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TD Economics



September 14, 2011

BAY STREET UNITE

Current Round of Forecasts are Singing the Same Song

The month of September typically heralds in a revised set of economic projections by Canada's major financial institutions. Indeed, TD Economics weighed in yesterday with its September 2011 Quarterly Economic Forecast (<http://www.td.com/economics/analysis/economics-index.jsp>). While TD's economic growth forecasts fall at the low end of Bay Street expectations, the divergence in opinions across financial institutions can be deemed trivial in light of the extreme global uncertainty, especially surrounding events in Europe. Put another way, forecasters are generally singing from the same songbook. This fact was reinforced in spades at last Thursday's Economic Outlook presentation attended by senior/chief economists of the five banks at the Canadian Economic Club.

Forecasts can be characterized by ten key themes:

- *Slower for longer* – recoveries from balance sheet crises are long and painful. And those being experienced in the United States and Europe, where excessive debt and risk-taking was most pronounced, are no different. Despite already being mired in deep economic and financial woes for 4-5 years, these economies appear to be only half way through the healing process brought on by excessive debt, high structural employment and weak banking systems. Even though Bay Street forecasters had been predicting a half speed recovery, longer-term growth expectations have been scaled back in this forecast round to better recognize the extent of structural problems that exist in the U.S. and Europe.
- *A temporary pause along this long-term path* – there has been broad recognition over the past year that recoveries were tenuous and could stall along the way. Based on the current round of projections, this risk is materializing. U.S. real GDP growth projections in the second half of 2011 have been cut to 1.5-2% (annualized) from earlier estimates of around 3%, and the risk of a “technical” recession has been increased to 33-50%. In Europe, forecasts have incorporated an even higher risk of recession.
- *Emerging market growth story intact* – While China and other BRIC economies are not immune to weakness in the advanced world, nobody has thrown cold water on the long-term story that strong growth will remain intact over the next several years. On the plus side, inflation worries in these regions appear to have ebbed to some extent, as economic growth cools moderately.
- *Commodity prices to remain relatively elevated* – propelled by demand from emerging markets, prices for commodities are expected to remain at the high end of their 10-year ranges. For instance, baseline assumptions have crude oil hovering in the range of US\$80-100 per barrel range over the next 12-18 months. Forecasters also remain bullish on gold prices, given its renewed status as a alternative store

of value.

- *Canada in better shape but not an island* – Unlike the U.S. and Europe, Canada’s economy continues to reap the rewards of its strong financial system, commodity orientation and relatively low level of government indebtedness. Nonetheless, a weaker U.S. outlook and heightened stress in global financial markets will not be lost on this country’s growth performance going forward. Although Canada’s economy is expected to outperform that of the U.S. in the second half of 2011 and in 2012, its growth, too, has been downgraded significantly from earlier this year. What’s more, most place the risk of a technical recession in Canada over the next year roughly on par with that of the U.S.
- *Interest rates lower for longer* – Forecast timetables for a return to more “normal” levels of short-term interest rates in North America and globally continue to be pushed back. In the U.S., forecasters have assumed that the Fed will make good on its commitment to keep its overnight rate unchanged at zero until mid-2013. In Canada, the central bank is expected to keep its benchmark rate at the current level of 1% until at least mid-2012. TD Economics expects that first hike to be delayed until early 2013.
- *Canadian dollar strong, U.S. dollar weak* – Supported by Canada’s strong economic foundations, forecasters generally foresee a continued high Canadian dollar over the next few years. Expected trading ranges for the loonie in the coming quarters vary from projection to projection, but Bay Street forecasters are of the mind that the currency will trade at parity (or higher) on average over the remainder of this year and in 2012.
- *High risk environment* – most analysts tend to cast the focus on downside risks, especially in this current economic climate. These include the possibility of an escalation in Europe’s problems or a double-dip recession in the United States. However, a good forecast should represent an equal weighting of upside and downside risks. And, indeed, the prevailing consensus view of modest growth across the advanced clearly builds in more than just bad news. For example, there is always the chance that policymakers in Europe and the U.S. take bold steps to address their fiscal challenges.
- *Volatility the watchword* – While forecasting is a difficult game these days, one bet looks particularly probable: volatility in financial markets will remain in the coming months as investors digest news coming out of Europe and the United States. The problems in Europe won’t be resolved overnight. And all eyes will likely return to the U.S. budget impasse as the deadline for the U.S. Joint Committee on Deficit Reduction to reach an agreement nears in November.
- *Expect the unexpected* – Forecasters would all agree that the path that the global economy will ultimately follow will be filled with more twists and turns than can ever be captured in their recently-released baseline projections.

Derek Burleton
Vice President and
Deputy Chief Economist (Canada)
416-982-2514

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