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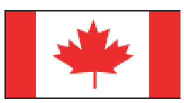
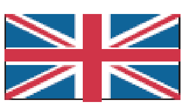
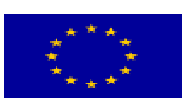
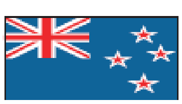
European crisis holds the spotlight

Like the Hydra, a nine-headed mythical monster that could grow back two heads if one was cut off, the European debt crisis seems continually to sprout appendages with the latest being a deterioration in the health of the Spanish banking sector. These strains compounded concerns about when Spain will meet its deficit targets and pushed the cost of borrowing for the government to a level that the Finance Minister mused was shutting Spain out of debt markets; however, these concerns proved unfounded with buyers turning up at the government's latest debt auction. As the list of problem facing European policymakers mounts, investors piled into safe-haven markets and sent yields on German bunds, US Treasury bonds, and Canadian government bonds tumbling. Investors' risk appetite returned this week on optimism that European Union leaders will unveil a roadmap outlining further integration within the region at the Leaders Summit later this month.

Economic news from Europe has been dismal with the composite purchasing managers' indices (PMI), a measure of activity in the services and manufacturing sectors, falling to the lowest level since June 2009 and marking the fourth month of contraction. The euro area unemployment rate rose to an all-time high of 11.0%. This sharp deterioration in the economy raises the prospect that, rather than avert a recession in the first quarter of 2012 (real GDP growth was flat), it was merely postponed. Chinese data reports were worrisome with the manufacturing sector sliding although the sting was soothed by an increase in service-sector activity. The central bank lowered the policy rate on June 7 as a step toward countering the recent weakening.

Central bank near-term bias

Bias three-months out

	↔	The BoC held rates steady in June and reiterated that "some modest withdrawal of the present considerable monetary policy stimulus may become appropriate" as long as growth continues and excess supply is absorbed.
	↘	The Fed remains committed to maintaining stimulative policy as a means to bolster growth and reduce unemployment with another purchase program still on the table.
	↔	The BoE left both rates and its asset purchase target unchanged at this week's MPC meeting with policy likely to remain on hold unless there is evidence of a marked deterioration in the UK growth outlook.
	↔	The ECB left rates steady at this week's meeting, though the accompanying statement carried a more dovish tone reflecting deteriorating conditions in the region.
	↘	The RBA cut the Official Cash Rate by 25bp to 3.50% in June and we now expect that rates will be cut further to 2.75% over the next 12 months, with the next move likely in August.
	↔	Further easing by the RBNZ is not our base case but we expect the current accommodative stance of policy to remain through 2013.

Highlights

▲ Persistent negative shocks from Europe keep investors piling into safe-haven markets.

▲ Markets are looking forward to the unveiling of a Master Plan to address Europe's problems later this month.

▲ US data have been mixed with the slower pace of job gains stealing the limelight while other indicators suggest a decent quarter for growth.

▲ The data reports do not provide a clear cut case for more QEIII although policymakers are likely to keep their hand in and announce that the Fed will purchase a modest amount of MBS to curtail any unwanted negative reaction in financial markets.

This cut to the official borrowing rate since September 2010 combined with the acceleration of infrastructure projects are likely to limit the weakening in activity going forward. Canada and US data had their ups and downs during the past month but on balance confirm that both economies are experiencing modest, though sustained, economic growth.

US jobs report disappoints…

There is no denying that May's employment report was disappointing as it confirmed that after a blistering pace of job creation in the winter, hiring slowed significantly in the spring. The economy created an average 73,000 jobs per month in April and May thereby falling short of the range suggested by Chairman Bernanke that is required if the Fed's forecast for the unemployment rate is to be realized. The unemployment rate at 8.2% is still down materially from the recent high of 9.1% recorded in August 2011 due to both the acceleration in the pace of job growth in the winter and a decline in the participation rate. Looking ahead, an increasing number of returning workers will limit the pace of decline in the unemployment rate; however, there are also demographic factors at play that will prevent the participation rate from returning to its pre-recession peak. The recent easing in the pace of hiring indicates that some of the strength from December 2011 to February 2012 (average monthly increases of 252,000) was due to a warmer than normal winter that reduced layoffs and brought forward hiring of seasonal workers. Fear that, against a backdrop of uncertainty regarding the European debt crisis, the pace of job creation will slow further is keeping the prospect of additional Fed asset purchases alive with markets looking to the Federal Open Market Committee (FOMC) meeting later this month for guidance.

