CAPITAL MARKETS RESEARCH

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Daily Points

— Tracking the Numbers

On Deck for Wednesday, March 23

Country	Date	Time	Event	Period	BNS	Consensus	Latest
US	03/23	07:00	MBA Mortgage Applications (WoW)	18-Mar	--	--	2.7
US	03/23	10:00	New Home Sales (MoM)	FEB	3.5	2.1	-12.6

KEY POINTS:

- BoC implications were the most important aspect to yesterday's Federal Budget
- Yesterday's Cdn retail sales weakness was not to be explained away by Quebec's tax hike
- Dovish BoE minutes, as the majority vote for a policy hold
- UK budget will clarify how much fiscal drag will be imposed
- Portugal could take a big step toward a bail-out today
- Ireland's funding costs continue to blow out
- Bernanke's first speech since last rate decision, but Fisher will likely get more attention again
- US new home sales continue to struggle
- EC industrial new orders disappoint
- US mortgage applications up 2.7%
- BoC to sell C$3.2 billion in 3s
- Us Fed to purchase US$6.5-8.5 billion in Treasuries

CANADA

Perhaps the biggest market implication to yesterday's Federal budget amazingly didn't receive any air time whatsoever from what I can tell. That lies in what it means for the Bank of Canada. We'll put out a more detailed note on this later this morning, but share a few thoughts for now. As all three opposition parties rejected the budget, and Finance Minister Flaherty rejected any notion of further compromise, the government could well likely fall by the weekend and an election will follow. This G&M piece is a useful summary of the scenarios that could spark an election: http://www.theglobeandmail.com/news/politics/how-the-tory-government-could-fall/article1952470/. That matters to the BoC for two reasons. First, the uncertainty over the near-term fiscal policy environment just went up in that it is less clear whether fiscal policy will act as a drag on growth if election goodies are dangled about. Second, over roughly the past twenty years, the BoC has generally avoided starting a tightening campaign in an election. It only did so in 1997, and that was because the economy was rapidly healing after the disaster of the first two thirds of the 1990s via over 734,000 jobs having been created in the back to back years of 1997-98. Now, if a May or June vote is in the cards, that adds to a long list of reasons why most analysts have abandoned much of any notion of a Spring hike. We've stuck to our October call throughout it all, and that call has been reinforced of late.

Yesterday's retail sales figures reinforce this view. The consumer is tapped out. Exhausted one might say. Forget the chatter about how a hike in the

BoC Events

BoC Overnight Lending Rate
Current Rate: 1.0%
Next Move: April 20 @ 1.0%
Bias: Neutral

Province of Saskatchewan (4:15pmEST) to present 2011-12 Budget.

Fed Events

Fed Funds Target Rate
Current Rate: 0-0.25%
Next Move: April 27 @ 0-0.25%
Bias: Dovish

Today's Speeches:
Dallas Fed President Richard Fisher (7:00amEST) will speaks on challenges and opportunities in the U.S. and global economies at a forum hosted by American Academy in Berlin.

Fed Chairman Ben Bernanke (12:00pmEST) will speak on "Community Banking in a Period of Recovery and Change" at the Independent Community Bankers of America's National Convention and Techworld.

Key International Events

BoJ
Current Rate: 0.10%
Next Move: April 7 @ 0.10%
Bias: Dovish

BoE
Current Rate: 0.50%
Next Move: April 7 @ 0.50%
Bias: Dovish

ECB
Current Rate: 1.00%
Next Move: April 7 @ 1.00%
Bias: Dovish

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Quebec sales tax distorted the picture. That's nonsense. For one thing, sales fell by about a half percentage point m/m in each of Ontario, BC and Alberta where there were no tax changes. For another, the impact of a hike in the QST isn't that theoretically obvious. A higher sales tax puts upward pressure on prices which should lift nominal retail sales. Front loading purchases prior to the tax hike would put downward pressure on retail sales. Thus, faced with competing effects, a 1% rise in the QST that sparked a 1% drop in sales is somewhat harsh to fully pin on the QST hike. It says to me that there was indeed a sales tax influence, but that Quebec's sales apart from this effect would have been weak anyway. Add to this the evidence that sales fell in so many categories on nationwide terms, thus reflecting broad based weakness. Why such weakness? The consumer is tapped out. There is no pent-up demand in this country. Real consumer spending indexed to the start of 2007 for Canada compared to other major economies shows Canada as being unique in moving on to record highs through the crisis and following, while every other major economy was flat to down.

