

July in Review

The Canadian equities market continued to lead international financial markets higher, as consumer staples and financials helped the S&P/TSX Composite Index advance higher. Bonds experienced another month of positive returns and have now appreciated by 5.5% year to date. Global equities closed out the month relatively flat, and oil declined as concerns eased over tightening supplies.

Lower growth predicted for Canada. The Bank of Canada (BoC) lowered its growth projections for the Canadian economy, pushing out a full recovery to 2016, later than previously forecast. BoC Governor Poloz blamed declining exports for the lower growth forecast, but remained confident that the economy would improve as a weaker Canadian dollar would make Canadian exports more attractive to foreign buyers.

U.S. economy pauses to catch its breath. Following the 2.9% economic contraction in the first quarter, U.S. economists have reduced their gross domestic product (GDP) projections for the second quarter to 3.0% from 3.5%. For 2014 as a whole, they have lowered their GDP growth expectations to 1.6% from 2.5%. Overall, lower consumer spending has been a main contributor to the reduced outlook, as was an increased trade deficit and reduced demand for factory production of goods. Canadian exporters generally see increasing sales to the U.S. as the economy strengthens.

Fewer Americans claim unemployment benefits. In contrast to reduced GDP forecasts, the U.S. Department of Labor reported that the number of people seeking unemployment benefits fell to an eight-year low. The number of applicants over the four-week period fell 6% to 284,000, signalling that the economy laid off fewer individuals, giving support to the U.S. Federal Reserve Board's view that the economy is strengthening after a weak start to the year.

Europe faces threat of deflation. With consumers spending less and retailers lowering the prices of goods under intense competition, the threat of deflation has increased in the eurozone. Annual inflation is currently at 0.5%, and below the 1.0% threshold that the European Central Bank (ECB) has identified as a "danger zone". Although there are signs of deflation in some corporate earnings results, the ECB does not see any evidence that markets are expecting a prolonged period of falling prices, causing a deflationary spiral. Corporate profits have been squeezed in Europe, due to higher raw material costs and lower selling prices, making it harder for the economy to expand. See page 2 for more information about deflation.

Exports just aren't what they used to be. China reported exports grew 7.2% for the month of June, lower than growth expectations of 10.6%. Imports also grew after having declined during the previous month, and when combined with the export data, China's trade surplus decreased to \$31.6 billion, a drop of 12%. Declining exports and a narrowing trade surplus may make it harder for China to achieve its growth target of 7.5%. Lower Chinese growth could potentially translate to less demand for Canadian resources.

INDEX (C\$) [†]	1 Mth	Change (%) YTD	1 Yr	Index Level
Treasury bills [‡] (FTSE TMX Canada 60 Day T-Bill)	0.08	0.52	0.93	157
Bonds [‡] (FTSE TMX Canada Universe Bond)	0.63	5.48	5.80	932
Canadian equities (S&P/TSX Composite)	1.42	14.47	26.46	15,331
U.S. equities (S&P 500)	0.73	8.30	23.83	2,103
Global equities (MSCI World)	0.53	7.47	23.45	1,868
Emerging markets (MSCI EM)	4.20	11.17	22.54	1,161

CURRENCIES [†]	1 Mth	Change (%) YTD	1 Yr	Exchange Rate
C\$/US\$	-2.17	-2.59	-5.77	0.9170
C\$/Euro	0.04	-0.03	-6.40	0.6847
C\$/Pound	-0.89	-4.49	-15.14	0.5430
C\$/Yen	-0.75	-4.92	-1.04	94.2450

COMMODITIES (US\$) [†]	1 Mth	Change (%) YTD	1 Yr	Price
Gold Spot (\$/oz)	-3.37	6.38	-3.22	1,282.55
Oil WTI (\$/barrel)	-6.83	-0.25	-6.53	98.17
Natural Gas (\$/MMBtu)	-13.90	-9.20	11.46	3.84

[†] As at July 31, 2014. Source: Bloomberg.

[‡] The DEX 60 Day T-Bill Index is now referred to as FTSE TMX Canada 60 Day T-Bill Index. The DEX Universe Bond Index is now referred to as FTSE TMX Canada Universe Bond Index.

Worth watching this month

The BoC will be releasing inflation figures on **August 22**. Current inflation as measured by the Consumer Price Index (CPI) was up 2.4% in June, its fourth straight monthly increase according to the BoC, while Core CPI, which does not include volatile items such as fuel and food items, was up 1.8% during the same period.

Letting some air out of the tires

A nickel ain't worth a dime anymore – YOGI BERRA

It probably doesn't come as a surprise that over time the cost of goods and services tends to rise. In 1935, a litre of milk cost \$0.10 and a dozen eggs cost \$0.31.* Fast forward almost 80 years, and prices like these at your local grocery store would be considered a fantastic bargain. While this is a clear example of monetary inflation at work, it's important to note that prices don't generally go up at the same pace – some increase gradually, and others more rapidly.

Strong economies create money with every year of growth in the form of higher sales, profits and wages. With more money chasing the same number of goods, prices increase as buyers are willing to pay a little more for an item. Over decades, these small price increases begin to add up, and what once cost a dime might now cost a loonie.

Much less common are deflationary periods where prices actually decrease. The Great Depression of the 1930s,

a period of high unemployment and deflation, was an example of this. When prices decrease, it's hard for the economy to grow because as prices decline, so do people's wages.

In between inflation and deflation is their lesser-known cousin – disinflation. Disinflation is the pathway from rising prices to falling prices, and is characterized by *slowing price* increases. If the price of bread rose 3% two years ago and 1% last year, the decrease in the rate of change from 3% to 1% is disinflation at work. Canada has been experiencing disinflation since 2011.*

Even though no one expects the cost of everyday living to go back to 1935 levels, prices have been increasing at their slowest pace in decades, and aren't expected to surprise anyone in the near-term. While disinflation is with us for now, it's probably safe to say that 80 years from now, today's prices won't look that expensive.



Did you know? In 1935, the average personal income was \$313 per year and by 2010 it had risen to \$39,200. This represents an increase of 125 times over 75 years. As the cost of living has been impacted by inflation, wages have also experienced inflation and risen as well.*

*Source: Statistics Canada. Based on annualized year-end data.

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