…although not the only story in town

May reports on manufacturing and service-sector activity showed that the US economy continued to expand while home sales perked up in April. By some measures, home prices not only stopped falling but posted decent gains relative to a year earlier. These data reports set up for the US economy to expand faster than the 1.9% annualized rate recorded in the first quarter of 2012 with RBC forecasting growth of 2.8%. To be sure, the slower pace of hiring combined with volatility in financial markets weighed on consumer confidence in May with the Conference Board's index slipping. That being said, at 64.9, the index stood well above the recent trough of 40.9 in October 2011, and spending data for April alone set the stage for consumption growth of 2.0% annualized relative to the first-quarter 2012 average.

Fed focus is the key

US policymakers have committed to keeping monetary policy supportive for the domestic economy for the foreseeable future. And, while the weakening in the pace of job growth in the second quarter of 2012 raises the prospect that the Fed will introduce another round of securities purchases, with interest rates already at, or near, record lows, the size of the program is unlikely to be sufficient enough to drive yields much lower. The run of safe-haven flows into US Treasury bonds saw the 10-year yield slide to 1.47%, which is a record low. Two-year yields are holding around 0.25% with markets expecting the fed funds target to remain at 0% to 0.25% until 2014. The prospect of investors remaining risk averse given the persistent uncertainty about the end game in Europe will likely keep funds flowing in the US Treasury market and downward pressure on yields. We adjusted our near-term forecast for longer-term rates to reflect these persistent safe-haven flows. Our forecast for the 10-year government bond yield now stands at 1.75% for the end of the third quarter of 2012 and 2.0% for year-end 2012 from 2.05% and 2.25%, respectively. We made only small tweaks to our interest rate forecasts for 2013 given our unchanged baseline assumption that Europe will have a plan in place to address its economic and fiscal challenges later this year, and that the pace of US growth will continue to accelerate.

Bank of Canada sticks to policy plan

The Bank of Canada left the overnight rate at 1.00% and in a press statement provided an assessment of the domestic economy and risks to the global economy due to the European debt crisis. Importantly, the Bank maintained its stance that domestic economic conditions are evolving in line with their expectations. At this juncture, however, the deterioration in the global economic outlook and heightened uncertainty regarding the European sovereign-debt crisis are outweighing positive domestic fundamentals. That said, the Bank hinted of an eventual withdrawal of policy stimulus and reiterated that "some modest withdrawal of the presently considerable monetary policy may become appropriate" although made it clear that conditions in both the domestic and external economies will be taken into account.

Canada's economy grew at a 1.9% annual rate in the first quarter of 2012, thereby matching the increase in the fourth quarter of 2011. Although the overall growth rate met market expectations, the composition of output held some surprises with net exports subtracting from the quarterly rate defying earlier-reported monthly trade reports implying a net add to growth. Offsetting this unexpected weight on the economy was a build-up of inventories. Such a run up in inventories raises the prospect of lower future production; however, given that the stock-to-sales ratio stands in line with its historical average, our view is that this build was consistent with the pace of economic growth and will not act an impediment to production going forward.

The monthly GDP reports were weaker than expected in February and March; however, this was largely due to declines in mining and utilities output. Mild winter weather reduced demand for heating while temporary shutdowns at production facilities resulted in a drop in mining output. The cutbacks in production contributed to the slowing in export growth in the first quarter of 2012, and as these facilities are brought back online, the weakness in both output and export activity will reverse.

Canada's economy to post stronger growth in the second quarter

Our forecast is that the economy will accelerate smartly in the second quarter of 2012, and we maintain our call for second-quarter 2012 real GDP growth of 3.1% at an annualized rate and a further reduction in the output gap. Domestic conditions, therefore, support the case for the Bank gradually to reduce the amount of stimulus. Uncertainty about the global outlook, however, argues for the Bank to continue to provide ample stimulus to counter any negative fallout on domestic activity. We, therefore, maintain our view that the Bank will be in position to raise the overnight rate in 2012, but for it to occur late in year when financial markets have stabilized and the risks facing the global economy have swung to positive from negative. As indicated previously, our baseline assumption is that by year end, policies will be in place to address the European crisis sufficiently to dampen the downside risks to the global economic outlook and pull the euro area economies out of recession.

