



Economics

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"...we would be cautious about getting too enamoured with commodities as a buy-and-hold asset."

THE WEEK AHEAD

January 18-22, 2010

The Stuff That Recoveries Are Made Of

by Avery Shenfeld

Commodities markets are inherently cyclical. Indeed, they represent the stuff that economic recoveries are made of—the metals used in construction and durable goods, the rubber that hits the road when those vehicles are driven more, and the fuels that gear up activity in factories and transportation systems. So with increasing optimism that the world's economies are on the mend, investors began to add weight late last year to positions in energy and industrial materials.

The climb in resource prices is already looking a bit extended relative to past recoveries. That's true even relative to recoveries that saw the global economy trace out a sharper "V" shaped rebound.

There are reasons behind the force of the rally that could persist into the next quarter or two, or at least prevent a sharp reversal of fortune. Metals markets are benefiting from the tilt in global growth towards China and other emerging markets, where metals use per unit of GDP far exceeds that of the developed world. Government infrastructure spending, ramped up under stimulus plans in many countries, can also be materials intensive relative to the rest of the economic pie. Unusually cold weather across both the US and Europe has been a boon to natural gas prices, helping to bring inventories under control. Speculative demand, including pre-buying by final users in anticipation of even higher prices ahead, has also been encouraged by reports of rebounding economic growth and low financing costs.

But we would be cautious about getting too enamoured with commodities as a buy-and-hold asset. For one, judged by historical elasticities, about a quarter of the resource rally has simply reflected the weakening of the US dollar, since commodities are measured against that numeraire. The dollar is likely to be more stable against other majors as US economic reports look better than those in Europe or Japan, a prospect evidenced by declining FX option vols. Second, global growth, particularly in commodities-heavy activity like government infrastructure, is likely to decelerate later this year in synch with the same trends in stimulus spending and inventory rebuilding. By 2011, budget cuts by governments, and restraint by China in particular, will be hitting the demand for a range of materials.

In other cases, supply responses to today's higher prices will be showing their colours as we move ahead. OPEC is already ramping up output, without the fanfare of any announcements to that effect, and Iraq has more potential if it can keep political violence at bay. At this early stage of the cycle, we're not anywhere near pre-recession days, when OPEC was running full tilt, and the only relief valve for demand pressures came in the form of sharply escalating prices.

Owning "stuff"—raw commodities or the related equities—looks attractive for the near term, as we expect healthy growth to persist for the first half of 2010. But we would be selling into any sharp rallies in anticipation of a cooling fever for resources later this year.

<http://research.cibcwm.com/res/Eco/EcoResearch.html>



Week Ahead Calendar And Forecast

CANADA		CIBC		Consensus		Prior	
Monday January 18	8:30 AM INT'L. SEC. TRANSACTIONS (Nov) (M)						\$5.8B
Tuesday January 19	AUCTION: 3-M BILLS \$6.8B, 6-M BILLS \$2.6B, 1-YR BILLS \$2.6B CASH MANAGEMENT BUYBACK (Jun '10 - Jun '11) - \$1B						
	8:30 AM LEADING INDICATORS M/M (Dec) (M)			1.0%		1.3%	
	9:00AM BANK OF CANADA RATE (Jan) (H)	0.25%		0.25%		0.25%	
Wednesday January 20	7:00 AM CPI M/M (Bank of Canada core) (Dec) (H)	-0.2%		0.0%		0.5%	
	CPI M/M (Bank of Canada core) (Dec) (H)	-0.2%		-0.2%		0.4%	
	CPI Y/Y (Bank of Canada core) (Dec) (H)	1.4%		1.6%		1.0%	
	CPI Y/Y (Bank of Canada core) (Dec) (H)	1.6%		1.7%		1.5%	
	8:30 AM MANUFACTURING SHIPMENTS M/M (Nov) (H)	0.5%		0.5%		2.0%	
Thursday January 21	8:30 AM WHOLESALE TRADE M/M (Nov) (M)			0.3%		0.3%	
	10:30 AM BANK OF CANADA MONETARY POLICY REPORT						
Friday January 22	8:30 AM RETAIL TRADE TOTAL M/M (Nov) (H)	-0.3%		-0.2%		0.8%	
	RETAIL TRADE EX-AUTO M/M (Nov) (H)	0.3%		0.4%		0.2%	
H, M, L = High, Medium or Low Significance SAAR = Seasonally Adjusted Annual Rate							
Consensus Source: Reuters (Canada), Bloomberg (US)							
UNITED STATES							
Markets closed							
AUCTION: 3-M BILLS \$23B, 6-M BILLS \$25B							
	9:00 AM NET CAPITAL INFLOWS (TICS) (Nov) (L)					\$30.0B	\$20.7B
	1:00 PM NAHB HOUSING INDEX (Jan) (L)					17	16
AUCTION: 4-WEEK BILLS \$10B (prev)							
	7:00 AM MBA-APPLICATIONS (Jan-15) (L)						14.3%
	8:30 AM HOUSING STARTS SAAR (Dec) (H)					574K	574K
	BUILDING PERMITS SAAR (Dec) (H)					580K	589K
	PPI M/M (Dec) (H)					0.0%	1.8%
	PPI M/M (core) (Dec) (H)					0.1%	0.5%
	PPI Y/Y (Dec) (H)					4.6%	2.4%
	PPI Y/Y (core) (Dec) (H)					1.0%	1.2%
	8:30 AM CONTINUING CLAIMS (Jan-09) (H)						4596K
	INITIAL CLAIMS (Jan-16) (H)					440K	444K
	10:00 AM PHILADELPHIA FED LEADING INDICATORS M/M (Jan) (M)					18.0	22.5
						0.7%	0.9%

