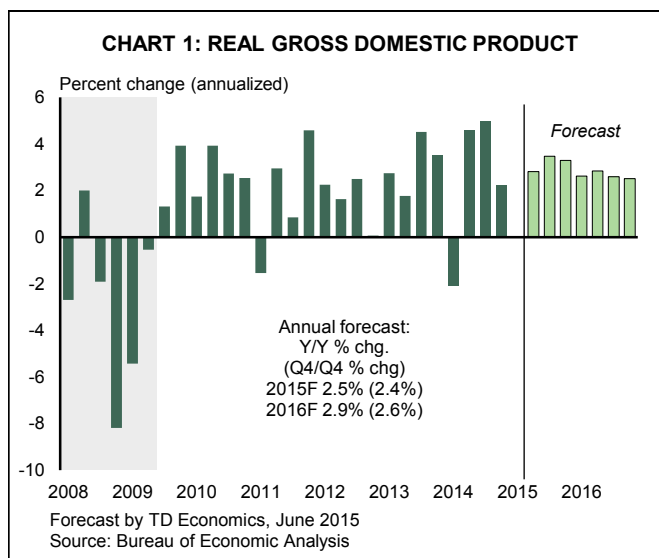
U.S. OUTLOOK: GETTING BETTER (SERIOUSLY)

Highlights

- The American economy stumbled coming out of the gate in 2015, but found its footing in the spring and appears to finally be hitting its stride. Real GDP growth is on track for 2.7% in the second quarter, proof that the misstep was short-lived.
- The theme of the economic outlook is unchanged from our previous forecasts. Pent-up demand will get a boost from continued momentum and tightening in the labor market, nascent wage growth, and low inflation. Faster consumer spending and housing investment will provide the main thrust to accelerated economic growth.
- Declining oil and gas drilling activity subtracted an estimated 0.5 percentage points from economic growth over the first half of the year. With the price of oil moving gradually higher from its bottom in March and rig counts stabilizing, this drag on growth will abate.
- The dollar will remain a headwind to growth, weighing on exports and raising imports. However, global growth should improve modestly over the remainder of the year and the worst of the drag from the external sector is likely in the rear-view mirror.
- Real GDP is expected to advance by 2.5% in 2015, up slightly from 2.4% in 2014, but down 0.5 percentage points from our March forecast due to the slower than expected start. Economic growth is expected to improve to 2.9% in 2016, a hair above our previous forecast for 2.8%.

The economic outlook has not played out precisely as we had anticipated three months ago. Real GDP growth came in weaker to start the year and the rebound during the spring months has been slower than expected. Admittedly, reading the economic tea leaves has become more difficult of late. Bad weather, port disruptions, and even questions about whether the data are being properly adjusted for regular seasonal patterns have clouded the near-term view. Revisions to past data have added to the difficulty. Real GDP growth was first estimated at a very modest +0.2% (annualized) in the first quarter, only to be revised down to -0.7%. We anticipate it will be revised back up to flat on the third estimate based on better data for international trade, consumer spending, and construction. Fortunately, the economy's performance in the second quarter is putting to rest concerns that the U.S. economy is backsliding. Real GDP growth is tracking 2.7%, offering confidence that the weakness in the first quarter was an aberration.

Thematically, the outlook has not changed. Continued momentum and tightening in the labor market, nascent wage growth, and low inflation due to falling energy prices will remain supportive to consumer spending and housing demand. These sectors will provide the main impetus to faster domestically-driven economic growth.

