



January 30, 2012

### EASY MONEY

#### Highlights

- Faced with weaker demand across the developed world, and the ongoing financial crisis in Europe, central banks are keeping the easy money flowing for the foreseeable future, and by any means necessary.
- Most importantly, the U.S. Federal Reserve announced that FOMC members don't expect interest rate hikes to begin until late 2014, far longer than previously anticipated.
- The ECB has extended unprecedented liquidity to the European banking system to mitigate the effects of the sovereign debt crisis, and more rate cuts and outright asset purchases are likely in store.

The message from central banks around the world is clear: borrowing costs will remain low for the foreseeable future. This policy stance reflects the prospects for weak demand across the advanced economies combined with an ongoing financial crisis in Europe that requires the provision of cheap money.

The Federal Reserve is doing everything it can to stimulate the U.S. economy. It has had the fed funds rate at the floor of 0 to 0.25% over the past three years, and it is now signaling that it will remain at that level until towards the end of 2014. This is far longer than we anticipated, and we have revised our outlook for U.S. bond yields downward over the forecast horizon (see tables at back). For example, we now expect the 10-year Treasury to reach a yield of 2.75% at the end of 2013, a full year later than in our December forecast. Nevertheless, for quite some time we have argued that America is in the grips of a Japan-like lost decade with the U.S. economy growing close to trend (around 2-2.5%) for several more years. Many on the FOMC appear to agree with this perspective, expecting the fed funds rate to remain close to zero for a total of six years (late 2008 to 2014).

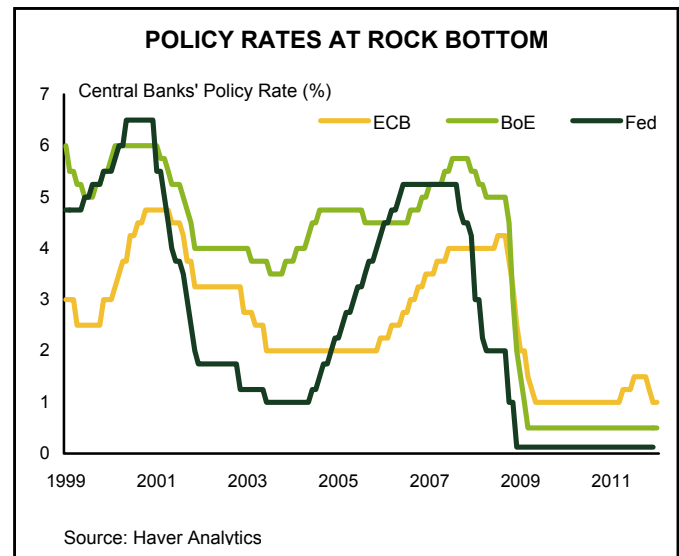
The decision by the Fed to publish interest rate forecasts is yet another example of unconventional monetary policy that has taken many forms. We have had two rounds of quantitative easing (purchases of bonds to inject money into the economy), conditional commitments on interest rates, and efforts to lower long-term interest rates through the management of the Fed's balance sheet (Operation Twist). While the Fed seems resistant to embark on another round of quantitative easing, it is clear that the Fed Chairman has not ruled out the possibility if economic and financial conditions require such action. If it does occur, we expect a large portion of the purchased bonds to be mortgage backed securities (MBS). The central bank has been stressing that more progress needs to be made in restoring health to the real estate market – a position we heartily agree with. The problem is that the main policy options with regards to real estate lie outside the purview of monetary policy. Nevertheless, a heavy emphasis on MBS purchases in any future quantitative easing would be a signal that the Fed is doing what it can to help address the headwinds coming from the real estate sector.

The European Central Bank (ECB) has also been kicked into high gear. After, in our opinion, foolishly raising interest rates in early 2011, the central bank reversed course and has cut rates. In the coming months, we expect a further easing of monetary policy, with a 50 basis-point cut in March, and quantita-

tive easing in the second quarter. Even more importantly, however, the ECB has taken actions to limit the near-term risk of a banking crisis in Europe. On December 21st, the ECB extended €489.2 billion of 3-year loans to European banks at 1%. A second issuance of more 3-year loans is scheduled for February 29th. The effect is to ensure that European banks have adequate access to financing while the sovereign debt crisis plays out. In effect, the ECB is saying that it will act as a lender of last resort to the banking system, but not play the role of lender of last resort to governments. In truth, to the extent that some banks are opting to borrow money from the ECB and invest in government bonds, one could argue that the ECB is providing support to governments through the back door. So far, it appears that limited funds are being channeled from the banks to government debt.

