



Weekly Market Insight

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NORTH AMERICAN & INTERNATIONAL ECONOMIC HIGHLIGHTS

Canada: 2010 Pop and Fizzle

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No economic recovery goes in a straight line and the current one will be the most non-linear of them all. As in the US, many of the chief drivers of the Canadian recovery will run out of fuel by mid-year, and will give way to sub-par growth in the second half of the year.

The headline GDP numbers for Q3 were disappointing, but they masked strong momentum in the domestic economy. Final domestic demand rose at an annualized pace of 4.7% in the quarter, capping off the strongest six-month period in any initial post-war recovery. That momentum clearly reflects the recent improvement in the labour market which, beyond the volatility of the monthly figures, is showing a clear upward trend. While health and educational jobs are being created in large numbers, these categories are not “recovery makers” or major cyclical forces. What traditionally carries or destroys a recovery are the construction and manufacturing sectors, and here the non-linear nature of the current recovery will be most evident.

Housing Stall Will Weigh on Growth

Construction jobs are playing a major role in supporting the current recovery in the job market. While many will argue that government infrastructure spending is behind the revival of the construction sector, the reality is that more construction jobs march to the tune of house prices.

But as we found in our recent analysis (see December 2009 *Economic Insights*) house prices are already overshooting. Facing an increased supply this spring, and higher mortgage rates down the road, real estate values could level off in coming months and even decline in some of the now-hot markets. As a result, the current wave of hiring in the construction sector will give way to more subdued job growth in this sector in the second half of the year, particularly since first-half activity will have been boosted by builders running ahead of the July 2010 implementation of sales tax reform in Ontario and British Columbia.

But flattening housing prices will have an additional negative impact beyond construction employment cutbacks. According to the Bank of Canada’s estimates, consumers spend 5.7 cents yearly out of every dollar increase in the value of their homes. Note that this housing wealth effect is significantly more powerful than the wealth effect associated with rising stock prices. Housing wealth is much more broadly distributed across income levels than stock wealth and its impact on consumer spending is much more immediate. The negative wealth effect seen early in the recession clearly had a negative impact on spending, but the current recovery will see a cumulative increase in the wealth effect of close to \$10 billion by mid-year—an amount equivalent to one-fifth of the projected increase in overall consumer spending in 2010. But with house prices flattening or potentially falling in the second half of the year, that important boost to consumption will evaporate.

The Inventory Cycle: A Double-Edged Sword

To a lesser extent than in the US, where the earlier decline was sharper, a recovery in inventories will give a significant but temporary lift to growth. During the worst of the panic in early 2009, inventories were slashed, weighing heavily on GDP growth. Now with businesses starting to see the light, inventories are being cut at a much slower pace. This change means that once again inventories are a positive contributor to GDP growth—a process that will reach its zenith in the second quarter of the year before dropping off in the second half as inventories reach a more optimal level relative to sales. Note that these measures somewhat exaggerate the actual lift to Canadian GDP, due to the heavy import content of retail and wholesale inventories in Canada.

Beyond its direct contribution to GDP growth, the inventory cycle is an important factor behind the swings in factory jobs. After shedding over 200,000 jobs during the recession, the manufacturing sector is starting to show signs of recovery with modest job creation in the last six months of 2009. And we can expect further gains in that sector in the first half of 2010 as depleted inventories are replenished. But if history is any guide, those job gains won't be sustainable once the inventory refills are completed. Note that in past recoveries the bulk of the factory jobs created were in the early stages of the upturn (i.e. similar to our current situation), when inventories had moved from their trough to zero. But once that phase ends (likely in the second half of the year for the current recovery), manufacturing jobs won't be as forthcoming. Note that the historical average 2% growth in factory jobs in that phase is biased upwards because it masks the impact of a NAFTA-related structural change in manufacturing in the early 1990s. In fact, excluding that jobless recovery, all other cyclical upswings have seen manufacturing jobs fall during the more mature stage of the inventory cycle. Given the competitive challenge of an overvalued C\$, this cycle is unlikely to be an exception.

Indeed, as important as the domestic inventory cycle is to the shape of the recovery, inventory refills in the US could potentially play an even bigger role. To get an idea of how tied the fortunes of Canadian exporters are to the American inventory cycle, one just has to look at the past decade. The collapse in trade in the recent recession was a result of a massive cutback in US inventories, and the restocking stateside should provide a commensurate bounce back in Canadian exports, something that will lift GDP over the first half of 2010. The outlook for exporters afterwards, however, is less rosy. The completion of US inventory refills, a slowdown of the American economy, and an overvalued Canadian dollar, will cause trade to revert to being a net drag on the economy.

