

Financial Market Update

February 2012
Prepared By: FCC Treasury

Canada commentary

Overnight interest rate held at one per cent

As expected by all major economists, the Bank of Canada (BoC) announced that it was maintaining its target for the overnight rate at one per cent at January's BoC meeting. The Bank has stated that the global economy has deteriorated and uncertainty has increased since it released its October Monetary Policy Report. Risk aversion has risen with the heightened European sovereign debt crisis. Many economists expect the BoC to continue to hold interest rates at the current level for the rest of the calendar year and into the second quarter of 2013. Over the past few months, economists have continually adjusted their rate hike forecasts further into the future.

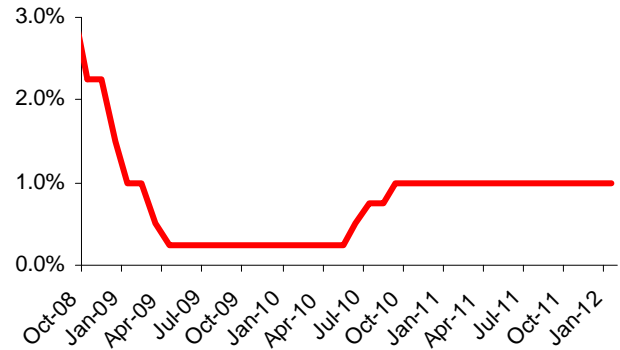
Gross domestic product (GDP) unexpectedly falls

Following zero growth in October, Canada's GDP in November unexpectedly fell 0.1 per cent. Economists expected GDP to rise 0.2 per cent. Statistics Canada reported lower output in the energy sector, wholesale trade, finance and insurance, and construction which consequently led to the lower GDP figure. With softer growth, economists expect the BoC to be comfortable with keeping interest rates on hold. Prior to October, GDP experienced monthly increases from June to September ranging from 0.2 to 0.4 per cent.

TSX rises to a four per cent monthly gain

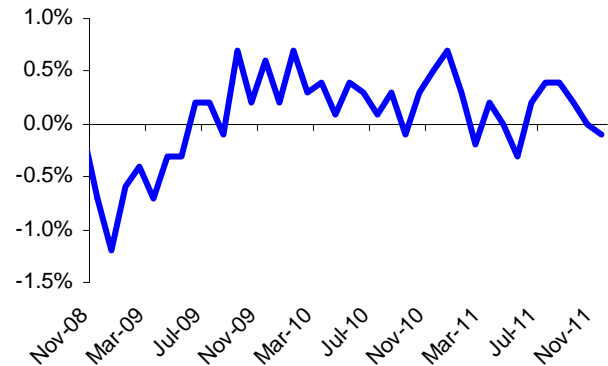
January was a strong month for Canadian stocks as a whole with Canada's benchmark stock index, the S&P/TSX composite, finishing the month off at 12,452.15. This was 4.16 per cent higher for the month. Seven of the 10 main sectors that make up the index ended higher, with the mining-heavy materials sector experiencing the biggest gain of 10.34 per cent. The financials and energy sectors, the two sectors that make up more than half of the index, experienced modest gains of 2.6 per cent and 3.5 per cent, respectively.

Target for the overnight rate



Source: Bloomberg

Canadian GDP (month-over-month)



Source: Bloomberg

S&P/TSX composite index



Source: Bloomberg

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U.S. commentary

The Volcker rule

The Volcker rule, named after former U.S. Federal Reserve Chairman Paul Volcker, has been a hot topic in the financial markets lately. The rule seeks to stop regulated banks that receive support from the government from making risky bets with their own money. Goldman Sachs is one of many companies that have argued that the rule could harm capital markets by reducing the role of banks and placing new limitations on them. BoC Governor Mark Carney also voiced concern over the current draft of the rule, but from the perspective of the BoC. As the rule is currently written, it exempts any trades in U.S. government securities from prohibition but not other countries' government bonds. Carney is concerned that this may cause trading activity to freeze up in markets outside the U.S. Japan also raised objections to the rule, saying that the rule would increase the cost of trading Japanese government bonds unless the rule was amended to exempt them.