Week Ahead's Market Call

by Avery Shenfeld

In the US, a holiday-shortened week will also be short on economic news. Homebuilding would be important if it was staging a real recovery, but starts are simply bouncing along multi-decade lows in the face of a still-considerable inventory of vacant existing homes. PPI tends to get little attention when it comes out after the same month's CPI, as is the case this time. That will leave the focus squarely on corporate earnings results.

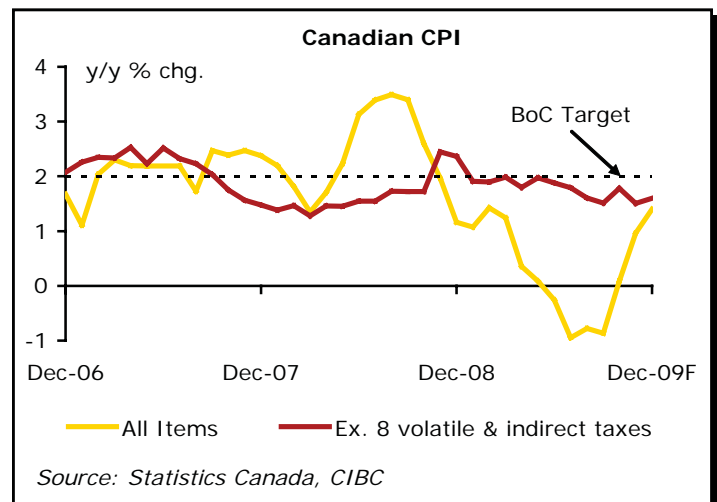
In Canada, the Bank of Canada takes centre stage, not with its obvious decision to keep rates on hold, but in the language accompanying that call, and the subsequent policy report. Expect Carney's tone to show greater confidence that the anticipated recovery is indeed underway, but a maintained commitment to stand by until mid-year given still-substantial economic slack. None of that should be a shocker relative to what is now priced into the OIS market. Elsewhere, we are softer than the consensus for CPI and retail sales which would add up to a good week for bonds, and a negative for the C\$ if we're on the mark.

Week Ahead's Key Canadian Number:**Consumer Price Index—December**

(Wednesday, 7:00 a.m.)