Business Investment Constrained by Capacity Glut

Business investment was strong in the third quarter in line with a normal cyclical trend, as the first wave of investment is mostly replacement investment which is necessary regardless of where we are in the cycle. But the expansion investment that follows is usually much weaker and this time, it will be even weaker given a record low capacity utilization rate.

The 2.3% GDP growth projected for 2010 will mask two opposing trends. Boosted by temporary factors such as the inventory cycle on both sides of the border, real estate activity and replacement investment, first half growth will advance at an impressive annual rate of more than 3%. But this euphoric performance will give way to a much more subdued second half which will see growth decelerating below the 2% mark—a performance that will force the Bank of Canada to pause very early in the tightening cycle.

Market Snapshot

US	Current*	yesterday*	a week ago*	a month ago*	a year ago
TED SPREAD (bps)	21	21	20	22	108
10Y / 2Y SPREAD (bps)	279	283	285	272	192
2Y SWAP SPREAD (bps)	26	26	27	35	77
3M T-Bill (%)	0.04	0.04	0.05	0.03	0.21
LIBOR 1 MONTH (%)	0.23	0.23	0.23	0.23	0.55
LIBOR 3 MONTH (%)	0.25	0.25	0.25	0.25	1.29
2-YR BOND (%)	0.88	0.92	0.98	0.82	0.95
5-YR BOND (%)	2.42	2.49	2.58	2.26	1.88
10-YR BOND (%)	3.67	3.75	3.83	3.54	2.87
A Rated / 10Y TREASURY (bps)	161	160	157	175	362
B Rated / 10Y TREASURY (bps)	496	496	496	554	1271
BB Rated / 10Y TREASURY (bps)	400	400	396	456	946
CANADA					
PRIME / BA SPREAD (bps)	185	185	185	185	183
CDOR 3 MONTH (%)	0.45	0.45	0.46	0.47	1.20
CDOR 3 MONTH / 3M T-BILL SPREAD (bps)	28	27	28	27	75
10Y / 2Y SPREAD (bps)	220	226	229	216	198
2-YR BOND (%)	1.30	1.32	1.33	1.25	0.96
5-YR BOND (%)	2.64	2.71	2.72	2.55	1.87
10-YR BOND (%)	3.50	3.58	3.62	3.40	2.94
A Rated / 10Y TREASURY (bps)	109	104	104	113	327
BBB Rated / 10Y TREASURY (bps)	169	168	175	185	423
CAN Sovereign Agency / 10Y TREASURY (bps)	43	38	39	35	51
Provincial / 10Y TREASURY (bps)					
ALTA	62	59	59	62	140
BC	81	78	79	85	157
MAN	82	78	80	79	166
NB	77	74	76	81	164
PEI	107	103	106	108	171
NFLD	112	109	109	122	196
ONT	97	93	93	98	181
QUE	102	99	99	106	187
SASK	99	95	96	102	170
NS	90	86	87	91	165
COMMODITIES					
WTI CRUDE FUTURE (US\$ / bbl.)	78.9	79.8	82.3	70.3	45.5
NATURAL GAS (US\$ / MMBtu)	5.7	5.8	5.7	5.3	3.9
SILVER (US\$ / t oz.)	18.6	18.6	18.4	17.3	13.3
GOLD (US\$ / t oz.)	1133.7	1139.5	1130.2	1126.7	942.7
WHEAT (US¢ / bu.)	523.5	533.3	556.3	517.8	516.3
SOYBEANS (US¢ / bu.)	984.8	983.3	1009.0	1037.5	879.0
SUGAR (US¢ / lb.)	27.6	28.1	28.0	23.1	12.8
CORN (US¢ / bu.)	378.8	379.3	419.3	380.5	352.8
FX					
C\$ / US\$	1.028	1.030	1.035	1.053	1.287
US\$ / EURO	1.439	1.449	1.432	1.465	1.265
C\$ / EURO	1.479	1.492	1.482	1.543	1.629
YEN / US\$	90.920	91.296	92.960	89.435	98.250
US\$ / BRITISH POUND	1.630	1.631	1.596	1.623	1.409
SWISS FRANCS / US\$	1.025	1.021	1.032	1.033	1.158

* As of 11:00 a.m.

Note: Data is for reference only.

