

focus

A Weekly Financial Digest

FEATURE ARTICLE, PAGE 6

Should I Stay (Fixed), or Should I Go (Variable)?

- Bank of Canada Downgrades Forecast, Firms Commitment to Hold Rates Through 2010Q2
- BoC Talk Hammers Loonie
- Dow and Oil Climb to 2009 Highs
- U.S. Housing Data Mixed
- Ontario Fiscal Deficit Widens Sharply
- U.K. Economy Unexpectedly Contracts in Q3



DOUGLAS PORTER

After recently securing the summer Olympics for 2016, Brazil is now leading another race it apparently is much less keen on winning—world’s strongest major currency. In a loud voice of disapproval of the rip-roaring real, Brazil slapped a 2% tax on portfolio capital inflows on Monday (for both bond and stock purchases) in a clear bid to cool the currency and avert a bubble in its domestic financial markets. This highly unusual step to control capital inflows shows just how concerned Brazil is about the potential damage of a strong currency—after all, how many countries actively seek to dampen their stock market?

Most analysts, including the IMF Chief, doubted that the measure would have anything but a fleeting impact, and sure enough the Bovespa and the real were right back in rally mode after a one-day setback. Stocks fell 2.9% on Tuesday, but were still headed for little weekly change by Friday morning. The real initially fell almost 4%, but has snapped back to within 1% of its pre-announcement level. Since the start of 2009, the real is now up 35% against the US\$, leaving it behind only the Seychelles rupee as the strongest currency in the world this year. Meantime, the Bovespa is now up 76% ytd, leaving investors in Brazil with a massive 138% gain in US\$ terms so far this year. That’s battling Peru and Russia for the world’s top equity market in 2009, in what has been a banner year globally for stocks.

Brazil is simply at the extreme edge of a trend affecting all commodity producers who are even remotely well-managed. Amid a mounting reflation trade, surging currencies and bubbling asset markets are concerns to many emerging markets, Australia, Norway, and now Canada. In response, the Bank of Canada has ratcheted up the rhetoric another notch, by a) reasserting to a (disbelieving) market that currency intervention remains a possibility, b) “keeping their focus” on holding rates steady until mid-2010, and c) suggesting the currency’s rise has more than offset all the other positive financial market developments of recent months. (Sidebar: yet, the Bank maintains one of the most optimistic forecasts around, looking for 3% GDP growth next year.) But the challenge of keeping the loonie calm was highlighted by this week’s news that Korea’s state-owned oil company, KNOC, was buying Harvest Energy in a \$4.1 billion deal—simply put, the world wants more Canada (or at least its companies).

What may finally bring the loonie to heel is the underlying damage to Canada’s fundamentals that the currency itself is inflicting. The trade deficit has already risen to a record high, and Canada is on track to post a larger current account shortfall as a share of GDP (almost 3%) than the U.S. this year. Meantime, Canada’s ostensibly superior fiscal fundamentals keep deteriorating before our eyes, with Ontario now expecting a whopping \$24.7 billion deficit for this year, equal to a hefty 4.4% of GDP. Combining all provinces and the federal government leaves a total shortfall of more than 6% of GDP (and climbing, apparently), no longer light years away from Washington’s deficit of 9.9% in the latest fiscal year. So, similar to the U.S., Canada now has large twin deficits, very similar inflation readings, nearly identical interest rates and a battered manufacturing sector. The only thing between us and the deep blue sea of the plunging US\$ would be commodities.




SAL GUATIERI

Although it took a baby step back this week, the lofty loonie remains a serious concern for Canadian business. Our advice is: get used to it. If commodity prices move higher and the greenback lower next year, as we expect, the loonie will surely test parity, barring the BoC unexpectedly leaping into the QE pond with the Fed. Over-indebted Americans facing a further loss of purchasing power won't exactly be lining up outside our door to buy things (except perhaps discounted Leaf tickets).

