

# *focus*

*A Weekly Financial Digest*

FEATURE ARTICLE, PAGE 6

## **Is It Two and Through For Carney & Crew?**

- No Easing Hints from Bernanke
- U.S. Home Sales Plunge
- Canadian Retail Sales Volumes Solid
- Global Bonds Rally Further
- Aussie Election Uncertainty



SHERRY COOPER

## Uncertainty Remains

With all the negative news flow, it is not surprising that businesses are cautious and concerned about the weak household sector. To be sure, after the Great Recession, lingering concerns of a double-dip proliferate. The U.S. election cycle compounds this negativism. And, post-traumatic stress syndrome, aggravated by weak U.S. economic data, shakes Canadian confidence. Some local pundits suggest that we are heading for a U.S.-style housing collapse as the Canadian housing data weakened sharply this summer.

Certainly, the U.S. recession that began in December 2007 ranks as the worst since World War II. It carved a huge slice out of Americans' financial wealth and caused the biggest drop in jobs in the post-war era. Even though the stock market rebounded in 2009 and U.S. output began to grow in the second half of that year, the recession continues to take a terrible toll on the incomes and the psychological health of many families. In some regions, particularly Florida, Arizona, Nevada and parts of California, the overhang of coming home foreclosures continues to dampen the outlook.

But housing this cycle is a lagging indicator and so is employment. And while the Canadian housing market has weakened sharply since the spring, this year's earlier pace of housing activity was unsustainably strong and much was borrowed ahead of the July introduction of the HST. As well, the Bank of Canada raised overnight rates to slow what looked like a potentially inflationary situation. The output gap in Canada has fallen sharply and employment has nearly returned to its October 2008 peak.

Of course, Canadian prosperity is impacted by the U.S. outlook and the American output gap is more than twice the size of Canada's. But, the U.S. economy is gradually recovering and many indicators suggest that employment growth will likely rise as we move into 2011. U.S. aggregate hours worked is a leading indicator of employment, and it bottomed in 2009Q3. As well, private sector layoffs peaked in April 2009 and have subsequently fallen sharply. The recent surge in government layoffs has been the result of temporary census workers and budget woes at the state and local levels, which have triggered additional federal funding. Perhaps more importantly, corporate balance sheets are in great shape. Free cash flow is at record levels (in both countries) and after-tax corporate profits have hit new record highs, more than reversing recession losses.

It just makes sense that since American companies have stepped up spending on equipment and software, hiring additional workers should be next. Mitigating the rebound, however, is the overhang of fear generated by the deep recession and continued uncertainty regarding the policy outlook. The private sector is deleveraging, which means the government sector remains a key source of growth. If Washington or Ottawa were to aggressively restrain spending or raise taxes, the economy would slump once again. The rebound in American jobs will be halting and moderate through the first half of next year. U.S. businesses appear to be buying new equipment simply to replace old machinery, rather than expand capacity. Firms are wary of taking on new staff because they still have fresh scars from the worst downturn in the post-war era. Finally, firms are uncertain about the impact new financial sector reforms, as they might tighten credit conditions, or new taxes, that are likely to be required to clean up the fiscal mess.

*Sherry*



DOUGLAS PORTER

Are we—consumers, business leaders, investors, economists—going to collectively give up on this recovery because of a few sour months for the economy? What if Churchill had said: *“We shall fight on the beaches, we shall fight on the landing grounds, we shall fight on the streets, but if we see some ugly home sales numbers and a downbeat durable goods orders release, we’re so gonna throw in the towel and run?”* There is no doubt the U.S. economy is skidding through a very real soft patch, which is reverberating to undermine fragile business sentiment and to pose a risk of a renewed downturn. But let’s not talk ourselves into it. Yes, we could wallow in the mire of gloom and despair, and focus exclusively on the negative (of which there is no shortage in the wake of the worst post-war recession). But, let’s recall that policy remains exceptionally accommodative globally, corporate finances are in stellar shape, spending on big-ticket items (especially homes) is already at rock-bottom levels and has little place to go but up, and the emerging market economies are forging ahead with new growth opportunities.

Still, the steady erosion in sentiment, which has spilled into business confidence, (as well as the more mundane downward revision to Q2 GDP), has prompted us to scale back our call on GDP growth in the U.S. and Canada. We noted three months ago that the European debt crisis, and the ensuing financial turmoil, had brought out the forecast axe for the first time in more than a year, and now we are swinging it. We expect second-half U.S. GDP growth to average around 1½% (similar to Q2, but down from our prior view of 2½%). Similarly, we are trimming next year’s outlook to 2.2% growth from 2.7%. Canada is not immune, of course, and we are now expecting growth of about 2% in H2 (2.3% before), and are looking for 2.5% for all of next year (versus 2.8% previously, and the Bank of Canada’s latest call of 2.9%). While certainly not in double-dip terrain, these growth rates are modest by past recovery standards, and would be consistent with limited employment growth (especially in the U.S.). For interest rates, the slower growth profile will also delay even further (for the Fed) or stretch out (for the Bank of Canada) future hikes.

As a sidebar, it’s ironic that the European debt turmoil appears to have taken a big toll on the U.S. recovery (through the market upset and ensuing uncertainty), yet has barely touched the European growth outlook. The 2010 GDP forecast has actually been revised higher for the Eurozone since the crisis broke wide open in the spring (thanks to the solid Q2 results). In fact, it now appears that Germany may be the fastest growing G7 economy this year (yes, topping Canada). Clearly, the Europeans learned a thing or two from Churchill.




