

CAPITAL MARKETS RESEARCH

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Closing Points

— A Daily Recap and Look Ahead

KEY POINTS:

- Equities trade lower on European concerns
- US housing starts, industrial production accelerate—along with Canada manufacturing
- Further Fed monetary intervention remains on the table
- Spain to auction bonds
- Japan Q1 2012 GDP due out

Today's North American Close

Positive US economic data failed to lift markets. While US April housing starts were higher and industrial production rebounded, US markets sold off as the trading session continued, slipping on news that the ECB might cut funding to Greek banks. US equity indices were down by roughly 0.5% while Canadian equities performed somewhat more strongly. WTI fell by US\$1.30 to close at \$92.68 and the DXY was up moderately on the session. For a full write-up of today's US and Canada economic data releases, please see the Economic Data Recap section below.

The Fed released the minutes from its April 24-25 meeting today, and they are making headlines for reasons that we find hard to discern. The minutes included the sentence “several members indicated that additional monetary policy accommodation could be necessary if the economic recovery lost momentum or the downside risks to the forecast became great.” Minutes from the March 13 meeting said “A couple of members indicated that the initiation of additional stimulus could become necessary if the economy lost momentum or if inflation seemed likely to remain below its mandate-consistent rate of 2 percent over the medium run.” We are hesitant to read too much into the difference between “several” and “a couple” members thinking that stimulus is a possibility, and in general, we are wary of engaging in comparable forms of Fed interpretation that resemble esoteric theology. In our view, the larger point is that stimulus has been and remains on the table if the economy turns south. One's view on the likelihood of stimulus is thus contingent on one's view of the trajectory of the US economy. We have been and continue to be less optimistic than consensus in our outlook for the US economy in 2012, and therefore we have been and continue to be of the view that there is a meaningful risk that the Fed will engage in some form of unconventional monetary stimulus during H2 2012. As an advisor to a once-U.S. Presidential candidate is rumored to have said, “It's the economy, stupid!”

Overnight Markets

Spain will be auctioning bonds with maturities in 2015 and 2016 tomorrow. The auction will come following statements from the leadership of the largest Spanish banks to the effect that they have reached their maximum exposure to Spanish sovereign debt, and a further announcement from one of Spain's larger banks that it will require a capital injection from the Spanish government.

Japan GDP will be released overnight and markets are anticipating a fairly strong GDP print of 0.9% q/q (3.5% annualized). That's much stronger than Q4 2012 (-0.7% annualized) and would be the first solid GDP increase that wasn't essentially a 'base effect' jump since Q2 2010. What do we mean by 'base effect jump'? Japan GDP increased by 7.1% at an annualized rate in Q3 2011, but that was only an improvement on the deep contractions in GDP during Q1 and Q2 2011 in the aftermath of the Tohoku tragedy (-6.9% and -1.2%). The jump did not even get Japan past the earthquake destruction. Thus far, Japan GDP has failed to rebound in the fashion that many had forecast that it would as rebuilding initiatives intensified.

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Tomorrow's North American Open

US jobless claims data will be released and we suggest watching these fairly carefully as they will cover a week that falls into the 'reference period' for non-farm payrolls. The trend in non-farm payrolls turned negative in March and we'll be watching to see if the weakness continues into May.

Canada wholesale sales for March will be released, and while wholesale trade only represents a limited percentage of GDP, they swung the monthly number for February by expanding at a very rapid 1.6% m/m rate. Revisions are always a possibility after that type of swing, and we'll be watching to see how the number evolves. Strong manufacturing sales during the corresponding period imply that wholesale trade may have picked up, although this indicator is notoriously difficult to forecast.

Mexico Q1 GDP will be released tomorrow morning, and Scotia's Latam economics team notes that leading indicators such as industrial production, retail sales and global economic activity indicator (IGAE) suggest that the economy maintained solid growth through the first quarter, mainly driven by a faster reactivation of domestic demand. We expect GDP to have expanded by 4.4% y/y in the first quarter.

Economic Data Recap

U.S., Housing Starts SAAR (000s), April:

Actual: 717.0

Scotia: 685.0

Consensus: 685.0

Prior: 699.0 (revised from: 654.0)

U.S., Building Permits SAAR (000s), April:

Actual: 715.0

Scotia: 675.0

Consensus: 730.0

Prior: 769.0 (revised from: 747.0)

* So much for apartments driving the resurgence in US housing starts. The number of US housing starts in April increased to 717k, essentially the highest number since housing starts nose-dived to all-time lows in Q4 2008.