Krishen Rangasamy (416) 956-3219

	CIBC	Mkt	Prior
CPI m/m NSA	-0.2%	0.0%	0.5%
CPI yr/yr	1.4%	1.6%	1.0%
Ex 8 volatile items m/m NSA	-0.2%	-0.2%	0.4%
Ex 8 volatile items yr/yr	1.6%	1.7%	1.5%



Cheaper gasoline was likely the main driver in restricting CPI to only a 0.1% increase on a seasonally adjusted basis (or -0.2% NSA) in December. Further downward price pressures in the month may have come from continued softness in mortgage interest costs, as well as discounting on some consumer items timed to move inventory during the holiday sales season. Nonetheless, prices seem to be heating up again for items such as autos and houses, which will help lift core CPI. A 0.2% seasonally adjusted increase in the core rate translates to 0.2% drop NSA, smaller than the drop in December 2008, hence taking the year on year core inflation rate one notch higher to 1.6%.

Forecast Implications—With the end of the recession, inflation is back on the radar screen. While both headline and core prices are on their way up, excess capacity should limit the ascent, with the year-on-year core inflation rate remaining below or close to the Bank of Canada's 2% target.

Market Impact—We are slightly below consensus expectations, which should be negative for the C\$ and positive for fixed income if we're on the mark.

Other Canadian Releases:**Retail Trade—November**

(Friday, 8:30 am)

Since hitting a cycle trough in December 2008, retail sales have been on a clear uptrend with gains in eight of the subsequent ten months. That trend may have been temporarily interrupted in November, with a 0.3% drop in the headline, dragged by softer auto dealership revenues, with volumes reported to have fallen significantly in the month. Ex-autos performance held up better (+0.3%) with the support of strong receipts from gas stations, in line with higher pump prices in November, and price-related gains in a range of other products including food, personal care supplies, and household equipment.

Manufacturing Shipments—November

(Wednesday, 8:30 am)

Higher industrial product prices likely allowed factory shipments to grow roughly 0.5% in November despite flat export volumes seen in the month's merchandise trade report. Gains in revenues from petroleum and coal products may have offset drops in other categories. December was probably even better, given the relatively strong auto production data in that month. The recovery in factory activity is likely to extend through the first half of 2010, especially with the inventory-related pick-up in US growth. The picture for the second half, however, is not as uplifting for manufacturers. Factories will have to deal with an overvalued Canadian dollar, and a potential relapse in US demand once the restocking period comes to completion south of the border.

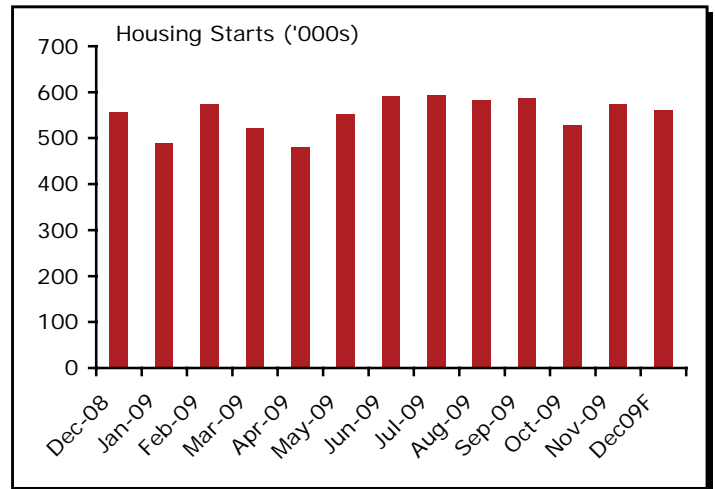
Week Ahead’s Key US Number:

Housing Starts—December

(Wednesday, 8:30 a.m.)

Meny Grauman (416) 956-6527

	CIBC	Mkt	Prior
Housing Starts, SAAR	560K	574K	574K
Building Permits, SAAR	580K	580K	589K



After dropping by 10% in October, US housing starts made up some ground in November, but are unlikely to add to that gain in December. Despite a small projected decline to 560K annualized units, activity in the residential construction sector is still essentially unchanged relative to where it bottomed out in early 2009. The good news for the real estate market is that the federal government’s homebuyers tax credit was recently extended and expanded, likely spurring some demand that had been waiting on the sidelines. Nevertheless, starts activity should remain rangebound over the coming few quarters as the looming shadow inventory of yet-to-be foreclosed homes helps keep builders from putting too many new shovels in the ground just yet.

Forecast Implications—After 14 consecutive quarters of decline, real residential investment began growing again in Q3. That positive development should have extended into Q4, but at a much more modest pace. Because of still-high inventories and housing’s significantly reduced share of US GDP, residential construction spending should not be a significant driver of economic output in 2010, or even 2011 for that matter.