BENJAMIN REITZES

Europe has fallen out of the headlines lately, after taking the spotlight for much of May through July. While attention has moved back toward the U.S. amid recent weak data, Europe still faces significant challenges. S&P downgraded Ireland’s credit rating one notch to AA- this week and kept a negative outlook, on concern the bank bailout will prove costlier than prior estimates. The ratings cut, along with melting global economic sentiment, pushed up bond yields of the Euro Area’s weaker sisters. The interest rate spread between Irish 10-year bonds and German Bunds hit a record high (since the

euro's inception), while Greek, Portuguese, Spanish and Italian spreads have also turned higher since late July.

A good portion of the widening spread is due to the continued rally in German bonds (thank you, flight-to-safety), as Spanish and Italian yields have actually fallen. However, Greek and Portuguese 10-year yields have risen, reflecting continued doubt about their commitment to austerity measures. Meantime, the German economy boomed in Q2 and looks to be on pace for a decent Q3. France and other less-debt-burdened members are seeing decent growth, but nothing close to Germany. The strength in core Europe means the ECB will upgrade its 2010 growth forecast at next week's policy meeting, and highlights that the extreme pessimism over Europe a few short months ago was overdone. Even so, 2011 growth will be restrained by heavy fiscal cutbacks. While the headlines have shifted elsewhere, peripheral Europe's debt problems haven't gone away and aren't likely to fade anytime soon.




MICHAEL GREGORY

What would Bernanke do, faced with escalating risks of a deflationary double dip? Today's Jackson Hole speech reordered the arrows in the Fed's policy quiver. The three policy options, in order of preference, are now: (1) quantitative and unsterilized credit easing, (2) language modification, and (3) reducing the IOER (interest on excess reserves) rate. The speech laid out the benefit-cost tradeoffs of each option, providing some policy insights.

The next arrow to be pulled out, if need be, will have QE and CE stamped on it. The order of preference emphasizes how much more risky the economic situation must have become in Bernanke's mind. If the Fed has to act again, they want something that is sure to work, despite the potential costs... *"I believe that additional purchases of longer-term securities, should the FOMC choose to undertake them, would be effective in further easing financial conditions"...* *"A potential drawback of using the FOMC's post-meeting statement to influence market expectations is that, at least without a more comprehensive framework in place, it may be difficult to convey the Committee's policy intentions with sufficient precision and conditionality."*

Bernanke said *"the FOMC will strongly resist deviations from price stability in the downward direction. Falling into deflation is not a significant risk for the United States at this time, but that is true in part because the public understands that the Federal Reserve will be vigilant and proactive in addressing significant further disinflation. It is worthwhile to note that, if deflation risks were to increase, the benefit-cost tradeoffs of some of our policy tools could become significantly more favorable."* Re the first underlined phrase: The Fed's talk and walk is now all about convincing us not to adopt a deflation mentality. Re the second underlined phrase: If the Fed sees the whites of deflation's eyes, policy option costs fall considerably... they will throw them all at the problem.

While Bernanke was specific about the Fed's policy options, there was conditionality in his tone. He is prepared to deploy them, but is still not convinced that he will have to. Perhaps this is why the bond market sold off after the speech. Although the economic data have been bad of late, they are going to have to get worse before the next policy arrow gets fired. In our view, it's only a matter of time.



Jennifer Lee, Senior Economist

## CANADA

- Wait for next week's Q2 GDP release
- Finance Minister Flaherty states *"United States is still struggling, and that's a major worry for the Canadian economy"*

## UNITED STATES

- Fed Chairman Bernanke maintains cautious tone at Jackson Hole confab... warns that policymakers' work is *"far from complete"*
- July... a terrible month for housing

## EUROPE

- S&P's downgrade of Ireland reignites Eurozone worries
- Moody's warns that low economic growth combined with EU austerity measures will have a negative impact

## JAPAN

- JPY @ 15-yr high
- Strong JPY hits exports for third consecutive month

### GOOD NEWS

**Retail Sales** +0.1% (June)—disappointing but volumes +0.9%

**Employment (Establishment)** +20,367 (June)

**Ottawa's Budget Deficit** narrows to \$2.8 bln (June)—from \$5.0 bln a year ago

**Initial Claims** -31,000 to 473,000 (Aug. 21 wk)

**Redbook** +1.0% (Aug. 21 wk)

**Mortgage Delinquency Rate** slips to 9.9% (Q2)

**Eurozone—Industrial New Orders** +2.5% (June)

**Eurozone—M3** rises 0.1% y/y (3 mths to July)

**Eurozone—Consumer Confidence** +2.3 pts to -11.7 (Aug. A)

**Germany—Ifo Survey** +0.5 pts to 106.7 (Aug.)—highest since June 2007

**Germany—GfK Consumer Confidence** inches up to 4.1 (Sep.)

**Germany—Consumer Prices** unch (Aug. P)

**U.K.—Real GDP** revised up a tad to +1.2% q/q (Q2)

**Jobless Rate** -0.1 ppts to 5.2% (July)

**Household Spending** +1.1% y/y (July)

CANADA

U.S.