Canadian business will need to take action to mitigate the effects of a strong dollar on their bottom line, and the economy. Here's what they should do. First, take advantage of record low interest rates to buy new equipment and technology to boost productivity and add value to current products. This is the only way, in the long run, to remain competitive with a rising dollar. Second, shift sales away from the U.S. (continuing a trend, with the U.S. now buying 77% of Canada's goods exports, down from 87% earlier this decade) and towards countries whose currencies are either rising (Brazil, Australia, Norway) or holding relatively steady (Euro area, Japan, U.K.) against the loonie. Remember, China will likely increase its share of the American wallet given the yuan's renewed "peg" to the sliding greenback. Third, notwithstanding the weakening yuan, China's stellar growth (almost 9% for GDP and 15% for retail sales) is a clarion call for Canadian firms to continue striving for further export penetration of this market (China buys 3% of Canada's goods exports, up from less than 1% earlier this decade). China now has the largest motor vehicle market in the world. Fourth, don't overlook Canadian shoppers, many of whom will see their incomes climb alongside commodity prices in the year ahead. But to succeed, businesses will need to do what a growing number of households will be doing in the next year: sourcing ever-cheaper imports—and then pass the cost savings along to customers. These adjustments won't be easy for Canadian business, but they will be necessary to defend against that other health concern this winter: Dutch disease.



MICHAEL GREGORY

The Bank of Canada reiterated its commitment this week to keep the policy rate at 0.25% until the end of June 2010, conditional on the inflation outlook. This was widely expected. However, the Bank's signal of heightened concern about the currency was more than the market was betting for. The policy announcement said: *"The current strength in the dollar is expected, over time, to more than fully offset the favourable developments since July."* The *"more than fully offset"* phrase was the strongest statement of concern the Bank has made since currency appreciation was indentified as a key risk in the June policy announcement. A heftier C\$ headwind also contributed to a downgrade of the Bank's economic projection for 2010 and 2011, which pushed back by one quarter the return of core inflation to the 2% target (to 2011 Q3).

Although Canadian businesses got a taste of parity in late 2007, and many firms are now better able to cope with a lofty loonie, the Bank's heightened concern reflects the fact that the current bout of appreciation is occurring amid very sluggish U.S. domestic demand conditions (a double-whammy for Canadian exporters). Meantime, a larger proportion of the current run-up is owing to a weak U.S. dollar, as opposed to

rising commodity prices and expanding export receipts (thus, less offsetting gain for all the pain). After trading as high as 97.4 U.S. cents ahead of the Bank's policy pronouncements this week, the loonie slid to just under 95 cents as the week closed. Jawboning works, at least for a while. Importantly, in his press conference, Governor Carney hinted that the strong loonie could be taken into account in setting future monetary policy by emphasizing that rates wouldn't necessarily rise immediately after the end of the commitment period. However, with asset prices now a faint blip on the Bank's radar screen (a new upside risk to their inflation projection), we still judge that the Bank will not wait too long before, at a minimum, moving policy rates from their current emergency lows to levels that could be deemed merely accommodative.

Ponti



BENJAMIN REITZES

Global imbalances continue to be a main theme for G20 central banks and finance ministers. The Bank of Canada's MPR noted that *"in the absence of policies to bring about a sustained rotation of global demand, these imbalances may widen again with the recovery, carrying the risk of disorderly adjustments."* A weaker US\$, which has been a major theme recently, is a key remedy to global imbalances. Indeed, the U.S. trade deficit has narrowed sharply as the greenback has fallen, and the current account deficit now sits just below 3% of GDP, down sharply from a 6.5% peak in 2005. Since the U.S. accounted for 43% of global current account deficits in 2008, weakness in the US\$ is an essential ingredient to narrowing global imbalances, and so should not necessarily be seen as a negative (which is becoming a mainstream view). While US\$ weakness is certainly needed, other adjustments must also be made if global imbalances are to narrow.

An equally important adjustment is that the Chinese yuan be allowed to appreciate. China has essentially pegged the yuan to the US\$ since mid-2008, meaning the yuan has declined broadly with the greenback. A weaker currency has made Chinese goods relatively cheaper in most countries, which has helped pace its robust 8.9% y/y GDP growth, but will lead to widening trade imbalances. Because China plays such a big role in global trade (accounting for over 20% of the global current account surplus in 2008) the lack of a more flexible currency regime is counterproductive to global efforts to reduce imbalances. Going one step further, China's currency peg and capital controls boost other currencies, as capital that would otherwise be headed for the Middle Kingdom is redirected elsewhere. Until China allows the yuan to appreciate, global imbalances will not narrow sufficiently and, barring a big bounce-back in consumption in developed economies, China might have difficulty continuing its world-leading growth.

BR

Jennifer Lee, Economist

CANADA

- CAD hit after BoC cautions that CAD strength will offset positive developments...
- ...but repeats that target rate will stay at 0.25% until end 2010H2
- MPR suggests slight downside risk to growth and inflation

UNITED STATES

- Q3 earnings maintain positive tone
- Bernanke warns of global trade imbalances
- Beige Book... a little more upbeat but still very 'beige'

EUROPE

- U.K. mired in recession... still
- European finance officials express worry over strong €

JAPAN

- ¥ backs off 10-month highs

CHINA

- The world's largest stimulus plan... success!
- What's next?

