

# *focus*

*A Weekly Financial Digest*

FEATURE ARTICLE, PAGE 6

## **Likelihood of a New Reserve Currency Is de Minimis**

- Canadian and U.S. Core Inflation Accelerate But Still Not a Concern
- Canadian Home Sales Humming; September Data Solid
- BoC Governor Carney and President Obama Urge China to Revalue Yuan
- U.S. Retail Sales Rise
- Bank of Japan on Hold



DOUGLAS PORTER

Concerns are starting to emerge about the water damage from the flood of stimulus measures unleashed around the world in the past year in response to the credit crisis fire. On the fiscal side, policymakers globally are starting to face up to the steep, steep deterioration in public finances. Most famously, Obama warned (a bit bizarrely, frankly) that the U.S. could sink into a double-dip recession if steps weren't taken with great haste to reel in the budget deficit. This follows recent warnings from ratings agencies that the U.K. could soon be downgraded due to its even more problematic budget gap. However, if deteriorating government finances are a true threat to the recovery, somebody forgot to inform the bond market. Instead of forging higher amid the wave of public sector borrowing, 10-year Treasury yields have instead dropped to just 3.3%, and are flirting with their lowest level of the past six months, while 2-year yields hit their lowest level of the year this week.

Meantime, the extreme monetary policy measures of the past year—most notably the prolonged period of near-zero rates—are beginning to make more of a watermark. For example, a top property developer in China warned of a property bubble, which almost seems akin to the fox complaining about the lack of security at the hen house. Closer to home, the ongoing flare-up in Canada's housing market has got more people talking about a bubble. Beyond double-digit national price gains from a year-ago in October, Toronto existing home sales jumped 84% y/y in the first half of November, and line-ups have been spotted for the opportunity to buy a new condo. Canada's market may not yet tick all the bubble boxes, but it's looking distinctly pre-bubblish. And, there's not a lot the Bank of Canada can realistically do about the housing froth—the rest of the economy is simply still too weak to withstand rate hikes, and an early tightening would send the Canadian dollar soaring.

More generally, there is not a lot policymakers can do just yet to repair the water damage. The U.S. is clearly still struggling to break fully free of the recession's shackles, as vividly displayed by the unnerving sag in housing starts, still-high jobless claims, and still-soft consumer sentiment. And with bond markets far from forcing the issue, it's highly unlikely we will see any kind of removal of stimulus for quite some time in the industrialized world, even with the brave talk.




MICHAEL GREGORY

September is shaping up to be the best reading for Canadian real GDP growth in 14 months, a standard not too difficult to surpass given that there has been only one positive print during the period (+0.1% in June). This week's reports showed 0.3% and 1.8% rises in real wholesale and manufacturing sales, respectively. Next week, we're projecting a strong 1%-range gain in retail sales volumes. Previous reports showed decent increases in real merchandise exports (3.4%) and the volume of existing home sales (3.0%), along with employment (0.2%) and hours worked (1.6%, the largest move in more than five years). It hasn't been a positive flush: real imports dipped and housing starts slipped. However, the positive momentum seems overwhelming.

This should provide a solid handoff to Q4 economic performance (in October, so far, posting strong gains were housing starts along with vehicle and existing homes

sales volumes, although employment and hours worked dropped). But, it might not be enough to save Q3. It would take a 0.5% September result to lift the three-month average up enough to simply prevent another negative quarter-to-quarter comparison. It's not impossible, but the upper end of our arithmetic points to a decent but still-inadequate 0.3%. However, this does not necessarily mean that Canada will join the U.K. in being the only G7 nation left in recession last quarter.

The quarterly GDP data, not the monthly figures, are the consensus measure for recession indication and the two metrics can give different results. The quarterly figures add up all domestic spending, and then subtract the spending on inventories and imports to estimate domestic production. The monthly figures estimate domestic production by adding up production inputs (e.g., hours worked and energy usage). The two methods are not expected to generate the same quarterly growth rate (and neither, for that matter, is the third method of estimating GDP by adding up incomes), but the growth trends should be comparable. Since the latest version of the monthly data started in 1997, the three-month average has ranged from understating actual quarterly growth by as much as 1.8 percentage points to overstating it by as much as 1.2 points. The median "miss", however, is zero.

With September and Q3 GDP data looming on November 30<sup>th</sup>, the poor monthly pattern is acting as a catalyst for forecast downgrades. In a Thursday evening speech, BoC Governor Carney said that Q3 growth would be "*somewhat softer*" than their prior projection of 2% annualized (but he was "*comfortable*" with their inflation forecast, meaning that Q4 and other quarters would be consequently upgraded). This week, the OECD projected that Canadian Q3 growth could be "*flattish*", an assessment even Finance Minister Flaherty agreed with. We are currently forecasting 1.3% annualized growth, and acknowledge the net downside risk. So, while we wait for Statistics Canada, a look around would show mounting evidence of low interest rates doing their job (and then some) to stimulate credit-based spending in the economy. Canadian GDP is destined to do better in Q4 and beyond, whatever Q3 has in store. **Ponti**



Several minor cracks are starting to form in the porous U.S. housing market foundation. After making limited headway through the spring, homebuilder sentiment has stalled in recent months, with buyer traffic and prospective sales flat-lining. Consequently, after bouncing off all-time lows in the spring, new home starts stopped rising in the summer and pulled back a wrenching 11% in October. A similar pattern in permits suggests little chance of a quick rebound in starts. Although existing home sales continue to trend higher and new home sales are off their lows, homebuilders are dogged by rising foreclosures, which add to the glut of existing (and vacant) homes on the market. Because of the easy pickings in the resale market, builders are taking a record 13 months on average to sell a completed new home. A startling 1-in-7 mortgaged households (and 1-in-4 in Florida) are either in foreclosure or at least one month behind on payments. With the rate of severely delinquent mortgages showing no sign of let up, and a wave of interest-only mortgages due for reset (What? I need to

pay down the principal?), foreclosures probably won't peak for some time, at least not before the jobless rate does.