EUROPE

JAPAN

### BAD NEWS

**Existing Home Sales** -27.2% to 3.83 mln a.r. (July)

**New Home Sales** -12.4% to 276,000 a.r. (July)—lowest ever

**FHFA House Prices** -1.7% y/y (June)

**Durable Goods Orders Ex. Transportation** -3.8% (July)

**Real GDP** revised down to +1.6% a.r. (Q2)

**U of M Consumer Sentiment Index** revised down to 68.9 (Aug.)

**Eurozone—Manufacturing PMI** -1.7 pts to 55.0;

**Services PMI** -0.2 pts to 55.6 (Aug. A)

**Exports** -1.4% (July)—but still up 23.5% y/y

**Consumer Prices** -0.9% y/y (July)

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

# Is It Two and Through For Carney & Crew?

Michael Gregory, CFA, Senior Economist

Money market participants pared the odds of a third 25-bp rate hike by the Bank of Canada on September 8th to below 50% in the wake of weaker-than-expected results in the latest CPI and retail sales releases. With inflation and real GDP growth running under the Bank of Canada’s projections, and double-dip risks south of the border on the rise, the market is betting the Bank’s rate-hike appetite is waning. Interestingly, when forced into a binary bet, the latest (post-CPI) survey of primary dealer economists showed unanimity on a rate hike next month. Below, we survey some of the factors weighing on the Bank’s decision.

The Bank of Canada’s core inflation metric inched up 0.1% (s.a.) in July, slowing the annual change to 1.6% y/y from 1.7%. This marked the second consecutive downside surprise. In the July Monetary Policy Report, the Bank projected a 1.9% core inflation average for Q2, but a lower-than-expected June reading left the quarterly average at 1.8%. The 1.6% July print is even more offside, relative to the Bank’s 1.8% forecast average for Q3 (and the following two

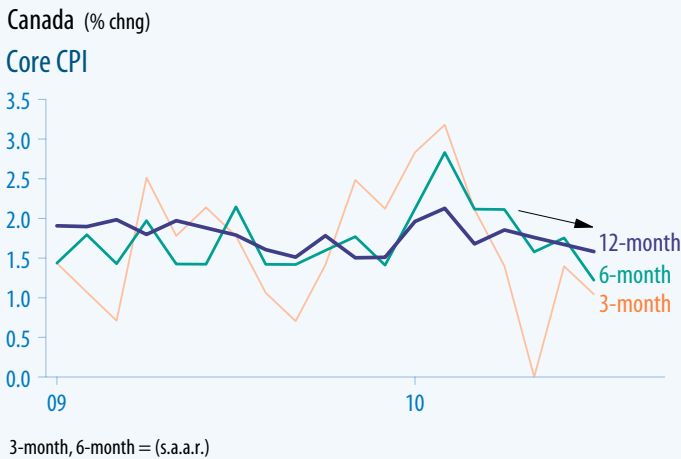
quarters). Core inflation could move back outside in the months ahead, but the shorter-term trends suggest otherwise. The six-month core inflation rate was a 28-month-low 1.2% annualized in July with the more volatile three-month change at just 1.0% annualized (*Chart 1*).

Persistent downside inflation “misses” are interpreted by the Bank as indicating that existing economic slack is exerting more disinflationary pressure than first presumed and/or there is a larger output gap than first estimated. This builds a case for the Bank to follow a less aggressive path for policy rates than the one currently embedded in the MPR projection, particularly if economic growth is also coming up short.

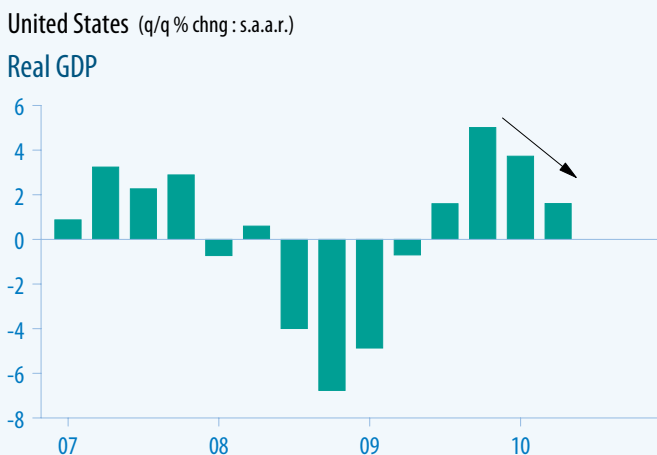
The Canadian economy has lost much of its post-recession bounce. During the seven months ended March, real GDP charged at a 6.0% annual rate, but growth ground to a halt in April and May (to just 1/10<sup>th</sup> its prior pace). June GDP data are due next week, with monthly growth probably around 0.1%, pointing to annualized growth of around 2 1/2% for the quarterly figures. This falls short of the Bank’s 3.0% forecast for Q2. Indeed, we judge the Bank’s 2.8% and 3.2% forecasts for Q3 and Q4, respectively, will be even harder to hit, owing to dimming U.S. economic prospects.

The recent slew of weak U.S. data was the last straw in leading us to downgrade our U.S. economic outlook. Not only was Q2 real GDP growth revised down from 2.4% to 1.6% (*Chart 2*), but we now look for growth to average around 1 1/2% for the remainder of the year (down from our

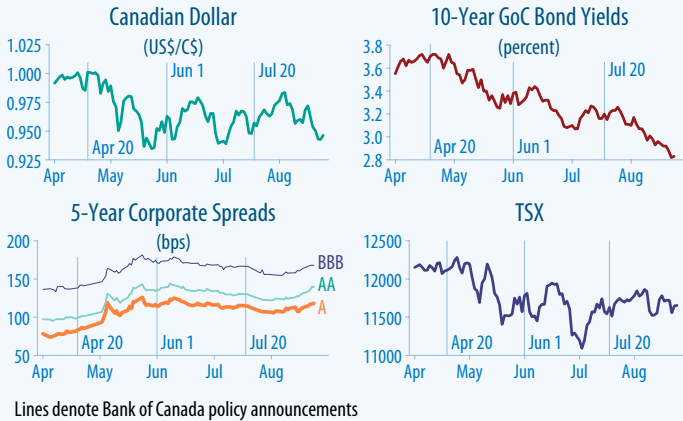
**CHART 1**  
**CORE INFLATION COOLING**