GOOD NEWS

Leading Index +1.1% (Sep.)
Retail Sales +0.8% (Aug.)
Foreigners buy a net \$5.1 bln of Canadian securities (Aug.)

Leading Index +1.0% (Sep.)
Existing Home Sales +9.4% to 5.57 mln a.r. (Sep.)
Housing Starts +0.5% to 590,000 a.r. (Sep.)
Redbook +1.8% (Oct. 17 wk)
Producer Prices -0.6% (Sep.)—**core** -0.1%

Eurozone—Manufacturing PMI +1.4 pts to 50.7;
Services PMI +1.4 pts to 52.3 (Oct. A)
Eurozone—Industrial New Orders +2.0% (Aug.)
Germany—Ifo Survey +0.6 pts to 91.9 (Oct.)
Germany—Producer Prices -0.5% (Sep.)
France—Consumer Spending +2.3% (Sep.)
U.K.—Rightmove House Price Index +2.8% (Oct.)

All-Industry Activity +0.9% (Aug.)
Tertiary Index +0.3% (Aug.)
Export Volumes +10.7% (Sep.)

Real GDP +8.9% y/y (Q3)
Retail Sales +15.1% y/y (Jan.-to-Sep.)
Industrial Production +8.7% y/y (Jan.-to-Sep.)
Fixed Asset Investment +33.3% y/y (Jan.-to-Sep.)
Consumer Prices -0.8% y/y (Sep.)
Producer Prices -7.0% y/y (Sep.)

CANADA

U.S.

EUROPE

JAPAN

CHINA

BAD NEWS

Wholesale Trade -1.4% (Aug.)
Ottawa's Budget Deficit \$23.7 bln (Apr.-to-Aug.)
Ontario's Budget Deficit \$24.7 bln (FY2009/10)

Initial Claims +11,000 to 531,000 (Oct. 17 wk)
NAHB Housing Index -1 pt to 18 (Oct.)
FHFA House Price Index -0.3% (Aug.)
Building Permits -1.2% to 573,000 a.r. (Sep.)

Italy—Industrial Orders -8.6% (Aug.)
Italy—Retail Sales -0.1% (Aug.)
U.K.—Real GDP -0.4% q/q (Q3 A)
U.K.—M4 slowed to +11.3% y/y (Sep. P)
U.K.—Retail Sales unch (Sep.)

Department Store Sales -7.8% y/y (Sep.)

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

Should I Stay (Fixed), or Should I Go (Variable)?

Douglas Porter and Benjamin Reitzes

The age-old question of whether to lock into a longer-term fixed mortgage rate or stay in a variable rate has become an increasingly complex and important issue recently, with short-term rates at extreme lows and pressure likely to build for higher rates in the year ahead. Historically, there is little debate which has been the better option: typically borrowers save money by staying in variable products, and riding the rollercoaster of fluctuating rates. In fact, fully 82% of the time since 1975, the cost-effective route for borrowers was to stay variable (*Chart 1*). And, if anything, the spread between 5-year fixed mortgage rates and variable rates has been widening further in recent years, and is now close to an all-time high (*Chart 2*). However, there are a number of important caveats to point out, before rushing to assume that the variable option is again the hands-down winner.

- We have been in a long-term declining rate environment, almost without a break, since the early 1980s.
- The Bank of Canada’s overnight rate is now as low as it can go, so there is simply no further downside for variable rates. The surprises by definition can only be to the high side from here.
- Posted rates do not tell the whole story, and the actual rates that borrowers negotiate have made the call much closer between fixed and floating in recent years than the headline figures would suggest.
- Fixed rates were advantageous during only two recent periods—through the late 1970s and briefly in the late 1980s; in both cases, ahead of a period of rising interest rates, as is the case now.