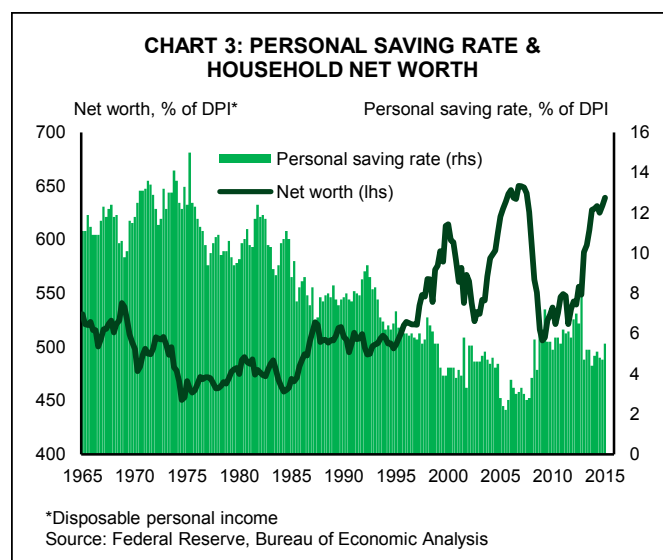
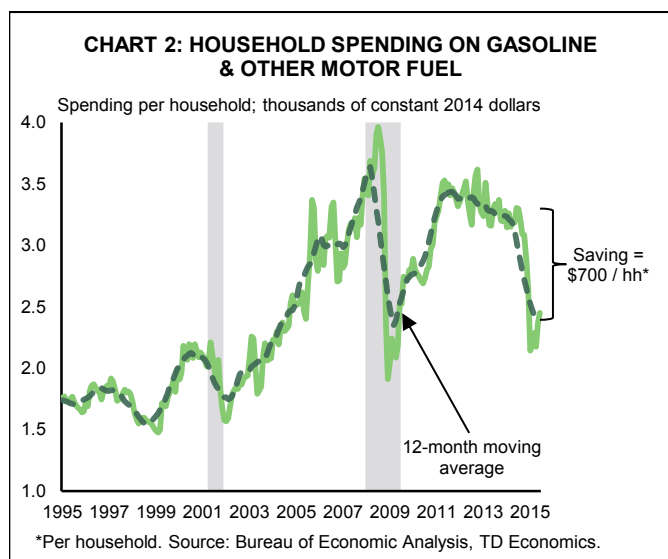


At the same time, the headwind to growth from declining oil and gas investment will diminish over the second half of the year. While the strong dollar will continue to pose a challenge to exporters and some of the increase in domestic spending will be met with higher imports, a slightly better global growth picture means the worst of the drag from the external sector is likely now in the rear-view mirror.

All told, we expect real GDP growth of 2.5% in 2015, down 0.5 percentage points from our March forecast because of the slow start to the year. Growth is expected to improve to 2.9% in 2016, a hair above our previous forecast for 2.8%. Importantly, the downward revision to economic growth has not changed expectations for the labor market materially. Job growth is expected to average over 220k per month over the course of 2015, bringing the unemployment rate to 5.2% by the fourth quarter of this year. The pace of job creation will taper modestly in 2016 as the unemployment rate moves toward its longer-term trend rate of around 5.0%.

Waiting on consumers

One of the sources of disappointment over the first half of the year has been the pace of consumer spending. While the situation looks better with recent data (and revisions), consumer spending growth has been closer to 2.0%, rather than the 3% growth anticipated in the March QEF edition. The disappointment requires some explanation. Unseasonably cold weather takes the blame for some of it, but other factors are also at play. First, the dividend from lower energy prices has not yet showed up in spending in a noticeable way. Instead, when the price of gasoline fell, the saving rate rose from 4.5% in November of last year, to 5.6% in April.



Higher savings means less spending, at least immediately.

There are a few explanations for the rise in savings. First, the savings to individual households from lower pump prices are small at first, but accrue over time. Given the drop in gasoline prices, the saving from filling up a mid-size 16 gallon gas tank (from empty) amounts to a little over \$15 relative to a year ago. Households will surely appreciate the money that is not going into their gas tank, but they may not be in a rush to spend the windfall. The longer that gasoline prices remain well below last year's peak levels, households become increasingly more confident that net savings will be permanently enjoyed, causing them to reallocate spending to other areas. There is support for this notion in the data. Looking back to the mid-1980s, energy prices fell 20% through the end of 1986, but real spending did not really accelerate until roughly a year later.

A second explanation for the softness in spending is that households are still being cautious and increasing savings in response to weak balance sheets and reduced expectations for future income growth. This has some appeal, especially given the relative weakness in median income growth. However, it is not entirely in tune with moves in the saving rate, which outside of the recession and a temporary jump at the end of 2012 (on account of changes in tax law), has been fairly stable around the 5.0% mark over the past two years. Meanwhile, debt service costs remain at historic lows and household balance sheets have continued to improve due to both rising equity and home prices.

