WEEKLY PUBLICATION

FX Snapshot

NATIONAL BANK

August 13, 2012

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Major News this Week

Last week was practically a washout in terms of any political news that could move the market. In the absence of news from Europe or much in the way of economic data, the Canadian dollar fluctuated in a narrow range, mirroring stock market movements. This was the case at least until Friday, when disastrous Canadian employment data were released. While the market was looking for the creation of 9,500 jobs, many were disappointed to hear that in fact 30,000 jobs had been lost. The loonie dropped about 40 basis points on this news. However, it would appear that foreign investments in Canadian assets are continuing unabated; market participants profited from the weakness of the Canadian dollar to add to their positions.

Canada

The only important news expected in Canada this week will be the release on Friday of the Consumer Price Index. Economists are expecting a figure of 2% for July, or the same as the last reading.

United States

This will be an important week for economic indicators south of the border. On Tuesday we will have the Producer Price Index as well as Retail Sales for the month of July. Analysts are forecasting retail sales to have increased 0.3% in July, 0.8% more than in June. On Wednesday we can expect the important inflation figure. Economists are expecting a reading of 1.5%. With the slow economic recovery taking place in the U.S., many market players are hoping that the Federal Reserve will introduce a new round of quantitative easing, and inflation numbers below 2% would certainly leave more room for the Fed to implement expansionary monetary policy. The week will end with results from the University of Michigan Consumer Sentiment Index.

International

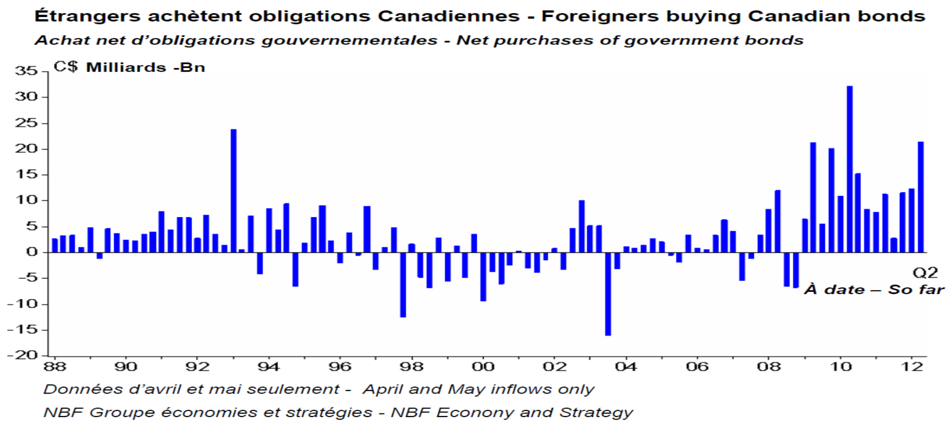
The release of international economic data begins tomorrow with second-quarter GDP numbers for France, Germany and the Eurozone. Economists are expecting figures of -0.2%, 0.1% and -0.2%, respectively. Also on Tuesday, Germany will release its ZEW Economic Sentiment Index. On Thursday, Europe's Consumer Price Index will be released. The market is expecting 2.4%, unchanged from the last reading. Have a good week!
Gardy Pharel

The Loonie

“Shoot for the moon and if you miss, you will still be among the stars”. Les Brown

A little more than a year ago we looked at the possibility that the Canadian dollar could become a “safe haven.” Such a status would be founded on our great political stability and enviable financial position. However, the strong correlation between the Canadian and U.S. dollars makes the CAD less attractive. In addition, the cyclical nature of the Canadian economy (with its strong dependence on energy and raw material prices) produces uncertainty about the strength of our currency during recessions. In the end, we doubted that the CAD could acquire safe haven status. Independent of the strength of these arguments, foreigners have been quite fond of the CAD since the 2008-09 financial crisis, due to the strength of Canadian banks in the face of market turmoil.

