CAPITAL MARKETS RESEARCH

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Daily Points

— Tracking the Numbers

On Deck for Tuesday, March 1

Country	Date	Time	Event	Period	BNS	Consensus	Latest
CA	03/01	09:00	Bank of Canada Rate, %	1-Mar	1.00	1.00	1.00
US	03/01	10:00	Construction Spending MoM	JAN	- -	-0.4	-2.5
US	03/01	10:00	ISM Manufacturing	FEB	61.1	61.0	60.8
US	03/01	10:00	ISM Prices Paid	FEB	- -	83.0	81.5
US	03/01	17:00	Domestic Vehicle Sales, unit mns	FEB	9.7	9.6	9.6
US	03/01	17:00	Total Vehicle Sales, unit mns	FEB	12.7	12.6	12.5

KEY POINTS:

- Markets over-priced for a hawkish BoC?
- Explaining our BoC call
- China PMI largely meets expectations
- EU Commission slightly raises growth, adds to inflation forecast
- Bernanke likely to downplay inflation risk, avoid specific exit signals
- US ISM manufacturing likely to extend advances
- RBA extends pause
- Australian retail sales beat, on higher food prices
- Japanese indicators disappoint
- Pan-European PMI confirmed at highest level since mid-2000
- German unemployment rate falls further in February
- US vehicle sales expected to improve on pent-up demand, weather
- US Fed to purchase US$1.5-2.5 billion in Treasuries

CANADA

With CAD hovering three cents above parity, the risk is that FX markets are set up for potential disappointment following **this morning's BoC statement**. The BoC is unlikely to signal a move to the exits, acknowledging that growth has recently come in stronger in Q4 after disappointing BoC expectations for Q3 even after upward revisions to Q3 growth. But it is more likely to be concerned about growth ahead, particularly in the back half of the year and into 2012, post April mortgage rule changes that front-load housing activity and once fiscal drag kicks in through allowing stimulus to drop off the books. But more important is that the BoC is likely to flag more intense concerns about CAD, and geopolitical risk. Don't expect the BoC to abandon its commitment to arguing that over the full cycle, Canada's lackluster productivity gains and an elevated currency will constrain the extent to which Canada leverages up the US recovery just because one quarter's worth of data counsels otherwise. Carney's recent comments on not being data dependent in the short-run reinforce this.

Which brings us to explaining our longer run BoC view. Scotia Economics is the latest within consensus when it comes to forecasting the resumption of rate hikes by the BoC. We think that doesn't occur until October of this year. Our currency view is a key part of why we expect such an outcome, and quite frankly, if we're right on the currency then one cannot rule out the risk of an even more extended pause or a rate cut at some point in future.

BoC Events

BoC Overnight Lending Rate
Current Rate: 1.0%
Next Move: March 1 @ 1.0%
Bias: Neutral

Fed Events

Fed Funds Target Rate
Current Rate: 0-0.25%
Next Move: March 15 @ 0-0.25%
Bias: Dovish

Today's Speeches:
Fed Chairman Bernanke (10:00amEST) will testify before the Senate Banking Committee on the Fed's semiannual report on monetary policy.

Treasury Secretary Geithner (10:00amEST) will testify on mortgages to House Financial Services Committee.

Key International Events

ECB
Current Rate: 1.00%
Next Move: March 3 @ 1.00%
Bias: Dovish

BoE
Current Rate: 0.50%
Next Move: March 10 @ 0.50%
Bias: Dovish

BoJ
Current Rate: 0.10%
Next Move: March 15 @ 0.10%
Bias: Dovish

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What particularly differentiates Scotia from other shops is that we are among the most bearish on the USD's prospects. That makes Scotia Economics and FX bullish on the Euro, and CAD, with CADUS to continue appreciating throughout 2011-12. Our CAD view is a full dime higher than the lowest in the Canadian consensus in our current print forecast. The core house view entails timing the point at which we think the US fiscal landscape is set to markedly deteriorate. We think that happens as President Obama extends stimulus introduced last fall, instead of allowing it to expire in a Presidential election year. We think that rating agencies and bond markets will react adversely, thereby diminishing appetite for the USD. Just as Europe will be placed further along the path toward fiscal repair, the US will not have even materially started and yet its fiscal position is as bad if not worse, especially on a fully consolidated basis across Federal, State and Local governments as well as off-book obligations through social security and medicare.