The bottom line is that despite the disappointment, there is good reason to expect household spending to pick up speed over the remainder of this year. It is not just the

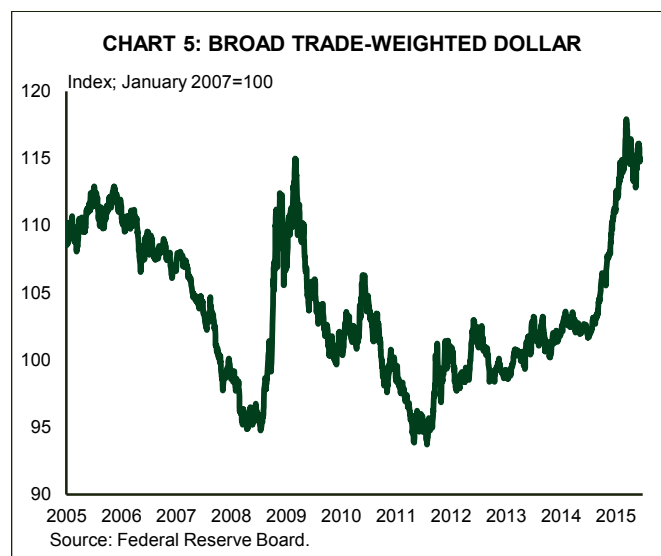
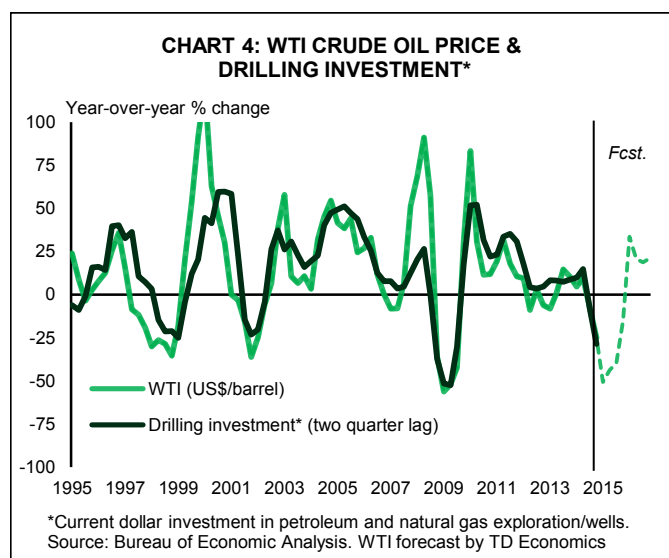
benefit of lower energy prices, but also the continued growth in employment and wages. With job growth continuing to average above 200k a month and wage growth moving up, income growth will maintain its recent momentum, giving support to spending.

Our expectation for consumer spending growth to accelerate above 3.6% over the second half of the year does not entirely make up for the disappointment in the first half of the year. All told, we have brought down our forecast by 0.3 percentage points relative to March.

Headwind from falling oil and gas production is significant, but will abate

Another element that has contributed to the weakness in economic growth has been the rapid decline in oil and gas investment. Petroleum and natural gas exploration, a subcomponent of non-residential structures investment, directly subtracted 0.5 percentage points from economic growth in the first quarter of the year and is anticipated to have the same outsized impact in the second quarter. The exceptionally rapid and steep adjustment in supply was not adequately built into our previous forecast.

The good news is that after falling close to 30% in each of the past two quarters, oil and gas rig counts appear to be stabilizing. Given the rise in oil prices since hitting a trough in March, we are likely close to a bottom in terms of the decline in drilling investment. While it is not expected to rebound swiftly or contribute positively to economic growth over the remainder of the year, the swing to neutral adds about a half percentage point to growth on average over the second half of the year.



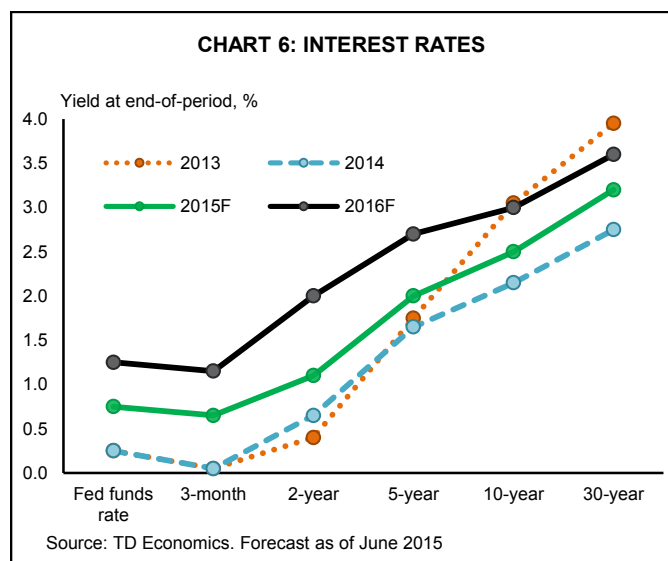
Dollar to remain lofty, but global growth will improve