This confidence among foreign investors is seen in the massive purchases of Canadian bonds over the last few years. Even if the financial markets are not referring to the Canadian dollar as a safe haven, the value of our loonie benefits from foreigners’ enthusiasm. One thing is sure: as in politics, sometimes our greatest strength is the weakness of our adversaries; the uncertainties swirling around the Euro and the downgrade on U.S. government bonds have allowed the CAD to shine. At least part of this renewed confidence is due to the CAD’s good performance against the USD in a context of weak commodity prices[1].



Source : Global insight

So what does the future hold? The uncertainty over the survival of the Euro is not going away. It should intensify once a German court renders its decision (expected on September 12) on the constitutional legality of transferring additional powers (budgetary control) to pan-European organizations. In the U.S., growing electoral fever should harden positions in the two main parties, making the compromise needed to break through the U.S. fiscal deadlock unlikely. So even if the CAD does not glitter, its star should nevertheless remain highly visible in such a dark sky. Have a good week! *Guy Desrochers.*

[1] Contact your foreign exchange trader or the Manager International trade (MIT) to obtain a brief analysis of the CAD’s current overvaluation prepared by our economics team.

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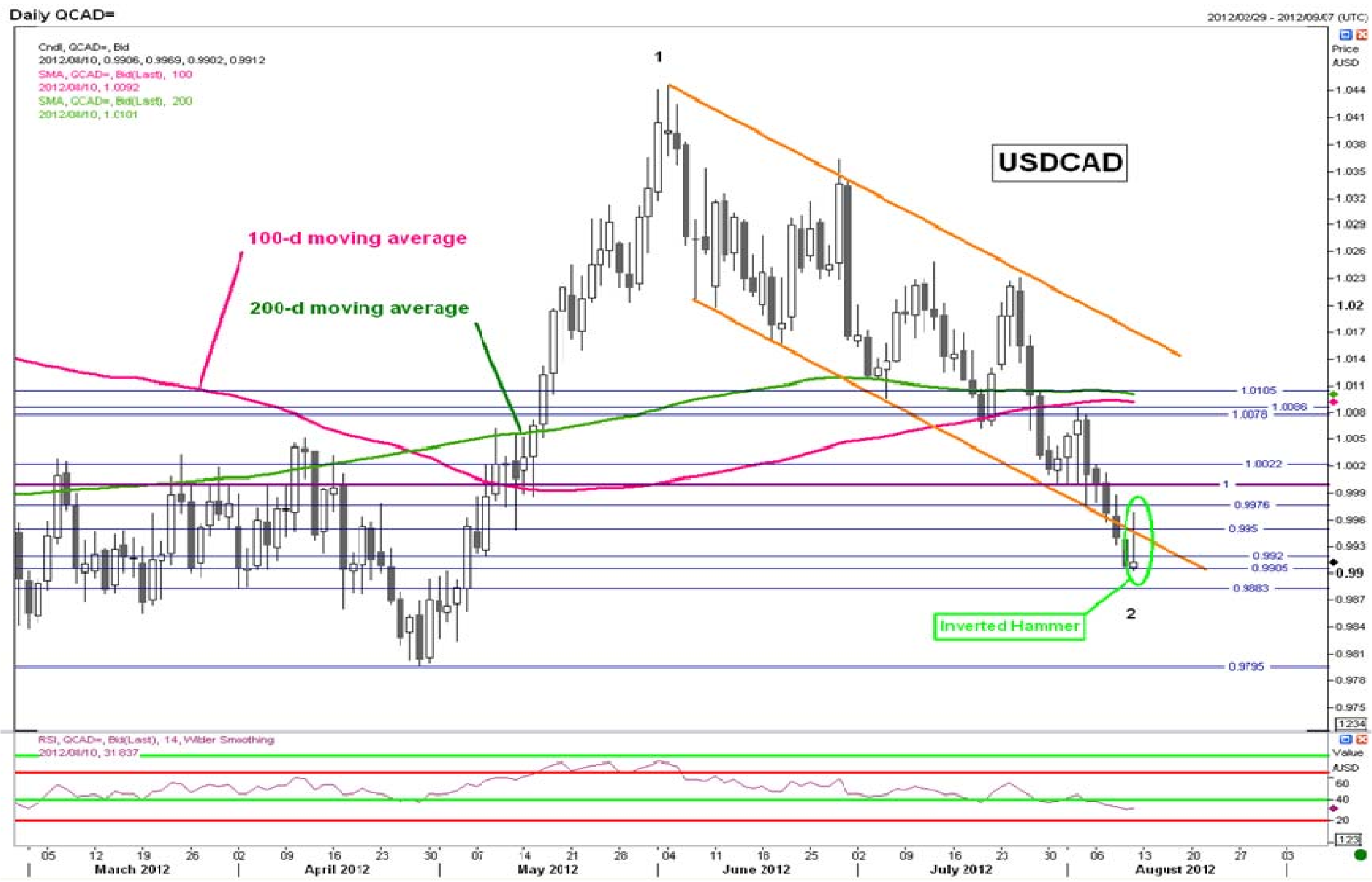
Technical Analysis: USDCAD: *(Friday, Aug 10, 2012, USDCAD chart in daily data)*