The **Bank of Canada** (12:00pmEST) will sell C$3.2 billion in three-year notes.

UNITED STATES

The MBA Mortgage Applications Index rose 2.7% w/w in the week of March 18. Gains were equally spread across purchases and refis. After retreating in four of the past five weeks, the 30-year contract rate remained virtually unchanged at 4.8%.

New home sales (10:00amEST) have been moving along the floor since mid-2010, after the expiry of the extended first-time homebuyers' tax credit. With our forecast for a gain of 3.5% to 294k — in part supported by a weak base effect — we do not expect a significant change to have occurred in February. Sales of deeply-discounted distressed homes, and generally more lower-priced resale properties, are siphoning demand from the new home market.

Following the end of last week's communication blackout period, Fed members are back in the spotlight. In his first speech since early March and the FOMC's last rate decision, **Fed Chairman Ben Bernanke** (12:00pmEST) will deliver a speech on "Community Banking in a Period of Recovery and Change" at the Independent Community Bankers of America's National Convention. Little if any market reaction is expected. The Fed's most vocal hawk **— Dallas Fed President Richard Fisher** (7:00amEST) — will deliver his second speech of the week today. In Berlin, Fisher will address a forum hosted by the American Academy on challenges and opportunities in the U.S. and global economies.

The **US Fed** (11:00amEST) will purchase US$6.5-8.5bln in Treasuries.

INTERNATIONAL

The **Bank of England's minutes** to its March 10th meeting were more dovish than anticipated, sparking a bid to gilts and a mild blow to the pound. The vote was unchanged with 6 standing by their views that a continued hold has merit, and three hawks voting to take the punch bowl away. The balance of the discussion as reflected in the minutes was geared toward uncertainty stemming from four factors. One is that "It was not yet clear that the weakness in output growth seen in the latter part of 2010 would prove temporary." Second is that the policy committee members wished to give some time to evaluate the impact of higher oil prices on growth. This serves as a reminder to hawks that hiking rates in response to a relative price shock spurred on by higher commodities that risk demand destruction could be unwise. Third, the BoE is concerned about soft household spending and confidence gauges. Finally, the standard debate over the inflation outlook ensued, with the balance of the dialogue skewed toward viewing it as a function of temporary influences through the impact of the past depreciation in the pound motivating higher import prices, the impact of a higher VAT, and the effects of higher commodity prices. Unless another VAT hike lies in the cards, unless oil doubles again, and unless the pound reverses the more recent appreciation, then each of these effects on inflation drop out and there remains merit to seeing through such pressures to the other side that is expected to be marked by a sudden deceleration in inflation into next year. The hawks flag uncertainty over the role of inflation expectations and their concern is with merit. But thus far, we side with Governor King in believing that there is not enough evidence of unanchored inflation expectations to prompt policy tightening. Household inflation expectations are adaptive to what has already happened and a poor guide to future actual inflation and decision making, while linkers break-evens haven't budged materially throughout this year after having priced out the global deflation risk trade after last summer.

All of which leads to what kind of drag effect today's **UK budget** will deliver to the UK economy (8:30amET).

The Portuguese government could well fall today after a vote scheduled for 3pm Lisbon time. The opposition parties are widely expected to derail the government's deficit austerity plans. Should this happen, then it's difficult to imagine how the country can avoid tapping on the shoulders of Germany and France for a bail-out. Portuguese ten year yields climbed again overnight, and sit at 7.59% -- well above the 7% or lower threshold that is deemed to trigger unsustainable finances. There is a risk that cooler heads will prevail, but the general story as it is unfolding is consistent with what we have warned about for some time regarding the likelihood that peripheral spreads would widen around the time of the EU Summit that arrives tomorrow and Friday. Irish 10s were hammered again overnight, climbing to the 10% mark. In fact, the whole Irish curve is exacting a heavy risk premium with 2s yielding 10.5%. The agreement reached a week and a half ago did not, in our view, allay concerns over the ECB's financial stability mandate. Higher guarantees that increase the effective size of the stabilization apparatus call into question the credit worthiness of the majors through added contingent liabilities. Further, only the supply side of the funding apparatus was strengthened, but the demand side faces the ongoing problem of how one can lead a horse to water but what if it refuses the offering. Ireland is nowhere close to accepting further EU intrusion into its domestic corporate tax policy as a German quid pro quo for granting more aid. Lastly, the ECB was disappointed by the fact that the stabilization apparatus will only buy bonds at auction – not in the secondary market. All combined, this keeps pressures upon the Eurozone – and the euro itself – alive and well, and counsels caution on policy moves by the ECB especially as higher oil and a higher euro crimp the growth outlook more so than earlier expectations. We continue to have low expectations for any more convincing and more permanent solution to Europe's fiscal woes stemming from the EU summit.

