WEEKLY PUBLICATION

FX Snapshot

October 29, 2012 nbc.ca/fxsnapshot

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Major News this Week

In contrast to comments he made in British Columbia the week before, Mark Carney's Opening Statement on monetary policy mentioned that the BoC is still ready to increase the key interest rate, but that it would happen later rather than sooner. The global growth outlook continues to drive stock markets. The disappointing earnings figures released by U.S. businesses over the last 3 weeks have weighed heavily on the S&P 500 and the Dow Jones, and this has trimmed the wings of our loonie.

Canada

This will be another important week in Canadian news. The strength of the loonie is due in part to Mr. Carney's openness to raising the key interest rate, but also to continuous capital inflows from various central banks and foreign investors looking for a safe haven to invest their funds. The USD/CAD pair, having climbed close to 190 basis points since early October, appears poised to test new highs. The catalyst needed to propel the USD/CAD could come from one of two economic indicators expected this week: GDP for August (YoY), to be released on Wednesday, and the Employment Change, expected on Friday. Economists are forecasting figures of 1.7% and 7,500 respectively.

United States

The week will also be busy south of the border, beginning with the CB Consumer Confidence index on Tuesday. On Thursday, ADP Nonfarm Employment Change data and the ISM Manufacturing Index will be released. Analysts are forecasting that the private sector created 137,500 jobs in October. The week will also end with Nonfarm Payrolls data for October. Economists believe 120,000 jobs were created in October, 6,000 less than the last reading. With just a few days remaining before the presidential election, these indicators will be closely watched by U.S. voters.

International

The week in international news begins today with Germany's Consumer Price Index, followed on Tuesday by results from the Consumer Confidence survey for the Eurozone. On Wednesday we will know the figures for German Retail Sales, the Eurozone's Unemployment Rate for September, followed by Purchasing Managers' Index figures for France, Germany and the Eurozone on Friday. Have a good week! *Gardy Pharel*

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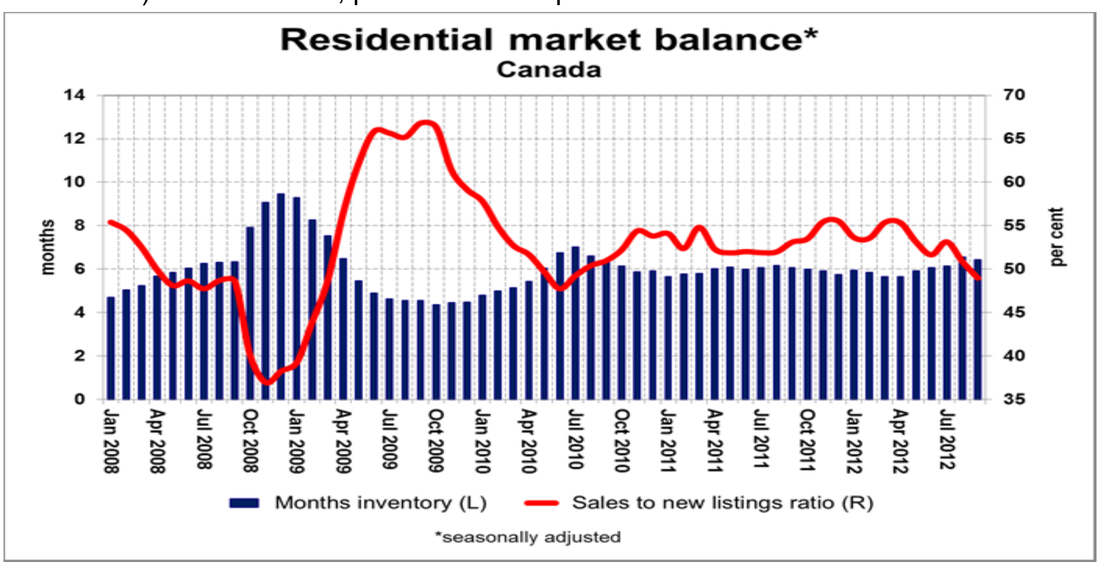
The Loonie

"History is a gallery of pictures in which there are few originals and many copies."- Alexis de Tocqueville

In June of this year, the Federal Minister of Finance Jim Flaherty announced a tightening of the mortgage regulations in order to avoid the recent cataclysm of the American mortgage sector. One of those measures consisted of decreasing the maximum allowable amortization period for government insured mortgages from 30 to 25 years in order to dissuade excessive credit-seekers that do not have the means to acquire real estate. The debt level of Canadians, measured by the debt per capita over disposable income, recently reached a level of 152%. The hike in home prices, which more than doubled over the last 10 years, highly contributed to this. In only a few months, the implementation of those measures was beneficial and we are witnessing a cooling down of the housing sector. In spite of the fact that prices have not declined, re-selling of homes are in deceleration mode. The following graph illustrates the consequences of the mortgage tightening regulations on the Canadian real estate market. We observe that the sales to new listings ratio (the red line) is declining since July and that the inventory of houses on the market (the blue bars) are on the rise; proof that the implemented measures are efficient.