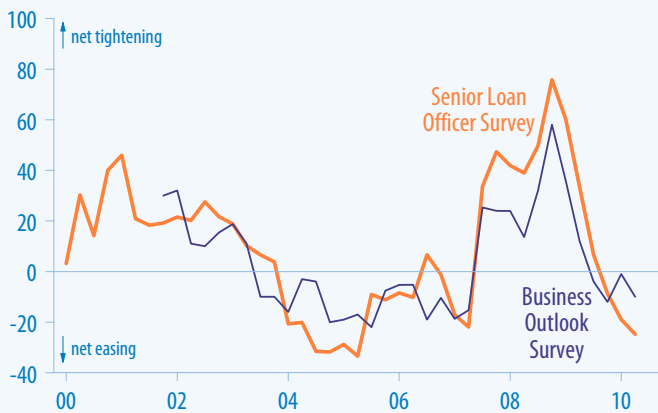
**CHART 2**  
**U.S. ECONOMIC MOMENTUM FADING**



**CHART 3**  
**FINANCIAL CONDITIONS: A MIXED BAG**  
 Canada – 2010



**CHART 4**  
**LENDING STANDARDS LOOSENING**  
 Canada (percent : balance of opinion)



obviously not standing in the way of a rate hike. The same can be said about Government of Canada bond yields, which have decreased 30-to-40 bps along the curve since the last announcement. Corporate bond yield spreads have drifted a bit wider while equity prices have drifted sideways, but bank lending standards have continued to loosen (*Chart 4*). Strong increases in household credit at banks and credit unions through June show that Canadians continue to take advantage of historically low interest rates to add to their already record debt loads, which remains a key concern for the Bank.

**Bottom Line:** We are sticking to our call for a third Bank of Canada rate hike on September 8<sup>th</sup>, so it's not going to be "two and through". We are also sticking to our call for a subsequent pause, as U.S.-centric downside risks to Canadian growth and inflation mount this autumn. However, the coming policy pause could now easily last a year (we thought about four months before), as the risks of a double-dipping deflationary spiral south of the border likely escalate to levels that elicit the Fed to re-open its monetary floodgates. Looking to next month and beyond, the catch phrase could be "one and done" for a while, when it comes to Bank of Canada policy.

previous H2 call for a low-2%-range result). This reflects three factors: (1) The housing sector is suffering a more pronounced payback for past tax incentives and underlying housing demand has probably weakened in the interim (to wit: new home sales dropped back to record lows in July); (2) Already soft job growth is becoming softer (to wit: the latest four-week average for initial jobless claims hit a nine-month high); and, (3) Businesses are beginning to scrimp on machinery and equipment spending, which had been one of the economy's strongest links (to wit: core capital goods orders plummeted in July).

The lower U.S. growth profile and resulting larger output gap should apply even greater disinflation pressure. In consequence, we now judge that the Fed will opt to expand further its unconventional easing efforts before the end of the year (e.g., ballooning its balance sheet again), in order to mitigate the risk of negative prints for both growth and inflation.

Arguably, the U.S. evidence of economic headwinds for Canada could be too fresh to convince the Bank of Canada to alter its immediate policy plans (presuming a September hike was in those plans), particularly with revised economic and inflation projections available for the October 19<sup>th</sup> announcement. Meanwhile, Canadian financial conditions aren't arguing for any immediate policy path alteration either (*Chart 3*).

The Canadian dollar has averaged 96.4 US cents since July 20<sup>th</sup>, bang on the average assumed in the MPR. Currently, however, the loonie is trading just under 95.0 cents and

