

CAPITAL MARKETS RESEARCH

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Daily Points

— Tracking the numbers



On Deck for Thursday, September 02

US	09/02	(08:30)	Initial Jobless Claims (000s)	Aug. 28	465	475	473
US	09/02	(08:30)	Continuing Claims (mn)	Aug. 21	4.43	4.45	4.46
US	09/02	(08:30)	Unit Labor Costs (q/q a.r.)	Q2-P	--	1.2	0.2
US	09/02	(08:30)	Productivity (q/q a.r.)	Q2-P	--	-1.9	-0.9
US	09/02	(10:00)	Factory Orders (m/m)	Jul	0.4	0.2	-1.2
US	09/02	(10:00)	Pending Home Sales (m/m)	Jul	-2.3	-1.0	-2.6
US	09/02	(10:30)	ICSC Chain Store Sales - Monthly (y/y)	Aug	--	--	2.8

KEY POINTS:

- ECB to lower 2011 growth
- Would the BoC risk CAD over-reaction on a hiking path?
- US jobless claims: nonfarm revision risk is all that matters
- US factory orders: will renewed optimism continue?
- US pending home sales likely pushed lower again
- Lower US vehicle sales point to weak retail sales
- US productivity growth waning as a negative for earnings
- French job markets post best print since March 2008
- UK house prices fall again
- Sweden hikes rates
- Spanish unemployment rises by most since February
- Eurozone Q2 GDP meets expectations
- US TIPS reopening at 1pm
- Three Fed speeches today
- No Canadian releases today

CANADA

One of the related issues over whether the Bank of Canada can sustainably raise interest rates ahead of the Fed is the impact on the Canadian dollar. We think that such concerns are somewhat exaggerated. Using widely cited research done by the Bank of Canada on currency drivers (Issa, Lafrance and Murray, 2006, "Turning the Black Tide: Energy Prices and the Canadian Dollar,") we figure that a 100bps sustained rise in Canada-US spreads would result in about a 4% long-run appreciation in the Canadian dollar. If today's exchange rate were to accurately incorporate known information to date and if it contained no rate expectations already built into today's spot, then it would mean that CAD could rise to near parity against the USD over the next year should the BoC keep hiking by another 100bps while the Fed sleeps as we believe is within the range of what is likely to occur. That's roughly a four cent appreciation in the Canadian dollar's rate of exchange against the USD. Further, the real outcome also depends upon what is happening to other currency drivers like energy and non-energy commodity prices given the effects that Issa, Lafrance and Murray empirically estimated. Every 1% rise in energy prices leads to an appreciation of one-fifth that pace in CAD against the USD, and every 1% rise in non-energy commodity prices results in a rise of about one-third that pace. Scotia Economics is of the view that commodity

BoC Events

BoC Overnight Lending Rate**Current Rate:** 0.75%**Next Move:** September 8 @ 1.0%**Bias:** Neutral

Fed Events

Fed Funds Target Rate**Current Rate:** 0-0.25%**Next Move:** Sept. 21 @ 0-0.25%**Bias:** Dovish

Fed Chairman Bernanke will testify before the financial Crisis Inquiry Commission at 9amET in Washington.

Fed's Rosengren and Pianalto will speak at 9amET at a Washington summit examining the impacts of foreclosed and vacant properties on neighbourhoods.

The **reopening of 10-year TIPS** is scheduled for 1pmET.