The recent spate of disappointing news wouldn't be so bad if home sales were to forge higher, but the recent slippage in mortgage applications raises a few doubts. Applications for purchases have fallen in the last six weeks to 12-year lows, in spite of lower mortgage rates (courtesy of the Fed's purchase program which runs to the end of March) and the recent extension of the first-time home buyer tax credit (to April) and expansion to current owners. It's hoped that uncertainty about the extension of the program explains some of the recent softness in the data. Investors will closely watch next week's releases on October existing and new home sales, where moderate gains are expected. Any disappointment could rock equities. A renewed slump in sales would almost certainly destabilize house prices—and fan recovery risks.




So you've heard the Canadian housing market is on fire. Among other things, what's interesting is the fact that the monumental rebound in home sales and prices has come against a backdrop of so-so affordability. That is, most affordability measures that take mortgage rates, house prices and disposable income into account barely got back to average levels before the market bottomed early this year—so, despite the flurry of buying activity, house prices were/are no bargain. While below-posted mortgage rates are one factor making affordability better than it seems on the surface, so, too, is an increasing preference for amortization terms longer than the traditional 25 years.

An annual survey of 2,000 Canadians conducted by the Canadian Association of Accredited Mortgage Professionals recently reported that 47% of new mortgages taken out for a new purchase in the past twelve months had an amortization period of more than 25 years. That's up from 37% in 2007, the first year after CMHC decided to insure 30, 35, and 40-year mortgages (they since dropped the 40-year). To illustrate how this improves affordability, a homebuyer would pay \$1,578 per month for a \$400,000 house, at 4%, with 25% down and a 25-year amortization (pretty standard stuff). Extend the amortization to 35 years, and that monthly cost becomes just \$1,322. In other words, a buyer only concerned about today's cash flow can now go out and bid almost \$460,000 (15% more) for that same house and see the same monthly cost (in this case, his initial down payment still covers the 20% threshold, so no CMHC insurance is required).

Whether this is good, bad or neither is open to debate. What's clear is that this shift is among the various factors adding upward pressure to Canadian home prices.



Jennifer Lee, Economist

## CANADA

- Economy likely grew in September
- BoC Governor Carney says the Bank's Q3 real GDP forecast of 2% growth is at risk

## UNITED STATES

- Disappointing setback in housing and initial claims
- Bernanke makes highly unusual move by commenting on the USD

## EUROPE

- Trichet talks up USD... says the EUR "*wasn't created to become a reserve currency*"
- BoE Minutes highlighted debate over QE levels

## JAPAN

- BoJ on hold, and gives a slight upgrade to its economic assessment

### GOOD NEWS

**Leading Index** +0.7% (Oct.)  
**Manufacturing Sales** +1.4% (Sep.)  
**Manufacturing New Orders** +8.3% (Sep.)  
**Wholesale Trade** +0.2% (Sep.)  
**Existing Home Sales** +41.5% y/y (Oct.)  
**Consumer Prices** +0.1% (Oct.)  
**Foreign Purchases of Canadian Securities** +\$13.6 bln (Sep.)

**Leading Indicator** +0.3% (Oct.)  
**Retail Sales** +1.4% (Oct.)  
**Redbook** +4.4% (Nov. 14 wk)  
**Philadelphia Fed Index** +5.2 pts to 16.7 (Nov.)  
**Foreign Purchases of Long-Term U.S. Securities** \$40.7 bln (Sep.)

**Eurozone—Consumer Prices** revised down to +0.2% (Oct.)  
**Eurozone—Trade Surplus** grew to €6.8 bln (Sep.)  
**Germany—Producer Prices** unch (Oct.)  
**Italy—Industrial Orders** +5.2% (Sep.)  
**U.K.—Retail Sales** +0.4% (Oct.)

**Real GDP** +4.8% a.r. (Q3 P)

CANADA

U.S.

EUROPE

JAPAN

### BAD NEWS

**Housing Starts** -10.6% to 529,000 a.r. (Oct.)  
**Building Permits** -4.0% to 552,000 a.r. (Oct.)  
**NAHB Housing Index** unch at 17 (Nov.)  
**Industrial Production** +0.1% (Oct.)—disappointing  
**Empire State Manufacturing Survey** -11.1 pts to 23.5 (Nov.)  
**Business Sales** -0.3% (Sep.)  
**Consumer Prices** +0.3% (Oct.)—more than expected  
**Producer Prices** +0.3% (Oct.)  
**Initial Claims** unch at 505,000 (Nov. 14 wk)

**U.K.—Rightmove House Prices** -1.6% (Nov.)  
**U.K.—Consumer Prices** +0.2% (Oct.)—first increase in 8 months  
**U.K.—M4** +11.0% y/y (Oct.P)—slowing

**All-Industry Activity Index** -0.6% (Sep.)  
**Tertiary Index** -0.5% (Sep.)  
**Department Store Sales** -10.5% y/y (Oct.)

Indications of stronger growth and a move toward price stability are good news for the economy.