In terms of the global picture, the movement in the dollar remains a headwind to growth. On a trade-weighted basis, the dollar has risen close to 15% over the past year. Against major-advanced economies it has risen close to 20%. The rise in the dollar has long been a factor on the economic outlook and its expected negative impact has not changed from our previous forecast.

Nonetheless, net exports did subtract a hefty 1.7 percentage points from real economic growth in the first quarter, which was more than we had anticipated. It is important to note that the weakness in net exports was not just a dollar story. A labor disruption on west-coast ports contributed to the decline in exports due to a resulting backlog that will be made up in the months ahead.

However, external economic weakness has been another key part of the U.S. export picture. Foreign economic growth weighted by its share in U.S. exports fell to an estimated 1.8% in the first quarter, the slowest quarterly growth rate in over two years, when the Eurozone was in the midst of recession. Economic growth languished in some of America's largest trading partners, including Canada, where real GDP declined by an estimated 0.6%, and Mexico, which slowed to 1.6%. Feeble growth in China also contributed to a considerable widening in America's trade deficit with the country.

While the dollar will remain a headwind to growth, foreign GDP growth is likely to strengthen to around 3% over the remainder of this year and through 2016. All this to say that the drag on growth from net exports should continue to diminish.



Strong job market means the Fed is on course to raise interest rates

In contrast to headline GDP, the job market continues to exude strength. In May, payrolls grew by a consensus-beating 280k. Over the first five months of the year, job growth has averaged 217k a month. In other words, even as economic growth moved below its estimated potential rate, employment advanced at a pace well above it. The difference is explained by weak productivity, which declined in the first quarter and has shown virtually no growth over the past year. If sustained, low productivity is cause for concern, signaling a slower cruising speed for the economy. However, it is not something that monetary policy is particularly good at correcting.

Unless it begins to show up in the labor market, the Fed is likely to look past the economic soft patch. If faster growth takes shape over the remainder of the year as we expect, the federal funds rate is likely to begin moving up. We continue to expect the Federal Reserve to raise its key lending rate at its September meeting. Nonetheless, as Fed Vice Chairman, Stanley Fischer has noted, the increase in rates will be more akin to a crawl than a liftoff. The fed funds rate is likely to remain at an accommodative level through the end of 2016,

when we expect it to end the year at 1.25%.

The combination of a “go-slow” Fed, low inflation and global risks is likely to prevent a further significant and sustained increase in longer-term yields during the second half of this year. We expect the 10-year yield to hold near its current level this year and reach roughly 3.0% by the end of 2016.

Expect more volatility

As the Fed raises rates for the first time in nearly a decade, further volatility can be expected in financial markets. While the Fed will aim to communicate a gradual approach, investors should brace for periodic overshoots. What is more, external events remain highly uncertain. The case for fed rate hikes rests on domestic fundamentals, but this does not preclude an external shock (for example, a Greek default) from throwing a wrench in their plans. This may be enough to delay the first move, but, given the proximity of the unemployment rate to the Fed’s longer-term goal, it will not prevent it from occurring.

Bottom line

As it did in 2014, the economy struggled coming out of the gate in 2015. However, after all is said and done, performance in the first half of the year doesn’t look to be quite as bad as it had looked initially or even a few weeks ago. The recent data flow suggests that a rebound in domestic spending is taking hold. As the headwinds weighing on growth in the first half of the year fade, the economy is likely to make up for it with stronger growth in the second half of the year.

The ongoing strength in the labor market is one of the main reasons for optimism. Employment growth is supported by job openings that continue to push to record levels. A virtuous cycle is taking hold. Alongside falling unemployment, this will lead to faster wage growth that will support consumer spending. While this augurs for a gradual move away from zero-interest rates, the Fed will remain cautious, sustaining the recovery and moving inflation and unemployment toward target.