Market Impact—Our slightly below-consensus call for December housing starts should not have a material impact on markets.

Equity Insights

Peter Buchanan and Meny Grauman

China's Economy Took Time to Respond To People's Banks' Last Aggressive Tightening

Reacting to early-2010's lending jump, China followed up last week's surprise T-bill rate increase with a more substantive 50-bp reserve ratio hike this week. Although commodity markets reflexively sold off, it will be some time before those actions—and the more aggressive ones that are expected to follow—weigh appreciably on the economy and resource demand. The People's Bank's last aggressive round of braking actions began early in 2007. The economy was still motoring ahead at a rapid clip a year later then—right up, in fact, to the time that the global financial crisis derailed exports.

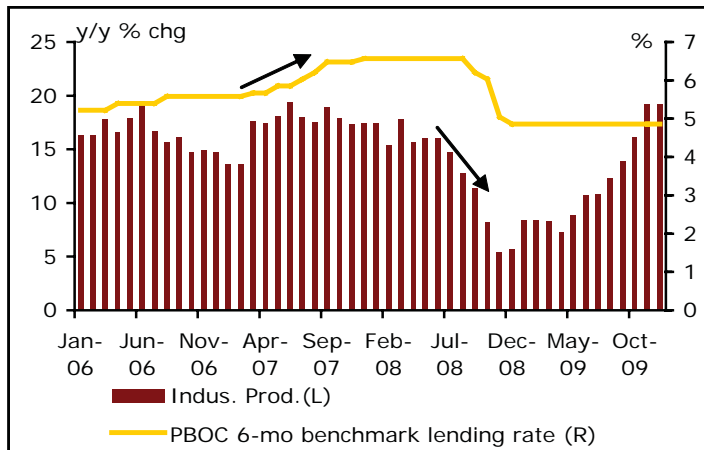
Will US Business Equipment Spending Surpass Subdued Expectations in 2010?

The old adage is don't bet against the US consumer, but it may be corporations who surprise this year. Equipment investment has trailed depreciation recently. That part of the capital stock will consequently decline for the first time since WW II, if firms don't spend more. A near-record gap between corporations' internal cash flows and investment outlays suggest, moreover, that large firms aren't encountering the same financing hurdles as households or small businesses. Capacity utilization at just 72%, is arguably a barrier to increased spending. Equipment outlays, however, grew strongly after the 1982 recession despite comparably low usage levels. Computer spending was a key driver of growth then. The capital stock's near-record age suggests strong pressures exist these days, as then, for replacing obsolescent or worn-out equipment.

Consumer Outlook Remains Negative Despite the Good Quarter

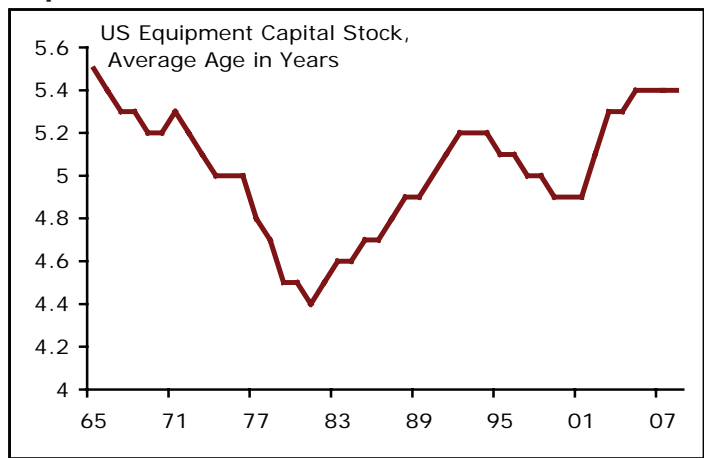
Although US retail sales were up a very healthy 7% in Q4, the consumer outlook remains decidedly negative for 2010 as a whole. In fact despite the recent gains, the S&P500 retail sector has actually treaded water over the last few months, and has recently lost ground versus the overall index. Nominal consumer spending is back above where it was before the recession, but that is largely due to an upswing in services. Retail sales are still back at early 2006 levels, and are being held down in particular by ongoing weakness in sales of big ticket durable goods.

