CAPITAL MARKETS RESEARCH

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Daily Points
— Tracking the Numbers

On Deck for Wednesday, July 20

Country	Date	Time	Event	Period	Actual	Consensus	Latest
US	07/20	07:00	MBA Mortgage Applications (WoW)	15-Jul	15.5	--	-5.1

Country	Date	Time	Event	Period	BNS	Consensus	Latest
CA	07/20	08:30	Wholesale Sales (MoM)	MAY	- -	0.1	-0.1
US	07/20	10:00	Existing Home Sales (mns)	JUN	5.04	4.9	4.8
US	07/20	10:00	Existing Home Sales (MoM)	JUN	5.0	1.9	-3.8

KEY POINTS:
- US 'Cut, Cap and Balance Act' sails through the House, won't fly in the Senate
- 'Gang of Six' proposal may well not get support in the US House, but it's the only possibility for averting a US downgrade
- Will Merkel attend tomorrow's Summit?
- European spreads pull tighter on Summit speculation
- BoC chose an awkward moment at which to turn hawkish
- US home resales could rebound
- US mortgage apps jump on refis
- BoE minutes turn more dovish

CANADA

The BoC chose an awkward juncture at which to abruptly go hawkish, and will have a further opportunity to explain its bias shift in this morning's Monetary Policy Report (10:30amET) and the ensuing press conference. The BoC could have easily bought more time in the face of key global risks but may have felt uncomfortable doing so given that the next best chance to more fully explain any shift in thinking wouldn't have come until the October MPR. Thus, it went more hawkish, but left itself plenty of outs by way of taking an optimistic approach to Europe's difficulties but flagging "clear risks." We are not, as yet, changing our forecast since a near term hike is contingent upon many things simultaneously going right. Unless Europe pulls a rabbit of its hat and gets a serious deal on the table as opposed to continuing the pattern of deferral, and unless the US Congress stops modeling its behaviour after European states (yesterday's 'gang of six' debt proposal may stand little chance of advancing), then material instability to global financial markets could well be coming down the pipeline. Further, the domestic economy remains weak. Q1 growth of 3.9% was largely driven by an undesired inventory build as the economy displayed weakness before the Japanese shocks arrived in such a manner as to broadside Q2 GDP growth. Q3 will get a post-supply shock lift, but underlying momentum is unlikely to be strong in Q4 and beyond.

BoC Events

BoC Overnight Lending Rate
Current Rate: 1.0%
Next Move: Sept. 7 @ 1.0%
Bias: Neutral

Today's Events:
The BoC will release its quarterly Monetary Policy Report at 10:30am ET, followed by a press conference with Governor Carney at 11:15am ET.

Fed Events

Fed Funds Target Rate
Current Rate: 0-0.25%
Next Move: August 9 @ 0-0.25%
Bias: Dovish

Key International Events

BoJ
Current Rate: 0.10%
Next Move: August 5 @ 0.10%
Bias: Dovish

BoE
Current Rate: 0.50%
Next Move: August 4 @ 0.50%
Bias: Dovish

ECB
Current Rate: 1.50%
Next Move: August 4 @ 1.50%
Bias: hawkish

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UNITED STATES

Last night's vote on the "Cut, Cap and Balance Act" sailed through the House but will die when it hits the Democrat controlled Senate. It was a purely symbolic effort by the Republicans. That leaves the attention placed squarely upon yesterday's hopeful peace offering from the bi-partisan "gang of six". Key parts of this proposal didn't meet with the approval of the staunch conservatives particularly represented within the Tea Party movement, so it's unlikely that the proposal will be the silver bullet that markets are betting upon.

We are thus left with four proposals from which the details of any final agreement will need to be drawn in any possible hybrid agreement: President Obama's 'Grand Bargain' that was too focused on tax hikes for the Republicans to support; last night's 'Cut, Cap and Balance Act' that will not garner Democrat support in the Senate; the McConnell plan that would increase the debt ceiling in three steps with contingent austerity measures required at each phase, but which lacks support in the House; finally, the latest 'Gang of Six' proposal that is encouraging but that may well be shot down by the most conservative elements in the GOP that rule the House. S&P has stipulated that a serious effort on the order of a $4 trillion deficit reduction package over 10 years is required to avoid a US downgrade, so only the 'Gang of Six' proposal would meet this requirement. Yesterday's decision by Moody's to put five States with AAA ratings on negative watch was the latest warning shot. In this respect, settling the debt ceiling dispute would not be some magical elixir; a downgrade and/or serious fiscal retrenchment at the expense of long-run US growth are the bigger issues here.