In addition to the ECB funding decision, there was an important international development late last year to support the global financial system. On November 30th, the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, the Federal Reserve and the Swiss National Bank announced that banks would be able to swap their domestic currencies for currencies of the participating central banks at 1%. In other words, banks can now borrow euros from the ECB at 1% and they can then use those euros to get foreign currency funding for an additional 1%. The effect of these two policies together greatly reduces the risk of any bank failures unless various governments start actually defaulting on their debt.

Meanwhile, faced with the UK economy teetering on the brink of recession, the Bank of England (BoE) announced another round of quantitative easing late last year. We do expect the UK to tip into recession along with the euro zone, and for the BoE to deliver two more rounds of stimulus in the form of asset purchases in February and again in May.



Fortunately all of these nonconventional monetary policy actions have helped to calm financial markets a little so far this year, reversing some of the flight-to-safety swings. In line with this, we have raised our 2012 commodity price forecasts nearly across the board. In particular, the price of oil, which is also supported by tensions in the Middle East, is expected to retreat only modestly to \$92 per barrel in the second quarter, and average \$98 per barrel for the year as a whole. And we have weakened our year-end targets for the U.S. dollar against every currency we forecast (see page 3).

The bottom line is that the prospects for the global economy are calling for continued hyper-stimulative monetary policies across the advanced world, and central banks are responding to that need. In the long run, however, this will inevitably lead to economic and financial imbalances, but central bankers seem to be of the view that they will deal with those problems when they arise.