USDCAD: Inverted hammer

We wrote last week that signs of rebound or just signs of exhaustion in the USDCAD fall had yet to bee seen. After five days in a row of black candles (lower USDCAD) and a clear break of parity, here is a first positive pattern: an "inverted hammer" formed on Friday (green ellipse). In other words, Bulls (USD buyers) strongly showed up on Friday morning after the Canadian unemployment numbers. "Bears" counterattacked in the afternoon, but still, the fight between Bulls and Bears could be more balanced from now. A positive day (USDCAD higher) on Monday would confirm this change in sentiment. As mentioned last week, there are still many levels to break to the upside to start taking about a change in trend. *Olivier Cosialls*

USD/CAD res. levels
1.0000
0.9976
0.9950
0.9920
Support levels
0.9905
0.9900
0.9888
0.9858



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Fixed Income

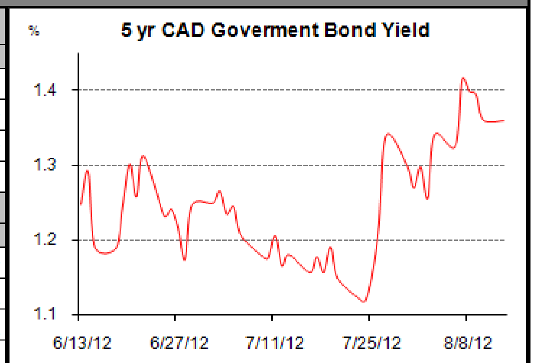
Canadian rates slowly pursued their journey upwards last week, as investors continued to find comfort in the prospects for new stimulus from the European and US central banks.

- Both equities and bond yields rose with investors still feeling the hype following the latest US job numbers.
- Fed officials also mentioned an aggressive bond buying program could be implemented to support the US economy until unemployment falls further.
- The upward move in yields was somehow restrained on Friday, following weak data on the Chinese trade surplus and Canadian job numbers.
- Chinese exports rose only 1% versus the estimated 8% in July while the Canadian job market lost 30K jobs last month compared to economists' expectations of a 6K gain. Bond yields lost a few bps following the two reports.

For the week ahead, the US retail sales will be released on Tuesday, while the US and Canadian inflation numbers will be published respectively Wednesday and Friday. Enjoy your week. *Alexandre Lemieux*