Canadian interest rates follow lead of US

Interest rates on Government of Canada 10-year bonds fell to an all-time low in early June as concerns about the global economic outlook weighed on stock markets and commodities thereby driving investors into the safety of government securities. Two-year rates also slipped, falling briefly below the 1.0% funding rate, although staying above their all-time low of 0.78%. The Bank's reiteration of its assessment that the scope for a reduction in policy stimulus remains in place cooled sentiment that the Bank would consider cutting its policy rate further. While the near-term volatility and uncertainty will likely keep yields near the low end of their 2012 trading range, we expect that this drive to safety will stall in the second half of the year; at which time, yields will rise.

Highlights

▲ The Bank of Canada reiterated that a gradual withdrawal of stimulus may be appropriate as long as the economy expands and the output gap narrows

▲ The economy grew at a 1.9% annualized pace in Q1/12, and we look for a faster 3.1% increase in Q2/12.

▲ The Bank is likely to stay on the sidelines until risks to the global economy turn positive from negative.

Highlights

▲ The euro area avoided falling into a technical recession in Q1/12 with a flat reading for GDP growth in the quarter.

▲ UK real GDP contracted by a downwardly revised 0.3% in Q1/12 reflecting a larger decline in construction output.

▲ The RBA followed the unexpectedly large 50bp cut to the OCR in May with a further 25bp cut in June to 3.50%.

'Will they or won't they' breakup drama drags on in euro area

As the recent re-intensification of sovereign-debt concerns in Spain combines with the prolonged 'will they or won't they' relationship drama of Greece, the region's economic backdrop continues to deteriorate as well. The euro area avoided a technical recession in the first quarter of 2012 with a flat GDP reading in the quarter; however, indicators for the current quarter have been anything but encouraging. The region's PMI has plunged deep into contractionary territory, with the April and May readings, that in isolation, areconsistent with a sharp contraction in real output in the second quarter of 2012. Barring a material pick up in activity in the coming weeks, the third quarter is likely to start in a considerable hole, thereby suggesting that the stabilization in activity seen in the first three months of the year may have merely represented a delay of a recession rather than one averted. The weakening economic and financial conditions in Europe were reflected in the *Introductory Statement* of the European Central Bank's (ECB) June policy decision, which was dovish in tone and noted "increased downside risks to the economic outlook." The central bank's staff forecasts for both growth and inflation, however, were left largely intact. Accordingly, the ECB (whose sole mandate is to maintain price stability) left interest rates unchanged in June. Given the Governing Council's stated view that monetary policy is not a panacea, we continue to anticipate that the ECB will not likely change its current stance any time soon as central bank policymakers firmly believe that structural adjustments on the fiscal side must do the heavy lifting to soothe what ails the euro area.

The MPC keeps its finger on the policy button

The release of the May *Inflation Report* saw the Bank of England's Monetary Policy Committee (MPC) incorporate the recent flow of disappointing activity data into its outlook, with growth projections revised lower for this year and next. With respect to price pressures, policymakers made fairly sizable upward revisions to the near-term inflation profile, with annual CPI growth now expected to moderate to 2.9% by the end of this year compared to 1.9% in the forecast made in February. With that said, the MPC retained its view that inflation will fall sharply thereafter (drifting below the Bank's 2% target in the second half of 2013) and made a modest downgrade to the probability that CPI growth will be above target for the policy-relevant medium term. The balanced risks to inflation in the forecast horizon gave way to the MPC holding policy steady in June, thereby keeping the Bank rate at 0.50% and maintaining the asset purchase program target at £325 billion. Despite the unchanged policy stance, the Committee remains weary of potential risks to the outlook, and additional policy action remains on the table, with the May meeting minutes stating "further stimulus could be added if the outlook warranted it." Indeed, we believe that the MPC stands ready to undertake further quantitative easing if needed, although we expect the Committee to hold off on such a decision unless there is evidence of a marked deterioration in the UK growth outlook.

Deteriorating global conditions guiding the RBA's hand

The Reserve Bank of Australia (RBA) followed the 50 basis point cut to the Official Cash Rate (OCR) in May with a further 25 basis point cut in June to reduce the policy rate to 3.50%. While the decision in May was largely driven by domestic considerations (the accompanying statement highlighted below-trend output growth, softening labour market conditions, and lower than expected inflation), Governor Stevens clearly stated that the June move was prompted by "a weaker and more uncertain international environment." In particular, the June statement pointed to risks to the outlook stemming from Europe (heightened political uncertainty and concerns about fiscal sustainability, and the strength of some banks) and China (growth in Asia "could be dampened by slower Chinese growth"). We believe that global growth prospects will guide the RBA's hand in the coming 12 months. As such, we expect further rate cuts despite positive domestic developments such as this month's solid GDP and employment reports. We now expect the OCR to be cut to 3.00% by the year-end 2012 (compared to 3.25% previously), with 25 basis point cuts coming in August and December, followed by one final cut in the first quarter of 2013 to bring the policy rate to a new terminal level of 2.75% for this easing cycle.