CHART 1
VARIABLE INVARIABLY SUPERIOR (ALMOST)

Canada (percent)

Mortgage Rates

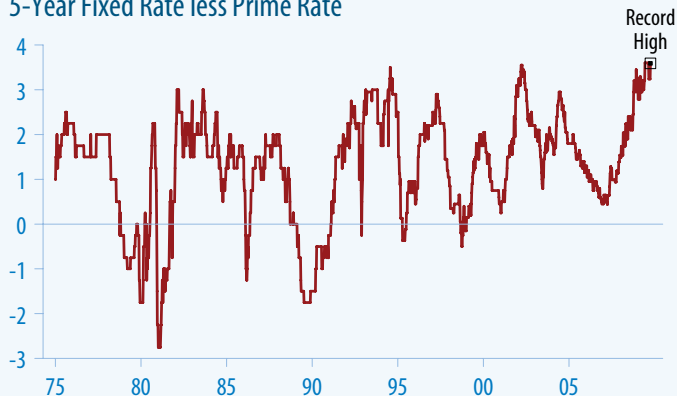


Variable = (m.a. of the next five years) Fixed = 5-year

CHART 2
PEACE OF MIND COMES WITH A PRICE

Canada (ppts)

5-Year Fixed Rate less Prime Rate



The Case for Staying Fixed

A conventional fixed rate mortgage can mitigate a number of risks. Inflation hasn’t been a problem in Canada since the Bank of Canada adopted inflation targeting, averaging precisely 2% since 1991. However, there is an outside risk of an inflation flare-up as global central banks keep the pedal to the policy metal, and amid record government deficits. These efforts risk sparking inflation, especially if the global economic recovery is stronger than expected. Either of those potential scenarios could force the Bank of Canada to raise interest rates aggressively, driving variable mortgage rates higher, but leaving fixed rate choosers

unscathed. Another reason fixed rates are attractive in the current environment is that short-term rates are already as low as they can go—rates are only going to move higher from here as the economy recovers. Considering the likely upward trend in interest rates (similar to the late 1970s and 1980s) as the economy is emerging from recession, this may be one of those rare periods when a fixed rate turns out to be the superior choice. Further illustrating the potential rationale for going fixed is the near-record low “real” 5-year rate (*Chart 3*). Finally, a fixed rate may ultimately prove more expensive, but you get certainty, and that certainty is worth something to many.

The Case for Going Variable

The clearest advantage to a variable rate mortgage is that it has been consistently less costly than its conventional counterpart over time. There have only been a small handful of occasions in modern history where a variable rate was the less favourable option. And, the current outlook for inflation remains benign, with significant excess capacity in both

Canada and the U.S., which will likely keep price pressures at bay well into 2011. The soaring Canadian dollar is putting additional downward pressure on prices, reducing the near-term need for the Bank of Canada to raise rates. There even remains some risk of deflation south of the border. Low and steady inflation, taken with a fragile global economic recovery, points to the Bank keeping its commitment to hold rates steady through June 2010 (conditional on the inflation outlook). There is also some risk to locking in as fixed rates could fall if the economy performs worse than anticipated. Even as rates start to rise, one can always lock into a fixed rate at a later date. But with BMO’s 5-year variable rate at a record low 2.25% (matching the prime rate), the extra 2.29 percentage points on the special 5-year fixed rate offer may simply be tough to swallow for many (*Table 1*).

The verdict: The decision really does depend on the individual. For those who don’t have a lot of financial flexibility, and would run into difficulty from a pronounced upswing in interest rates (typically first-time buyers), the moderate extra cost for peace of mind may be a price worth paying. And frankly there is a reasonable scenario where fixed rates may actually prove to be a cheaper alternative at this point. In fact, mortgage pricing is relatively efficient and the fixed rate is usually a good approximation of expectations of the variable rate. However, our core view is that the most likely economic and interest rate outlook will ultimately again slightly favour the variable rate option, and that’s particularly the case given BMO’s current rate of 2.25%—but it’s a much closer call than usual.

CHART 3
REALLY GOOD TIME TO BUY

Canada (percent)

5-Year Fixed Rate less Core CPI



Core CPI = (y/y % chng)

TABLE 1
BMO MORTGAGE RATES
(percent : posted as of October 21, 2009)

	Fixed	Variable
1-Year	3.70	—
2-Year	3.95	—
3-Year	4.45	3.05 *
4-Year	5.29	—
5-Year	5.84	2.25
5-Year Special	4.54	—