CANADA	2010				2011				ANNUAL		
	I	II	III	IV	I	II	III	IV	2009	2010	2011
Real GDP (q/q % chng : a.r.)	6.1	2.4 ↑	1.8 ↓	2.3 ↓	2.5 ↓	2.7 ↓	3.0	2.8	-2.5	3.2	2.5 ↓
Consumer Price Index (y/y % chng)	1.6	1.5	1.9	1.6	1.6	2.1	1.8	1.6	0.3	1.7	1.8
Unemployment Rate (%)	8.2	8.0	8.0	7.9	7.8 ↑	7.7 ↑	7.6 ↑	7.5 ↑	8.3	8.0	7.7 ↑
Housing Starts (000s : a.r.)	198	199	181	163	169	179	182	185	149	185	179
Current Account Balance (\$blns : a.r.)	-31.3	-44.4	-44.3	-44.0	-43.7	-44.9	-45.3	-46.2	-43.5	-41.0	-45.0
<b>Interest Rates</b>											
(average for the quarter : %)											
Overnight Rate	0.25	0.33	0.83	1.00	1.00 ↓	1.00 ↓	1.08 ↓	1.58 ↓	0.40	0.60	1.17 ↓
3-month Treasury Bill	0.19	0.41	0.71	0.92	0.93 ↓	0.94 ↓	1.03 ↓	1.54 ↓	0.33	0.56	1.11 ↓
10-year Bond	3.47	3.47	2.98 ↓	2.77 ↓	2.88 ↓	3.06 ↓	3.25 ↓	3.44 ↓	3.23	3.17 ↓	3.16 ↓
<b>Canada/U.S. Interest Rate Spreads</b>											
(average for the quarter : bps)											
90-day	8	26	55	76 ↓	77 ↓	78 ↓	87 ↓	99 ↓	18	41	85 ↓
10-year	-25	-2	25 ↑	30 ↑	25 ↑	18 ↑	10 ↑	2 ↑	-3	7 ↑	14 ↑
<b>UNITED STATES</b>											
Real GDP (q/q % chng : a.r.)	3.7	1.6	1.3 ↓	1.8 ↓	2.2 ↓	2.5 ↓	3.2 ↑	3.0 ↓	-2.6	2.6 ↓	2.2 ↓
Consumer Price Index (y/y % chng)	2.4	1.8	1.1	0.9	0.7	1.3	1.3	1.4	-0.3	1.5	1.2
Unemployment Rate (%)	9.7	9.7	9.5	9.4 ↑	9.3 ↑	9.2 ↑	9.1 ↑	8.9 ↑	9.3	9.6 ↑	9.1 ↑
Housing Starts (mlns : a.r.)	0.62	0.60	0.54	0.57	0.63	0.68	0.71	0.74	0.55	0.58	0.69
Current Account Balance (\$blns : a.r.)	-436	-505 ↓	-506 ↓	-512 ↓	-513 ↓	-520 ↓	-523 ↓	-524 ↓	-378	-490 ↓	-520 ↓
<b>Interest Rates</b>											
(average for the quarter : %)											
Fed Funds Target Rate	0.13	0.13	0.13	0.13	0.13	0.13	0.13 ↓	0.46 ↓	0.13	0.13	0.21 ↓
3-month Treasury Bill	0.11	0.15	0.16	0.16	0.16	0.16 ↓	0.16 ↓	0.56 ↓	0.15	0.14	0.26 ↓
10-year Note	3.72	3.49	2.73 ↓	2.47 ↓	2.63 ↓	2.89 ↓	3.15 ↓	3.41 ↓	3.26	3.10 ↓	3.02 ↓
<b>EXCHANGE RATES</b>											
(average for the quarter)											
US¢/C\$	96.0	97.3	96.1	94.8	94.5 ↓	95.9 ↓	97.6 ↓	99.4 ↓	88.0	96.1	96.8 ↓
C\$/US\$	1.041	1.028	1.041	1.055	1.058	1.043	1.024	1.006	1.141	1.041	1.033
¥/US\$	91	92	86 ↓	87 ↓	90 ↓	93 ↓	96 ↓	99 ↓	94	89 ↓	95 ↓
US\$/Euro	1.38	1.27	1.29	1.30 ↑	1.33 ↑	1.35 ↑	1.33 ↑	1.31 ↑	1.39	1.31 ↑	1.33 ↑
US\$/£	1.56	1.49	1.56	1.58 ↑	1.61 ↑	1.62 ↑	1.61 ↑	1.58 ↑	1.57	1.55 ↑	1.61 ↑

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

## CANADA

Douglas Porter, Deputy Chief Economist

### Current Account Deficit

Monday, 8:30 am

<b>Q2 (e)</b>	<b>\$44.4 bln a.r.</b>
Consensus	\$42.4 bln a.r.
Q1	\$31.3 bln a.r.

Canada's merchandise trade swung back into a deficit in Q2, which will, in turn, drive the broader current account balance deeper into the red. After two quarters of improvement, we look for the current account gap to widen to a \$44 billion annual rate (\$11 billion). While a bit shy of the record shortfalls posted in the middle of last year—during the depths of the U.S. recession—this still marks a tidal shift from the string of surpluses in the prior decade. Our call would put the deficit at 2.7% of GDP, almost right in line with last year's 2.8% shortfall, and a bit below the expected 3.3% deficit for the U.S. in Q2.

### Real GDP

Tuesday, 8:30 am

		<b>Chain Prices</b>
<b>Q2 (e)</b>	<b>+2.4% a.r.</b>	<b>+2.5% a.r.</b>
Consensus	+2.5% a.r.	n.a.
Q1	+6.1% a.r.	+4.4% a.r.
<b>Real GDP at Basic Prices</b>		
<b>June (e)</b>	<b>+0.1%</b>	
Consensus	+0.2%	
May	+0.1%	

After a blazing start to 2010, the Canadian economy almost reached for the snooze button in Q2. We estimate that GDP rose at a modest 2.4% annual rate in the quarter, less than half the 6.1% surge in Q1, but quite close to the economy's 25-year average growth rate. Consumer spending and housing cooled markedly in the spring, while net exports look to have carved heavily into growth (alone chopping more than 4 percentage points off GDP). In contrast, it looks like business investment sprung to life in the quarter, as we expect contributions from each of machinery & equipment outlays, non-residential construction and inventory rebuilding. Our call would leave GDP up 3.6% from year-ago levels, marking a better-than-expected first year of recovery. Unfortunately, all signs point to much more moderate growth in the second year of recovery, likely starting with less than 2% annualized growth in Q3.

The expected softening of Q3 GDP is largely due to the pronounced slowdown in U.S. activity, and will be flagged by the loss of momentum in the monthly GDP data at the end of Q2. June GDP is expected to rise just 0.1%, matching the slow growth in the previous month. Solid gains in retail sales, manufacturing, resources and utilities will be offset by declines in construction, wholesale trade and financial services.