Interest rate outlook

%, end of period

	Actuals					Forecast						
	11Q1	11Q2	11Q3	11Q4	12Q1	12Q2	12Q3	12Q4	13Q1	13Q2	13Q3	13Q4
Canada												
Overnight	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.25	1.50	1.75	2.00	2.00
Three-month	1.10	0.90	0.80	1.10	0.92	1.05	1.10	1.30	1.60	1.80	2.05	2.10
Two-year	1.85	1.42	0.88	1.00	1.20	1.10	1.35	1.55	1.80	2.05	2.25	2.40
Five-year	2.65	2.06	1.39	1.50	1.56	1.35	1.60	1.80	2.05	2.35	2.50	2.65
10-year	3.25	2.91	2.15	2.30	2.11	1.90	2.10	2.25	2.45	2.60	2.80	2.90
30-year	3.85	3.42	2.77	3.10	2.64	2.35	2.50	2.65	2.85	3.05	3.30	3.50
United States												
Fed funds	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13
Three-month	0.15	0.03	0.02	0.05	0.07	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Two-year	0.70	0.41	0.25	0.30	0.34	0.25	0.25	0.25	0.40	0.50	0.55	0.75
Five-year	2.10	1.45	0.96	1.10	1.04	0.70	0.80	0.95	1.10	1.25	1.50	1.65
10-year	3.45	2.92	1.92	2.15	2.20	1.60	1.75	2.00	2.15	2.35	2.65	2.75
30-year	4.50	4.27	2.92	3.20	3.32	2.70	2.90	3.25	3.50	3.70	3.95	4.00
United Kingdom												
Bank rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25
Two-year	1.30	0.70	0.60	0.70	0.43	0.40	0.40	0.40	0.50	0.80	1.10	1.40
10-year	3.65	3.13	2.44	2.45	2.00	1.80	1.90	2.20	2.40	2.80	3.00	3.00
Eurozone												
Refi rate	1.00	1.25	1.50	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Two-year	1.75	1.34	0.66	0.65	0.09	0.10	0.25	0.35	0.50	0.70	0.80	0.90
10-year	3.30	2.83	1.90	2.20	1.61	1.50	1.65	2.00	2.25	2.35	2.50	2.50
Australia												
Cash target rate	4.75	4.75	4.75	4.25	4.25	3.50	3.25	3.00	2.75	2.75	2.75	2.75
Two-year	5.00	4.65	3.63	3.15	3.49	2.50	2.40	2.30	2.25	2.50	2.75	3.00
10-year	5.55	5.05	4.22	4.05	4.10	3.00	3.00	3.15	3.25	3.40	3.65	3.65
New Zealand												
Cash target rate	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50	2.50
Three-year	3.25	3.22	2.88	2.85	3.06	2.60	2.60	2.60	2.70	2.70	2.80	2.90
10-year	5.50	5.02	4.39	4.25	4.09	3.80	3.80	3.85	4.10	4.30	4.55	4.75
Yield curve												
Canada	140	149	127	130	91	80	75	70	65	55	55	50
United States	275	251	167	185	186	135	150	175	175	185	210	200
United Kingdom	235	243	184	175	157	140	150	180	190	200	190	160
Eurozone	155	149	124	155	152	140	140	165	175	165	170	160
Australia	55	40	59	90	61	50	60	85	100	90	90	65
New Zealand	225	180	151	140	103	120	120	125	140	160	175	185

* Two-year/10-year spread in basis points **New Zealand's yield curve: 10-year vs. three-year

Source: Reuters, RBC Economics Research

Central bank policy rate

%, end of period

		Current	Last	
United States	Fed funds	0.0-0.25	1.00	Dec. 16, 2008
Canada	Overnight rate	1.00	0.75	Sep. 8, 2010
United Kingdom	Bank rate	0.50	1.00	Mar. 5, 2009
Eurozone	Refi rate	1.00	1.25	Dec. 14, 2011
Australia	Cash rate	3.50	3.75	Jun. 5, 2012
New Zealand	Cash rate	2.50	3.00	Mar. 10, 2011

