



Economics & Strategy

Jeffrey Rubin
(416) 594-7357
jeff.rubin@cibc.ca

Avery Shenfeld
(416) 594-7356
avery.shenfeld@cibc.ca

Benjamin Tal
(416) 956-3698
benjamin.tal@cibc.ca

Peter Buchanan
(416) 594-7354
peter.buchanan@cibc.ca

Meny Grauman
(416) 956-6527
meny.grauman@cibc.ca

Krishen Rangasamy
(416) 956-3219
krishen.rangasamy@cibc.ca

"The David Dodge world of a sub-6% unemployment rate coexisting with a 2% inflation rate might simply not be possible for Mark Carney."

The New Job Got a Lot Tougher

by Avery Shenfeld

Let's hope Mark Carney likes a challenge, because his new posting at the top of the Bank of Canada could be a lot tougher than it was for his predecessor.

The Bank's single instruction is to contain inflation, but presumably, to do so without wrecking the economy in the process. Governor Dodge's mandate wasn't without its own bumps in the road. But he had one major trend smoothing the way, a general decline in global inflationary forces, and in the last few years, a skyrocketing Canadian dollar that countered the sharp climb in energy costs.

As a result, Dodge never had to face a truly tough decision in terms of sacrificing growth to keep the CPI at 2%. When the economy faltered, he could be aggressive in cutting interest rates. When it boomed, he could test the waters of ever-lower unemployment rates and the associated pick-up in wage rates, counting on falling prices for Chinese imports, cheap global food prices, and new and more aggressive competitors in retailing to keep inflation at bay.

In terms of their inflation impacts, energy aside, all of the global shocks in the past decade were in the direction of tamer prices. The stagflation of the 1970s, when inflation was heightened even when growth was depressed, was not a risk.

For now, that's where things still stand in Canada. In the wake of the prior year's C\$ climb and a resulting tumble in prices for autos and other imports, inflation is low

enough to provide the cover for an additional rate cut or two as a means of helping the economy avoid the worst of the US slump.

But looking further out, the choices will become much tougher. On commodities, the Bank's monetary policy report can't seem to make up its mind, citing, in two adjacent paragraphs, the risks of higher or lower resource prices.

But it concedes that much of the rise in resource costs relates to the economic boom in developing economies, one that has a long road ahead of it. If, as we expect, food and energy prices continue to climb, keeping the Canadian CPI reigned in at 2% will mean that other prices are going to have to be well under than pace.

And there's the rub. With a likely diminishing disinflationary benefit from retail competition and Chinese exports, to accomplish that feat, Carney might have to keep interest rate settings high enough to send the C\$ soaring ever higher, making life even more difficult for Canada's non-resource exporters.

Or, those same interest rates are going to have to be at settings that leave much more economic slack in Canada's labour market than we've been used to of late, in order to keep wages and services prices under wraps. The David Dodge world of a sub-6% unemployment rate coexisting with a 2% inflation rate might simply not be possible for Mark Carney.