U.S. ECONOMIC OUTLOOK:

Period-Over-Period Annualized Per Cent Change Unless Otherwise Indicated

	2014				2015				2016				Annual Average			4th Qtr/4th Qtr		
	Q1	Q2	Q3	Q4	Q1E	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	14	15F	16F	14	15F	16F
Real GDP	-2.1	4.6	5.0	2.2	0.0	2.7	3.5	3.3	2.6	2.8	2.6	2.5	2.4	2.5	2.9	2.4	2.4	2.6
Consumer Expenditure	1.2	2.5	3.2	4.4	2.1	2.8	3.7	3.5	2.7	2.8	2.6	2.5	2.5	3.1	3.0	2.9	3.0	2.6
Durable Goods	3.2	14.1	9.2	6.2	2.0	8.6	6.3	5.6	5.1	4.6	4.1	3.7	6.9	6.4	5.2	8.1	5.6	4.4
Business Investment	1.6	9.7	8.9	4.7	-1.7	1.9	5.3	6.8	5.8	5.0	4.3	4.0	6.3	3.5	5.2	6.2	3.0	4.8
Non-Res. Structures	2.9	12.6	4.8	5.9	-18.3	-10.1	-1.6	6.2	4.8	4.9	4.7	4.6	8.2	-4.4	3.2	6.5	-6.4	4.8
Equipment & IPP*	1.2	8.9	10.1	4.4	3.1	5.4	7.2	6.9	6.0	5.1	4.2	3.8	5.8	5.7	5.7	6.1	5.6	4.8
Residential Construction	-5.3	8.8	3.3	3.8	5.4	8.6	13.0	14.9	14.2	12.0	11.7	10.3	1.6	7.2	12.9	2.5	10.4	12.1
Govt. Consumption & Gross Investment	-0.8	1.7	4.4	-1.9	-0.2	2.8	1.1	0.9	0.9	0.7	0.6	0.7	-0.2	1.0	0.9	0.8	1.2	0.7
Final Domestic Demand	0.7	3.4	4.1	3.3	1.3	2.9	3.7	3.8	3.1	3.1	2.8	2.6	2.5	2.9	3.2	2.9	2.9	2.9
Exports	-9.2	11.0	4.6	4.5	-6.3	6.5	4.7	5.5	5.4	6.0	5.4	5.6	3.2	2.5	5.5	2.4	2.5	5.6
Imports	2.2	11.3	-0.9	10.4	5.5	5.2	6.4	6.8	6.4	5.6	5.0	4.8	4.0	6.1	6.0	5.6	6.0	5.4
Change in Private Inventories	35.2	84.8	82.2	80.0	96.5	87.3	89.3	81.7	70.2	63.1	57.1	52.0	70.6	88.7	60.6	---	---	---
Final Sales	-1.0	3.2	5.0	2.3	-0.4	3.0	3.4	3.5	2.9	3.0	2.8	2.6	2.3	2.4	3.1	2.4	2.4	2.8
International Current Account Balance (\$Bn)	-466	-440	-443	-522	-563	-557	-589	-622	-678	-728	-776	-816	-468	-583	-750	---	---	---
% of GDP	-2.7	-2.5	-2.5	-2.9	-3.2	-3.1	-3.3	-3.4	-3.7	-3.9	-4.1	-4.3	-2.7	-3.2	-4.0	---	---	---
Pre-tax Corporate Profits including IVA&CCA	-32.6	38.3	12.8	-5.5	-19.6	6.0	6.9	3.8	2.6	2.8	2.9	2.7	-0.8	-0.9	3.6	-0.2	-1.4	2.8
% of GDP	11.4	12.2	12.3	12.1	11.5	11.5	11.6	11.5	11.5	11.4	11.4	11.3	12.0	11.5	11.4	---	---	---
GDP Deflator (Y/Y)	1.4	1.6	1.6	1.3	0.9	0.7	0.8	1.1	1.6	1.6	1.8	1.9	1.5	0.9	1.7	1.3	1.1	1.9
Nominal GDP	-0.8	6.8	6.4	2.4	-0.1	4.2	5.1	4.9	4.4	4.6	4.7	4.6	3.9	3.3	4.6	3.7	3.5	4.6
Labor Force	2.1	-0.5	1.0	0.7	2.0	0.9	1.0	1.1	1.1	1.1	1.1	1.1	0.3	1.1	1.1	0.8	1.2	1.1
Employment	1.6	2.3	2.2	2.5	2.2	1.9	1.8	1.7	1.6	1.7	1.5	1.4	1.9	2.1	1.7	2.1	1.9	1.6
Change in Empl. ('000s)	545	795	744	850	778	667	635	608	580	589	545	502	2,629	2,957	2,360	2,934	2,688	2,216
Unemployment Rate (%)	6.6	6.2	6.1	5.7	5.6	5.5	5.3	5.2	5.2	5.1	5.0	5.0	6.2	5.4	5.1	---	---	---
Personal Disp. Income	4.8	5.5	3.6	3.7	3.2	4.2	4.6	4.4	3.9	4.2	4.5	4.4	3.9	3.9	4.2	4.4	4.1	4.3
Pers. Saving Rate (%)	4.9	5.1	4.8	4.7	5.5	5.5	5.3	5.0	4.8	4.7	4.6	4.6	4.9	5.3	4.7	---	---	---
Cons. Price Index (Y/Y)	1.4	2.1	1.8	1.2	-0.1	-0.1	0.1	0.8	2.1	2.1	2.2	2.3	1.6	0.2	2.2	1.2	0.8	2.3
Core CPI (Y/Y)	1.6	1.9	1.8	1.7	1.7	1.8	2.0	2.1	2.3	2.2	2.3	2.3	1.7	1.9	2.3	1.7	2.1	2.3
Housing Starts (mns)	0.93	0.98	1.03	1.06	0.98	1.09	1.14	1.21	1.27	1.33	1.38	1.43	1.00	1.10	1.35	---	---	---
Productivity:																		
Real Output per hour (y/y)**	0.6	1.1	1.2	-0.1	0.3	-0.2	-0.5	0.5	1.6	1.8	1.5	1.4	0.7	0.0	1.6	-0.1	0.5	1.4