Source: Bloomberg, Reuters, RBC Economics Research

Economic outlook

Growth outlook

% change, quarter-over-quarter in real GDP

	11Q1	11Q2	11Q3	11Q4	12Q1	12Q2	12Q3	12Q4	13Q1	13Q2	13Q3	13Q4	2010A	2011A	2012F	2013F
Canada*	3.6	-1.0	4.5	1.9	1.9	3.1	3.2	2.9	2.7	2.2	2.2	2.2	3.2	2.4	2.6	2.6
United States*	0.4	1.3	1.8	3.0	1.9	2.8	2.5	3.2	3.2	3.0	3.0	3.5	3.0	1.7	2.5	3.0
United Kingdom	0.2	-0.1	0.6	-0.3	-0.3	0.1	0.7	0.3	0.5	0.5	0.5	0.5	2.1	0.7	0.2	1.8
Eurozone	0.7	0.1	0.1	-0.3	0.0	-0.1	0.1	0.3	0.3	0.4	0.4	0.4	1.8	1.5	-0.1	1.1
Australia	-0.5	1.4	1.0	0.6	1.3	0.7	0.5	0.5	0.8	0.9	1.0	1.0	2.6	2.1	3.5	3.0
New Zealand	0.5	0.3	0.2	0.3	0.4**	0.6	0.8	1.0	0.9	0.8	0.7	0.6	1.5	1.1	1.9	3.3

*Seasonally adjusted annualized rates, **forecast

Inflation outlook

% change, year-over-year

	11Q1	11Q2	11Q3	11Q4	12Q1	12Q2	12Q3	12Q4	13Q1	13Q2	13Q3	13Q4	2010A	2011A	2012F	2013F
Canada	2.6	3.4	3.0	2.7	2.3	1.8	1.8	1.6	1.5	1.7	2.1	2.1	1.8	2.9	1.9	1.9
United States	2.1	3.4	3.8	3.3	2.8	2.0	1.7	1.8	1.7	1.9	1.8	1.9	1.6	3.2	2.1	1.8
United Kingdom	4.0	4.4	4.8	4.7	3.5	3.3	3.2	3.4	3.1	2.8	2.6	2.4	2.8	4.5	3.3	2.8
Eurozone	2.5	2.8	2.7	2.9	2.7	2.5	2.2	2.1	1.7	1.6	1.7	1.8	1.6	2.7	2.4	1.7
Australia	3.3	3.6	3.5	3.1	1.6	1.3	2.2	2.9	3.6	3.7	3.0	3.1	2.8	3.4	2.0	3.4
New Zealand	4.5	5.3	4.6	1.8	1.6	1.1	1.2	1.7	1.6	1.6	1.7	1.9	2.3	4.0	1.4	1.7

Source: Statistics Canada, Bureau of Labor Statistics, Bank of England, European Central Bank, Reserve Bank of Australia, Reserve Bank of New Zealand, RBC Economics Research

Inflation tracking

Inflation Watch

	Measure	Current period	Period ago	Year ago	Three-month trend	Six-month trend
Canada	Bank of Canada core CPI[1]	Apr.	0.5	2.0	2.0	1.9
United States	Core PCE[2]	Apr.	0.1	1.9	2.0	1.7
United Kingdom	All-items CPI	Apr.	0.6	3.0	3.2	3.0
Eurozone	All-items CPI	Apr.	0.3	2.5	1.8	2.0
Australia	Trimmed mean	Q1	0.3	2.2	N/A	N/A
New Zealand	CPI	Q1	0.5	1.6	N/A	N/A

1 Seasonally adjusted measurement.
2 Personal consumption expenditures less food and energy price indices.

Source: Statistics Canada, US Bureau of Labor Statistics, Bank of England, European Central Bank, Reserve Bank of Australia, Reserve Bank of New Zealand, RBC Economics Research

Currency outlook

Level, end of period

	Actuals					Forecast						
	11Q1	11Q2	11Q3	11Q4	12Q1	12Q2	12Q3	12Q4	13Q1	13Q2	13Q3	13Q4
Canadian dollar	0.97	0.96	1.05	1.02	1.00	1.03	1.02	1.00	0.97	0.95	0.95	0.96
Euro	1.42	1.45	1.34	1.30	1.33	1.25	1.24	1.23	1.22	1.20	1.18	1.18
U.K. pound sterling	1.60	1.61	1.56	1.55	1.60	1.56	1.57	1.58	1.58	1.56	1.55	1.55
New Zealand dollar	0.76	0.83	0.76	0.78	0.82	0.77	0.75	0.78	0.79	0.80	0.80	0.79
Japanese yen	83.1	80.6	77.0	76.9	82.9	78.0	76.0	73.0	70.0	72.0	74.0	76.0
Chinese renminbi	6.55	6.46	6.38	6.30	6.29	6.35	6.33	6.30	6.25	6.20	6.15	6.15
Australian dollar	1.03	1.07	0.97	1.02	1.03	1.00	1.00	1.03	1.02	1.01	1.00	0.98
Mexican peso	11.9	11.7	13.9	14.0	12.8	13.8	13.8	13.5	13.3	13.0	12.8	12.8