<http://research.cibcwm.com/res/Eco/EcoResearch.html>



CIBC World Markets

Week Ahead Calendar And Forecast

	CANADA			UNITED STATES		
	CIBC World Markets	Consensus	Prior	CIBC World Markets	Consensus	Prior
Monday April 28				AUCTION: 3-M BILLS \$20B , 6-M BILLS \$20B		
Tuesday April 29	AUCTION: 3-M BILLS \$7.1B, 6-M BILLS \$2.7B, 1-YR BILLS \$2.7B CASH MANAGEMENT BUYBACK (June '08 - Dec '08) - \$1B			AUCTION: 4-WEEK BILLS \$8B (prev)		
Wednesday April 30	8:30 AM GDP M/M INDUSTRIAL PROD. PRICES M/M RAW MATERIALS M/M	(Feb) (H) (Mar) (M) (Mar) (M)	0.6% 0.1% 0.5%	9:00 AM S&P CASE SHILLER INDEX 10:00 AM CONF. BOARD CONSUMER CONFIDENCE 5:00 PM ABC CONSUMER CONFIDENCE	(Feb) (M) (Apr) (H) Apr-27 (L)	180.7 64.5 -40.0
Thursday May 1	8:30 AM GDP M/M INDUSTRIAL PROD. PRICES M/M RAW MATERIALS M/M Speaker(s): 3:30 PM Mark Carney (Governor) 3:30 AM Paul Jenkins (Deputy)	(Feb) (H) (Mar) (M) (Mar) (M)	0.2% 0.6% 0.8%	7:00 AM MBA-APPLICATIONS 8:15 AM ADP EMPLOYMENT CHANGE 8:30 AM GDP EMPLOYMENT COST INDEX 9:45 AM CHICAGO PMI 2:15 PM FED RATE ANNOUNCEMENT	Apr-25 (L) (Apr) (H) (Q1) (H) (Q1) (H) (Apr) (M) (Apr) (H)	-14.2% 8K 0.6% 0.8% 48.0 2.00%
Friday May 2	8:30 AM PERSONAL INCOME PERSONAL SPENDING PCE DEFlator Y/Y PCE DEFlator Y/Y (core) NEW VEHICLE SALES INITIAL CLAIMS CONTINUING CLAIMS 10:00 AM CONSTRUCTION SPENDING M/M ISM - MANUFACTURING 8:30 AM NON-FARM PAYROLLS UNEMPLOYMENT RATE MANUFACTURING PAYROLLS AVERAGE HOURLY EARNINGS AVERAGE HOURS WORKED 10:00 AM FACTORY ORDERS	(Mar) (M) (Mar) (M) (Mar) (H) (Mar) (H) (Apr) (M) (Apr) (L) (Mar) (M) (Apr) (H) (Apr) (H) (Apr) (H) (Apr) (H) (Mar) (M)	0.4% 0.1% 3.3% 2.0% 15.1M 342K 2934K -0.6% 48.0 -75K 5.2% -40K 0.3% 33.7 0.3%	0.5% 0.1% 3.4% 2.0% 15.1M 342K 2934K -0.3% 48.6 -80K 5.1% -48K 0.3% 33.8 -1.3%		

Week Ahead's Market Call

by Avery Shenfeld

In the US, the Fed hawks will vote “no” on a further rate cut, but there should be enough doves, including the Chairman, to get agreement on a 25-bp reduction, with the wording not at this point promising anything more. That said, we expect to see a follow-up rate cut or two over the next few months as the economic data darken before they get better, with a 100,000 drop in payrolls in Friday's report being a case in point. GDP growth for Q1 looks to be close to zero, and even if it manages to have a plus sign, that would only be because January started the year ahead of the fourth-quarter average, with activity falling month to month since then. House price data will show further declines as well.

In Canada, February GDP will show a modest 0.2% advance, but a drop looks to be in store for March based on what we saw in full time employment. Governor Carney appears twice on the calendar, but he will stick closely to the script of the past week's Monetary Policy Report.

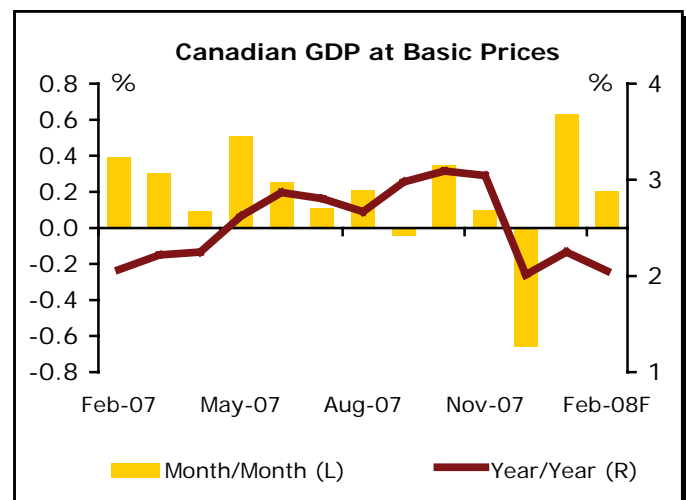
Week Ahead’s Key Canadian Number:

Real GDP (at Basic Prices)—February

(Wednesday, 8:30 a.m.)

Avery Shenfeld (416) 594-7356

	CIBC WM	Mkt	Prior
GDP (m/m)	0.2%	0.2%	0.6%



Canada’s economy had some big winners and equally big losers in February, netting out to a middling 0.2% rise in real GDP. Oddly the wins were in some of the weakest links in the economy, with manufacturing seeing a second strong rise, but one that still hasn’t made up for a huge plunge in December. March doesn’t look likely to continue that streak, with the earlier downtrend set to resume under the weight of slumping activity stateside.