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| INTEREST & FOREIGN EXCHANGE RATE OUTLOOK |             |           |       |       |       |       |       |       |       |       |       |       |       |       |
|--|-------------|-----------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|  |             | Spot Rate | 2011  |       |       |       | 2012  |       |       |       | 2013  |       |       |       |
|  |             | Jan-27    | Q1    | Q2    | Q3    | Q4    | Q1F   | Q2F   | Q3F   | Q4F   | Q1F   | Q2F   | Q3F   | Q4F   |
| <b>Interest Rates</b>                    |             |           |       |       |       |       |       |       |       |       |       |       |       |       |
| Fed Funds Target Rate                    |             | 0.25      | 0.25  | 0.25  | 0.25  | 0.25  | 0.25  | 0.25  | 0.25  | 0.25  | 0.25  | 0.25  | 0.25  | 0.25  |
| 3-mth T-Bill Rate                        |             | 0.05      | 0.09  | 0.01  | 0.02  | 0.05  | 0.10  | 0.10  | 0.10  | 0.10  | 0.10  | 0.10  | 0.10  | 0.10  |
| 2-yr Govt. Bond Yield                    |             | 0.21      | 0.82  | 0.20  | 0.25  | 0.25  | 0.25  | 0.20  | 0.20  | 0.20  | 0.20  | 0.20  | 0.20  | 0.30  |
| 5-yr Govt. Bond Yield                    |             | 0.75      | 2.27  | 0.94  | 0.95  | 0.90  | 0.65  | 0.65  | 0.85  | 1.00  | 1.05  | 1.20  | 1.30  | 1.45  |
| 10-yr Govt. Bond Yield                   |             | 1.89      | 3.47  | 2.18  | 1.75  | 2.10  | 1.90  | 1.95  | 2.25  | 2.35  | 2.35  | 2.45  | 2.65  | 2.75  |
| 30-yr Govt. Bond Yield                   |             | 3.06      | 4.51  | 3.53  | 2.91  | 3.05  | 3.10  | 3.25  | 3.50  | 3.70  | 3.75  | 3.90  | 4.15  | 4.25  |
| Yield Curve (10-yr - T-Bill Spread)      |             | 1.84      | 3.38  | 2.17  | 1.73  | 2.05  | 1.80  | 1.85  | 2.15  | 2.25  | 2.25  | 2.35  | 2.55  | 2.65  |
| <b>Exchange rate to U.S. dollar</b>      |             |           |       |       |       |       |       |       |       |       |       |       |       |       |
| Japanese yen                             | JPY per USD | 77        | 83    | 81    | 77    | 77    | 77    | 77    | 78    | 78    | 80    | 80    | 82    | 82    |
| Euro                                     | USD per EUR | 1.322     | 1.416 | 1.450 | 1.339 | 1.296 | 1.280 | 1.240 | 1.280 | 1.320 | 1.300 | 1.300 | 1.350 | 1.350 |
| U.K. pound                               | USD per GBP | 1.583     | 1.603 | 1.605 | 1.557 | 1.554 | 1.524 | 1.494 | 1.561 | 1.610 | 1.566 | 1.566 | 1.688 | 1.688 |
| Swiss franc                              | CHF per USD | 0.911     | 0.919 | 0.840 | 0.911 | 0.939 | 0.953 | 1.008 | 0.977 | 0.985 | 1.000 | 1.000 | 0.963 | 0.963 |
| Canadian dollar                          | CAD per USD | 1.002     | 0.971 | 0.963 | 1.050 | 1.020 | 1.031 | 1.064 | 1.031 | 1.010 | 1.010 | 1.010 | 0.980 | 0.952 |
| Australian dollar                        | USD per AUD | 1.066     | 1.033 | 1.072 | 0.970 | 1.020 | 1.020 | 0.970 | 0.990 | 1.020 | 1.020 | 1.020 | 0.990 | 0.990 |
| NZ dollar                                | USD per NZD | 0.825     | 0.762 | 0.829 | 0.760 | 0.777 | 0.800 | 0.780 | 0.810 | 0.830 | 0.830 | 0.830 | 0.810 | 0.810 |
| <b>Exchange rate to Euro</b>             |             |           |       |       |       |       |       |       |       |       |       |       |       |       |
| U.S. dollar                              | USD per EUR | 1.322     | 1.416 | 1.450 | 1.339 | 1.296 | 1.280 | 1.240 | 1.280 | 1.320 | 1.300 | 1.300 | 1.350 | 1.350 |
| Japanese yen                             | JPY per EUR | 101       | 118   | 117   | 103   | 100   | 99    | 95    | 100   | 103   | 104   | 104   | 111   | 111   |
| U.K. pound                               | GBP per EUR | 0.835     | 0.883 | 0.903 | 0.860 | 0.834 | 0.840 | 0.830 | 0.820 | 0.820 | 0.830 | 0.830 | 0.800 | 0.800 |
| Swiss franc                              | CHF per EUR | 1.205     | 1.301 | 1.219 | 1.220 | 1.217 | 1.220 | 1.250 | 1.250 | 1.300 | 1.300 | 1.300 | 1.300 | 1.300 |
| Canadian dollar                          | CAD per EUR | 1.324     | 1.374 | 1.397 | 1.406 | 1.322 | 1.320 | 1.319 | 1.320 | 1.333 | 1.313 | 1.313 | 1.324 | 1.286 |
| Australian dollar                        | AUD per EUR | 1.240     | 1.371 | 1.353 | 1.380 | 1.271 | 1.255 | 1.278 | 1.293 | 1.294 | 1.275 | 1.275 | 1.364 | 1.364 |
| NZ dollar                                | NZD per EUR | 1.603     | 1.859 | 1.749 | 1.761 | 1.668 | 1.600 | 1.590 | 1.580 | 1.590 | 1.566 | 1.566 | 1.667 | 1.667 |
| <b>Exchange rate to Japanese yen</b>     |             |           |       |       |       |       |       |       |       |       |       |       |       |       |
| U.S. dollar                              | JPY per USD | 77        | 83    | 81    | 77    | 77    | 77    | 77    | 78    | 78    | 80    | 80    | 82    | 82    |
| Euro                                     | JPY per EUR | 101       | 118   | 117   | 103   | 100   | 99    | 95    | 100   | 103   | 104   | 104   | 111   | 111   |
| U.K. pound                               | JPY per GBP | 121       | 133   | 129   | 120   | 120   | 117   | 115   | 122   | 126   | 125   | 125   | 138   | 138   |
| Swiss franc                              | JPY per CHF | 84        | 90.5  | 95.8  | 84.5  | 81.9  | 80.8  | 76.4  | 79.9  | 79.2  | 80.0  | 80.0  | 85.2  | 85.2  |
| Canadian dollar                          | JPY per CAD | 77        | 85.6  | 83.6  | 73.3  | 75.4  | 74.7  | 72.4  | 75.7  | 77.2  | 79.2  | 79.2  | 83.6  | 86.1  |
| Australian dollar                        | JPY per AUD | 82        | 85.9  | 86.3  | 74.7  | 78.4  | 78.5  | 74.7  | 77.2  | 79.6  | 81.6  | 81.6  | 81.2  | 81.2  |
| NZ dollar                                | JPY per NZD | 63        | 63.3  | 66.8  | 58.5  | 59.8  | 61.6  | 60.1  | 63.2  | 64.7  | 66.4  | 66.4  | 66.4  | 66.4  |