Below is a summary of the 'Gang of Six' proposal as outlined by Scotia's Mary Webb:

> "The Bipartisan Plan submitted by six Senators, representing the latest instalment in the U.S. debt ceiling impasse, aligns with the December 2010 recommendations of the President's bi-partisan National Commission on Fiscal Responsibility and Reform. The proposals would trim Washington's budget deficit from Scotia Economics' forecast of a shortfall equal to 8.9% of GDP in fiscal 2011 (FY11) to 6.7% in FY12, 3.0% by FY14 and 2.0% for FY18-FY21. From the Congressional Budget Office's March 2011 baseline projection of a cumulative FY12-FY21 deficit of US$6.7 trillion, this proposal shaves US$3.7 trillion, stabilizing the publicly held debt relative to GDP by FY14 and trimming this debt burden to 70% of GDP by FY21 (compared with 36.2% in FY08). It is a two-stage process, with a $500 billion expenditure saving followed by a second-stage of mid-term reforms. Social Security would be reformed to a 75-year solvency basis, with savings during the reform reinvested in the program, not deficit reduction.
>
> The President praises the program for its balance – essentially one-quarter tax cuts and three-quarters reduced expenditures and interest payments. And therein is the sticking point – though marginal tax rates would be scaled back and the Alternative Minimum Tax abolished as personal and corporate income tax expenditures are curtailed, the net impact does not avoid the Republican stipulation of avoiding any tax increase during the reform process. Some of the reported benefits, such as a simpler and more internationally competitive tax code, have not swayed many Republicans to date. The argument of the Plan's authors, that if the CBO scored the Plan it would report net tax relief of US$1.5 trillion is unlikely to be convincing.
>
> The Plan calls for wide-ranging cuts that include Medicare, the Armed Services, Education and Labour, but its protection of the most vulnerable may also be contentious. Budget restraint through a number of procedures including sequestering accounts at year-end to recoup any excessive spending by Congress add to the "balance" advocated by the Plan's sponsors."

US debt ceiling talks, further developments in Europe ahead of tomorrow's EU summit and Q2 earnings will likely garner more market attention this morning than **US existing home sales** (10:00am ET). Nonetheless, if we witness an upside surprise akin to yesterday's US housing starts report, equity markets could look to the positive results for support. Indeed, we are expecting a modest rebound of 1.9% m/m in resales in June—although consensus estimates currently range from –1.3% to +8.1% suggesting that there is a large amount of uncertainty surrounding this report—after two months of weakness as pending home sales rose over 8% the previous month. Recall that pending home sales, which measure the number of contacts signed, tend to be a decent leading indicator for existing home sales which measure actual closings. However, the recent trend continues to point downward as US economic growth remains morose alongside weaker employment conditions, sluggish wage growth and slowing global growth despite low borrowing costs and continued downward pressure on home prices via elevated supply levels. Thus, any rally we do witness on the news will likely be short-lived until the US housing market really starts to show signs of improvement. But, for that to happen, the number of foreclosures added to the market every month would have to drop substantially which won't likely happen anytime soon.

MBA mortgage applications soared 15.5% after four consecutive weeks of decline as both fixed and variable rates declined last week amid increased worries of contagion in Europe and ongoing US debt ceiling talks. All of the gain was registered in the refinancing component which jumped 23.1% while purchase applications declined 0.1%. The average loan size also rebounded after declining by over 20% the previous week.

INTERNATIONAL

The global risk trade has a firm bid beneath its wings this morning as solid earnings lift equities. Optimism over a US debt deal is also contributing, but the longevity of this factor is in doubt. The week risks ending on disappointment in Europe and in the US debt ceiling debate but the optimists are in the driver's seat for now.