## Likelihood of a New Reserve Currency Is de Minimis

Dr. Sherry Cooper, Chief Economist

There has been much speculation, especially by the Chinese, that the U.S. could or should lose its reserve currency status, but there is simply no reasonable alternative to the dollar and there won't be for the foreseeable future. No one would seriously consider a return to the gold standard, and no other currency in the world has the depth, breadth and acceptance of the U.S. dollar. The greenback is backed by a central bank (and presumably government) that is fully committed to price stability. Barring a public debt crisis, it should maintain its reserve status for many years to come. Certainly the renminbi is a long way from attaining that stature and the Chinese government will not allow its currency to rise to the levels that market forces would warrant were the currency to be unpegged. Moreover, China lacks the financial and legal infrastructure essential for reserve currency status.

The yen also is not a contender, as Japan's economy is in secular decline. One might consider the euro. However, members of the EMU have widely divergent fiscal and political policies that could be highly destabilizing in times of crisis. As well, it is not even clear if the euro will survive as member countries squabble over the so-called Maastricht requirements for debt and deficit levels and new entrants are relatively poor countries with serious demographic problems.

Some have suggested that another possible alternative would be a 'constructed' currency similar to Special Drawing Rights (SDRs). The SDR is an international reserve asset, created by the IMF in 1969 to support the Bretton Woods fixed exchange rate system. A country participating in this system requires official reserves—government or central bank holdings of gold and widely accepted foreign currencies—that could be used to purchase the domestic currency in foreign exchange markets, as required to maintain its exchange rate. But the international supply of two key reserve assets—gold and the U.S. dollar—proved inadequate for supporting the expansion of world trade and financial development that was taking place. Therefore, the international community decided to create a new international reserve asset under the auspices of the IMF.

However, only a few years later, the Bretton Woods system collapsed and the major currencies shifted to a floating exchange rate regime. In addition, the growth in international capital markets facilitated borrowing by creditworthy governments. Both of these developments lessened the need for SDRs.

The SDR is neither a currency, nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members. Its value varies with the exchange rates of the underlying currency, providing little more certainty and stability than we have now. The fact is that, in a flexible exchange rate regime, the reserve currency necessarily depreciates over time to accommodate global growth. Currently, however, the burden of the dollar's fall is unfairly heavy on the Canadian dollar, the euro, yen and other major currencies because the number-one exporter to the U.S., China, has fixed its currency relative to the U.S. dollar for more than a year. Rather than calling for a new reserve currency, China must allow the renminbi to rise more rapidly to reduce the global trade imbalance.

### What Would Be the Consequences of the U.S. Dollar Losing Its Reserve Currency Status?

- The U.S. government would need to pay more to borrow, making it harder to sustain its debt, resulting in bigger tax increases and spending cuts to restrain the deficit.

- U.S. interest rates would generally be higher than otherwise, constraining economic growth.
- Gold and other hard commodities would likely receive some further price lift.

### What is the Impact of Further U.S. Dollar Weakness on America's Economy?

#### Positives:

- Will help the economy de-leverage (by raising import costs).
- Will help the economy return to full health faster. A weaker dollar, together with recent strong productivity gains, has likely given the U.S. a big competitive advantage over some other countries (including Canada and the Euro area).

#### Negatives:

- Could spur inflation, but that seems remote given the wide output gap.
- Could push interest rates higher. Global investors would demand higher U.S. rates to compensate for potential currency devaluation. As well, could compel the Fed to take back the stimulus sooner and faster.

### Misconceptions of the U.S. Dollar's Role

Many have suggested that the fall in the U.S. dollar is reflective of the sad state of American economic affairs replete with surging budget deficits, profligate consumer spending, overleveraged banks, an enormous current account deficit and an increasing reliance on foreign capital inflows to finance the overspending. The reality, however, is that the role the U.S. dollar plays as the world's sole reserve currency ensured that such imbalances developed, otherwise the growth in global reserves would have been impossible. Think of it this way: a growing global economy requires a growing global money supply to provide the liquidity necessary to finance rising activity. The U.S. provides that underlying liquidity to the world by spending more than it saves or, in essence, spending more than it

can finance domestically. The U.S. became the consumer (importer) of last resort, providing currency to the rest of the world. This currency has been at least partially recycled back to the U.S. in the form of foreign purchases of private and U.S. government and agency debt. Without this recycling, the other currencies of the world would strengthen rapidly vis-à-vis the U.S. dollar, rendering these foreign exporters less competitive, returning the system to balance. The fall in the U.S. dollar is the equilibrating mechanism that reduces the net imports of the U.S., thereby reducing its current account deficit and, ultimately, its demand for foreign capital.

The broad trade-weighted U.S. dollar began falling in February 2002 and bottomed in July 2008 (*Chart 1*). With the onslaught of the credit crisis, the flight to quality (safe-

CHART 1

### U.S. DOLLAR VULNERABLE

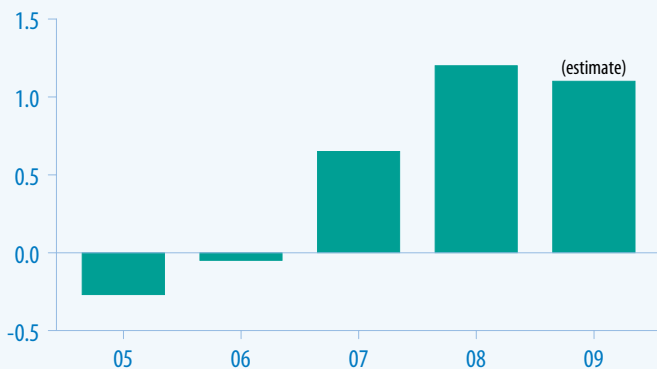
(as of November 19, 2009)