f: Forecast by TD Bank Group as at January 2012; All forecasts are end-of-period: Source: Federal Reserve, Bloomberg, TDBG

| GLOBAL STOCK MARKETS |        |               |            |              |             |
|----------------------|--------|---------------|------------|--------------|-------------|
|                      | Jan-27 | 30-Day % Chg. | YTD % Chg. | 52-Week High | 52-Week Low |
| S&P 500              | 1 316  | 4.7           | 3.1        | 1 364        | 1 099       |
| DAX                  | 6 512  | 9.5           | 6.6        | 7 528        | 5 072       |
| FTSE 100             | 5 733  | 2.0           | 1.1        | 6 091        | 4 944       |
| Nikkei               | 8 841  | 4.0           | 3.3        | 10 858       | 8 160       |
| MSCI AC World Index* | 318    | 6.1           | 4.1        | 358          | 272         |

\* Is a weighted equity index including both developing and emerging markets  
Source: Bloomberg



| COMMODITY PRICE FORECASTS |                 |                 |                |       |       |       |       |       |       |       |       |       |       |       |       |       |       |
|---------------------------|-----------------|-----------------|----------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|                           | Price<br>Jan-27 | 52-Week<br>High | 52-Week<br>Low | 2011  |       |       |       | 2012F |       |       |       |       | 2013F |       |       |       |       |
|                           |                 |                 |                | Q1    | Q2    | Q3    | Q4    | Q1F   | Q2F   | Q3F   | Q4F   | Avg.  | Q1F   | Q2F   | Q3F   | Q4F   | Avg.  |
| Crude Oil (WTI, \$US/bbl) | 100             | 114             | 76             | 94    | 103   | 90    | 94    | 95    | 92    | 100   | 105   | 98    | 100   | 102   | 108   | 105   | 104   |
| Natural Gas (\$US/MMBtu)  | 2.60            | 4.92            | 2.25           | 4.18  | 4.36  | 4.12  | 3.48  | 3.15  | 3.25  | 3.10  | 3.50  | 3.25  | 4.00  | 3.75  | 3.55  | 4.50  | 3.95  |
| Gold (\$US/troy oz.)      | 1739            | 1900            | 1333           | 1385  | 1507  | 1701  | 1683  | 1725  | 1850  | 1975  | 2150  | 1925  | 2150  | 2000  | 1900  | 1850  | 1975  |
| Silver (US\$/troy oz.)    | 33.90           | 49.18           | 26.79          | 31.80 | 38.59 | 38.88 | 31.84 | 32.75 | 35.50 | 40.75 | 45.00 | 38.50 | 40.00 | 36.00 | 30.00 | 28.00 | 33.50 |
| Copper (cents/lb)         | 386             | 462             | 305            | 438   | 416   | 408   | 341   | 370   | 385   | 425   | 415   | 399   | 365   | 400   | 385   | 370   | 380   |
| Nickel (US\$/lb)          | 9.84            | 13.29           | 7.60           | 12.20 | 11.03 | 10.00 | 8.34  | 9.54  | 9.00  | 9.50  | 8.85  | 9.22  | 8.90  | 8.50  | 8.40  | 8.25  | 8.50  |
| Aluminum (Cents/lb)       | 103             | 127             | 89             | 113   | 118   | 109   | 95    | 100   | 105   | 115   | 108   | 107   | 104   | 113   | 109   | 106   | 108   |
| Wheat (\$US/bu)           | 9.56            | 14.71           | 8.99           | 11.68 | 12.75 | 10.30 | 10.10 | 9.40  | 9.25  | 9.80  | 10.05 | 9.65  | 10.15 | 10.20 | 10.40 | 10.55 | 10.33 |

F: Forecast by TD Bank Group as at January 2012; All forecasts are period averages; Source: Bloomberg, USDA (Haver)

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