Key International Events

ECB**Current Rate:** 1.00%**Next Move:** October 7 @ 1.00%**Bias:** Dovish**BoE****Current Rate:** 0.50%**Next Move:** September 9 @ 0.50%**Bias:** Dovish**BoJ****Current Rate:** 0.10%**Next Move:** September 7 @ 0.10%**Bias:** Dovish

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prices are generally moving sideways into next year on an average annual basis, so CAD is unlikely to get a further lift. Indeed, if global growth disappoints as we think it is likely to in 2011, then commodities may face a softening bias at points. So pushing CAD more than a few pennies above where it is now as a long-run sustained forecast is a mild outcome stemming from the impact of a 100bps further interest rate differential. Some of that, however, is already priced into the short-ends of the Canadian and US markets such that CAD's rate of appreciation could well be significantly less than what we've argued above. As for the economic impact of a stronger CAD, we continue to believe that it's a different ball game today than in past cycles over prior decades. See our "CAD Parity Doesn't Mean What it Used To," April 6th 2010. On balance, we figure that it would have a modest impact on the overall Canadian economy notwithstanding regional or sector effects that are more the responsibility of fiscal than monetary policy.

UNITED STATES

Pending home sales (10:00amET) are expected to have fallen again in July, but opinions are more divided than on earlier reports. The NAHB's index of homebuyer traffic fell in July over June, and while that's more useful in guesstimating new home sales, it's also a reading of relevance to the general attitude toward purchasing a home during the month. Of more direct relevance to pending home sales (that track resales) is that mortgage purchase applications fell by about 3% in July over June. Since pending home sales close and mostly show up in the resales data 30-60 days later, ongoing weakness in pending home sales points to expectations for resales to remain near their lows until at least into the readings for September.

Factory orders (10:00amET) are likely to get only a modest lift this morning. The July print will be only partly buoyed by what we already know happened to durables that were up a mild 0.3% m/m in July as heavy aerospace orders were offset by a steep decline in core durable goods orders ex transportation. There are two unknowns going into this morning's report. One is whether it will capture fresher perspectives on durables given that the reference period for the durable goods report was the first half of the month and that Boeing orders primarily surged only in the last half of the month and may not have been fully captured in the first go at durables. Further, the swing factor is nondurable goods orders that we expect will post only a minor gain.

The end of day company add-up on reports released during yesterday showed that **U.S. vehicle sales** fell by about 1% in July over June, and were revised 2.5% lower for June. That speaks to downside risks to retail sales for the month of July (September 14th) and more material downside revision risks to June. Should June be revised lower, then combined with yesterday's construction spending figures, the risk is pointing toward another downward revision to Q2 GDP growth that came in at 1.6% on the second of three prints with the next one on tap for September 30th.

Productivity growth is reversing course in the US economy. After a temporary super spike to within the 6-8% range at quarterly annualized rates over 2009Q2-Q4, productivity growth is likely to have fallen by around 2% in Q2 based upon downward revisions to real GDP. That's a negative for corporate earnings that optimistic equity analysts may not be recognizing on their year-ahead profit targets. US corporate earnings are unlikely to get the kind of lift from operating leverage that they did in the early stages of recovery as companies will have to work harder for earnings growth going forward.

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INTERNATIONAL

Watch for two key issues in this morning's **rate decision by the ECB** (7:45amET, press conference 8:30amET). One will be that upward revisions to 2010 growth are likely to be accompanied by downward revisions to its 2011 views. Second, ECB President could extend emergency lending measures to banks into next year along the lines of earlier guidance provided by Bundesbank President Axel Weber.

Sweden's Riksbank met expectations for a 25bps hike in its key repo rate. That's the second consecutive rise off the 0.25% floor. The decision wasn't unanimous as one dissenter wanted to keep rates flat. Sweden's central bank provides fairly direct guidance for rate expectations, with Governor Stefan Ingves noting "More rate increases will follow for quite a while."



The **French jobless rate** unexpectedly fell to 9.7%, from 9.9%, its first decline in two years. Markets were looking for a modest increase to 10.0%. Economic activity accelerated in the second quarter — up 0.6% q/q from 0.2% in the previous three months — boosting business sentiment.

Yet another measure of **UK house prices**, with **this** fell 0.9% m/m, marking their second consecutive month of decline — and at an accelerating pace — a first since early 2009. Recent data show increasing evidence that the UK housing market is starting to weaken, as supply-demand dynamics remain out of balance.