* open; all other rates are for closed term

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	0.6	1.1	1.4	2.0	1.7	2.4	0.3	1.5
Unemployment Rate (%)	7.6	8.4	8.6	8.8	8.9	8.7	8.5	8.3	6.1	8.3	8.6
Housing Starts (000s : a.r.)	140	128	149	149	147	148	150	155	211	141	150
Current Account Balance (\$blns : a.r.)	-30.9	-44.8	-54.1	-50.2	-50.4	-51.7	-52.9	-53.1	8.1	-45.0	-52.0
Interest Rates											
(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	3.46 ↑	3.56 ↑	3.65 ↑	3.73 ↑	3.82 ↑	3.61	3.24 ↑	3.69 ↑
Canada/U.S. Interest Rate Spreads											
(average for the quarter : bps)											
90-day	43	8	6	16 ↑	16 ↑	24 ↑	60 ↑	57 ↑	94	18 ↑	39 ↑
10-year	15	-11	-10	2 ↑	-3 ↑	-6 ↑	-10 ↑	-14 ↑	-6	-1 ↑	-8 ↑
UNITED STATES											
Real GDP (q/q % chng : a.r.)	-6.4	-0.7	3.8	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	1.1	2.0	2.2	1.8	1.7	3.8	-0.4	1.9
Unemployment Rate (%)	8.1	9.2	9.6	10.0	10.2	10.0	9.9	9.8	5.8	9.2	10.0
Housing Starts (mlns : a.r.)	0.53	0.54	0.59	0.61	0.68	0.74	0.78	0.82	0.90	0.57	0.75
Current Account Balance (\$blns : a.r.)	-418	-395	-409	-379	-375	-373	-369	-361	-706	-400	-370
Interest Rates											
(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	0.06 ↓	0.06 ↓	0.06 ↓	0.19 ↓	0.69 ↓	1.39	0.15 ↓	0.25 ↓
10-year Note	2.74	3.31	3.52	3.44 ↑	3.58 ↑	3.71 ↑	3.83 ↑	3.96 ↑	3.67	3.25 ↑	3.77 ↑
EXCHANGE RATES											
(average for the quarter)											
US\$/C\$	80.3	85.6	91.1	96.6	98.7	99.7	100.7	100.3	94.3	88.4	99.8
C\$/US\$	1.245	1.168	1.097	1.035	1.013	1.003	0.993	0.997	1.067	1.136	1.002
¥/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	1.60 ↑	1.62 ↑	1.66 ↑	1.70 ↑	1.74	1.85	1.56 ↑	1.68 ↑

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

Real GDP at Basic Prices

Friday, 8:30 am

	Real GDP at Basic Prices
Aug. (e)	unch
Consensus	unch
July	unch

CANADA

Michael Gregory, CFA, Senior Economist

The Canadian economy likely drifted sideways in August, for the second month in a row and following a puny +0.1% June move. While these results are major improvements from the preceding 10 consecutive months of decline (averaging -0.5% per period), they are lacklustre nevertheless. We seem to be limping out of recession, owing to the dual growth drags: a lofty loonie and sluggish U.S. domestic demand. These were obvious in August, with real merchandise exports and factory sales down sharply. However, the fact that the economy managed to break even at all reflects offsetting support from domestic spending, stoked, in turn, by record low interest rates and fiscal stimulus measures. Retail sales volumes rose moderately in August, as housing starts capped four consecutive monthly increases. The latter should result in the first positive print for construction output since last October. Important for consumer spending, the labour market managed to more than break even in August, registering the first job gains in 10 months. This, along with rebounding household wealth (e.g., resale homes prices, equities), served to boost consumer confidence and reinforce the rise in domestic spending.

Another offset is coming from revved up automotive output, driven by depleted inventories. The latter is the legacy of the lengthy shutdowns during the spring and summer (particularly at GM and Chrysler), and the U.S. cash-for-clunkers program. Indeed, owing to the typical statistical smoothing of the auto sector's seasonal production shutdowns and ramp-ups, there's a risk that this year's atypical pattern could result in a larger August GDP gain, let alone an upside revision to the prior month's flat figure. While the current economic dichotomy—firming internal but soft external sales—is expected to continue, we judge that domestic demand will eventually get the upper hand. Overall, GDP growth should top 1¼% annualized in Q3, and accelerate to near 3½% in Q4.

S&P/Case-Shiller Home Price Index

Tuesday, 9:00 am

Aug. (e)	-12.3% y/y
July	-13.3% y/y

UNITED STATES

Sal Guatieri, Senior Economist

After sliding 32% since mid-2006, existing home prices have stabilized, with steadily rising demand offsetting still-lofty supply. However, a dip in FHFA house prices suggests the Case-Shiller measure took a breather in August after three straight monthly gains. A flat performance in the month would still reduce the annual rate of decline by one percentage point to -12.3%.

Conference Board Consumer Confidence

Tuesday, 10:00 am

Oct. (e)	54.5
Consensus	54.0
Sep.	53.1

Consumer confidence is slowly picking itself off the mat, helped by soaring equities and steadying house prices, though still pummeled by ongoing job losses. The Conference Board's index likely rose modestly to 54.5 in October, retracing the prior month's setback. While more than doubling from February's low, the index is still a long way from the long-run norm of 95. Consumers feel better, but not great, about their financial prospects, and are likely to spend cautiously until job growth resumes.