Canadian dollar cross-rates

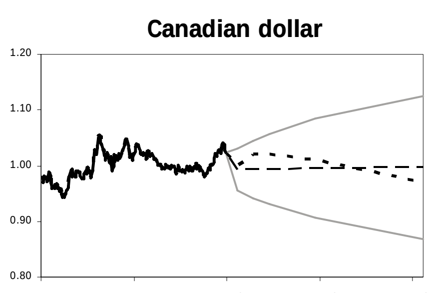
	11Q1	11Q2	11Q3	11Q4	12Q1	12Q2	12Q3	12Q4	13Q1	13Q2	13Q3	13Q4
EUR/CAD	1.37	1.40	1.41	1.32	1.33	1.29	1.26	1.23	1.18	1.14	1.12	1.13
GBP/CAD	1.56	1.55	1.64	1.59	1.60	1.61	1.60	1.58	1.54	1.48	1.48	1.49
NZD/CAD	0.74	0.80	0.80	0.79	0.82	0.79	0.77	0.78	0.77	0.76	0.76	0.76
CAD/JPY	85.6	83.6	73.3	75.3	83.0	75.7	74.5	73.0	72.2	75.8	77.9	79.2
AUD/CAD	1.00	1.03	1.01	1.04	1.03	1.03	1.02	1.03	0.99	0.96	0.95	0.94

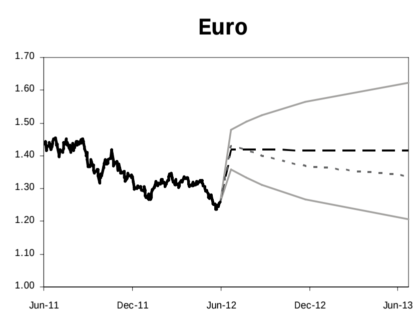
Rates are expressed in currency units per US dollar and currency units per Canadian dollar, except the euro, UK pound, Australian dollar, and New Zealand dollar, which are expressed in US dollars per currency unit and Canadian dollars per currency unit.

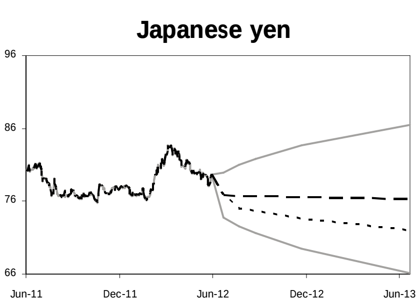
Source: Bloomberg, RBC Economics Research

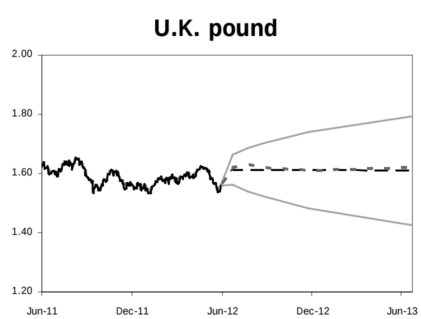
RBC Economics outlook compared to the market

The following charts track historical exchange rates plus the forward rate (dashed line) compared to the RBC Economics forecast (dotted line) out one year. The cone for the forecast period frames the forward rate with confidence bounds using implied option volatilities as of the date of publication.









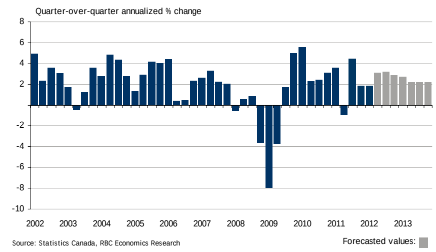
Central bank watch

Bank of Canada

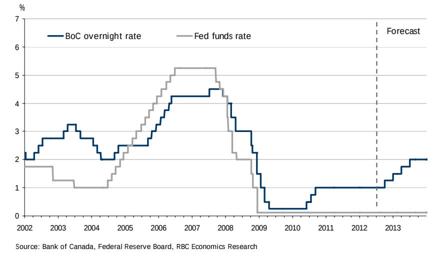
- Canada's economy grew by an annualized 1.9% in Q1/12, matching the gain in Q4/11, but below the BoC's latest forecast due to temporary shutdowns in the energy and mining sectors.