* Source: Canadian Real Estate Association

Being conscious yet alarmed by the over consumption of Canadians, the Bank of Canada sent a clear message early last week while its monetary policy announcement. The Bank of Canada emphasized its intentions to squeeze the current accommodating policy, probably by increasing the overnight rate of interest which is presently sitting at 1%, a level maintained since September 2010. Not surprising that the Bank supported Mr. Flaherty as it reiterated its main worry of the increasing level of Canadian citizens' debt. An increase in the overnight rate will not be an easy decision for the Bank of Canada. The loonie sits a little over parity vis-à-vis the USD and the impact of a higher overnight rate than its current level is certainly not an ideal situation for exporters. However, if we do not want a repeat of the 2008 financial mortgage crisis, the Bank has to act promptly. Undeniably, a difficult task! *Rana Karim*

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Technical Analysis: Unbreakable Parity? *(Monday, October 29, 2012)*

The momentum is here but parity has not been seen yet (as of Monday morning). The resistance is very strong and the presence of the 200-d moving average at 0.9993 does not help.

However, many positive indicators (ROC, MACD, RSI…) increase the likelihood of a test of parity in the coming days or weeks.

Fibo levels to watch above are 1.0038, 1.0080 and 1.0134.

It is also interesting to note that the drop in the S&P 500 is showing signs of weakness (doji) when approaching 1,400. The double top objective remains at 1,390. Equity markets will be closed today due to hurricane Sandy.

Once again, USD sellers should start hedging their FX exposures at the current levels as a change in trend has yet to materialize. *Olivier Cosialls*

USD/CAD res. levels
1.0134
1.0080
1.0038
1.0000
Support levels
0.9940
0.9920
0.9840
0.9810

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Fixed Income

Yields were slightly on the rise last week mostly due to the comments of the Bank of Canada at its rate decision on Tuesday.

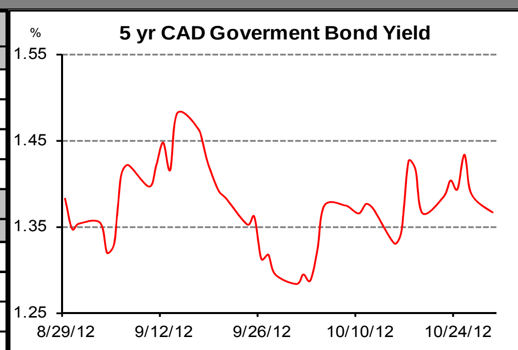
- Governor Mark Carney warned the current level of household debt in Canada is too high, suggesting he could raise rates to discourage further borrowing. A few investors were positioned for a softer speech so rates rose on the release.
- Friday, the relatively strong GDP report in the U.S. failed to revive markets as the uncertainty of the upcoming U.S. presidential election is keeping investors in check.
- All in all, last week earnings releases were good for US corporations, although positive earnings surprises were lower than for the previous quarters, adding to the volatility of recent trading sessions.
- The week could start slowly, especially in the big apple with the expected storm, but investors are preparing for more important earnings reports in the coming days.

In Canada, GDP numbers will be released on Wednesday, while the job statistics are scheduled for Friday. Finally, US Nonfarm payrolls, the last job before the elections, are expected on Friday as well. Enjoy your week.

