CAPITAL MARKETS RESEARCH

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Daily Points

— Tracking the Numbers

On Deck for Tuesday, March 29

Country	Date	Time	Event	Period	BNS	Consensus	Latest
US	03/29	09:00	S&P/CS Composite-20 (YoY)	JAN	-3.0	-3.2	-2.4
US	03/29	10:00	Consumer Confidence	MAR	- -	65.0	70.4

KEY POINTS:

- Carney's message was to Brazil, Boivin's applies more to Canada
- What the WSJ missed on Canada's housing bubble
- Dip in US consumer confidence could weigh on risk trade
- US house prices could fall for seventh straight month
- German inflation adds to ECB pressures
- Japanese consumers back peddled before disasters struck
- French consumer spending nearly doubles consensus
- UK GDP contracted slightly less than initially estimated
- US Fed to purchase TIPS, Treasury to auction $35 Billion in 5s today

CANADA

Two BoC speeches traded off against one another yesterday in terms of how they were received in some quarters. They shouldn't have in our opinion. Carney's weekend speech was tailored more toward Latin American central banks than Canada. That should have been evident in the title of the speech and the forum at which it was presented, but also in the arguments themselves. In advising central banks not to view commodity price strengths as temporary in a longer run sense, Carney was saying that countries with commodity-currencies need to be wary of fighting upward appreciation through capital and currency controls, or resisting tighter monetary policy for fear of what it would do to the currency. Inflation targeting must be the central banker's main job. While central bankers don't point fingers at each other in civilized global debate, the subtext made it a message that was more likely delivered to institutions likes Brazil's central bank, than either Mexico or Canada since inflation in both countries is trending lower. Canadian headline inflation is fairly well behaved, while core is sinking. In Canada, growth concerns are geared toward a lack of trade competitiveness and coming off cycle peaks in the household sector. The latter arguments were what Deputy Governor Jean Boivin emphasized in his speech yesterday that was more consistent with BoC messaging on Canadian circumstances over the past few months. On net, we don't take the two latest BoC communications to be signals of a pending bias shift compared toward a relatively dovish stance. Carney's speech was not hawkish on Canada in our view so much as it was a prescription for Lat-am central banks, while Boivin's speech was consistent with prior BoC messaging.

BoC Events

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

Province of Ontario (4:00pmET) to release 2011-2012 budget.

Fed Events

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

Today's Speeches:
St. Louis Fed President James Bullard (6:00amET) will speak at the 2011 European Banking & Financial Forum.

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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The **WSJ latched on to Canada's housing bubble** in this article (see: http://online.wsj.com/article/SB10001424052748703784004576220994025363866.html?mod=djemITP_h). While the article makes some good points and I continue to agree on the richness of house prices and evidence of speculative froth, I thought it missed the main point as to why Canada is not the US: chain-wide leverage. Yes, leverage is comparable on the household balance sheet, but the comparisons end beyond that. Banks are well capitalized. Dealers are generally owned in bank hold-co structures and have not run gearing ratios up to where Wall Street dealers did. Canada has a tiny shadow banking sector, and thus did not play the same role as in the US by way of having the appetite for taking mortgages, securitizing them, and compounding leverage upon leverage in off-balance-sheet ponzi schemes. Securitization is also only 30% of total residential mortgages in Canada, and securitized primarily through the National Housing Act offerings via the CMHC which has explicit government backing, is frankly a cash cow, and prices its insurance underwriting more effectively than was often the case in the US. More of the Canadian book is retail funded by more secure deposits. There are fewer adverse incentives operating in Canada, such as when US dealers cut off lines to mortgage companies and then shorted the stock. Yes, Canada added innovation late cycle when the government liberalized the mortgage insurance business in early 2007 – followed by tighter rules in October 2008, a year ago, and then again now - but the nature of the products in Canada remained more conservative than in the US. Your Canadian banker actually checks your T4, verifies that there is a home at the address being lent against, and asks questions for reasons that dawned upon US bankers too late in the game. Appraisals are generally more conservative in Canada and they hair cut properties. Mortgage brokers don't operate as significantly as in California where out-sourced brokers played off the best rate at competing institutions and then walked away with no skin in the game after the fact. Strategic defaults are only a limited option in Alberta and Saskatchewan. There is limited mortgage interest deductibility in Canada, in contrast to the US that long ago embraced one of the worst forms of tax policy imaginable. Uncle? Here's one more: household credit growth has already generally slowed sharply and is only getting a temporary lift in anticipation of tighter mortgage rules (now) and consumer lending rules (mid-April), so the BoC's concerns should arguably be turning more toward downside risks via an abrupt slow down than tightening policy in order to slow credit growth. The BoC has acknowledged this by pointing to a closer connection between income and credit growth today. Going forward, from Canada's current cycle top on variables like the home ownership rate and renovation spending, and with no pent-up consumer demand, the household sector won't be contributing to GDP growth as it has in the past. But barring a massive rate shock or sharp erosion in jobs, I don't see a large price correction. A modest one in a soft landing, yes, but the forces of leverage-reversal that amplified the downside risks in the US do not operate in the same manner within Canada. That said, I do view this as a nationwide problem and not one just confined to a handful of markets, as every province's house prices have risen by about 80-150% over the past decade. Other than gold, the retail investor's returns on tax-sheltered primary residences have been tough for alternative investments to compete against.