German Chancellor Angela Merkel and French President Sarkozy will meet and have dinner today in a last ditch effort at reaching an agreement before tomorrow's planned EU Summit. Merkel rejected hopes of a one-shot solution in comments she delivered yesterday. The range of proposals that is rumoured to be in play include funding a further Greek bail-out via a tax on European banks, contingent liability credit lines, and adding further capital into the European Financial Stability Fund perhaps in order to buy distressed debt off the market. All of these proposals face serious opposition including Germany's insistence that private debt holders share the pain, the ECB's insistence that any default scenario be averted as reinforced by Trichet's interviews and Nowotny's damage control yesterday, and the European banking lobby. Merkel has said she won't attend Thursday's summit if a material deal is unlikely, so there is the risk that we'll know the outcome of tomorrow's planned summit if she makes a statement today.

Markets are nonetheless expressing mild hope. Greek two year yields rose to a peak of 40.42% overnight but have slipped back to the still devastating 38.08% mark at the time of writing. Greek 10s are yielding 17.76%, still ruinous and at levels that are orders of magnitude greater than what Greece could sustain in an effort to gets its fiscal position back on track over a very long period, but off the intraday peak of 18.39% set the day before.

The **Bank of England** released the minutes to its July 6-7 meeting with no change to the split in votes of 7-2 in favour of keeping the current benchmark rate unchanged and 8-1 in favour of keeping the asset purchase target of £200 billion unchanged. Indeed, for most Committee members, the balance of risks to inflation in the medium term had not changed enough for them to change their views on monetary policy. Nonetheless, the discussion took on a more dovish tone as the majority argued that "it was likely that the current weakness in activity would persist for longer than previously thought" although they also made note that the weaker exchange rate and lower yields would provide some support to the economy. One member of the Committee argued that the BoE should increase their QE program while two other members voted to reduce some of the monetary stimulus at the meeting given the upside risks to inflation.

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.	0.39	0.37	0.35	149	144	144	2.93	2.88	2.88	4.23	4.19	4.17
CANADA	151	148	145	2.23	2.20	2.17	2.94	2.89	2.93	3.37	3.35	3.38
GERMANY	130	124	128	193	185	191	2.76	2.68	2.75	3.47	3.38	3.43
JAPAN	0.16	0.15	0.16	0.38	0.37	0.40	109	107	111	2.01	2.00	2.04
U.K.	0.71	0.70	0.71	179	177	183	3.08	3.05	3.12	4.13	4.11	4.18
	Foreign - U.S. Spreads (bps):											
CANADA	112	111	109	74	76	74	1	1	5	-86	-85	-80
GERMANY	92	87	93	44	42	48	-17	-20	-14	-75	-81	-74
JAPAN	-23	-22	-20	-111	-107	-104	-185	-181	-177	-222	-219	-213
U.K.	32	33	36	31	33	39	15	17	24	-10	-8	1

Equities			% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	13332.92	78.78	0.6	0.7	3.7	14.6
Dow 30	12587.42	202.26	1.6	1.1	4.2	23.0
S&P 500	1326.73	21.29	1.6	1.0	3.8	22.5
Nasdaq	2826.52	61.41	2.2	1.6	7.5	27.2
DAX	5849.18	59.19	1.0	-1.0	2.7	13.8
FTSE	7220.58	27.91	0.4	-0.7	1.0	21.0
Nikkei	10005.90	116.18	1.2	0.8	7.0	7.6
Hang Seng	22003.69	101.29	0.5	0.4	1.9	8.6
CAC	3747.01	52.06	1.4	-1.2	-1.4	8.0
Commodities			% change:			
WTI Crude	98.77	1.27	1.3	0.7	5.9	27.5
Natural Gas	4.58	0.04	1.0	4.0	6.0	-0.3
Gold	1601.00	2.00	0.1	3.3	4.1	35.6
Silver	38.59	-1.73	-4.3	5.0	8.5	119.9
CRB Index	346.54	2.73	0.8	0.7	3.1	32.5
Currencies			% change:			
USDCAD	0.9467	-0.0034	-0.4	-1.2	-3.4	-9.3
EURUSD	1.4219	0.0063	0.4	0.4	-0.6	10.4
USDJPY	78.9000	-0.2800	-0.4	-0.1	-1.7	-9.8
AUDUSD	1.0749	0.0016	0.1	-0.1	1.6	21.6
GBPUSD	1.6139	0.0016	0.1	0.2	-0.4	5.7
USDCHF	0.8209	-0.0032	-0.4	0.4	-3.0	-22.0

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