Alexandre Lemieux

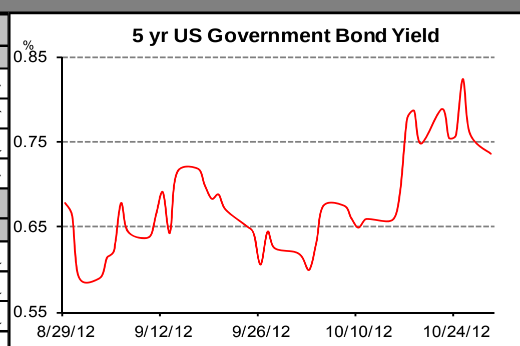
Canada

Key short-term rates	Weekly change				Yearly change		
	26-Oct-12	19-Oct-12	Change (pbs)		27-Oct-11	Change (pbs)	
Overnight Rate	1.0000%	1.0000%	0.0	-	1.0000%	0.0	-
3M Bill (Federal)	0.9970%	0.9680%	2.9	↑	0.9170%	8.0	↑
1-month CDOR	1.2150%	1.2150%	0.0	-	1.2000%	1.5	↑
Prime rate	3.0000%	3.0000%	0.0	-	3.0000%	0.0	-
Government bonds	Weekly change				Yearly change		
	26-Oct-12	19-Oct-12	Change (pbs)		27-Oct-11	Change (pbs)	
2 year	1.117%	1.087%	3.0	↑	1.143%	-2.6	↓
5 year	1.387%	1.365%	2.2	↑	1.713%	-32.6	↓
10 year	1.836%	1.845%	-0.9	↓	2.488%	-65.2	↓
30 year	2.416%	2.432%	-1.6	↓	3.138%	-72.2	↓



United States

Key short-term rates	Weekly change				Yearly change		
	26-Oct-12	19-Oct-12	Change (pbs)		27-Oct-11	Change (pbs)	
Fed Funds target	0.250%	0.250%	0.0	-	0.250%	0.0	-
3M Tbill	0.112%	0.091%	2.0	↑	0.010%	10.1	↑
1-month LIBOR	0.212%	0.211%	0.1	↑	0.246%	-3.4	↓
Prime rate	3.250%	3.250%	0.0	-	3.250%	0.0	-
Government bonds	Weekly change				Yearly change		
	26-Oct-12	19-Oct-12	Change (pbs)		27-Oct-11	Change (pbs)	
2 year	0.299%	0.296%	0.3	↑	0.311%	-1.2	↓
5 year	0.760%	0.748%	1.2	↑	1.203%	-44.3	↓
10 year	1.746%	1.764%	-1.8	↓	2.398%	-65.2	↓
30 year	2.905%	2.935%	-3.0	↓	3.456%	-55.1	↓



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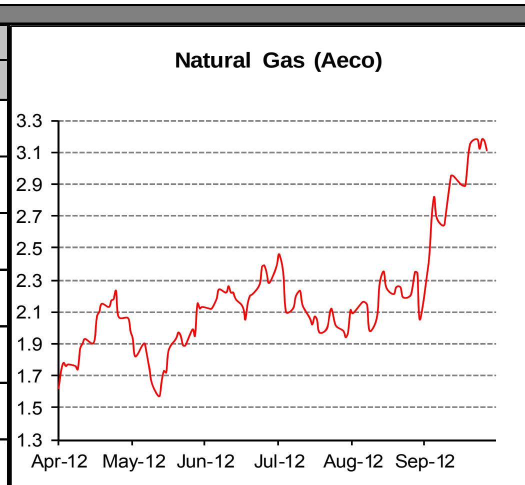
Commodities

Last week was difficult again for energy prices, but this was nevertheless good for businesses that had been waiting for softer markets for several weeks in order to implement hedges against fuel prices. It is also interesting to note that current fixed prices are quickly approaching the levels we had about the same time last year for all of 2012. According to the Organization of Petroleum Exporting Countries (OPEC), Iran's production is plummeting, and has reached 2.7 million barrels per day (mbd). According to Iran's leaders, production is currently 3.7 mbd. The situation between Iran and Western countries remains tense. Over the last few days, Iran said that it will stop exporting crude oil if any new sanctions are imposed against it. Hurricane Sandy will also have a significant impact on energy prices this week. Several refineries in northern U.S. are closed as a precautionary measure and that pushed up prices of all refined products. Have a great week!