#### Broad Trade-weighted US\$



**CHART 2**
**IMPROVED TRADE BALANCE BIG CONTRIBUTOR TO GDP**

United States (ppt contribution to real GDP)

**Net Exports of Goods and Services**

**TABLE 1**
**CURRENCY PERFORMANCES**

(% chng vs US\$: as of November 19, 2009)

	Feb '02 Peak to Present	2009 Year-to-date
AUSTRALIAN \$	78.5	30.9
EURO	72.4	6.8
SWISS FRANC	68.3	5.4
<b>CANADIAN \$</b>	51.2	14.6
JAPANESE YEN	50.8	1.8
CHINESE YUAN	21.2	0.0
UK POUND	17.4	14.2
TRADE-WEIGHTED US\$	-22.3	-5.9
MEXICAN PESO	-30.2	4.9

haven flows) into Treasuries boosted the trade-weighted dollar to a peak in early March of this year when the stock markets bottomed. As the financial crisis dissipated and stocks rebounded sharply, the dollar resumed its decline, reflecting the success of the global authorities—especially the Fed and the U.S. Treasury—in averting disaster. The recovery in economic activity was beginning, as reflected in stocks and commodity prices. The reduction in the U.S. trade deficit has been an important contributor to GDP performance (*Chart 2*).

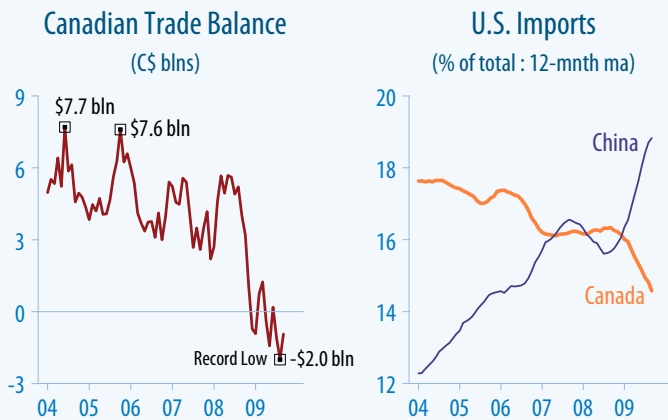
Even with the dramatic decline in the U.S. dollar since March, the trade-weighted dollar is still about 5% above its summer-'08 trough. Year-to-date, the Canadian dollar has risen 15%, but that is less than a number of other major currencies, particularly the Aussie dollar, which is up over 30% (*Table 1*). These commodity-related currencies have benefited from the economic revival, especially in China. Even so, the Canadian dollar, at over 93 cents, remains below the peak of \$1.10 hit in November 2007.

I expect the U.S. dollar to continue to decline—not because of American profligacy per se; but, because, under the current global monetary system, a fall in the dollar is the only way to reduce the global imbalances. The huge net inflow of foreign capital to the U.S., especially from China, facilitated America's overleveraging and underpricing of risk.

Ever since the Asian crisis in the late 1990s, emerging Asia (China) has been pursuing a policy of export-led growth by maintaining their currencies at undervalued levels. The U.S.'s consumption-led growth is the flipside of China's

export-led growth, taking consumption to a record high 71% of U.S. GDP. Thanks to enormous foreign capital inflows, capital in the U.S. was cheap and plentiful and risk was woefully underpriced, so consumers were incentivized to borrow. And borrow they did—extracting homeowner equity and running up huge credit card bills. Similarly, because of the inordinately low interest rates and risk premiums, investor demand for higher-yielding assets such as collateralized debt obligations (CDOs) surged, financing the subprime mortgage debt and housing bubble. The rest is history.

Being the sole reserve-currency country forced the U.S. into a current-account-deficit position, which by definition, ironically, weakens the currency over time. As long as the U.S. economy was strong, and the federal budget deficit was under control, no one worried much about the safety and soundness of the U.S. dollar. But with the explosion in U.S. government spending that was precipitated by the crisis and subsequent recession, the government deficit skyrocketed. Many began to worry about the

**CHART 3**
**CHINA NOW BIGGEST SUPPLIER OF IMPORTS TO U.S.**


ultimate inflation that might result if it were the only way to finance the deficit and so the currency weakened.

As the reserve-currency nation, the U.S. is the lender of last resort to the world. The Fed and the Treasury had to spend whatever it took to avert a global financial meltdown. Thus, in bad times, the dollar is necessarily vulnerable to inflation worries and ultimate devaluation. Right now, there are no other serious contenders to replace the U.S. dollar as the world's reserve currency.

It is essential that the Fed remain independent with no predilection or authority to conduct monetary policy in response to the dollar's fate; it is also required that the U.S. federal government remain solvent. That is certainly the case now, and will be for the foreseeable future. But the pessimists are very vocal and the media is increasingly

espousing their views that the Fed will run the printing presses for too long, thereby devaluing the dollar and using inflation to reduce the cost of deficit financing. Never mind that inflation is nowhere to be seen.

The enormous excess capacity in the U.S. economy and the downward pressure on real wages suggest, as the Fed avers, that there is a greater likelihood of falling inflation than rising inflation. The lower dollar helps to reverse these disinflationary pressures and improve the U.S. trade deficit, thereby boosting the economy. But sentiment is important, and the growing sense that the U.S. dollar is a "debauched" currency (similar to those in the 'Banana Republics' of the past) can become self-fulfilling if it triggers a dollar crisis. The unlikely, but possible, rout in the dollar could drive U.S. interest rates high enough to snuff out the recovery, debilitating the rest of the world's recovery. That is why it is so important to discredit the Chicken Littles.