### Auto Sales

Wednesday (expected)

<b>Aug.</b>	
July	+6.3% y/y

Canada has churned out eight consecutive months of year-over-year increases in auto sales, including a 6.3% y/y rise in July. In stark contrast to the U.S., auto sales have nearly returned to pre-recession trends. While the annual comparisons are getting tougher, even a flat monthly performance in August would still leave sales well up from a year ago.

## UNITED STATES

Benjamin Reitzes, Economist

### Income and Spending

Monday, 8:30 am

	<b>Personal Income</b>	<b>Personal Spending</b>
<b>July (e)</b>	<b>+0.3%</b>	<b>+0.4%</b>
Consensus	+0.3%	+0.3%
June	unch	unch
<b>Core PCE Deflator</b>		
<b>July (e)</b>	<b>+0.1%</b>	<b>+1.4% y/y</b>
Consensus	+0.1%	+1.4% y/y
June	unch	+1.4% y/y

Solid auto sales and a modest gain in core retail sales look to pace a 0.4% gain in July consumer spending. However, much of that is likely due to higher prices, with real spending expected to rise a modest 0.1%, matching the average gain over the past year. Income growth will likely fall just short of spending at +0.3%. Until payrolls turn higher, income and spending growth should remain restrained. On the inflation front, the core PCE deflator is expected to rise 0.1% from the prior month, holding the annual inflation rate at 1.4%, which should keep any inflation or deflation talk at bay.

---

**Consumer Confidence**

Tuesday, 10:00 am

<b>Aug. (e)</b>	<b>51.5</b>
<i>Consensus</i>	51.0
July	50.4

U.S. consumer confidence is expected to take a small step forward in August after two big steps back in the prior months, consistent with increases in other confidence metrics. However, the Conference Board measure is heavily weighted toward the job situation, which remains bleak and should limit the upside. Another increase in the 'jobs hard to get' measure would highlight a strong probability that the jobless rate will tick higher in August.

---

**FOMC Minutes**

Tuesday, 2:00 pm

The FOMC downgraded its near-term outlook at the August meeting and opted to reinvest proceeds from its mortgage-backed securities and agencies portfolio into Treasuries in order to keep its balance sheet steady. Media reports show the FOMC is divided on whether more stimulus is necessary. The minutes will be scoured for any hints toward potential triggers for further easing. Until the Fed's 2011 growth forecast (3.5%-to-4.2% as of June, well above potential) is cut, don't expect any action.

---

**Manufacturing ISM**

Wednesday, 10:00 am

<b>Aug. (e)</b>	<b>53.0</b>	<b>Prices-Paid</b>	<b>55.0</b>
<i>Consensus</i>	53.0		56.0
July	55.5		57.5

Mostly weaker regional manufacturing surveys point to a pull-back in the August manufacturing ISM. That would mark the fourth consecutive monthly decline since the index topped 60 in April, confirming the ebbing economic momentum. The employment sub-index should stay nicely above 50, even if it declines, suggesting an eighth straight month of manufacturing payroll gains.

**Nonmfg ISM**

Friday, 10:00 am

<b>Aug. (e)</b>	<b>53.5</b>
<i>Consensus</i>	53.5
July	54.3

The theme of the nonmanufacturing ISM will be similar, with a small decline expected, consistent with slowing growth. This indicator will likely get short shrift this month, as it is released on Friday, after payrolls.

---

**Auto Sales**

Wednesday (expected)

<b>Aug. (e)</b>	<b>11.8 mln a.r.</b>
<i>Consensus</i>	11.6 mln a.r.
July	11.5 mln a.r.

Surprisingly higher consumer confidence likely pushed auto sales up slightly to 11.8 mln units annualized in August, which would mark the strongest non-cash-for-clunkers pace in 23 months. With most data pointing to slowing economic momentum, a solid figure would be welcome and would suggest consumer spending is likely to continue its recent modest growth.

---

**Employment**

Friday, 8:30 am

<b>Aug. (e)</b>	<b>-115,000</b>
<i>Consensus</i>	-105,000
July	-131,000

	<b>Unemployment Rate</b>
<b>Aug. (e)</b>	<b>9.6%</b>
<i>Consensus</i>	9.6%
July	9.5%

	<b>Average Hourly Earnings</b>
<b>Aug. (e)</b>	<b>+0.1%</b>
<i>Consensus</i>	+0.1%
July	+0.2%

Nonfarm payroll employment likely fell 115,000 in August, the third consecutive decline thanks entirely to census-related layoffs. Recent initial claims data point to another month of soft private hiring. Meantime, state and local government financial problems likely mean more layoffs on that front, though recently approved funding from the federal government should alleviate those problems for at least a few months. Another month of weak employment growth is expected to push the jobless rate up a tick to 9.6%.