U.S. GDP

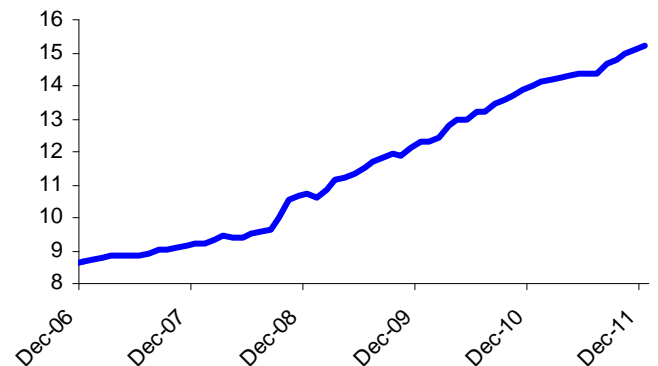
The U.S. economy expanded at a rate of 2.8 per cent in the last quarter of 2011, its fastest quarterly expansion since the second quarter of 2010. For all of 2011, the U.S. economy grew 1.7 per cent, almost half the three per cent rate in 2010. The Federal Reserve said that it expected economic growth to be modest and reduced its 2012 growth forecast to 2.7 per cent from 2.9 per cent.

Global commentary

More downgrades for the euro zone

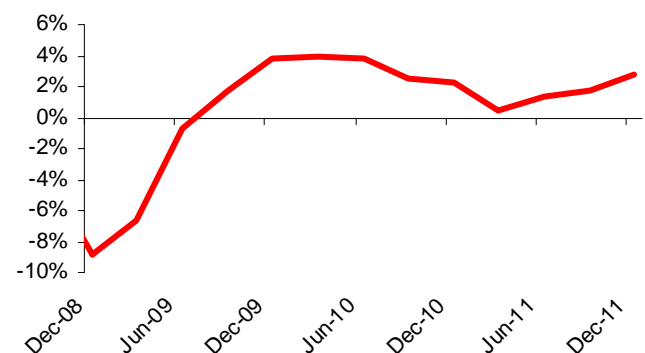
Standard and Poor's (S&P) rating agency downgraded nine countries in the euro zone, including the region's second biggest economy, France. France is now rated AA+. Italy, Portugal, Spain, and Cyprus were downgraded by two notches, resulting in Portugal's debt officially rated below investment grade or "junk" by the rating agency. Italy, now rated BBB+ by S&P, may face greater problems as it has a large amount of debt that requires refinancing this year. Spain pledged spending cuts and cleaning up its banking system in attempt to strengthen the country's economic reputation after the credit rating downgrade. Other countries that were downgraded include Austria, Malta, Slovakia, and Slovenia.

Total outstanding US debt (in trillion USD)



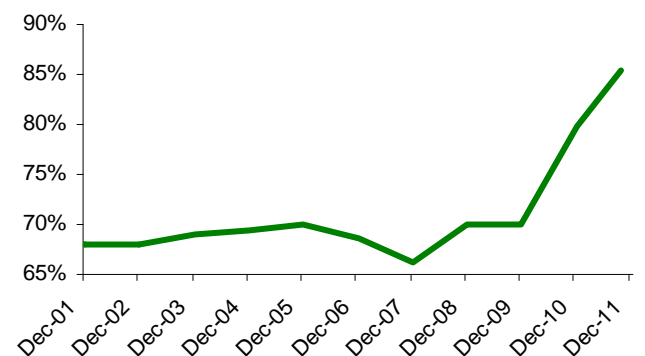
Source: Bloomberg

U.S. GDP (quarter-over-quarter)