**Bottom Line:** An orderly decline in the U.S. dollar is necessary to a sustained rebalancing of the global economy, which is a necessary precursor to a sustained global economic and financial recovery. The only way the American economy can de-leverage gradually over time is for the overspending to cease, which also goes hand-in-hand with a weaker American dollar. The U.S. must encourage some export-led activity and China must encourage some consumer-led activity, which means a smaller U.S. trade deficit and a smaller trade surplus in the rest of the world. We see this in spades in Canada where our record trade surplus has now melted into a record trade deficit (*Chart 3*). Products from China now account for a meaningfully larger share of U.S. imports than goods and services imported from Canada. Our exporters have been adjusting to this new reality since 2003 and further adjustment is necessary. Canadian business must raise productivity growth and add value to the goods and services we export. We must also broaden our export horizons, especially to the rapidly growing emerging economies of Asia.

CANADA	2009				2010				ANNUAL		
	I	II	III	IV	I	II	III	IV	2008	2009	2010
Real GDP (q/q % chng : a.r.)	-6.1	-3.4	1.3	3.4	2.9	3.3	3.5	2.9	0.4	-2.4	2.6
Consumer Price Index (y/y % chng)	1.2	0.1	-0.9	0.7 ↑	1.1	1.4	2.0	1.6	2.4	0.3	1.5
Unemployment Rate (%)	7.6	8.4	8.6	8.8	8.9	8.8	8.5	8.3	6.1	8.3	8.6
Housing Starts (000s : a.r.)	140	128	148	157 ↑	153 ↑	153 ↑	155 ↑	159 ↑	211	143 ↑	155 ↑
Current Account Balance (\$blns : a.r.)	-30.9	-44.8	-53.9	-50.0	-50.4	-51.6	-52.3	-52.5	8.1	-44.9	-51.7
<b>Interest Rates</b> (average for the quarter : %)											
Overnight Rate	0.83	0.25	0.25	0.25	0.25	0.25	0.58	1.08	2.96	0.40	0.54
3-month Treasury Bill	0.64	0.25	0.22	0.22	0.22	0.30	0.78	1.25	2.33	0.33	0.64
10-year Bond	2.89	3.20	3.42	3.44	3.52	3.62	3.72	3.82	3.61	3.24	3.67
<b>Canada/U.S. Interest Rate Spreads</b> (average for the quarter : bps)											
90-day	43	8	6	15	15	22	57	54	94	18	37
10-year	15	-11	-10	-2	-7	-9	-12	-14	-6	-2	-10
<b>UNITED STATES</b>											
Real GDP (q/q % chng : a.r.)	-6.4	-0.7	3.5	3.0	2.3	2.5	2.7	2.9	0.4	-2.4	2.5
Consumer Price Index (y/y % chng)	-0.2	-0.9	-1.6	1.3 ↑	2.3 ↑	2.4 ↑	2.0 ↑	1.7 ↑	3.8	-0.4	2.1 ↑
Unemployment Rate (%)	8.1	9.2	9.6	10.3	10.4	10.3	10.2	10.0	5.8	9.3	10.2
Housing Starts (mlns : a.r.)	0.53	0.54	0.59	0.55 ↓	0.63 ↓	0.72 ↓	0.78	0.82	0.90	0.55 ↓	0.74 ↓
Current Account Balance (\$blns : a.r.)	-418	-395	-472	-436	-431 ↓	-426 ↓	-423 ↓	-418 ↓	-706	-430	-425 ↓
<b>Interest Rates</b> (average for the quarter : %)											
Fed Funds Target Rate	0.13	0.13	0.13	0.13	0.13	0.13	0.25	0.75	1.86	0.13	0.31
3-month Treasury Bill	0.21	0.17	0.16	0.07	0.07	0.08	0.21	0.72	1.39	0.15	0.27
10-year Note	2.74	3.31	3.52	3.46	3.58	3.71	3.83	3.96	3.67	3.26	3.77
<b>EXCHANGE RATES</b> (average for the quarter)											
US\$/C\$	80.3	85.6	91.1	96.0	97.9	99.2	100.6	100.3	94.3	88.3	99.5
C\$/US\$	1.245	1.168	1.097	1.042	1.021	1.008	0.994	0.997	1.067	1.138	1.005
¥/US\$	94	97	94	91	93	95	97	99	103	94	96
US\$/Euro	1.30	1.36	1.43	1.49	1.51	1.52	1.53	1.55	1.47	1.40	1.53
US\$/£	1.44	1.55	1.64	1.64	1.67	1.70	1.72	1.74	1.85	1.57	1.71

Note: Blocked areas represent BMO Capital Markets forecasts  
Up and down arrows indicate changes to the forecast ↑↓

## CANADA

Michael Gregory, CFA, Senior Economist

### Retail Trade

Monday, 8:30 am

		<b>Ex. Autos</b>
<b>Sep. (e)</b>	<b>+1.0%</b>	<b>+1.1%</b>
<i>Consensus</i>	<i>+0.5%</i>	<i>+0.3%</i>
Aug.	+0.8%	+0.5%

September retail sales will be strong, against a background of two consecutive monthly job gains, historically low borrowing costs and seven straight monthly increases in consumer confidence. Big-ticket items were particularly in fashion, with sales volumes for vehicles and existing homes up 1.2% and 3.0%, respectively (and both were up even more in October). Although home sales do not feed directly into retail spending, the related outlays on renovations and decorations along with furnishings and appliances do. We look for the value of retail sales to surge 1.0% and 1.1% ex-autos. Lower gasoline prices will probably drag down service station receipts, leaving retail sales ex-autos and gas up a whopping 1.3%, the largest such move since December 2006. With retail prices flat in the month (if the CPI is any guide), the rise in retail sales will be all real, thus augmenting GDP growth.