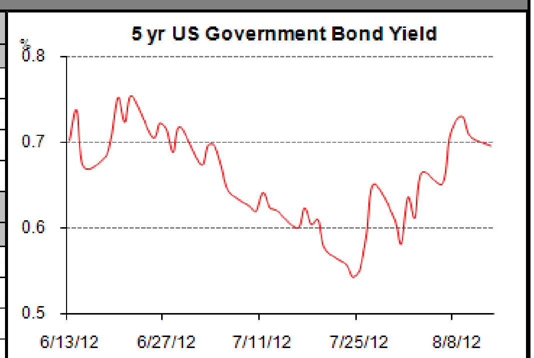
Canada

Key short-term rates	Weekly change				Yearly change		
	10-Aug-12	3-Aug-12	Change (pbs)		11-Aug-11	Change (pbs)	
Overnight Rate	1.0000%	1.0000%	0.0	-	1.0000%	0.0	-
3M Bill (Federal)	0.9810%	0.9810%	0.0	-	0.8360%	14.5	↑
1-month CDOR	1.2164%	1.2150%	0.1	↑	1.1921%	2.4	↑
Prime rate	3.0000%	3.0000%	0.0	-	3.0000%	0.0	-
Government bonds	**Weekly change**				**Yearly change**		
	10-Aug-12	3-Aug-12	Change (pbs)		11-Aug-11	Change (pbs)	
2 year	1.130%	1.120%	1.0	↑	0.915%	21.5	↑
5 year	1.360%	1.340%	2.0	↑	1.503%	-14.3	↓
10 year	1.783%	1.769%	1.4	↑	2.452%	-66.9	↓
30 year	2.319%	2.309%	1.0	↑	3.076%	-75.7	↓



United States

Key short-term rates	Weekly change				Yearly change		
	10-Aug-12	3-Aug-12	Change (pbs)		11-Aug-11	Change (pbs)	
Fed Funds target	0.250%	0.250%	0.0	-	0.250%	0.0	-
3M Tbill	0.101%	0.076%	2.5	↑	0.010%	9.1	↑
1-month LIBOR	0.240%	0.244%	-0.4	↓	0.207%	3.3	↑
Prime rate	3.250%	3.250%	0.0	-	3.250%	0.0	-
Government bonds	**Weekly change**				**Yearly change**		
	10-Aug-12	3-Aug-12	Change (pbs)		11-Aug-11	Change (pbs)	
2 year	0.263%	0.240%	2.3	↑	0.186%	7.7	↑
5 year	0.708%	0.665%	4.3	↑	1.017%	-30.9	↓
10 year	1.658%	1.564%	9.4	↑	2.340%	-68.2	↓
30 year	2.752%	2.644%	10.8	↑	3.770%	-101.8	↓



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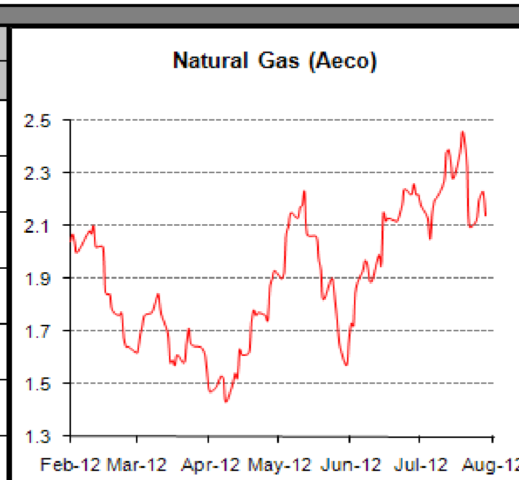
Commodities

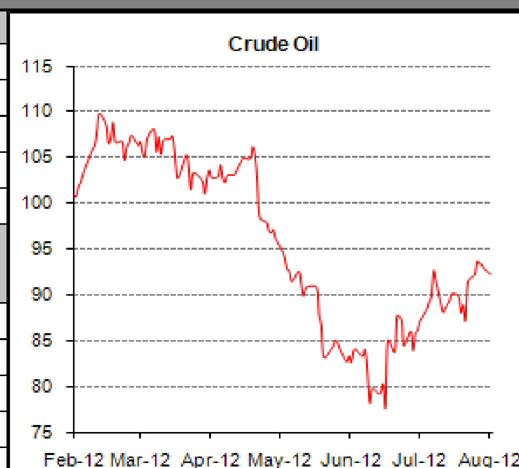
A Bloomberg article published last Friday reports the highest dependence between U.S. equity prices and oil prices in the last two years. Over the last 120 days, crude oil prices and the S&P 500, the main U.S. index, have maintained a correlation of almost 70%. This is due to the fact that, more and more, the market is discounting central banks' monetary easing measures. The main such measures at this time would be a third round of quantitative easing by the U.S. Federal Reserve or an announcement that the European Central Bank will be purchasing bonds. Equities and oil are more in lockstep because people are buying riskier assets. This appetite for risk has resulted in U.S.-dollar returns of 10.6% on WTI crude oil and 3.8% on the S&P 500. The smallest indication by one of the two central banks that it will meet market expectations would further boost this bullish move for all commodities. Have a great week! *Philippe Shebib*