*Intellectual property products. **Non-farm business sector. E: Estimate by TD Economics, June 2015. F: Forecast by TD Economics, June 2015

Source: U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Analysis, TD Economics

INTEREST RATE OUTLOOK

	2014				2015				2016			
	Q1	Q2	Q3	Q4	Q1	Q2*	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Fed Funds Target Rate (%)	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.00	1.00	1.25
3-mth T-Bill Rate (%)	0.05	0.04	0.02	0.04	0.03	0.00	0.50	0.65	0.85	0.85	0.95	1.15
2-yr Govt. Bond Yield (%)	0.44	0.47	0.58	0.67	0.56	0.66	0.90	1.10	1.35	1.60	1.75	2.00
5-yr Govt. Bond Yield (%)	1.73	1.62	1.78	1.65	1.37	1.63	1.85	2.00	2.15	2.35	2.50	2.70
10-yr Govt. Bond Yield (%)	2.73	2.53	2.52	2.17	1.94	2.32	2.45	2.50	2.60	2.70	2.80	3.00
30-yr Govt. Bond Yield (%)	3.56	3.34	3.21	2.75	3.09	3.05	3.20	3.20	3.30	3.35	3.40	3.60
10-yr-2-yr Govt. Spread (%)	2.29	2.06	1.94	1.50	1.38	1.66	1.55	1.40	1.25	1.10	1.05	1.00

F: Forecast by TD Economics, June 2015; All forecasts are for end of period; Source: Bloomberg, TD Economics.
 *Spot rate on June 17th, 2015

FOREIGN EXCHANGE OUTLOOK

Currency	Exchange Rate	2014				2015				2016			
		Q1	Q2	Q3	Q4	Q1	Q2*	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Canadian dollar	CAD per USD	1.11	1.07	1.12	1.16	1.27	1.22	1.27	1.30	1.33	1.27	1.22	1.18
Japanese yen	JPY per USD	103	101	110	120	120	123	123	125	125	125	127	127
Euro	USD per EUR	1.38	1.37	1.26	1.21	1.07	1.13	1.00	0.96	1.00	1.00	1.05	1.05
U.K. pound	USD per GBP	1.67	1.71	1.62	1.56	1.49	1.58	1.45	1.43	1.45	1.49	1.50	1.52
Swiss franc	CHF per USD	0.88	0.89	0.96	0.99	0.97	0.92	1.00	1.04	1.00	1.00	0.95	0.95
Australian dollar	USD per AUD	0.93	0.94	0.87	0.82	0.76	0.78	0.76	0.75	0.75	0.74	0.72	0.70
NZ dollar	USD per NZD	0.87	0.88	0.78	0.78	0.75	0.70	0.72	0.71	0.70	0.67	0.64	0.62