Source: Bloomberg

Euro zone debt-to-GDP

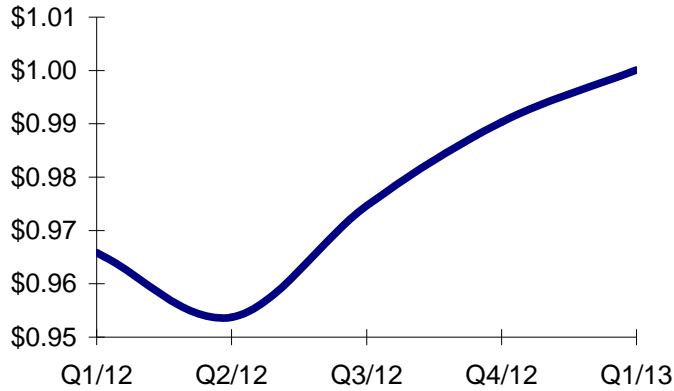


Source: Bloomberg

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Canadian Dollar Forecasts

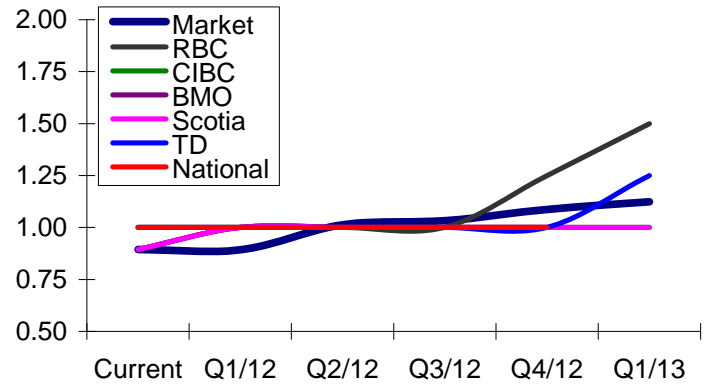
Canadian Dollar – Bank Forecasts Average



Source: Canadian Big 6 Banks

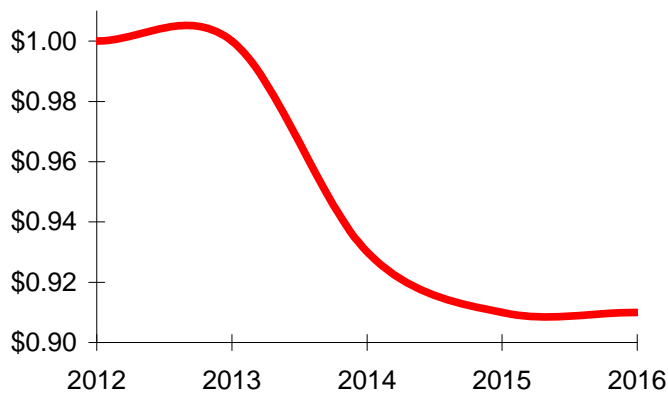
Interest Rate Forecasts

Bank of Canada Overnight Rate Forecasts (%)