UNITED STATES

US consumer confidence (10:00amET) could sway the risk trade to the down side and put a bid to Treasuries this morning. The Conference Board's gauge has most economists straddling the 62-68 range which would mark a significant deterioration from February's 70 reading that itself was the highest since February 2008 after climbing well off the lows of 25 back in February 2009. Higher gas prices and equity market volatility will play significant roles, alongside what is still a disappointing US job market 'recovery'. The fact that house prices have been falling for six months again and that the **S&P Case Shiller measure** (9:00amET) is likely to extend that streak to seven doesn't help.

INTERNATIONAL

Markets are in risk-off mode, particularly as European banks sell off on ECB tightening fears. **German inflation** didn't help allay such concerns. Saxony and Bavaria reported 0.5% m/m increases in headline CPI, unchanged from the prior month. Brandenburg also reported a 0.5% gain, which was a touch slower than the 0.6% reading in the prior month, while Hesse registered an advance of 0.4% compared to 0.6% the prior month. This follows on yesterday's North Rhine-Westphalia reading of 0.5% m/m, only one-tenth cooler than the prior month. An ECB rate hike appears to be in the bag for April 7th as its financial stability mandate takes the back seat to its inflation mandate, something that ECB communications have reinforced of late. In my opinion, markets are better advised to pull the rate hike profile forward rather than raise their end points, since 2012 could well be a different story as the lagged effects of euro appreciation and higher oil weigh against growth while market instability will be following Trichet's every step for a long time yet.

A month prior to the earthquake, **Japan's household spending** extended the downward trend, in part as stimulus programs continued to wind down. Volumes were down 0.2% y/y, marking their fifth straight month of retreat. The impact of the disastrous earthquake and tsunami — thought to have caused over US$300 billion in damage and left many without home and work — will put additional pressure on personal consumption, at least in the near term, until reconstruction gathers momentum. In a statement today, Japan's Prime Minister Naoto Kan indicated that the government is considering calling off proposed corporate tax cuts and imposing higher sales taxes to help fund rebuilding, which would not bode well for the consumer.

French consumer spending beat forecasts in February, increasing 0.9% m/m, nearly double the consensus call, as the outlook for the labour market showed signs of improvement. Although some support may have come from the upward revision to the prior month's drop, from -0.5% to -0.3%, strength was widespread across components. Retail, durable goods, motor vehicles and household products led the gains, posting comparable increases in the 0.9-1.1% range. French consumer spending has increased in three of the past four month, led by the durables segment.

The final print for **UK Q4 GDP** slightly surprised on the upside, showing a modest upward revision to -0.5% q/q from -0.6% in the prior estimate. Most of the support came from the upward revision to the gross fixed capital formation component, which is estimated to have been less of a drag, as well as slightly better factory output, construction activity and services sector. The Office for National Statistics maintained the view that the unseasonable weather conditions shaved off 0.5ppt off the headline. Even upon excluding the impact of poor weather conditions, flat output was a marked slowdown from the 0.7% gain posted in the prior quarter, leaving intact concerns about the outlook for consumer spending.

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.	0.79	0.75	0.65	2.19	2.18	2.04	3.44	3.43	3.33	4.50	4.50	4.44
CANADA	1.74	1.73	1.68	2.67	2.65	2.58	3.26	3.24	3.21	3.70	3.70	3.73
GERMANY	1.75	1.74	1.70	2.62	2.60	2.55	3.31	3.29	3.26	3.78	3.77	3.72
JAPAN	0.21	0.21	0.22	0.48	0.49	0.51	1.24	1.25	1.26	2.19	2.18	2.21
U.K.	1.26	1.27	1.30	2.36	2.36	2.37	3.60	3.60	3.60	4.33	4.33	4.34
	Foreign - U.S. Spreads (bps):											
CANADA	95	98	103	48	47	55	-19	-19	-12	-80	-80	-71
GERMANY	96	98	105	43	42	52	-14	-14	-7	-73	-73	-72
JAPAN	-58	-55	-43	-170	-169	-153	-221	-219	-207	-231	-232	-223
U.K.	47	51	65	18	19	33	16	17	27	-18	-17	-10

Equities			% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	13892.73	-146.66	-1.0	-0.9	-1.7	15.5
Dow 30	12197.88	-22.71	-0.2	1.3	-0.2	11.9
S&P 500	1310.19	-3.61	-0.3	0.9	-1.3	11.7
Nasdaq	2730.68	-12.38	-0.5	1.4	-1.9	13.6
DAX	5888.83	-15.66	-0.3	2.2	-1.8	3.1
FTSE	6881.59	-57.04	-0.8	1.5	-5.4	11.8
Nikkei	9459.08	-19.45	-0.2	-1.6	-11.0	-13.9
Hang Seng	23060.36	-7.83	-0.0	0.9	-1.2	8.6
CAC	3951.93	-25.02	-0.6	1.5	-3.9	-1.2
Commodities			% change:			
WTI Crude	103.30	-0.68	-0.7	-0.7	6.5	25.7
Natural Gas	4.36	-0.02	-0.4	2.4	7.9	13.4
Gold	1417.00	-19.00	-1.3	-1.0	0.4	29.2
Silver	36.62	-1.06	-2.8	1.3	9.3	117.3
CRB Index	354.86	-4.71	-1.3	0.5	0.6	30.2
Currencies			% change:			
USDCAD	0.9746	-0.0034	-0.3	-0.6	0.3	-4.6
EURUSD	1.4091	0.0004	0.0	-0.7	2.1	4.5
USDJPY	81.9400	0.2500	0.3	1.2	0.2	-11.4
AUDUSD	1.0236	-0.0008	-0.1	1.3	0.5	11.5
GBPUSD	1.6002	0.0010	0.1	-2.2	-1.6	6.8
USDCHF	0.9193	0.0025	0.3	1.7	-1.0	-13.5

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