Durable Goods Orders

Wednesday, 8:30 am

		Ex. Transport
Sep. (e)	+1.0%	+1.5%
Consensus	+0.8%	+0.7%
Aug.	-2.6%	-0.3%

Continued growth in the ISM orders index signals a rebound in durable goods purchases in September, likely up 1%. Recovering auto production and exports continue to support factory orders, though Boeing orders slipped in the month. Excluding aircraft and defence, capital goods orders should increase for the first time in three months, suggesting business spending is steadying after a 1½-year swoon.

New Home Sales

Wednesday, 10:00 am

Sep. (e)	438,000 a.r. (+2.0%)
Consensus	440,000 a.r. (+2.6%)
Aug.	429,000 a.r. (+0.7%)

New home sales likely rose for the sixth straight month in September, driven by good affordability and a desire to beat the November 30th first-time home buyer tax credit deadline. We look for sales to advance 2% to one-year highs of 438,000. While that would mark a one-third increase from January's low, sales would still be half of pre-boom levels a decade ago. Although inventories are shrinking, the still-slow pace of sales means that builders are taking a record 13 months to sell completed houses, which explains why new home prices continue to slide.

Real GDP

Thursday, 8:30 am

		GDP Deflator
Q3 A (e)	+3.8% a.r.	+2.2% a.r.
Consensus	+3.2% a.r.	+1.5% a.r.
Q2	-0.7% a.r.	unch

After contracting modestly further in Q2, real GDP likely rebounded 3.8% annualized in Q3, rubber-stamping an end to the recession. Consumer spending probably rose 3%, mostly due to the cash-for-clunkers program. Exports should see their biggest increase in more than a year, and the federal government surely continued to prime the fiscal pump. A slower rate of inventory drawdown amid rising production should assist growth. But, another big drop in non-residential construction and further slippage in business capital spending will temper the overall gain.

Employment Cost Index

Friday, 8:30 am

Q3 (e)	+0.5%	+1.7% y/y
Consensus	+0.5%	+1.7% y/y
Q2	+0.4%	+1.9% y/y

Continued job cuts and fewer work hours are keeping labour costs in check. However, July's hike in the minimum wage and rising medical benefit costs likely imply a 0.5% increase in the ECI in Q3. Still, this should reduce the yearly growth rate to a series-low (back to 1983) of 1.7%, half the rate of two years ago. Moderating employment costs will keep core inflation on a downward keel well into next year.

Personal Consumption Expenditure and Income

Friday, 8:30 am

	Personal Income	Personal Spending
Sep. (e)	+0.1%	-0.6%
Consensus	+0.1%	-0.5%
Aug.	+0.2%	+1.3%
Core PCE Deflator		
Sep. (e)	+0.2%	+1.3% y/y
Consensus	+0.2%	+1.3% y/y
Aug.	+0.1%	+1.3% y/y
Savings Rate		
Sep. (e)	3.7%	
Aug.	3.0%	

The September release on spending will be upstaged by the Q3 GDP report, though it's worth watching for signs of momentum heading into the all-important holiday shopping season. Unit auto sales reversed 35% in the month after the cash-for-clunkers program ended, though "core" retail sales rose a solid 0.5%. The latter should limit the expected decline in personal spending to -0.6%, retracing about half the prior month's gain. Personal income likely rose minimally, with still-rising wages (due to good productivity growth) offsetting still-shrinking payrolls. Look for the savings rate to snap back to 3.7%, before forging towards 6% next year. Higher motor vehicle prices and medical care costs likely lifted the core PCE deflator 0.2% in the month, with some offset from falling rents. This should hold the yearly increase to 1.3%—the lowest rate since 9/11 and well below the Fed's long-run forecast of about 2%.