F: Forecast by TD Economics, June 2015; All forecasts are for end of period; Source: Federal Reserve, Bloomberg, TD Economics.
 *Spot rate on June 17th, 2015

GLOBAL ECONOMIC OUTLOOK					
Annual per cent change unless otherwise indicated					
2013 Share*		2013	Forecast		
Real GDP	(%)		2014	2015	2016
World	99.9	3.4	3.4	3.2	3.6
North America	19.8	2.1	2.4	2.4	2.9
United States	16.3	2.2	2.4	2.5	2.9
Canada	1.5	2.0	2.4	1.6	2.3
Mexico	2.0	1.4	2.1	2.5	3.3
European Union (EU-28)	17.5	0.1	1.4	1.9	2.2
Euro-zone (EU-17)	12.4	-0.5	0.9	1.6	1.9
Germany	3.5	0.1	1.6	1.7	1.8
France	2.5	0.3	0.4	1.4	1.7
Italy	2.0	-1.7	-0.4	0.8	1.5
United Kingdom	2.4	1.7	2.8	2.5	2.6
EU accession members	2.7	1.3	2.6	2.8	2.9
Asia	41.1	5.5	5.2	4.9	5.1
Japan	4.6	1.6	0.0	1.1	1.4
Asian NIC's	3.4	2.9	3.3	3.0	3.1
Hong Kong	0.4	2.9	2.5	2.4	2.7
Korea	1.6	3.0	3.3	2.9	3.2
Singapore	0.4	4.4	2.9	3.1	3.1
Taiwan	1.0	2.2	3.7	3.3	3.4
Russia	3.4	1.3	0.6	-3.0	0.6
Australia & New Zealand	1.2	2.1	2.8	2.6	2.9
Developing Asia	28.6	7.0	6.8	6.7	6.5
ASEAN-4	4.7	5.1	4.5	4.8	4.9
China	15.7	7.8	7.4	6.9	6.5
India**	6.6	6.9	7.4	7.6	8.0
Central/South America	6.8	3.4	1.0	0.1	1.5
Brazil	3.1	2.7	0.1	-1.0	0.7
Other Developing	13.6	3.5	3.2	2.7	3.3
Other Advanced	1.0	1.9	2.2	1.6	1.7
*Share of world GDP on a purchasing-power-parity basis. Forecast as at June 2015. **Forecast for India refers to FY. Source: IMF, TD Economics.					

ECONOMIC INDICATORS FOR THE G-7 AND EUROPE				
	2013	Forecast		
		2014	2015	2016
Real GDP (Annual per cent change)				
G-7 (32.7%)*	1.5	1.6	2.0	2.3
U.S.	2.2	2.4	2.5	2.9
Japan	1.6	-0.1	1.1	1.4
EZ	-0.4	0.9	1.6	1.9
Germany	0.1	1.6	1.7	1.8
France	0.7	0.2	1.4	1.7
Italy	-1.7	-0.4	0.8	1.5
United Kingdom	1.7	2.8	2.5	2.6
Canada	2.0	2.4	1.6	2.3
Consumer Price Index (Annual per cent change)				
G-7	1.3	1.5	0.3	1.9
U.S.	1.5	1.6	0.2	2.2
Japan	0.4	2.7	0.7	1.1
EZ	1.3	0.4	0.3	1.6
Germany	1.6	0.8	0.6	1.9
France	1.0	0.6	0.4	1.7
Italy	1.3	0.2	0.3	1.6
United Kingdom	2.6	1.5	0.1	1.9
Canada	0.9	1.9	0.8	2.2
Unemployment Rate (Per cent annual averages)				
U.S.	7.4	6.2	5.4	5.1
Japan	4.0	3.6	3.4	3.2
EZ	12.0	11.6	11.1	10.7
Germany	5.2	5.0	4.7	4.5
France	10.3	10.3	10.5	10.3
Italy	12.2	12.7	12.4	12.0
United Kingdom	7.6	6.2	5.3	5.0
Canada	7.1	6.9	6.8	6.7
*Share of 2013 world gross domestic product (GDP)				
Forecast as at June 2015				
Source: National statistics agencies, TD Economics				

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