China: Past Policy Tightenings and Industrial Production

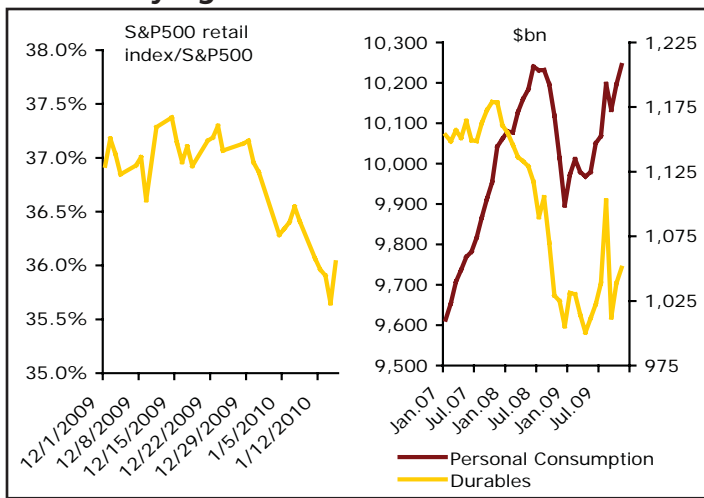


Note: Jan + Feb avg to adjust for shifting new year.

Aging Capital Stock Could Lift Replacement Investment



US Retail Stocks Underperform as Underlying Weakness Persists



Currency Currents

Avery Shenfeld and Krishen Rangasamy

C\$ Vols Have Room to Fall Further

It's been expensive over the past year to hedge against Canadian dollar volatility, but implied vols in the options market are finally coming back to earth. That's not a made-in-Canada story, as the same trend is in evidence in options markets for other major currencies against the greenback, and reflects diminished fears of new economic shockwaves. Fundamentals also point to still lower vols ahead, with decent first-half economic reports likely to give the US dollar at least a breather from its earlier sharply depreciating trend.

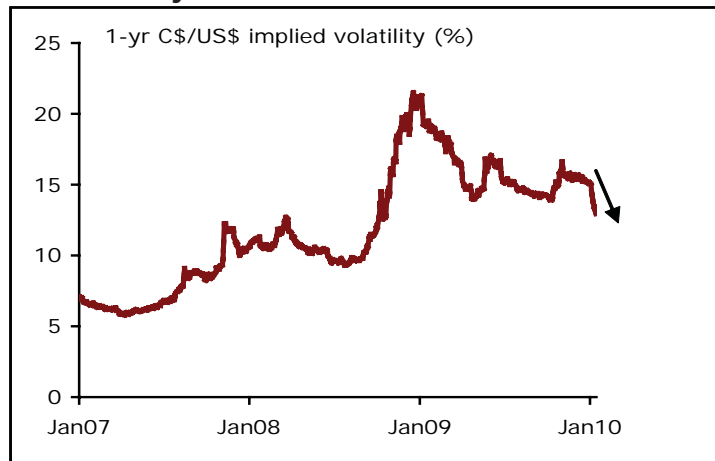
Canadian Trade Rebound Likely in December

November's disappointing trade report took some of the shine off the C\$ as markets gauged that the recovery will be impeded by the overvalued C\$. While the C\$'s negative impact on trade is undeniable, all was not bleak in the November report. First, rising imports might be partly a loss in local market share for Canadian manufacturers, but also reflect improving Canadian goods demand. Second, the \$0.5 bn monthly deterioration in the autos trade balance could be partly reversed in December if auto production data for the month is to be believed. More broadly, we expect a lift to US-bound exports in the first half of the year as America's economy sees reasonably vigorous growth. But further out, C\$ gains and a US slowdown will leave much more challenging conditions for exporters by the second half.