- The BoC once again made no change to the policy rate, and while it acknowledged that growth was slower than forecasted in Q1, it did not signal any substantive change to its outlook for 2012.

Canadian real GDP growth



Canadian and U.S. central bank policy rates

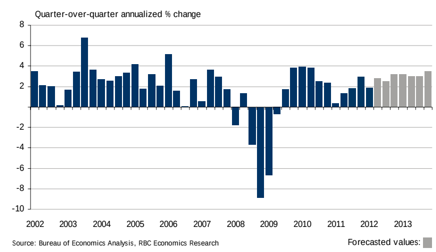


Federal Reserve

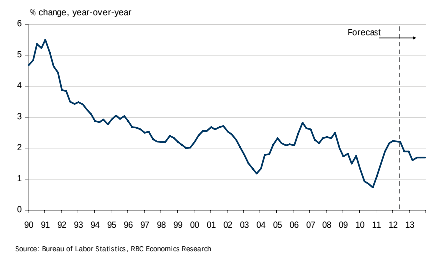
- The second estimate of US Q1/12 GDP growth was an annualized 1.9%, below the 2.2% advance estimate and the solid 3.0% gain recorded in Q4/11, as inventories contributed less to growth.

- The weakening in the pace of job growth in Q2 is keeping alive the prospect that the Fed will introduce another round of securities purchases.

U.S. real GDP growth



U.S. core CPI inflation

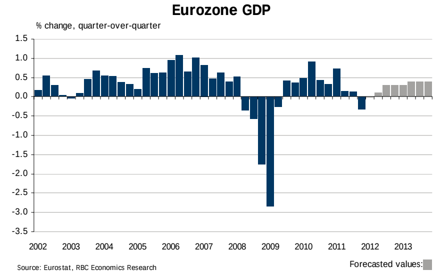


European Central Bank

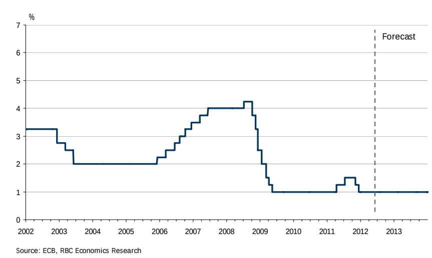
- The euro area evaded falling into a technical recession in Q1/12 by posting a flat reading for GDP growth in the quarter; however, indicators for Q2 have been far from encouraging.

- The ECB left rates steady at June's meeting, but the accompanying statement carried a more dovish tone, noting weak growth and "increased downside risks to the economic outlook."

Eurozone GDP



ECB refi rate

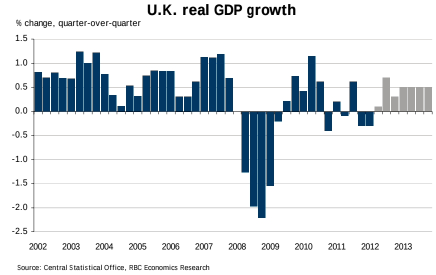


Bank of England

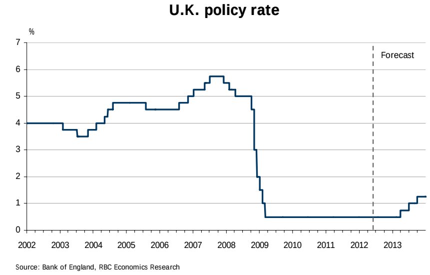
- UK GDP growth in Q1/12 was revised downward to show a non-annualized 0.3% contraction rather than the previously reported 0.2% decline.

- The MPC made no changes at its June meeting, and lack of a substantive statement means that any changes to the policy discussion will not be known until the minutes are released on June 20.

U.K. real GDP growth



U.K. policy rate



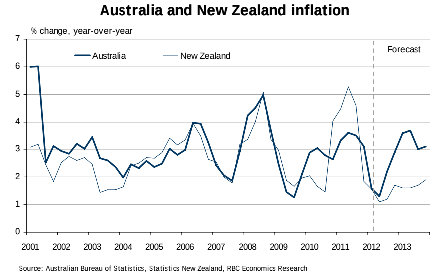
Australia and New Zealand

- The RBA reduced the OCR by 25bp in June as the outlook for inflation "afforded scope for a more accommodative stance of monetary policy" given the "weaker and more uncertain international environment."