As a consequence, Scotia is bullish on several FX crosses against the USD, including CAD and the Euro punching through 1.45 next year. In the BoC's parlance, a strong CAD owing to US fiscal problems would be 'type 2' tightening, as in not purely reflective of fundamental drivers. Therefore, this type of CAD strength imposes net tightening on the Canadian economy that we believe will do the BoC's tightening for them. We will elaborate further on several other key reasons behind our view that the BoC is on prolonged hold in a note later today.

UNITED STATES

Expect **Fed Chairman Ben Bernanke to be grilled by the Senate Banking Committee** in his semi-annual testimony (10:00amET), with the focus likely to be upon inflation concerns and Fed exit policies. He is likely to continue to signal moderate optimism toward the US recovery, repeat that the Fed has all the tools it needs in order to reverse stimulus and offset inflation risks when deemed appropriate to exercise them, and to avoid being pressured into signaling premature exits. A master communicator in a central banking sense, Bernanke will duck any pressure to signal with abject clarity what will happen to QE2 post June 30th. While QE3 is unlikely, the Fed is likely to use communication tools to keep the credible threat alive against bond vigilantes.

Activity in the US manufacturing sector has been picking up since September. We expect this trend to have extended into February, with our forecast looking for a small gain in the **ISM Manufacturing Index** (10:00amEST) to 61.1 in February, on a weaker greenback and improving regional indices, although a strong base effect from the prior month is likely to provide some offset. The prices paid index is likely to move higher, reflecting increased concern over rising cost pressures stemming from higher commodity prices.

Vehicle sales (5:00pmEST) — both overall and domestic — are likely to have picked up in February. We anticipate an increase to 12.7 million units from 12.54 million in the prior month and to 9.7 million from 9.59 million, respectively. Better weather conditions over January should have provided some support, as did the introduction of new models. As we have discussed in the January-21st issue of Global Views, there also seems to be more (overall) pent-up consumer demand in the United States, more so than in Canada. That said, rising gasoline prices may have kept some potential buyers on the sidelines.

The **Fed** (11:00amEST) will purchase US$1.5-2.5 billion in Treasuries.

INTERNATIONAL

Markets remain in cautious risk-on mode this morning, parking Middle East unrest on the back burner in favour of focusing on growth. With the Dow up 5.6% year to date, our equity bias at the start of the year is generally performing well but so far our bearish Treasury view is not.

China's purchasing managers' index slipped ever so slightly, but largely met expectations. The headlines are all about the slowest pace in six months, but that was priced in advance. China is thus far effectively steering its ship toward less aggressive growth in order to allay inflation concerns, and the private sector version of the PMI confirms this at it slowed even more than the state's. Within the components, the state's PMI signaled a slightly weaker pace of growth in new orders.

Australia's RBA kept its cash target rate unchanged as expected. The RBA flagged a strong A$ and expectations for slower job growth as among the reasons to continue its pause. Governor Stevens has also tended to argue in favour of seeing through the growth and inflation implications stemming from natural disasters.

Australian consumers gave additional cause for an RBA pause overnight. Retail sales climbed 0.4% m/m, slightly faster than expected, but only because of higher prices. Food spending went up 2.5% m/m in dollar terms, but spending on household goods fell 4.6%, and clothing spending fell 2.5%. Higher commodities do indeed appear to have crimped discretionary spending on other items. The push toward higher global food prices has been further amplified by domestic factors, particularly the impact of flooding of crop land. Natural disasters also likely played a role in postponing some consumption.

Japanese indicators were generally soft overnight. Housing starts fell against expectations for a small rise, the jobless rate remained unchanged at 4.9%, and household spending fell 1.0% y/y although that was a hair's width weaker than the expected 1.4% decline. BoJ Governor Shirakawa continues to hint that should it be required, the BoJ will apply further stimulus in a gentle recovery.