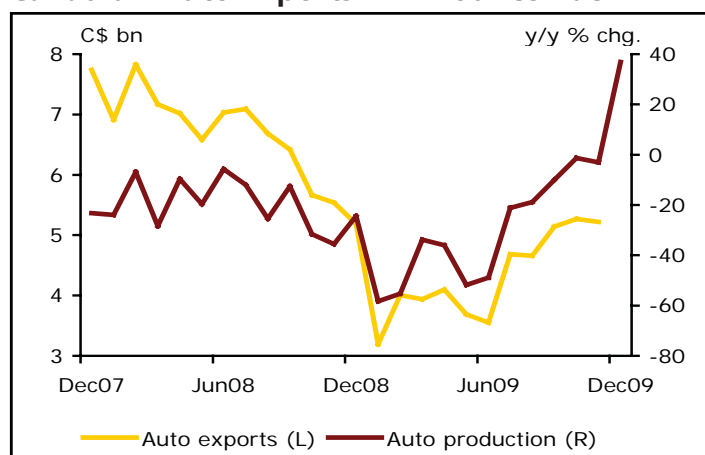
Wishful Thinking

Purchasing Managers at British factories have been a tad too optimistic to say the least. Since hitting bottom in May, factory output has effectively flattened out, contrasting with upbeat manufacturing PMI readings (which have consistently been above 50 through Q409). Talk of a global recovery may have lifted spirits a bit too much, and factory activity could continue to sputter in the months ahead. The financial sector, another economic lynchpin, is still plagued by bad loans, and faces risks of regulatory tightening. Sluggish growth should keep sterling soft against the US\$ in the first half of this year.