	Open 13-Aug-12	Prior 7-Aug-12	Variation	Year To date
CRUDE OIL (CAD/BARIL)	91.7086	93.0799	-1.47%	-9.21%
HEATING OIL (CAD/LITRE)	0.7930	0.7870	0.76%	0.06%
GASOLINE (CAD/LITRE)	0.7865	0.7852	0.16%	8.43%
NATURAL GAS (CAD/GJ)	2.1400	2.1900	-2.28%	-14.40%
RACK PRICE DIESEL (CAD/LITRE)	0.8640	0.8410	2.73%	-3.01%
RACK PRICE HO (CAD/LITRE)	0.8634	0.8386	2.96%	-2.01%
RACK PRICE GASOLINE (CAD/LITRE)	0.8712	0.8882	-1.91%	8.13%



SWAP PRICE	CRUDE OIL (CAD/BARIL)	NATURAL GAS (CAD/GJ)
Q4 12	92.5220	2.5060
Q1 13	93.9286	2.8880
Q2 13	94.5194	2.8760
Q3 13	94.7225	2.9330
Q4 13	94.8346	3.1870

SWAP PRICE	HEATING OIL (CAD/LITRE)	*Equivalent* RACK MTL DIESEL	RBOB (CAD/LITRE)	*Equivalent* RACK MTL GASOLINE
Q4 12	0.8291	0.9028	0.7560	0.8374
Q1 13	0.8357	0.9100	0.7412	0.8210
Q2 13			0.7768	0.8604
Q3 13			0.7819	0.8661
Q4 13			0.7870	0.8717



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Last Week at a Glance

Canada – In July, the Labour Force Survey flew in the face of consensus expectations, posting a net loss of 30K jobs instead of a net gain of 6K. As a result, the unemployment rate ticked up to 7.3%, though the damage was contained by the fact that the participation rate slid two notches to 66.5%. Private-sector employment fell by 2K, a third straight monthly decline that erased a little more of the sharp gains registered in March and April. The goods-producing sector retreated for a second consecutive month, giving up 13K jobs. Employment in the resources and manufacturing sectors slumped for a second month in a row, more than offsetting a strong rebound in the construction sector. The services-producing sector lost 17K jobs as gains in healthcare and social assistance, educational services, and finance, insurance, real estate and leasing were more than offset by drops elsewhere. Full-time employment sounded a positive note, climbing by 21K after a 29K increase the prior month. However, part-time employment sank a further 52K after sagging by 22K the month before. Hours worked advanced 0.2%. July's LFS report was disappointing overall, with the manufacturing sector in particular feeling the effects of slowing global demand. Averaging roughly 25K/month so far this year, full-time jobs provided a silver lining. In the first seven months of 2012, the labour market has lost some steam compared with the same period last year (+18K/month on average vs. +25K/month). Private-sector hiring from January to July this year has been at half the pace it was a year earlier. The number of hours worked is now tracking at +2.3% annualized in 2012Q3, down slightly from 2.6% in Q2. All told, the report is a reflection of an economy running at a GDP growth rate below 2%. In June, building permits fell 2.5% in dollar terms, reversing in part the 7.1% gain of the preceding month. The performance, however, was a bit better than expected by consensus, which had anticipated a drop of 3.9%. The decline in June was entirely due to the non-residential sector (-12.3%). In contrast, the value of residential permits rose 4.2% for both singles and multiples. Decreases were recorded in the Maritimes and the two westernmost provinces, while Saskatchewan, Manitoba and Central Canada provided offset. In real terms (i.e., the actual number of residential units in Canada), permits for singles and multiples rose 5.1% and 3.6%, respectively. In July, Canadian housing starts dropped to 208.5K, disappointing consensus expectations for a 213K print. The 6.1% decrease on the month was driven by multiples (-7.6%), though singles were down as well (-4%). On a regional basis, British Columbia saw the steepest decline in urban starts (-29%), reversing most of the prior month's outsized gains. Starts were down 18.4% in the Atlantic region and 8.8% in the Prairies. They were up slightly in Quebec and Ontario, though in the latter's case, the increase did not make up for the losses recorded in the previous couple of months. In June, Canada's merchandise trade deficit widened to C$1.8bn, which was much worse than expected by consensus. This was the largest deficit posted since September 2010. Moreover, the prior month's trade balance was revised downward. Exports rose 0.2% in the month, with declines in energy, industrial goods, machinery and equipment and agriculture counterbalanced by a 13.9% jump in auto exports. Imports climbed 2.3% as declines in the energy category were more than offset by increases elsewhere. In real terms, exports grew 0.3% while imports surged 2.5%. For 2012Q2, then, Canada's merchandise trade deficit amounted to roughly C$3.3 billion, its worst showing since 2011Q2 when the Japanese earthquake and tsunami disrupted global trade. Results would have been even worse had it not been for strong vehicle sales in the United States, which gave Canadian auto exporters a boost. June's non-energy trade deficit was the worse ever on record. This is cause for concern in that it is symptomatic of a soft global economy and what is arguably an overvalued Canadian dollar.