* It was a well rounded number, with the gain led by single family housing starts (492k, +11k over the previous month) while multi-family units also accelerated (225k, +7k over March).

* The 717k starts are consistent with the numbers from Q1 (the range was 699k – 718k). It seems as though housing starts have moved from a run rate of +/- 600k during 2009-2011 to a run-rate of +/- 700k at present.

* That's still a depressed level by historical standards (the 'normal' recession pace was 900k-1,000k starts) but is a significant improvement compared to post-crisis levels seen up until now.

* Housing permits fell by 7% m/m, although the level of building permits (715k) is still consistent with housing starts at their current level.

* In terms of regions, the best growth in housing starts was in the South (+11.6%) while the Midwest grew by 6.7%. The Northeast contracted by 20.7% entirely on slower apartment construction (singles were +2.2%) and the West fell by 8.1% with singles falling there as well (-3.1%).

U.S., Industrial Production SA (m/m%), April:

Actual: 1.1

Scotia: 0.6

Consensus: 0.6

Prior: -0.6 (revised from: 0.0)

* U.S. industrial production rebounded in-line with expectations, increasing by 1.1% in March (although February was revised down, netting out pretty close to Scotia's forecast and market expectations).

* All three major categories (manufacturing, mining, and utilities) were positive.

* Motor vehicle production outperformed, increasing 3.9% m/m and implying that the automotive industry is continuing with its production ramp-up that started in late 2011 and is now continuing through 2012.

* Manufacturing, which was up 0.6% m/m, would only have increased by 0.3% if motor vehicles and parts were excluded.

* Electricity output increased 3% as the US moves past the warm winter conditions of Q1 2012. Along with it, natural gas production increased by 17% after decreasing by amounts ranging from -4.8% to -6% during 4 out of the 5 months between Nov. 2011 and March of this year.

Canada, Manufacturing Shipments SA (m/m%), March:

Actual: 1.9

Scotia: -0.2

Consensus: 0.4

Prior: -0.2 (revised from: -0.3)

* All of the sharp upside on this print will flow straight through to March GDP since it was entirely driven by higher volumes and not price effects. That said, given weakness earlier in Q1, shipments for the full quarter came in down 2.2% in annualized terms over Q4. That points to manufacturing being a drag on the full first quarter GDP figure.

* Without adjusting for price effects, inventories dropped sharply in this report, falling by 1.2% m/m for the biggest decline since September 2009. At 1.3, the inventory to sales ratio reversed the build in January and February and sits back at about December levels. Watch for revision effects to our Q1 inventory story here.

* New orders climbed 2% m/m which signals a turn from a muted year-long performance marked by flat new orders compared to year-ago readings. That should lift shipments in future.

* Unfilled orders climbed 2% m/m which also points to further pipeline strength.

* Shipments were up in 13 of 21 sectors for a slim majority. Shipments fell in the primary metals, non-metallic mineral product, electrical equipment and appliance, plastics and rubber products, and textile mills categories. Against our expectations, aerospace products and parts climbed again, rising 9.9% m/m.

* By province, shipments climbed in everywhere except for Saskatchewan, Manitoba and Nova Scotia. The manufacturing heartland of Ontario (+1.9%) and Quebec (+1.2%) saw solid gains, but the biggest percentage swing was in New Brunswick (+21%).

Economic Releases — Today, Overnight and Tomorrow

North America - TOMORROW

Country	Date	Time	Event	Period	BNS	Survey	Actual	Prior
CA	5/17/2012	08:30	Int'l Securities Transactions	MAR	--	8.00B	--	12.49B
CA	5/17/2012	08:30	Wholesale Sales MoM	MAR	--	0.30%	--	1.60%
US	5/17/2012	08:30	Initial Jobless Claims	12-May	370K	365K	--	367K
US	5/17/2012	08:30	Continuing Claims	5-May	3280K	3230K	--	3229K
US	5/17/2012	10:00	Philadelphia Fed.	MAY	--	10	--	8.5
US	5/17/2012	10:00	Leading Indicators	APR	--	0.10%	--	0.30%