Euro zone industrial orders disappointed in January, with a gain of 0.1% m/m, while the market was looking for growth of 1.0%. Upward revision to the prior month's print, to 2.7% from 2.1%, only partly accounted for the weak results. Weakness was concentrated in capital goods (-2.6%) and non-durable consumer products (-1.3%), offset by improvement registered in the demand for intermediate goods (4.4%) and durable consumer products (2.8%). Of the region's top four economies, advances in Germany and Spain were neutralized by weakness seen in France and to a lesser extent Italy.

Fixed Income	Government Yield Curves (%):											
	2-YEAR			5-YEAR			10-YEAR			30-YEAR		
	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk
U.S.	0.64	0.65	0.55	2.01	2.04	184	3.29	3.33	3.17	4.40	4.44	4.36
CANADA	166	168	163	2.56	2.58	2.54	3.18	3.21	3.20	3.69	3.73	3.72
GERMANY	169	170	147	2.55	2.55	2.33	3.24	3.26	3.09	3.71	3.72	3.52
JAPAN	0.22	0.22	0.23	0.50	0.51	0.51	123	126	122	2.18	2.21	2.23
U.K.	128	130	117	2.34	2.37	2.22	3.57	3.60	3.48	4.33	4.34	4.24
	Foreign - U.S. Spreads (bps):											
CANADA	102	103	108	55	55	70	-11	-12	3	-71	-71	-64
GERMANY	105	105	93	53	52	49	-5	-7	-8	-70	-72	-84
JAPAN	-42	-43	-32	-152	-153	-134	-207	-207	-195	-223	-223	-213
U.K.	64	65	62	33	33	38	27	27	31	-7	-10	-12

Equities			% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	14000.00	-13.70	-0.1	3.3	0.3	16.2
Dow 30	12018.63	-17.90	-0.1	1.4	-0.7	10.4
S&P 500	1293.77	-4.61	-0.4	0.9	-1.0	10.2
Nasdaq	2683.87	-8.22	-0.3	0.6	-1.4	11.1
DAX	5788.68	25.97	0.5	3.4	-2.3	2.0
FTSE	6792.94	11.97	0.2	4.3	-5.6	12.9
Nikkei	9449.47	-158.85	-1.7	9.8	-10.7	-12.3
Hang Seng	22825.40	-32.50	-0.1	0.5	-0.4	8.8
CAC	3914.22	21.51	0.6	5.9	-2.5	-1.0
Commodities			% change:			
WTI Crude	105.43	0.46	0.4	7.6	7.5	28.7
Natural Gas	4.29	0.04	0.8	8.9	10.0	3.9
Gold	1426.00	-6.00	-0.4	1.8	1.8	30.0
Silver	35.95	-0.21	-0.6	6.1	9.3	114.2
CRB Index	356.45	3.21	0.9	5.4	2.5	31.2
Currencies			% change:			
USDCAD	0.9800	-0.0008	-0.1	-1.1	-1.0	-3.5
EURUSD	1.4214	0.0018	0.1	2.3	3.4	5.3
USDJPY	80.9100	-0.0600	-0.1	1.6	-1.9	-10.5
AUDUSD	1.0120	0.0017	0.2	2.9	1.0	10.1
GBPUSD	1.6305	-0.0059	-0.4	1.7	0.6	8.4
USDCHF	0.8996	-0.0039	-0.4	-0.9	-3.6	-14.9

Source: Bloomberg. All quotes reflect Bloomberg data as at the time of publishing.
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