	OCT 23 *	OCT 16	CHANGE FROM: (BASIS POINTS)		
			WEEK AGO	4 WEEKS AGO	DEC. 31/08
Canadian Money Market					
Call Money	0.25	0.25	0	0	-125
Prime Rate	2.25	2.25	0	0	-125
U.S. Money Market					
Fed Funds (effective)	0.25	0.25	0	0	0
Prime Rate	3.25	3.25	0	0	0
3-Month Rates					
Canada	0.22	0.23	-1	-2	-61
United States	0.05	0.06	0	-4	-2
Japan	0.20	0.15	5	5	0
Eurozone	0.73	0.74	-1	-1	-216
United Kingdom	0.60	0.57	2	4	-218
Australia	3.75	3.72	3	46	-110
Bond Markets					
2-year Bond					
Canada	1.52	1.60	-8	24	43
United States	1.00	0.96	5	2	24
10-year Bond					
Canada	3.49	3.48	1	13	81
United States	3.47	3.41	6	15	126
Japan	1.36	1.34	2	4	18
Germany	3.34	3.29	5	8	39
United Kingdom	3.65	3.60	5	4	63
Australia	5.70	5.58	12	47	171
Currencies					
				(% CHANGE)	
US\$/C\$	94.90	96.43	-1.6	3.5	15.7
C\$/US\$	1.054	1.037	—	—	—
¥/US\$	91.99	90.89	1.2	2.6	1.5
US\$/Euro	1.5007	1.4905	0.7	2.2	7.4
US\$/£	1.636	1.636	0.0	2.6	12.1
US\$/A\$	92.46	91.65	0.9	6.5	31.6
Commodities					
CRB Futures Index	281.76	276.10	2.0	12.5	22.7
Oil (generic contract)	80.25	79.02	1.6	21.6	79.9
Natural Gas (generic contract)	4.89	4.78	2.2	22.6	-13.1
Gold (spot price)	1058.70	1053.60	0.5	6.8	20.0
Equities					
S&P/TSX Composite	11485	11505	-0.2	2.4	27.8
S&P 500	1090	1088	0.2	4.4	20.7
Nasdaq	2178	2157	1.0	4.2	38.1
Dow Jones Industrial	10044	9996	0.5	3.9	14.4
Nikkei	10283	10258	0.2	0.2	16.1
Frankfurt DAX	5787	5743	0.8	3.7	20.3
London FT100	5269	5190	1.5	3.7	18.8
France CAC40	3835	3828	0.2	2.6	19.2
S&P ASX 200	4859	4836	0.5	3.1	30.5

* as of 10:30 am

JAPAN

EUROZONE

U.K.

OTHER

MONDAY OCTOBER 26
TUESDAY OCTOBER 27
WEDNESDAY OCTOBER 28
THURSDAY OCTOBER 29
FRIDAY OCTOBER 30

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Retail Sales		
Sep. (e)	+0.2%	-1.6% y/y
Aug.	+1.0%	-1.8% y/y

Manufacturing PMI		
Oct.		
Sep.	54.5	
Industrial Production		
Sep. P (e)	+1.0%	-19.3% y/y
Aug.	+1.6%	-19.0% y/y

Jobless Rate		
Sep. (e)	5.6%	
Aug.	5.5%	
Household Spending		
Sep. (e)	+1.0% y/y	
Aug.	+2.6% y/y	
CPI		
Sep. (e)	-2.2% y/y	
Aug.	-2.2% y/y	
Core CPI		
Sep. (e)	-2.4% y/y	
Aug.	-2.4% y/y	
Bank of Japan Monetary Policy Meeting & Semi-Annual Outlook Report		

GERMANY		
GfK Consumer Confidence		
Nov. (e)	4.5	
Oct.	4.3	

EUROZONE		
M3 Money Supply (smoothed)		
Sep. (e)	+2.5% y/y	
Aug.	+2.1% y/y	

GERMANY		
Consumer Price Index *		
Oct. P (e)	+0.1%	-0.1% y/y
Sep.	-0.5%	-0.5% y/y

EUROZONE		
Economic Confidence		
Oct. (e)	84.4	
Sep.	82.8	
GERMANY		
Unemployment		
Oct. (e)	+15,000	
Sep.	-12,000	
Jobless Rate		
Oct. (e)	8.3%	
Sep.	8.2%	

EUROZONE		
Consumer Price Index		
Oct. (e)	-0.1% y/y	
Sep.	-0.3% y/y	
Jobless Rate		
Sep. (e)	9.7%	
Aug.	9.6%	
GERMANY		
Retail Sales		
Sep. (e)	+1.0%	-2.2% y/y
Aug.	-2.4%	-2.6% y/y
FRANCE		
Producer Price Index		
Sep. (e)	-0.3%	-8.1% y/y
Aug.	+0.4%	-8.5% y/y
ITALY		
Consumer Price Index		
Oct. P (e)	+0.5%	+0.4% y/y
Sep.	+0.7%	+0.4% y/y
Producer Price Index		
Sep. (e)	-0.3%	-7.9% y/y
Aug.	+0.6%	-7.8% y/y

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M4 Money Supply		
Sep. F (e)	+11.3% y/y	
Aug.	+12.1% y/y	