International Stock Indexes

Thursday, January 14, 2010

Index (Regiona/Country)	DAILY				% Chg - +	YTD % chg	52 WEEK			3-yr % chg
	High	Low	Close	Chg			High	Low	% Chg	
Global										
The Global Dow (World)	2046.24	2034.17	2040.91	6.83	0.34	2.8	2047.33	1139.9	45.3	-1.5
The Global Dow (Euro) (World)	1330.31	1320.24	1327.7	7.54	0.57	1.9	1336.44	849.42	31.1	-5.1
DJ Global Index (World)	235.11	233.57	234.72	1.15	0.49	3.4	234.99	130.29	46.9	-5.5
DJ Global ex U.S. (World)	208.97	207.09	208.49	1.4	0.68	3.7	209.06	111.8	54.1	-4.7
MSCI EAFE* (World)	n.a.	n.a.	1642.2	14.07	0.86	3.9	1642.2	911.39	45.2	-7.4
Asia Pacific										
DJ Asia-Pacific (Asia-Pacific)	129.29	127.51	129.11	1.61	1.26	4.9	129.23	73.76	48.4	-3.7
All Ordinaries (Australia)	4949.9	4906	4929.4	29.28	0.6	1	4981.2	3111.7	41.8	-4.2
S & P/ASX 200 (Australia)	4920.5	4875.1	4898	29.91	0.61	0.6	4950.7	3145.5	38.8	-4.6
DJ CBN China 600 (China)	28632.67	28150.45	28624.67	461.15	1.64	-1.5	29890.92	16021.29	78.7	19.8
Dow Jones China 88 (China)	287.83	282.68	287.49	3.02	1.06	-4.6	327.69	174.25	65	12.9
Shanghai Composite (China)	3219.02	3165.6	3215.55	42.89	1.35	-1.9	3471.44	1920.21	67.5	6.4
Hang Seng (Hong Kong)	21988.93	21707.1	21716.95	-31.65	-0.15	-0.7	22943.98	11344.58	64	3.5
Bombay Sensex (India)	17628.04	17525.71	17584.87	75.07	0.43	0.7	17701.13	8160.4	94.4	7.8
Jakarta Composite (Indonesia)	2661.93	2633.58	2645.18	12.31	0.47	4.4	2659.55	1256.11	96.9	16.4
Nikkei 300 (Japan)	195.6	193.43	195.6	3.06	1.59	5.7	196.39	140.76	20.9	-16.6
Nikkei Stock Avg (Japan)	10909.94	10774.25	10907.68	172.65	1.61	3.4	10907.68	7054.98	35.9	-13.9
Topix Index (Japan)	959.01	948.63	959.01	14.99	1.59	5.7	975.59	700.93	20.5	-17.1
Kuala Lumpur Composite (Malaysia)	1294.94	1289.74	1294.71	5.2	0.4	1.7	1294.71	838.39	44.3	5
NZSX-50 (New Zealand)	3282.1	3275.03	3278.33	2.14	0.07	1.5	3310.23	2417.95	19.5	-6.8
KSE 100 (Pakistan)	9820.05	9742.74	9802.45	17.6	0.18	4.4	9845.73	4815.34	69.6	-2
Manila Composite (Philippines)	3121.91	3096.82	3121.91	25.21	0.81	2.3	3121.91	1759.33	59.7	1.4
Straits Times (Singapore)	2925.33	2902.66	2909.52	21.14	0.73	0.4	2933.53	1456.95	70.7	-0.4
Kospi (South Korea)	1692.78	1677.46	1685.77	14.36	0.86	0.2	1718.88	1018.81	51.7	6.7
Colombo Stock Exchange (Sri Lanka)	3541.92	3494.62	3536.71	...	Closed	4.5	3536.71	1612.33	117.1	8
Weighted (Taiwan)	8313.94	8237.67	8289.98	93.42	1.14	1.2	8327.62	4242.61	91.9	2.2
SET (Thailand)	751.93	747.94	749.42	2.68	0.36	2	751.86	411.27	75.8	5.1
Europe										
DJ Stoxx 600 (Europe)	259.28	257.41	258.84	1.89	0.73	2.2	259.15	157.97	35.4	-11.4
DJ Stoxx 50 (Europe)	2624.28	2605	2620.44	18.26	0.7	1.6	2629.34	1614.75	31.9	-11.4
DJ Euro Stoxx 50 (Euro zone)	3001.58	2972.54	2989.71	11.3	0.38	0.8	3017.85	1809.98	32.4	-10.5
DJ Euro Stoxx (Euro zone)	280.02	277.83	279.38	1.31	0.47	1.7	281.41	169.38	34	-11.4