Spanish unemployment swung upward in August. The number of unemployed climbed 1.5% m/m (61,083) to 3.97 million. Gains were widespread across services (1.7%), construction (1.8%) and the goods-producing sectors (1.9%). Spain hold the top spot, as the euro-zone economy with the highest unemployment rate, which came in at 20.9% in the second quarter. For the region as a whole, the aggregate unemployment rate currently sits at 10%, the most elevated level since August 1998.

Latest data confirmed that **second-quarter euro-zone GDP** was indeed 1.0% q/q. The annual growth rate improved to 1.9% from the original estimate of 1.7%. While the headline print did not change, components underwent revisions. Household final consumption (0.5%), business investment (1.8%), exports (4.0%) and imports (4.4%) were adjusted higher. Revisions reveal that trade played a smaller role than thought, and that it was consumer demand that was the key driver, advancing at the fastest pace since the third quarter of 2007. Improved business investment strengthens the case, as business confidence gradually returned after two years in the doldrums.

Bank Negara Malaysia kept its overnight policy rate unchanged at 2.75%.

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
US	050	051	052	141	140	138	258	258	248	365	365	351
CANADA	127	120	122	211	204	207	286	277	283	350	343	347
GERMANY	062	062	061	129	127	123	225	222	216	283	278	266
JAPAN	013	013	013	031	028	026	112	103	095	187	179	159
UK	072	069	063	173	170	159	297	293	284	396	392	384
Foreign- US Spreads (bps):												
CANADA	77	70	70	70	64	69	28	20	35	-14	-22	-4
GERMANY	11	11	9	-2	-3	-5	-32	-35	-32	-81	-87	-86
JAPAN	-37	-38	-39	-10	-11	-11	-146	-155	-153	-178	-166	-192
UK	22	19	11	31	30	21	39	36	37	32	27	33

Equities	Last		% change:			
	Change	1 Day	1-wk	1-mo	1-yr	
S & P/TSX	12003.78	89.92	0.8	3.1	2.5	12.2
Dow 30	10269.47	254.75	2.5	2.1	-3.8	10.7
S & P 500	1080.29	30.96	3.0	2.4	-4.0	8.6
Nasdaq	2176.84	62.81	3.0	1.6	-5.2	10.7
DAX	5365.48	-0.93	-0.0	5.0	-0.6	11.4
FTSE	6076.95	-6.95	-0.1	2.8	-3.4	14.2
Nikkei	9062.84	135.82	1.5	1.8	-5.3	-11.8
Hang Seng	20868.92	245.09	1.2	1.2	-2.5	6.9
CAC	3623.69	-0.15	-0.0	4.3	-3.4	1.4
Commodities	Last		% change:			
WTI Crude	73.77	-0.14	-0.2	0.6	-9.3	8.4
Natural Gas	3.75	-0.01	-0.3	-1.7	-20.2	38.2
Gold	1246.50	0.50	0.0	2.0	6.6	30.5
Silver	19.47	0.00	0.0	4.5	7.5	30.6
CRB Index	268.51	4.32	1.6	2.6	-3.0	7.6
Currencies	Last		% change:			
USDCAD	1.0502	0.0005	0.0	-0.7	2.7	-5.0
EURUSD	1.2823	0.0014	0.1	0.8	-2.7	-10.1
USDJPY	84.2500	-0.1900	-0.2	-0.2	-2.6	-8.6
AUDUSD	0.9083	-0.0033	-0.4	2.5	-0.6	8.9
GBPUSD	1.5402	-0.0052	-0.3	-0.8	-3.1	-5.4
USDCHF	1.0123	-0.0036	-0.4	-1.1	-2.6	-4.6

Source: Bloomberg. All quotes reflect Bloomberg data as at the time of publishing. While this source is believed to be reliable, Scotia Capital cannot guarantee its accuracy.