The **German unemployment rate** slipped unexpectedly to 7.3% in February from 7.4% in the prior reading. The number of unemployed workers fell by 52,000, nearly three times more than forecast, and the prior month's print underwent a favourable revision. German unemployment rate leads the euro zone, and currently sits at its lowest level since the reunification. It has been gradually retreating since mid-2009. This is a positive for the Germany's economy, reflecting stronger business confidence and suggests improvement in consumer spending.

The **European Commission** upwardly revised its economic growth forecast for 2011 ever so slightly, up 0.1ppt to 1.6%. That's so small as to be irrelevant. Headline consumer inflation, however, is anticipated to come in at 2.2%, up from 1.8% in the prior estimate, and largely reflects catch-up on higher commodity prices. While exports are expected to continue to support growth, the report indicated that "a rebalancing of growth toward domestic demand is expected for 2011, resulting in more sustainable growth." But it's still growth at a tepid pace.

The final print for February **European Purchasing Manager Indices** (PMIs) confirmed that the pan-regional headline index came in at a high of 59.0, the fastest pace of growth since mid-2000. Germany continued to lead the pack, with Greece as the laggard among the PIIGS peripheral economies. Gains were registered across components, including consumer, intermediate and investment goods.

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.	0.70	0.68	0.69	2.17	2.14	2.14	3.45	3.43	3.46	4.51	4.50	4.60
CANADA	186	178	188	2.65	2.58	2.75	3.31	3.29	3.46	3.70	3.70	3.85
GERMANY	154	152	143	2.43	2.39	2.36	3.20	3.17	3.15	3.61	3.59	3.58
JAPAN	0.25	0.25	0.23	0.56	0.56	0.57	129	126	128	2.19	2.16	2.22
U.K.	143	140	150	2.50	2.47	2.59	3.64	3.60	3.68	4.38	4.37	4.37
	Foreign - U.S. Spreads (bps):											
CANADA	116	109	119	47	44	62	-14	-14	0	-81	-80	-75
GERMANY	85	83	73	25	25	22	-25	-26	-31	-90	-92	-102
JAPAN	-45	-43	-46	-161	-159	-157	-216	-217	-217	-232	-235	-239
U.K.	73	71	81	33	33	46	19	17	23	-13	-14	-24

Source: Bloomberg. All quotes reflect Bloomberg data as at the time of publishing.
While this source is believed to be reliable, Scotia Capital cannot guarantee its accuracy.

Equities			% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	14136.50	84.37	0.6	0.1	3.1	20.5
Dow 30	12226.34	95.89	0.8	-1.3	1.5	17.5
S&P 500	1327.22	7.34	0.6	-1.2	1.5	19.0
Nasdaq	2782.27	1.22	0.0	-1.8	1.1	22.4
DAX	6009.41	15.40	0.3	0.2	0.9	11.2
FTSE	7318.59	46.27	0.6	0.0	1.9	28.1
Nikkei	10754.03	129.94	1.2	0.8	4.7	5.7
Hang Seng	23396.42	58.40	0.3	1.8	-0.4	11.1
CAC	4125.91	15.56	0.4	1.9	1.3	9.5
Commodities			% change:			
WTI Crude	97.13	0.16	0.2	3.8	7.0	23.4
Natural Gas	4.01	-0.03	-0.6	3.7	-7.7	-14.3
Gold	1411.00	8.50	0.6	0.6	7.0	27.3
Silver	33.49	0.95	2.9	0.2	25.5	107.8
CRB Index	352.58	1.29	0.4	3.2	3.0	29.3
Currencies			% change:			
USDCAD	0.9705	-0.0011	-0.1	-2.0	-2.0	-6.8
EURUSD	1.3826	0.0020	0.1	1.3	-0.0	2.0
USDJPY	82.1300	0.3500	0.4	-0.8	0.9	-7.9
AUDUSD	1.0187	0.0001	0.0	2.0	0.8	13.1
GBPUSD	1.6277	0.0020	0.1	0.9	0.8	8.6
USDCHF	0.9303	0.0014	0.2	-0.9	-0.5	-13.8