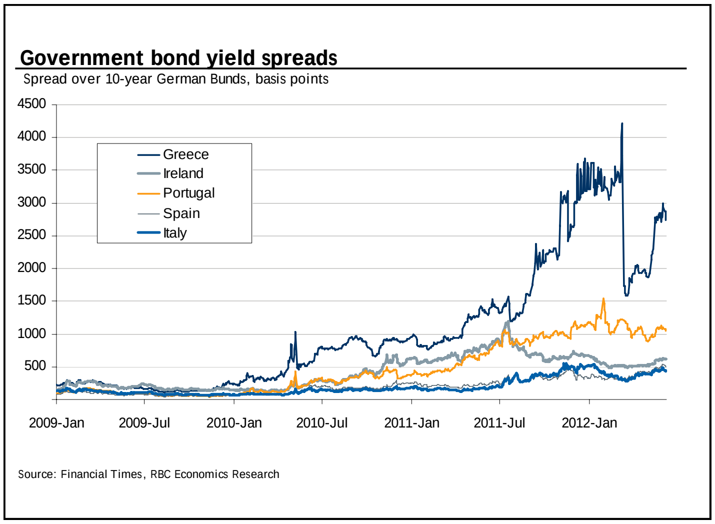
- Further easing from the RBNZ is not our base case, but we expect the current accommodative stance of policy to remain through 2013.

Australia and New Zealand GDP growth

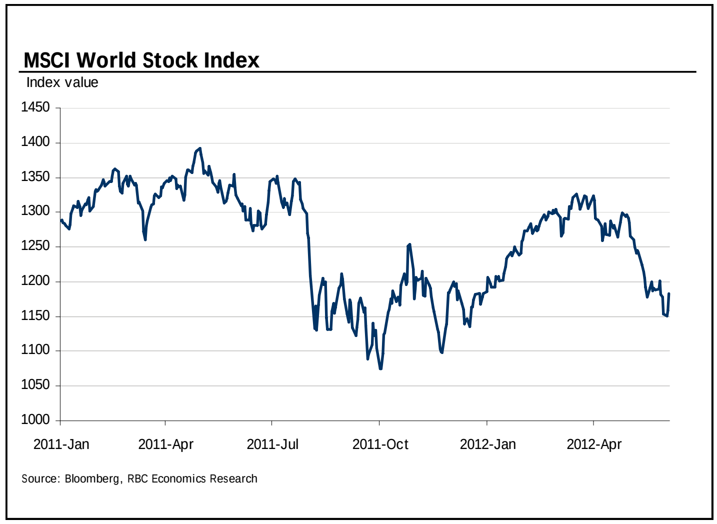
Australia and New Zealand inflation



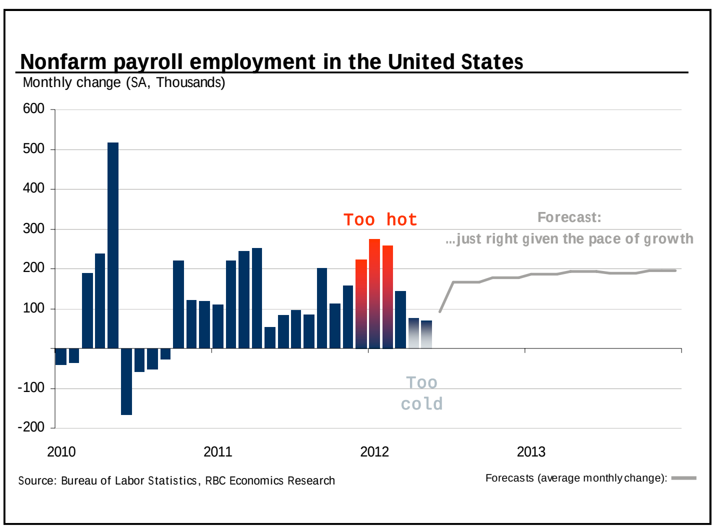
Investors demanded more risk premium to buy the debt of various impaired sovereigns…



...and shied away from equities resulting in the largest one-month drop in the world stock index in two years.



The volatility in the US labour data did not help sooth concerns about the global economy's prospects, although we expect that the spring slowdown will be followed by more robust gains in the second half of the year.



Financial conditions in Canada are supportive. Combined with a reversal of temporary factors that weighed on growth in the first quarter we remain confident that stronger growth lies ahead.