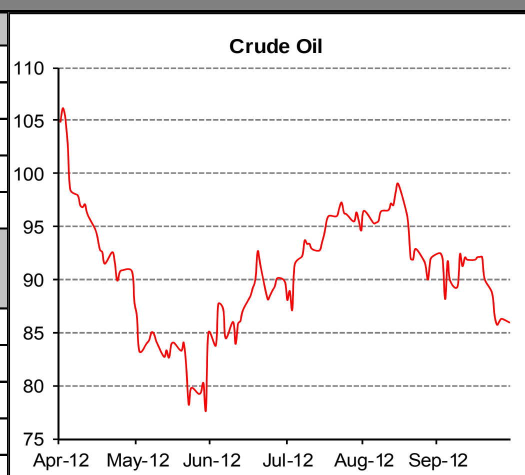
Emmanuel Tessier-Fleury

	Open 29-Oct-12	Prior 22-Oct-12	Variation	Year To date
CRUDE OIL (CAD/BARIL)	85.9342	88.7034	-3.12%	-14.90%
HEATING OIL (CAD/LITRE)	0.8296	0.8125	2.11%	4.72%
GASOLINE (CAD/LITRE)	0.7420	0.6992	6.13%	2.33%
NATURAL GAS (CAD/GJ)	3.1100	3.1800	-2.20%	24.40%
RACK PRICE DIESEL (CAD/LITRE)	0.8711	0.8991	-3.11%	-2.21%
RACK PRICE HO (CAD/LITRE)	0.8659	0.8939	-3.13%	-1.73%
RACK PRICE GASOLINE (CAD/LITRE)	0.7941	0.7952	-0.14%	-1.44%



SWAP PRICE	CRUDE OIL (CAD/BARIL)	NATURAL GAS (CAD/GJ)
Q4 12	86.2534	3.1980
Q1 13	87.6716	3.3280
Q2 13	88.9762	3.2800
Q3 13	89.5520	3.3430
Q4 13	89.6641	3.5630

SWAP PRICE	HEATING OIL (CAD/LITRE)	*Equivalent* RACK MTL DIESEL	RBOB (CAD/LITRE)	*Equivalent* RACK MTL GASOLINE
Q4 12	0.8480	0.8851	0.7361	0.7878
Q1 13	0.8298	0.8661	0.7624	0.8159
Q2 13			0.7599	0.8133
Q3 13			0.7650	0.8187
Q4 13			0.7701	0.8242



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Last Week at a Glance

Canada – In August, retail sales rose 0.3%, in line with consensus expectations. Sales were up in five of the 11 subsectors. Auto dealership revenues fell 0.2% after strong gains the prior month. Excluding autos, sales swelled 0.4%. This, too, met consensus, although the previous month's number was revised up a tick to +0.5. Ex-auto sales were driven by advances in food/beverage, gasoline, electronics, sporting goods and general merchandise. These more than offset lower sales in building materials, furniture/home furnishings, health/personal care, and clothing. The overall gains were due entirely to higher prices as sales actually declined 0.3% in real terms. Still, based on two months of data, real retail sales were tracking roughly at +2.6% annualized in 2012Q3, thanks to strong July sales volumes, after contracting in Q2. This is welcome news as it suggests that consumers provided some offset to weakness elsewhere in the Canadian economy in the quarter. According to Canada's Survey of Employment, Payrolls and Hours (SEPH), average weekly earnings rose 0.4% in August, taking year-on-year gains to 3.6%. Average weekly hours worked increased 0.3% to 33.1 from 33 in July, which largely explains the higher weekly earnings in August. Canadian wages continued to grow at a healthy pace in Q3 according to the survey, accounting in part for the apparent rebound in retail spending in the quarter. In September, the Teranet–National Bank National Composite House Price Index™ rose 3.6% year over year. Price changes varied widely across the 11 metropolitan areas covered. Gains were most notable in Halifax (+8.0%) and Toronto (+7.8%). Prices were down in Vancouver (-0.8%), Victoria (-1.0%) and Ottawa-Gatineau. Seasonally adjusted, the index increased at an annualized rate of 0.6% from June to September, its smallest 3-month variation since 2010. According to the Institut de la statistique du Québec, real GDP at basic prices grew 0.3% in the province in July (vs. +0.2% in Canada). This was the strongest monthly gain since December. The July showing was due in large part to a 2.1% jump in manufacturing output. Moreover, Q1 and Q2 data were revised showing a slightly less anemic growth path than previously estimated: for Q1, 0.5% was bumped up to 0.7% annualized, and for Q2, 0.8% was hoisted to 1.0%. The July report put Quebec GDP on track for expansion of 1.4% annualized in Q3. The BoC caused a surprise by emphasizing a tightening bias that explicitly linked monetary policy to household sector imbalances. However, in a press conference following the publication of the October MPR, Governor Carney clarified the Bank's interest-rate guidance. According to Carney, the case for an interest-rate adjustment had become less imminent but, over time, rates were more likely to go up than not. As far as household imbalances were concerned, he pointed out that regulatory efforts were bearing fruit and that the use of the monetary tool to address them would be a last resort. The BoC lowered its growth projection for Canada for 2012Q3 to 1.0% from 2.0% previously while raising the projection for Q4 marginally to 2.5% from 2.3%. Though this was a worse second half than estimated back in July's MPR, it still left the 2012 projection up one tick to 2.2% on account of historical revisions. The BoC also raised the growth outlook for the first half of 2013, while leaving the second half and 2014 little changed. In the end, GDP was projected to grow 2.3% in 2013 and 2.5% in 2014. As in its July forecasts, core inflation was expected to reach 2% by mid-2013.