	CHANGE FROM: (BASIS POINTS)				
	AUG 27 *	AUG 20	WEEK AGO	4 WEEKS AGO	DEC. 31/09
<b>Canadian Money Market</b>					
Call Money	0.75	0.75	0	0	50
Prime Rate	2.75	2.75	0	0	50
<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	0.66	0.62	4	0	47
United States	0.15	0.15	0	1	10
Japan	0.20	0.11	9	9	8
Eurozone	0.89	0.89	0	-1	19
United Kingdom	0.73	0.72	0	-2	12
Australia	4.77	4.78	-1	-3	75
<b>Bond Markets</b>					
<b>2-year Bond</b>					
Canada	1.27	1.31	-4	-20	-21
United States	0.53	0.49	4	-2	-61
<b>10-year Bond</b>					
Canada	2.84	2.92	-8	-28	-77
United States	2.56	2.61	-5	-35	-128
Japan	1.00	0.94	6	-8	-30
Germany	2.15	2.27	-12	-52	-123
United Kingdom	2.87	2.98	-11	-46	-115
Australia	4.81	4.91	-11	-39	-84
<b>Risk Indicators</b>					
VIX	27.8	25.5	2.3 pts	4.3 pts	6.1 pts
TED Spread	15	18	-3	-16	-5
Inv. Grade CDS Spread **	115	109	6	11	29
High Yield CDS Spread **	601	573	28	46	84
<b>Currencies</b>					
				(% CHANGE)	
US\$/C\$	94.36	95.47	-1.2	-2.8	-0.6
C\$/US\$	1.060	1.048	—	—	—
¥/US\$	84.88	85.62	-0.9	-1.8	-8.8
US\$/Euro	1.2702	1.2712	-0.1	-2.7	-11.3
US\$/£	1.546	1.553	-0.5	-1.5	-4.4
US\$/A\$	88.95	89.39	-0.5	-1.6	-0.9
<b>Commodities</b>					
CRB Futures Index	263.87	267.01	-1.2	-3.8	-6.9
Oil (generic contract)	72.77	73.82	-1.4	-7.8	-8.3
Natural Gas (generic contract)	3.76	4.12	-8.7	-23.7	-32.6
Gold (spot price)	1235.85	1227.80	0.7	4.6	12.7
<b>Equities</b>					
S&P/TSX Composite	11729	11722	0.1	0.1	-0.1
S&P 500	1050	1072	-2.0	-4.7	-5.8
Nasdaq	2125	2180	-2.5	-5.7	-6.3
Dow Jones Industrial	10043	10214	-1.7	-4.0	-3.7
Nikkei	8991	9179	-2.1	-5.7	-14.7
Frankfurt DAX	5876	6005	-2.2	-4.4	-1.4
London FT100	5142	5195	-1.0	-2.2	-5.0
France CAC40	3450	3526	-2.1	-5.3	-12.3
S&P ASX 200	4370	4431	-1.4	-2.7	-10.3

\* as of 10:30 am \*\* One day delay



CANADA

## MONDAY AUGUST 30

<b>8:30 am</b>	<b>Current Account Deficit Q2 (e)</b>	<b>\$44.4 bln a.r.</b>
	<i>Consensus</i>	\$42.4 bln a.r.
	Q1	\$31.3 bln a.r.
<b>8:30 am</b>	<b>Industrial Product Price Index</b>	<b>Raw Materials Price Index</b>
<b>July (e)</b>	<b>+0.4%</b>	<b>-0.5%</b>
<i>Consensus</i>	+0.4%	+0.7%
June	-0.9%	-0.3%

<b>8:30 am</b>	<b>Personal Income</b>	<b>Personal Spending</b>
<b>July (e)</b>	<b>+0.3%</b>	<b>+0.4%</b>
<i>Consensus</i>	+0.3%	+0.3%
June	unch	unch
<b>8:30 am</b>	<b>Core PCE Deflator</b>	<b>+1.4% y/y</b>
<b>July (e)</b>	<b>+0.1%</b>	<b>+1.4% y/y</b>
<i>Consensus</i>	+0.1%	+1.4% y/y
June	unch	+1.4% y/y
<b>8:30 am</b>	<b>Savings Rate</b>	
<b>July (e)</b>	<b>6.3%</b>	
June	6.4%	

10-year TIPS (re-open) auction announcement

**1:00 pm** **3 & 6-month T-bill auction \$60.0 bln**  
(New cash \$5.0 bln)

## TUESDAY AUGUST 31

<b>8:30 am</b>	<b>Real GDP</b>	<b>Chain Prices</b>
<b>Q2 (e)</b>	<b>+2.4% a.r.</b>	<b>+2.5% a.r.</b>
<i>Consensus</i>	+2.5% a.r.	n.a.
Q1	+6.1% a.r.	+4.4% a.r.
<b>8:30 am</b>	<b>Real GDP at Basic Prices</b>	
<b>June (e)</b>	<b>+0.1%</b>	
<i>Consensus</i>	+0.2%	
May	+0.1%	

**10:35 am** **3, 6 & 12-month T-bill auction \$13.0 bln**  
(New cash \$0.1 bln)

<b>8:55 am</b>	<b>Redbook</b>
<b>Aug. 28</b>	
Aug. 21	+1.0%
<b>9:00 am</b>	<b>S&amp;P Case-Shiller Home Price Index</b>
<b>June (e)</b>	<b>+3.9% y/y</b>
May	+4.6% y/y
<b>9:45 am</b>	<b>Chicago PMI</b>
<b>Aug. (e)</b>	<b>58.0</b>
<i>Consensus</i>	57.5
July	62.3
<b>10:00 am</b>	<b>Conference Board Consumer Confidence Index</b>
<b>Aug. (e)</b>	<b>51.5</b>
<i>Consensus</i>	51.0
July	50.4

**2:00 pm** **FOMC Minutes from August meeting**

<b>5:00 pm</b>	<b>ABC News Consumer Comfort Index</b>
<b>Aug. 29</b>	
Aug. 22	-44

## WEDNESDAY SEPTEMBER 1

	<b>Auto Sales *</b>
<b>Aug.</b>	
July	+6.3% y/y

**12:05 pm** **30-year bond auction \$1.4 bln**  
(New cash \$1.4 bln)

<b>7:30 am</b>	<b>Challenger Layoff Report</b>
<b>Aug.</b>	
July	-57.2% y/y
<b>8:15 am</b>	<b>ADP National Employment Report</b>
<b>Aug. (e)***</b>	<b>+20,000</b>
July	+42,000
<b>10:00 am</b>	<b>ISM Prices-Paid</b>
<b>Aug. (e)</b>	<b>53.0</b>
<i>Consensus</i>	53.0
July	55.5
<b>10:00 am</b>	<b>Construction Spending</b>
<b>July (e)***</b>	<b>-0.5%</b>
June	+0.1%
<b>10:30 am</b>	<b>DoE's Petroleum Status Report (Aug. 27 week)</b>
	<b>Total Vehicle Sales *</b>
<b>Aug. (e)</b>	<b>11.8 mln a.r.</b>
<i>Consensus</i>	11.6 mln a.r.
July	11.5 mln a.r.