United States – In June, the trade deficit narrowed to $42.9 billion from $48 billion a month earlier. Exports rose 0.9% while imports dropped 1.5% thanks to lower imports of crude oil. In real terms, exports sprang 2.9% while imports sank 0.3% (this included a 3.3% decrease in barrels of crude oil). The U.S. trade numbers painted a rather mixed picture. The increase in exports is good to see, but the drop in imports, particularly as regards consumer goods (down a third month running), suggests that demand in the world's largest economy is being tested by a generally sluggish labour market and waning consumer confidence. In other news, U.S. business non-farm labour productivity rose 1.6% annualized in 2012Q2, two ticks better than consensus expectations. The prior quarter was revised up four ticks from -0.9% to -0.5%. The rebound in Q2 productivity was the result of output (+2%) growing faster than hours worked (+0.4%). Unit labour costs climbed 1.7% after soaring by an upwardly revised 5.6% in Q1.

Chinese economic engine slowing – The latest data continue to suggest that the Chinese economy is undergoing a significant slowdown. In July, growth in industrial production cooled to 9.2%, its lowest annual rate since May 2009. As production let up, producer prices, too, showed signs of weaker demand. Indeed, the producer price index (PPI) slid 2.9% y/y, marking a fifth consecutive month of deflation. The last time the Chinese economy experienced such a sharp decline in producer prices was during the 2008-2009 financial crisis. The nation's consumer price index, too, has registered a sharp drop in recent months. In July, the CPI grew 1.8% y/y, well below the 6.5% observed 12 months before. Excluding food, consumer prices rose 1.5% y/y, down from the cycle high 3.0% recorded in June 2011. With the consumer goods PPI continuing along a disinflationary trend, CPI can be expected to follow suit. In light of these negative developments, conventional wisdom suggests the Chinese authorities will now intervene forcefully in order to spur growth in 2012H2. Though we agree with this assumption, we are not sure of the impact that such action could have given the collapse in exports of late. Indeed, total exports were up only 1% y/y in July, their worst showing since January. Making matters worse now, however, is the fact that weakness has become much more pervasive. As the chart below shows, exports to both the Euro zone and Japan are shrinking and those to the United States are on the verge of contracting as well. *Paul André Pinsonnault, Strategy and Economic department NBC*

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