United States – The first estimate of Q3 U.S. GDP growth came in at +2.0% (annualized), two ticks above the 1.8% expected by consensus. In the third quarter domestic demand was much improved thanks to consumption spending, residential investment and government spending, with this last component contributing to growth for the first time in nine quarters. Business investment detracted from growth for the first time in six quarters. Trade was a drag as well despite a drop in imports, the first since 2009Q1, while exports did poorly. Still, thanks to domestic demand, final sales (i.e., GDP excluding inventories) grew 2.1%. Inventories contributed negatively to growth for the third quarter in a row. The following chart breaks down the contribution to Q3 GDP by component. With the Q3 results, U.S. GDP is now 2.2% above its pre-recession level, which contrasts sharply with the euro zone where output is 2% below its 2008 peak. The Q3 results for the United States were a bit better than anticipated thanks to much improved final sales fuelled by surprising impetus from government spending. This last component was boosted by defence spending, which unfortunately is unlikely to be repeated in the coming quarters. The acceleration in consumption and a further contribution to GDP from residential construction (sixth straight quarter of growth) were good to see. Despite a listless labour market, consumption was likely being supported by a low household debt burden and by a positive housing wealth effect. Business investment was atypically weak, although the uncertainty regarding the fiscal cliff might be partly to blame for that. Slumping new orders pointed to yet another weak quarter for investment spending in Q4. Export demand softened in synch with a flagging global economy, turning trade into a drag on the economy. With the world economy stuck in a funk in early Q4 (if October PMI's are any indication), the odds of a sharp rebound in trade are poor indeed. The added drag from inventories is a positive factor for production going forward, although it is unclear whether stock rebuilding will occur soon given the headwinds in store for Q4 mentioned above. Consequently, we expect growth to fall back below 2% in Q4. For now, though, Q3 GDP is likely to be viewed as a positive on account of the fact that sales were decent and inventories were a drag on the quarter but a promise for the future. In September, new-home sales in the United States easily topping consensus expectations by rising 5.7% to 389K from a downwardly revised 368K the prior month. The 3-month average continued its uptrend reaching 377K, its highest level since April 2010. The supply of new homes at the current sales rate fell to 4.5 months, its lowest mark since 2005. Median new-home prices sagged a bit to $242,400 after rising sharply in August. The general trend in sales (e.g., 3-month average) was more evidence that the U.S. housing market was on the rise. Low inventories suggested new housing starts, which hit a 4-year high in September, could increase even further going forward. This explains why the NAHB Builder Confidence Index struck 41, its highest point in over six years. Still in September, durable-goods orders rose a consensus-topping 9.9% but did not reverse the prior month's steep 13.1% plunge. The higher orders were driven by aircraft, both defence and non-defence. As a result, transportation orders soared 31.7% after plummeting 33.7% the month before. However, orders for vehicles and parts sank further after dropping abruptly the prior month. Ex-transportation orders rose 2%, although non-defence capital goods orders excluding aircraft, a gauge of future investment spending, were flat in the month. Total shipments of durable goods were up 0.8% overall, but shipments of non-defence capital goods ex-aircraft slid 0.3% for a third straight decline.

Little change was expected to emerge from the October FOMC rate-setting meeting as committee members had updated their economic projections only a month and a half earlier. Economic indicators published since suggested that the U.S. economy had continued to expand at a moderate pace in recent months, with household spending advancing a bit more quickly than members had expected. Yet the FOMC remained concerned that without sufficient policy accommodation, economic growth might not be strong enough to generate sustained improvement in the labour market. Consequently, the Fed intended to proceed with the policy initiatives announced at its previous meetings (Operation Twist and QE3). The Fed also reiterated its guidance, namely, that it expected the fed funds rate to stay “exceptionally low” at least until mid-2015. Finally, the Thomson Reuters/University of Michigan Consumer Sentiment Index for October was revised down to 82.6 from its preliminary estimate of 83.1. This nonetheless represented an improvement over the previous month’s 78.3 reading.

Paul André Pinsonnault, Strategy and Economic department NBC

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