### Current Account Deficit

Friday, 8:30 am

<b>Q3 (e)</b>	<b>\$13.5 bln</b>
<i>Consensus</i>	<i>\$13.4 bln</i>
Q2	\$11.2 bln

In Q2, Canada registered its first merchandise trade deficit in 33 years, at \$1.7 billion. This worsened to \$4.0 billion in Q3, as the growth in imports nearly doubled the growth in exports. Despite a 4% average rise in commodity prices during the period, net exports were dragged down by a lofty loonie and pockets of much stronger Canadian domestic demand relative to the U.S. With the perennial shortfall in non-merchandise trade probably close to last quarter's \$9.5 billion, the overall current account deficit will likely widen to a record \$13.5 billion in Q3 from \$11.2 billion in Q2. As a share of GDP, the current account balance should be around 3.5%, up from 3.0% in the previous period, representing the largest relative shortfall since 1993. The same factors at play in Q3 (C\$ and relatively strong Canadian domestic demand) look to keep the current account balance in deficit territory for the foreseeable future, despite higher commodity prices.

## UNITED STATES

Sal Guatieri, Senior Economist

### Existing Home Sales

Monday, 10:00 am

<b>Oct. (e)</b>	<b>5.65 mln a.r. (+1.4%)</b>
<i>Consensus</i>	<i>5.70 mln a.r. (+2.3%)</i>
Sep.	5.57 mln a.r. (+9.4%)

### New Home Sales

Wednesday, 10:00 am

<b>Oct. (e)</b>	<b>410,000 a.r. (+2.0%)</b>
<i>Consensus</i>	<i>408,000 a.r. (+1.4%)</i>
Sep.	402,000 a.r. (-3.6%)

Back-to-back 6% gains in pending home sales likely flag a sustained upward trend in both new and existing sales in October. Very good affordability and the recent extension (to the end of April) and expansion (to some current owners) of the first-time home buyer tax credit should support sales through the New Year. However, a recent drop in new mortgage applications (to 12-year lows) might be a warning that sales could falter in the months ahead. The new homes inventory is lean and resale listings are shrinking, alleviating some of the downward pressure on prices.

### S&P/Case-Shiller Home Price Index

Tuesday, 9:00 am

<b>Sep. (e)</b>	<b>-9.0% y/y</b>
Aug.	-11.3% y/y

After sliding 33% since mid-2006, this popular measure of home prices has climbed in the past four months, supported by rising demand and shrinking supply. An expected 0.5% gain in September would slow the yearly rate of decline to -9.0% from -11.3%. Despite the upturn in prices, affordability remains attractive as mortgage rates have drifted lower since the spring. Given the boost to confidence, the upturn in prices may actually buoy demand in the near term.

**Conference Board Consumer Confidence**

Tuesday, 10:00 am

<b>Nov. (e)</b>	<b>48.5</b>
<i>Consensus</i>	48.1
Oct.	47.7

Consumer confidence has buckled in recent months under the weight of rising joblessness. However, after two straight monthly declines, the Conference Board measure likely firmed in November, amid offsetting support from higher equity values and steadier home prices. Although the index has more than doubled since February, it remains well below its long-run norm of 95. The current low level of confidence is consistent with sluggish spending.

**Minutes of the November 3-4 FOMC Meeting**

Tuesday, 2:00 pm

The meeting minutes probably won't reveal any breathtaking revelations about Fed policy. Most members on the policy committee believe that, while the recovery is progressing, the outlook for both growth and inflation remains subdued. As a result, there is unanimous support to keep rates exceptionally low for an extended period, at least as long as unemployment remains sky-high and inflation expectations lay dormant. The November press statement said the Fed will slow its purchases of agency debt and MBS and complete the program by the end of Q1, although that doesn't imply it will raise rates soon afterwards.

**Personal Consumption Expenditure and Income**

Wednesday, 8:30 am

	<b>Personal Income</b>	<b>Personal Spending</b>
<b>Oct. (e)</b>	<b>+0.2%</b>	<b>+0.7%</b>
<i>Consensus</i>	+0.2%	+0.5%
Sep.	unch	-0.5%
<b>Core PCE Deflator</b>		
<b>Oct. (e)</b>	<b>+0.1%</b>	<b>+1.3% y/y</b>
<i>Consensus</i>	+0.1%	+1.3% y/y
Sep.	+0.1%	+1.3% y/y
<b>Savings Rate</b>		
<b>Oct. (e)</b>	<b>2.8%</b>	
Sep.	3.3%	

A 13% jump in unit auto sales (to above pre-clunker levels) and a healthy 0.5% advance in "core" retail sales suggest consumer spending rose 0.7% in October. This would flag a 2% annualized gain in Q4, implying some pickup in underlying demand following the largely clunkers-led gain in Q3. Personal income likely rose modestly, supported by still-rising (though slowing) wages as a result of strong productivity growth. Look for the savings rate to retrace (temporarily) to 2.8%, as some households refuse to get with the new deleveraging mind-set of the times. The core PCE deflator should increase modestly, with higher prescription drug costs (and possibly motor vehicle prices) trumping lower rents. But the mild gain should keep the yearly rate at 1.3%—an 8-year low and below the Fed's long-run forecast range of 1.7% to 2%.