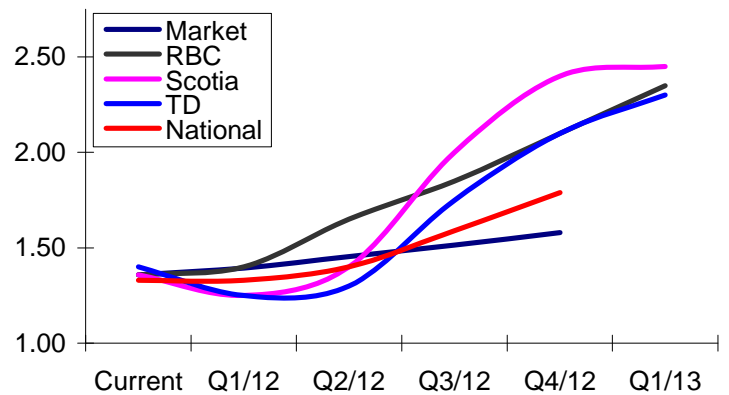
Source: Bloomberg, Canadian Big 6 Banks

Canadian Dollar – Bloomberg Composite Forecast



Source: Bloomberg

5 Year Government of Canada Rate Forecasts (%)

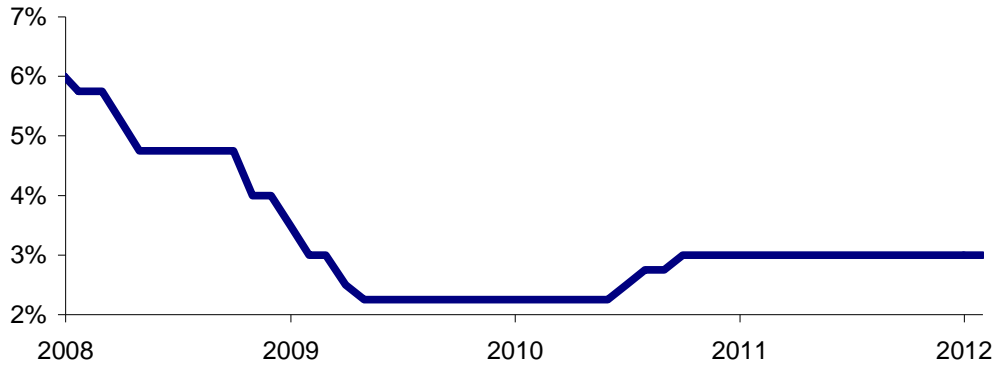


Source: Bloomberg, Canadian Big 6 Banks

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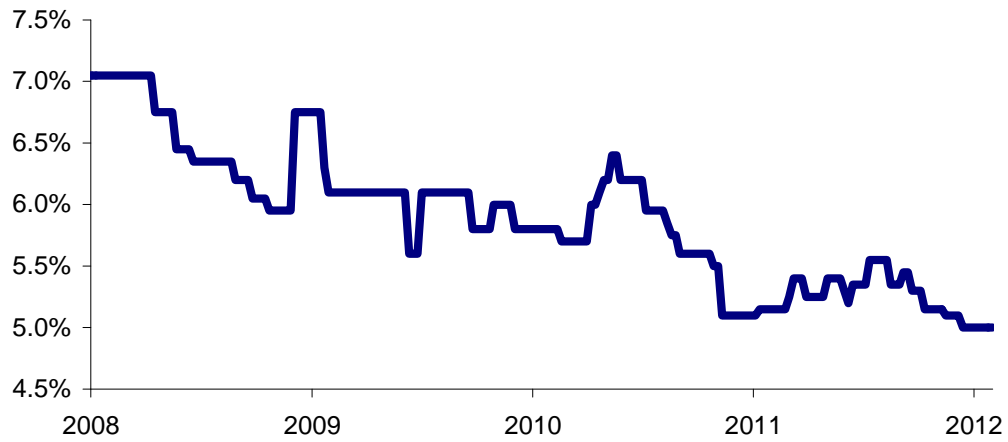
Historical Rates

Prime



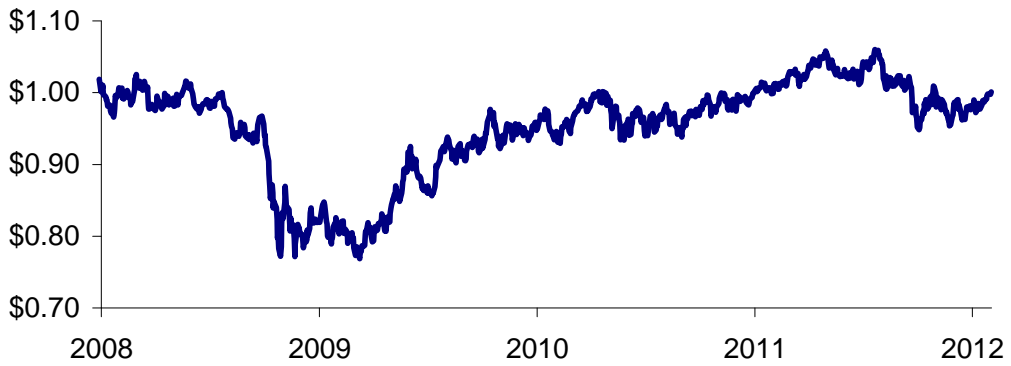
Source: Bloomberg

FCC 5 Year Fixed Rate



Source: FCC

Canadian Dollar



Source: Bloomberg