## THURSDAY SEPTEMBER 2

<b>8:30 am</b>	<b>Initial Claims</b>
<b>Aug. 28 (e)</b>	<b>470,000 (-3,000)</b>
Aug. 21	473,000 (-31,000)
<b>8:30 am</b>	<b>Productivity Unit Labour Costs</b>
<b>Q2 R (e)***</b>	<b>-2.0% a.r.</b>
Q2 P	-0.9% a.r.
Q1	+3.9% a.r.
<b>10:00 am</b>	<b>Factory Orders</b>
<b>July (e)</b>	<b>+0.7%</b>
<i>Consensus</i>	+0.5%
June	-0.7%
<b>10:00 am</b>	<b>Pending Home Sales</b>
<b>July (e)</b>	<b>-2.0%</b>
<i>Consensus</i>	-1.5%
June	-2.6%
<b>10:30 am</b>	<b>DoE's Natural Gas Status Report (Aug. 27 week)</b>
	<b>Chain-Store Sales</b>
<b>Aug. (e)</b>	<b>+2.7% y/y</b>
July	+2.8% y/y

3-year note auction announcement  
10 & 30-year bond (re-open) auction announcement

**1:00 pm** **10-year TIPS (re-open) auction**

## FRIDAY SEPTEMBER 3

<b>8:30 am</b>	<b>Nonfarm Payrolls</b>
<b>Aug. (e)</b>	<b>-115,000</b>
<i>Consensus</i>	-105,000
July	-131,000
<b>8:30 am</b>	<b>Unemployment Rate</b>
<b>Aug. (e)</b>	<b>9.6%</b>
<i>Consensus</i>	9.6%
July	9.5%
<b>8:30 am</b>	<b>Average Hourly Earnings</b>
<b>Aug. (e)</b>	<b>+0.1%</b>
<i>Consensus</i>	+0.1%
July	+0.2%
<b>10:00 am</b>	<b>Nonmfg ISM</b>
<b>Aug. (e)</b>	<b>53.5</b>
<i>Consensus</i>	53.5
July	54.3

UNITED STATES

The information, opinions, estimates, projections and other materials contained herein are provided as of the date hereof and are subject to change without notice. Some of the information, opinions, estimates, projections and other materials contained herein have been obtained from numerous sources and Bank of Montreal ("BMO") and its affiliates make every effort to ensure that the contents thereof have been compiled or derived from sources believed to be reliable and to contain information and opinions which are accurate and complete. However, neither BMO nor its affiliates have independently verified or make any representation or warranty, express or implied, in respect thereof, take no responsibility for any errors and omissions which may be contained herein or accept any liability whatsoever for any loss arising from any use of or reliance on the information, opinions, estimates, projections and other materials contained herein whether relied upon by the recipient or user or any other third party (including, without limitation, any customer of the recipient or user). Information may be available to BMO and/or its affiliates that is not reflected herein. The information, opinions, estimates, projections and other materials contained herein are not to be construed as an offer to sell, a solicitation for or an offer to buy, any products or services referenced herein (including, without limitation, any commodities, securities or other financial instruments), nor shall such information, opinions, estimates, projections and other materials be considered as investment advice or as a recommendation to enter into any transaction. Additional information is available by contacting BMO or its relevant affiliate directly. BMO and/or its affiliates may make a market or deal as principal in the products (including, without limitation, any commodities, securities or other financial instruments) referenced herein. BMO, its affiliates, and/or their respective shareholders, directors, officers and/or employees may from time to time have long or short positions in any such products (including, without limitation, commodities, securities or other financial instruments). BMO Nesbitt Burns Inc. and/or BMO Capital Markets Corp., subsidiaries of BMO, may act as financial advisor and/or underwriter for certain of the corporations mentioned herein and may receive remuneration for same. "BMO Capital Markets" is a trade name used by the Bank of Montreal Investment Banking Group, which includes the wholesale/institutional arms of Bank of Montreal, BMO Nesbitt Burns Inc., BMO Nesbitt Burns Ltée/Ltd., BMO Capital Markets Corp. and Harris N.A., and BMO Capital Markets Limited.

TO U.S. RESIDENTS: BMO Capital Markets Corp. and/or BMO Nesbitt Burns Securities Ltd., affiliates of BMO NB, furnish this report to U.S. residents and accept responsibility for the contents herein, except to the extent that it refers to securities of Bank of Montreal. Any U.S. person wishing to effect transactions in any security discussed herein should do so through BMO Capital Markets Corp. and/or BMO Nesbitt Burns Securities Ltd.

TO U.K. RESIDENTS: The contents hereof are not directed at investors located in the U.K., other than persons described in Part VI of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001.

™ - "BMO (M-bar roundel symbol) Capital Markets" is a trade-mark of Bank of Montreal, used under licence. © Copyright Bank of Montreal.