C\$ Volatility on the Decline

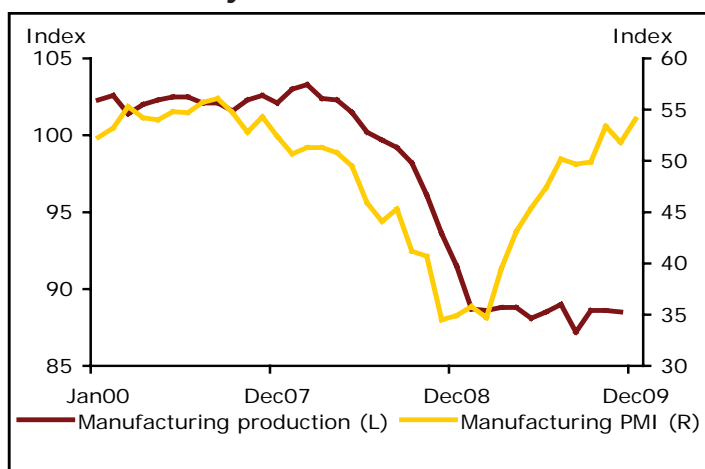


Canadian Auto Exports Will Bounce Back



Source: StatCan

UK Factory Output and Purchasing Managers' Index Out of Sync



CANADIAN RELEASE AND EVENT DATES January/February 2010



MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY																																																																																								
<p>HOUSING STARTS 11 8:15 AM 000's (AR)</p> <table border="1"> <thead> <tr> <th></th> <th>TOTAL</th> <th>SINGLES</th> </tr> </thead> <tbody> <tr> <td>OCT</td> <td>164</td> <td>72</td> </tr> <tr> <td>NOV</td> <td>165</td> <td>75</td> </tr> <tr> <td>DEC</td> <td>175</td> <td>79</td> </tr> </tbody> </table> <p>BUILDING PERMITS (\$) 8:30 AM M M (RES) (NON-RES)</p> <table border="1"> <thead> <tr> <th></th> <th>M</th> <th>M</th> </tr> </thead> <tbody> <tr> <td>SEP</td> <td>12.1</td> <td>-9.2</td> </tr> <tr> <td>OCT</td> <td>6.1</td> <td>43.8</td> </tr> <tr> <td>NOV</td> <td>9.1</td> <td>-21.9</td> </tr> </tbody> </table> <p>Bank of Canada Business Outlook Survey</p>		TOTAL	SINGLES	OCT	164	72	NOV	165	75	DEC	175	79		M	M	SEP	12.1	-9.2	OCT	6.1	43.8	NOV	9.1	-21.9	<p>12</p> <p>MERCHANDISE TRADE 8:30 AM \$MN 12 MO. BALANCE</p> <table border="1"> <thead> <tr> <th></th> <th></th> <th></th> </tr> </thead> <tbody> <tr> <td>SEP</td> <td>-781</td> <td>-628</td> </tr> <tr> <td>OCT</td> <td>503</td> <td>-3,315</td> </tr> <tr> <td>NOV</td> <td>-344</td> <td>-4,707</td> </tr> </tbody> </table> <p>NEW HOUSING PRICE INDEX 8:30 AM</p>				SEP	-781	-628	OCT	503	-3,315	NOV	-344	-4,707	<p>13</p> <p>CONSUMER PRICE INDEX 7:00 AM M (NSA) Y</p> <table border="1"> <thead> <tr> <th></th> <th>M (NSA)</th> <th>Y</th> </tr> </thead> <tbody> <tr> <td>OCT</td> <td>-0.1</td> <td>0.1</td> </tr> <tr> <td>NOV</td> <td>0.5</td> <td>1.0</td> </tr> <tr> <td>DEC</td> <td></td> <td></td> </tr> </tbody> </table> <p>SURVEY OF MANUFACTURING SHIPMENTS 8:30 AM M Y</p> <table border="1"> <thead> <tr> <th></th> <th>M</th> <th>Y</th> </tr> </thead> <tbody> <tr> <td>SEP</td> <td>1.0</td> <td>-18.5</td> </tr> <tr> <td>OCT</td> <td>2.0</td> <td>-16.6</td> </tr> <tr> <td>NOV</td> <td></td> <td></td> </tr> </tbody> </table>		M (NSA)	Y	OCT	-0.1	0.1	NOV	0.5	1.0	DEC				M	Y	SEP	1.0	-18.5	OCT	2.0	-16.6	NOV			<p>14</p> <p>WHOLESALE TRADE 8:30 AM</p> <p>Bank of Canada Monetary Policy Report Update</p>	<p>15</p> <p>CAR & TRUCK SALES 8:30 AM 000's (AR)</p> <table border="1"> <thead> <tr> <th></th> <th>TOTAL</th> <th>DOM.BUILT CAR SALES</th> </tr> </thead> <tbody> <tr> <td>SEP</td> <td>1,540</td> <td>437</td> </tr> <tr> <td>OCT</td> <td>1,594</td> <td>472</td> </tr> <tr> <td>NOV</td> <td>1,497</td> <td>429</td> </tr> </tbody> </table> <p>WAGE SETTLEMENTS 10:00 AM (%)</p> <table border="1"> <thead> <tr> <th></th> <th>PVT.</th> <th>PUB.</th> <th>TOT.</th> </tr> </thead> <tbody> <tr> <td>SEP</td> <td>2.0</td> <td>2.2</td> <td>2.1</td> </tr> <tr> <td>OCT</td> <td>1.8</td> <td>2.2</td> <td>2.2</td> </tr> <tr> <td>NOV</td> <td>1.3</td> <td>2.4</td> <td>2.0</td> </tr> </tbody> </table>		TOTAL	DOM.BUILT CAR SALES	SEP	1,540	437	OCT	1,594	472	NOV	1,497	429		PVT.	PUB.	TOT.	SEP	2.0	2.2	2.1	OCT	1.8	2.2	2.2	NOV	1.3	2.4	2.0
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U.S. RELEASE AND EVENT DATES January/February 2010



MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
11	12 GOODS & SERVICES BALANCE (BOP) \$B 8:30 AM GDS SERV TOT SEP -47.4 11.7 -35.7 OCT -45.2 12.0 -33.2 NOV -48.4 12.0 -36.4 <i>3-Yr NOTE AUCTION</i> <i>BOT (9:00) REDBOOK (10:40)</i>	13 Beige Book TREASURY BUDGET 2:00 PM <i>10-Yr NOTE AUCTION</i>	14 RETAIL SALES 8:30 AM M Y OCT 1.2 -2.0 NOV 1.8 2.5 DEC -0.3 5.4 BUSINESS INVENTORIES 10:00 AM <i>30-Yr BOND AUCTION</i> MONEY SUPPLY M-2 4:30 PM M Y OCT 0.3 5.4 NOV 0.4 5.1 DEC 0.2 3.1 <i>INITIAL JOBLESS CLAIMS (8:30)</i>	15 CONSUMER PRICE INDEX 8:30 AM M (SA) Y (NSA) OCT 0.3 -0.2 NOV 0.4 1.8 DEC 0.1 2.7 CAPACITY UTIL/IND. PROD. 9:15 AM LEV M Y OCT 71.0 0.2 -6.7 NOV 71.5 0.6 -4.9 DEC 72.0 0.6 -2.1 MICHIGAN SENTIMENT (P) 10:00 AM <i>3, 10-Yr NOTE SETTLEMENT</i> <i>30-Yr BOND SETTLEMENT</i>
18 MARTIN LUTHER KING JR. DAY (HOLIDAY) (Markets Closed)	19 NET CAPITAL INFLOWS TICS 9:00 AM <i>BOT (9:00) REDBOOK (10:40)</i>	20 HOUSING STARTS 8:30 AM MIL (AR) M OCT 0.527 -10.1 NOV 0.574 8.9 DEC PRODUCE PRICE INDEX 8:30 AM M (SA) Y (NSA) OCT 0.3 -1.9 NOV 1.8 2.4 DEC <i>BOT (9:00) REDBOOK (10:40)</i>	21 PHILADELPHIA FED INDEX 10:00 AM LEADING INDICATOR 10:00 AM <i>2, 5, 7-Yr NOTE ANNOUNCEMENT</i> <i>INITIAL JOBLESS CLAIMS (8:30)</i>	22
25 EXISTING HOME SALES 10:00 AM	26 S&P/CASE-SHILLER HOUSE PRICE INDEX 9:00 AM CONSUMER CONFIDENCE 10:00 AM FOMC Meeting Begins <i>2-Yr NOTE AUCTION</i> <i>BOT (9:00) REDBOOK (10:40)</i>	27 NEW HOME SALES 10:00 AM FOMC Rate Decision <i>5-Yr NOTE AUCTION</i>	28 DURABLE GOODS ORDERS 8:30 AM M Y OCT -0.6 -11.7 NOV 0.2 -7.8 DEC <i>7-Yr NOTE AUCTION</i> <i>INITIAL JOBLESS CLAIMS (8:30)</i>	29 GDP 8:30 AM (AR) REAL IMPLICIT GDP DEFLECTOR 09:Q2(F) -0.7 0.0 09:Q3(F) 2.2 0.4 10:Q1(P) EMPLOYMENT COST INDEX 8:30 AM WAGES & TOTAL SALARY BEN. 09:Q2 0.4 0.4 0.3 09:Q3 0.4 0.4 0.4 09:Q4 CHICAGO PMI 9:45 AM MICHIGAN SENTIMENT (F) 10:00 AM
1 PERS. INCOME & OUTLAYS 8:30 AM SAVING INCOME CONS RATE M M AR OCT 0.3 0.6 4.7 NOV 0.4 0.5 4.7 DEC ISM MFG SURVEY 10:00 AM COMP. PRICES INDEX INDEX NOV 53.6 55.0 DEC 55.9 61.5 JAN	2 LIGHT VEHICLES SALES MIL (AR) Y NOV 10.889 5.0 DEC 11.207 8.8 JAN <i>BOT (9:00) REDBOOK (10:40)</i>	3 ADP SURVEY 8:15 AM ISM NON-MFG SURVEY 10:00 AM <i>3, 10-Yr NOTE ANNOUNCEMENT</i> <i>30-Yr BOND ANNOUNCEMENT</i>	4 NON-FARM PRODUCTIVITY 8:30 AM Q/Q (AR) Y/Y 09:Q2 (R) 6.9 1.9 09:Q3 (R) 8.1 4.0 09:Q4 (P) FACTORY ORDERS 10:00 AM M Y OCT 0.8 -10.4 NOV 1.1 -3.2 DEC <i>INITIAL JOBLESS CLAIMS (8:30)</i>	5 EMPLOY. SITUATION 8:30 AM NON- CIV AVG FARM UNEMP HRLY PAYROLL RATE EARN (000s) M % Y NOV 4 10.0 2.3 DEC -85 10.0 2.2 JAN CONSUMER CREDIT 3:00PM
8	9 <i>BOT (9:00) REDBOOK (10:40)</i>	10	11 <i>INITIAL JOBLESS CLAIMS (8:30)</i>	12

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