**Durable Goods Orders**

Wednesday, 8:30 am

		<b>Ex. Transport</b>
<b>Oct. (e)</b>	<b>+0.4%</b>	<b>+0.6%</b>
<i>Consensus</i>	+0.5%	+0.6%
Sep.	+1.4%	+1.2%

Strength in the ISM manufacturers' orders index signals another solid increase in durable goods orders in October, although purchases of Boeing aircraft nose-dived that month. Excluding aircraft and defense items, capital goods orders likely rose for the second straight month, suggesting business equipment spending will advance further in Q4 (though recent softness in production of business machinery suggests only limited growth).

	NOV 20*	NOV 13	CHANGE FROM: (BASIS POINTS)		
			WEEK AGO	4 WEEKS AGO	DEC. 31/08
<b>Canadian Money Market</b>					
Call Money	0.25	0.25	0	0	-125
Prime Rate	2.25	2.25	0	0	-125
<b>U.S. Money Market</b>					
Fed Funds (effective)	0.25	0.25	0	0	0
Prime Rate	3.25	3.25	0	0	0
<b>3-Month Rates</b>					
Canada	0.22	0.22	0	0	-61
United States	0.01	0.05	-5	-5	-7
Japan	0.20	0.15	5	5	0
Eurozone	0.71	0.71	0	-2	-218
United Kingdom	0.61	0.61	0	2	-216
Australia	3.84	3.87	-2	7	-101
<b>Bond Markets</b>					
<b>2-year Bond</b>					
Canada	1.24	1.39	-16	-29	14
United States	0.70	0.81	-11	-30	-7
<b>10-year Bond</b>					
Canada	3.37	3.48	-11	-13	68
United States	3.35	3.42	-7	-14	114
Japan	1.30	1.35	-4	-7	13
Germany	3.27	3.38	-12	-8	32
United Kingdom	3.64	3.80	-15	-3	62
Australia	5.39	5.56	-16	-31	140
<b>Currencies</b>					
				(% CHANGE)	
US\$/C\$	93.28	95.09	-1.9	-1.7	13.7
C\$/US\$	1.072	1.052	—	—	—
¥/US\$	88.93	89.66	-0.8	-3.4	-1.9
US\$/Euro	1.4844	1.4903	-0.4	-1.1	6.2
US\$/£	1.650	1.668	-1.1	1.2	13.1
US\$/A\$	91.17	93.30	-2.3	-1.2	29.8
<b>Commodities</b>					
CRB Futures Index	273.07	269.12	1.5	-2.6	19.0
Oil (generic contract)	76.46	76.35	0.1	-5.0	71.4
Natural Gas (generic contract)	4.35	4.39	-1.0	-9.1	-22.6
Gold (spot price)	1137.85	1118.70	1.7	7.8	29.0
<b>Equities</b>					
S&P/TSX Composite	11513	11408	0.9	1.1	28.1
S&P 500	1089	1093	-0.4	0.9	20.5
Nasdaq	2139	2168	-1.3	-0.7	35.7
Dow Jones Industrial	10292	10270	0.2	3.2	17.3
Nikkei	9498	9770	-2.8	-7.6	7.2
Frankfurt DAX	5679	5687	-0.1	-1.1	18.1
London FT100	5264	5296	-0.6	0.4	18.7
France CAC40	3744	3806	-1.6	-1.7	16.4
S&P ASX 200	4686	4706	-0.4	-3.6	25.9

\* as of 10:30 am

JAPAN

**MONDAY NOVEMBER 23**
**TUESDAY NOVEMBER 24**
**WEDNESDAY NOVEMBER 25**
**THURSDAY NOVEMBER 26**
**FRIDAY NOVEMBER 27**

EUROZONE

**EUROZONE**
**Manufacturing PMI**

Nov. A (e) 51.2  
Oct. 50.7

**Services PMI**

Nov. A (e) 52.9  
Oct. 52.6

**EUROZONE**
**Industrial New Orders**

Sep. (e) +1.0% -17.3% y/y  
Aug. +2.0% -23.1% y/y

**GERMANY**
**Ifo Survey**

Nov. (e) 92.5  
Oct. 91.9

**Real GDP**

Q3 F (e) +0.7% -4.8% y/y  
Q2 -3.5% -6.7% y/y

**FRANCE**
**Consumer Spending**

Oct. (e) +0.4% +2.3% y/y  
Sep. +2.3% +1.0% y/y

**GERMANY**
**GfK Consumer Confidence**

Dec. (e) 4.0  
Nov. 4.0

**ITALY**
**Retail Sales**

Sep. (e) +0.1% -2.9% y/y  
Aug. -0.1% -2.9% y/y

**EUROZONE**
**M3 Money Supply (smoothed)**

Oct. (e) +1.7% y/y  
Sep. +2.5% y/y

**GERMANY**
**Consumer Price Index\***

Nov. P (e) unch +0.5% y/y  
Oct. +0.1% -0.1% y/y

**EUROZONE**
**Economic Confidence**

Nov. (e) 88.0  
Oct. 86.2

U.K.