ATX (Austria)	2702.49	2652.07	2702.49	50.65	1.91	8.3	2752.39	1411.95	59.5	-15
Bel-20 (Belgium)	2584.31	2565.07	2571.37	-3.74	-0.15	2.4	2606.93	1527.27	38.5	-16.9
PX 50 (Czech Republic)	1199.4	1191.8	1199	14.4	1.22	7.3	1199	628.5	44.2	-9.2
OMX Copenhagen (Denmark)	339.32	333.92	338.35	4.81	1.44	7.2	338.35	193.26	43.9	-7.7
OMX Helsinki (Finland)	6640.49	6584.58	6618.91	53.39	0.81	2.5	6690.24	4110.31	27.5	-11.4
CAC 40 (France)	4029.71	3993.5	4015.77	14.91	0.37	2	4045.14	2519.29	34	-10.6
DAX (Germany)	6009.91	5951.69	5988.88	25.74	0.43	0.5	6048.3	3666.41	38.1	-3.7
BUX (Hungary)	23009.66	22803.16	22981.48	246.15	1.08	8.3	22981.48	9461.29	90	-1.4
FTSE MIB (Italy)	23905.94	23692.61	23805.99	147.59	0.62	2.4	24425.98	12621	29.4	-17.3
AEX (Netherlands)	341.77	339.07	340.61	2.43	0.72	1.6	343.03	199.25	39.8	-12.2
All-Shares (Norway)	431.16	426.07	430.85	4.78	1.12	2.6	434.23	239.48	58.5	-4.4
WIG (Poland)	41347.69	40992.83	41088.61	-51.85	-0.13	2.8	41342.62	21274.28	58.5	-7
PSI 20 (Portugal)	8806.91	8697.07	8697.31	-42.54	-0.49	2.8	8882.69	5743.09	37.1	-8.9
DJ Russia Titans 10 (Russia)	5854.01	5548.77	5842.44	100.76	1.75	4.8	5842.44	2351.18	130	-2.2
RTS Index (Russia)	1561.91	1550.02	1561.91	23.48	1.53	9.5	1561.91	498.2	174.4	-4.6
IBEX 35 (Spain)	12050.4	11902.3	11999.8	41.5	0.35	0.5	12222.5	6817.4	39.4	-5.8
SX All Share (Sweden)	310.92	308.92	309.79	1.9	0.62	3.4	309.79	186.4	60	-6.4
Swiss Market (Switzerland)	6646.52	6573.64	6627.42	72.87	1.11	1.2	6631.44	4307.67	23.1	-9.8
Istanbul National 100 (Turkey)	55265.67	54460.34	54740.6	113.41	0.21	3.6	54972.94	23035.95	118.3	12.8
FTSE 100 (U.K.)	5521.9	5473.5	5498.2	24.72	0.45	1.6	5538.1	3512.1	33.4	-4.1
FTSE 250 (U.K.)	9630.72	9562.08	9568.03	-1.49	-0.02	2.8	9726.44	5769.79	54.2	-4.9
Americas										
DJ Americas (Americas)	305.81	304.17	305.23	0.38	0.12	2.9	305.67	172.41	43.4	-4.9
Merval (Argentina)	2385.73	2341.92	2381.04	42.97	1.84	2.6	2401.75	930.12	116.4	4.7
Sao Paulo Bovespa (Brazil)	70508.2	69661.25	69801.41	-584.06	-0.83	1.8	70729.34	36234.69	78.3	17.4
S & P/TSX Comp (Canada)	11888.33	11776.44	11804.38	-49.18	-0.41	0.5	11953.83	7566.94	32.9	-2.4
Santiago IPSA (Chile)	3787.38	3755.64	3782.53	22.52	0.6	5.6	3782.53	2360	52.3	11.3
IPC All-Share (Mexico)	32847.93	32429.67	32729.58	-106.5	-0.32	1.9	33064.57	16929.8	61.4	7.5
Caracas General (Venezuela)	59639.76	59136.42	59607.4	300.37	0.51	8.2	59607.4	34900.62	70.7	6
Other Countries										
CASE 30 (Egypt)	6680.8	6610.6	6680.8	99.21	1.51	7.6	7249.55	3389.31	54.4	-1.9
Tel Aviv (Israel)	1161.08	1144.37	1146.95	-4.95	-0.43	0.2	1179.12	637.23	72.1	7.3
Johannesburg All Share (South Africa)	28305.08	28022.3	28141.8	74.8	0.27	1.7	28346.78	18120.69	37.7	4.2

*Europe, Australia, Far East: U.S.-dollar terms.

Three year percent change is annualized.

Sources: Reuters; WSJ.com

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