Europe - OVERNIGHT

Country	Date	Time	Event	Period	BNS	Survey	Actual	Prior
SP	5/17/2012	03:00	GDP (Constant SA) (QoQ)	1Q F	-0.40%	-0.30%	--	-0.30%

Asia Pacific - OVERNIGHT

Country	Date	Time	Event	Period	BNS	Survey	Actual	Prior
JN	5/16/2012	19:50	GDP Annualized	1Q P	--	3.50%	--	-0.70%
JN	5/16/2012	19:50	Gross Domestic Product (QoQ)	1Q P	--	0.90%	--	-0.20%
JN	5/16/2012	19:50	Nominal GDP (QoQ)	1Q P	--	1.00%	--	-0.50%
SI	5/16/2012	20:00	GDP (QoQ)	1Q F	--	10.60%	--	9.90%
SI	5/16/2012	20:00	GDP (YoY)	1Q F	--	1.80%	--	1.60%
SI	5/16/2012	20:30	Electronic Exports (YoY)	APR	--	4.00%	--	2.80%
JN	5/17/2012	00:30	Industrial Production (MoM)	MAR F	--	--	--	1.00%
HK	5/17/2012	04:30	Unemployment Rate SA	APR	--	3.50%	--	3.40%

Fixed Income	Government Yield Curves (%):											
	2-YEAR			5-YEAR			10-YEAR			30-YEAR		
	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk
U.S.	0.29	0.27	0.25	0.74	0.73	0.75	1.76	1.77	1.82	2.90	2.92	3.02
CANADA	1.27	1.29	1.22	1.45	1.46	1.47	1.92	1.93	1.98	2.45	2.46	2.51
GERMANY	0.07	0.07	0.07	0.53	0.52	0.53	1.47	1.47	1.52	2.14	2.14	2.24
JAPAN	0.11	0.11	0.11	0.24	0.25	0.25	0.83	0.85	0.85	1.79	1.82	1.82
U.K.	0.37	0.39	0.40	0.88	0.92	0.95	1.88	1.90	1.90	3.18	3.22	3.21
Foreign - U.S. Spreads (bps):												
CANADA	98	101	97	71	73	71	16	17	16	-45	-46	-52
GERMANY	-22	-20	-18	-22	-21	-22	-29	-30	-30	-76	-78	-79
JAPAN	-18	-17	-14	-51	-48	-51	-93	-91	-97	-111	-110	-120
U.K.	8	12	15	14	19	19	12	13	8	28	30	19

Equities			% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	11326.08	-16.97	-0.1	-3.0	-5.9	-15.4
Dow 30	12598.55	-33.45	-0.3	-1.8	-2.5	0.4
S&P 500	1324.80	-5.86	-0.4	-2.2	-3.3	-0.4
Nasdaq	2874.04	-19.72	-0.7	-2.1	-3.8	3.3
DAX	6384.26	-16.80	-0.3	-1.4	-3.6	-13.6
FTSE	5405.25	-32.37	-0.6	-2.3	-4.6	-8.8
Nikkei	8801.17	-99.57	-1.1	-2.7	-7.0	-8.0
Hang Seng	19259.83	-634.48	-3.2	-5.3	-6.3	-15.9
CAC	3048.67	9.40	0.3	-2.2	-4.9	-23.6
Commodities			% change:			
WTI Crude	92.73	-1.25	-1.3	-4.2	-9.9	-4.8
Natural Gas	2.63	0.13	5.1	6.6	30.3	-39.2
Gold	1548.50	-8.00	-0.5	-2.1	-6.3	3.2
Silver	27.25	-1.03	-3.6	-5.3	-13.0	-20.7
CRB Index	289.35	0.21	0.1	-1.9	-3.8	-14.1
Currencies			% change:			
USDCAD	1.0124	0.0002	0.0	1.0	2.2	4.1
EURUSD	1.2715	-0.0001	-0.0	-1.7	-3.1	-10.7
USDJPY	80.31	-0.0200	-0.0	0.5	-0.7	-1.4
AUDUSD	0.9914	0.0000	0.0	-1.7	-4.6	-6.7
GBPUSD	1.5909	-0.0001	-0.0	-1.5	-0.1	-2.1
USDCHE	0.9446	0.0000	0.0	1.7	3.2	7.3

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