Nationwide House Prices *		
Oct. (e)	+0.6%	+1.8% y/y
Sep.	+0.9%	unch y/y
GfK Consumer Confidence		
Oct. (e)	-14	
Sep.	-16	

AUSTRALIA		
Producer Price Index		
Q3 (e)	+0.3%	+0.5% y/y
Q2	-0.8%	+2.1% y/y

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AUSTRALIA		
Consumer Price Index		
Q3 (e)	+0.9%	+1.2% y/y
Q2	+0.5%	+1.5% y/y

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* date approximate

CANADA

UNITED STATES

MONDAY OCTOBER 26

8:55 am **BoC Governor Carney speaks in Montreal**

TUESDAY OCTOBER 27

11:00 am **BoC Governor Carney and Deputy Governor Jenkins speak before the House Finance Committee**

Quebec Fiscal Update

10:35 am **3, 6 & 12-month T-bill auction \$16.0 bln**
(New cash -\$0.8 bln)

WEDNESDAY OCTOBER 28

4:00 pm **BoC Governor Carney and Deputy Governor Jenkins speak before the Senate Banking Committee**

THURSDAY OCTOBER 29

8:30 am	Average Weekly Earnings	
Aug. (e)	+1.5% y/y	
July	+1.6% y/y	
8:30 am	Industrial Product Price Index	Raw Materials Price Index
Sep. (e)	-0.2%	-1.1%
Consensus	-0.2%	-0.9%
Aug.	+0.5%	+3.7%

10-year bond auction announcement

FRIDAY OCTOBER 30

8:30 am	Real GDP at Basic Prices
Aug. (e)	unch
July	unch

8:55 am Redbook
Oct. 24
Oct. 17 +1.8%

9:00 am S&P Case-Shiller Home Price Index
Aug. (e) -12.3% y/y
July -13.3% y/y

10:00 am Conference Board Consumer Confidence Index
Oct. (e) 54.5
Consensus 54.0
Sep. 53.1

5:00 pm ABC News/Washington Post Consumer Comfort Index
Oct. 25
Oct. 18 -50

Treasury Secretary Geithner speaks in New York

8:30 am Durable Goods Orders **Ex. Transport**
Sep. (e) +1.0% +1.5%
Consensus +0.8% +0.7%
Aug. -2.6% -0.3%

10:00 am New Home Sales
Sep. (e) 438,000 a.r. (+2.0%)
Consensus 440,000 a.r. (+2.6%)
Aug. 429,000 a.r. (+0.7%)

10:30 am DoE's Petroleum Status Report (Oct. 23 week)

8:30 am Initial Claims
Oct. 24 (e) 515,000 (-16,000)
Oct. 17 531,000 (+11,000)

8:30 am Real GDP **GDP Deflator**
Q3 A (e) +3.8% a.r. +2.2% a.r.
Consensus +3.2% a.r. +1.5% a.r.
Q2 -0.7% a.r. unch

10:00 am Homeowner Vacancy Rate
Q3 (e) 2.4%
Q2 2.5%

10:30 am DoE's Natural Gas Status Report (Oct. 23 week)

8:30 am Employment Cost Index
Q3 (e) +0.5% +1.7% y/y
Consensus +0.5% +1.7% y/y
Q2 +0.4% +1.9% y/y

8:30 am Personal Income **Personal Spending**
Sep. (e) +0.1% -0.6%
Consensus +0.1% -0.5%
Aug. +0.2% +1.3%

8:30 am Core PCE Deflator
Sep. (e) +0.2% +1.3% y/y
Consensus +0.2% +1.3% y/y
Aug. +0.1% +1.3% y/y

8:30 am Savings Rate
Sep. (e) 3.7%
Aug. 3.0%

9:45 am Chicago PMI
Oct. (e) 48.0
Consensus 48.5
Sep. 46.1

10:00 am Univ. of Michigan Consumer Sentiment
Oct. F (e) 70.0
Consensus 70.0
Oct. P 69.4
Sep. 73.5

1:00 pm **5-year TIPS auction \$6.0 bln**
(New cash \$6.0 bln)

1:00 pm **3 & 6-month T-bill auction \$59.0 bln**
(New cash -\$1.0 bln)

1:00 pm **2-year note auction \$44.0 bln**
(New cash \$20.1 bln)

1:00 pm **5-year note auction \$41.0 bln**
(New cash \$41.0 bln)

1:00 pm **7-year note auction \$31.0 bln**
(New cash \$31.0 bln)

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