**Real GDP**

Q3 P (e) -0.3% -5.1% y/y  
Q2 -0.6% -5.5% y/y

OTHER

**AUSTRALIA**
**New Motor Vehicle Sales**

Oct.   
Sep. +2.9% -2.0% y/y

**MEXICO**
**Retail Sales**

Sep. (e) -3.5% y/y  
Aug. -5.5% y/y

**MEXICO**
**Trade Deficit**

Oct. P (e) \$1.1 bln  
Sep. \$1.1 bln

**Jobless Rate**

Oct. (e) 6.2%  
Sep. 6.4%

**Merchandise Trade Balance**

Oct. '09 (e) +¥466 bln  
Oct. '08 -¥75 bln

**BoJ Monthly Report**
**Minutes from the BoJ  
Monetary Policy Meeting**
**Jobless Rate**

Oct. (e) 5.4%  
Sep. 5.3%

**Retail Sales**

Oct. (e) -0.9% -1.6% y/y  
Sep. +0.9% -1.3% y/y

**Household Spending**

Oct. (e) +0.6% y/y  
Sep. +1.0% y/y

**CPI**
**Core CPI**

Oct. (e) -2.4% y/y -2.2% y/y  
Sep. -2.2% y/y -2.3% y/y

**Nationwide House Prices\***

Nov. (e) +0.3% +2.4% y/y  
Oct. +0.4% +2.0% y/y

**Bank of Mexico  
Monetary Policy Meeting**

CANADA

**MONDAY NOVEMBER 23**

<b>8:30 am</b>	<b>Retail Sales</b>	<b>Ex. Autos</b>
Sep. (e)	+1.0%	+1.1%
Consensus	+0.5%	+0.3%
Aug.	+0.8%	+0.5%

**Ottawa's Budget Balance \***

<b>Sep. '09</b>	
Sep. '08	-\$0.4 bln

**NHA MBS Auction**

<b>10:00 am</b>	<b>Existing Home Sales</b>
Oct. (e)	5.65 mln a.r. (+1.4%)
Consensus	5.70 mln a.r. (+2.3%)
Sep.	5.57 mln a.r. (+9.4%)

UNITED STATES

**TUESDAY NOVEMBER 24**

**10:35 am** **3, 6 & 12-month T-bill auction \$13.5 bln**  
(New cash -\$0.9 bln)

<b>8:30 am</b>	<b>Real GDP</b>	<b>GDP Deflator</b>
Q3 P (e)	+3.0% a.r.	+0.8% a.r.
Q3 A	+3.0% a.r.	+0.8% a.r.
Q2	+3.5% a.r.	+0.8% a.r.

<b>8:30 am</b>	<b>Pre-Tax Corporate Profits</b>
Q3 P (e)	-9.9% y/y
Q2	-12.6% y/y

<b>8:55 am</b>	<b>Redbook</b>
Nov. 21	+4.4%
Nov. 14	+4.4%

<b>9:00 am</b>	<b>S&amp;P Case-Shiller Home Price Index</b>
Sep. (e)	-9.0% y/y
Aug.	-11.3% y/y

<b>10:00 am</b>	<b>FHFA House Price Index</b>
Sep. (e)	-2.8% y/y
Aug.	-3.5% y/y

<b>10:00 am</b>	<b>Conference Board Consumer Confidence Index</b>
Nov. (e)	48.5
Consensus	48.1
Oct.	47.7

**2:00 pm** **FOMC Minutes from November Meeting**

<b>5:00 pm</b>	<b>ABC News/Washington Post Consumer Comfort Index</b>
Nov. 22	-45
Nov. 15	-45

<b>1:00 pm</b>	<b>5-year note auction \$42.0 bln</b> (New cash \$42.0 bln)
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**WEDNESDAY NOVEMBER 25**

<b>8:30 am</b>	<b>Initial Claims</b>
Nov. 21 (e)	490,000 (-15,000)
Nov. 14	505,000 (unch)

<b>8:30 am</b>	<b>Durable Goods Orders</b>	<b>Ex. Transport</b>
Oct. (e)	+0.4%	+0.6%
Consensus	+0.5%	+0.6%
Sep.	+1.4%	+1.2%

<b>8:30 am</b>	<b>Personal Income</b>	<b>Personal Spending</b>
Oct. (e)	+0.2%	+0.7%
Consensus	+0.2%	+0.5%
Sep.	unch	-0.5%

<b>8:30 am</b>	<b>Core PCE Deflator</b>
Oct. (e)	+0.1%
Consensus	+0.1%
Sep.	+0.1%

<b>8:30 am</b>	<b>Savings Rate</b>
Oct. (e)	2.8%
Sep.	3.3%

<b>10:00 am</b>	<b>New Home Sales</b>
Oct. (e)	410,000 a.r. (+2.0%)
Consensus	408,000 a.r. (+1.4%)
Sep.	402,000 a.r. (-3.6%)

<b>10:00 am</b>	<b>Univ. of Michigan Consumer Sentiment</b>
Nov. F (e)	67.0
Consensus	67.0
Nov. P	66.0
Oct.	70.6

<b>10:30 am</b>	<b>DoE's Petroleum Status Report (Nov. 20 week)</b>
<b>12:00 pm</b>	<b>DoE's Natural Gas Status Report (Nov. 20 week)</b>

<b>1:00 pm</b>	<b>7-year bond auction \$32.0 bln</b> (New cash \$32.0 bln)
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**THURSDAY NOVEMBER 26**

<b>8:30 am</b>	<b>Average Weekly Earnings</b>
Sep. (e)	+1.9% y/y
Aug.	+2.0% y/y

30-year real return bond auction announcement

Thanksgiving Day  
(markets closed)

**FRIDAY NOVEMBER 27**

<b>8:30 am</b>	<b>Current Account Deficit</b>
Q3 (e)	\$13.5 bln
Consensus	\$13.4 bln
Q2	\$11.2 bln

\* date approximate

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