Retail and wholesale activity both dropped in the month, a result that will weigh on their GDP performance. While Ontario’s new “family day” holiday will not be picked up by the formal seasonal adjustment process (which needs three years of history), it will not show up as a drop in GDP in affected sectors. Some service output measures use employment (which won’t be hit by the holiday) rather than hours worked, and in other cases, adjustments will be made to the raw data to correct for the distortion.

Forecast Implications—March GDP could see an outright decline, given weakness in full time employment, and our expectations for a poor month for manufacturing and a weather hit to construction. Moreover, this quarter started in a hole created by December’s GDP dive, which left output at the end of Q4 well below its average for the quarter. As a result, we expect real growth of only 1%. That won’t be a surprise to the Bank of Canada, since it matches their recent forecast.

Market Impact—Our call is in line with the consensus, so don’t expect any immediate response in financial markets.

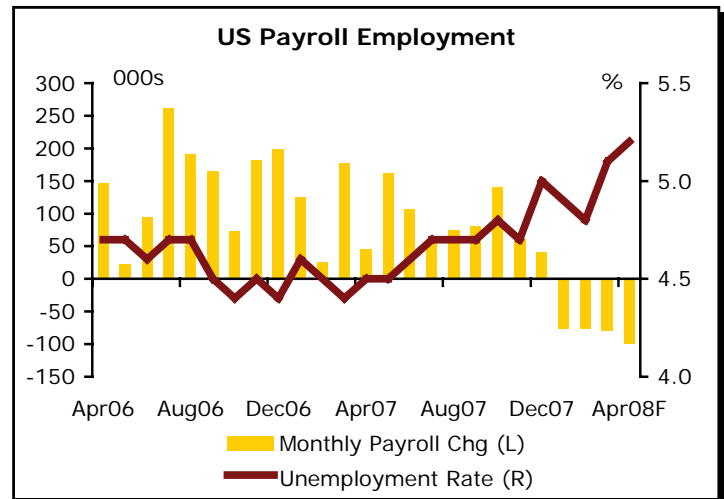
Week Ahead’s Key US Number:

Non-Farm Payrolls—April

(Friday, 8:30 a.m.)

Meny Grauman (416) 956-6527

	CIBC WM	Mkt	Prior
Non-Farm Payrolls (chg)	-100K	-75K	-80K
Unemployment Rate	5.2%	5.2%	5.1%
Avg. Hrly Earnings (m/m)	0.3%	0.3%	3.6%



Not only did March’s nonfarm payroll report show that the US economy shed jobs for the third consecutive month, but it also pointed to more underlying weakness than previously reported. It dragged down the three-month moving average of employment growth to—77K , and confirmed a very reliable recessionary signal. Since then the picture of the American labour market has not improved materially, jobless claims fell below an early April spike, but the trend in continuing claims is strongly positive. Recessions typically see job losses in the 200K range, and jobless claims above 400K. This has not happened yet, which suggests that we are in store for a less dramatic decline of 100K jobs in April. The labour market should get worse before it gets better.

Forecast Implications—April’s nonfarm payroll number will be our first firm indication of the health of the US economy in the second quarter. Although we are still not calling for employment to drop off a cliff, a fourth consecutive month of increasing job declines is consistent with our view that Q2 will mark the low point of this current economic cycle.

Market Impact—Like our forecast, consensus expectations for this report are consistent with a mild recession. Since investors are already pricing in this news, we do not expect this release to be particularly market moving.

Other US Releases:

Real GDP—Q1 (Advance)

(Wednesday, 8:30 a.m.)

We continue to call for a small decline of -0.2% in real GDP growth in Q1, but won’t be surprised by a small positive number. Consumer spending should be above water, but will still drop to its lowest growth rate since

the early 1990s. A small positive print may be cheered by the market, but should not be interpreted as a strong vote of confidence for the US economy. The trend is clearly down and Q2 should be significantly weaker.

Equity Insights

Meny Grauman

The Cross-Border Grocery Blues

Vicious competition and some crucial missteps have made Canadian food retailing stocks an abysmal proposition for the better part of two years. However, that is only part of the story, because the business is also under some pressure south of the border. US grocery store stocks have handily outperformed their Canadian comparables, but have also suffered more recently as rising food prices have squeezed margins. Despite their problems, Canadian food retailers have partially escaped the global phenomenon of rapidly rising wholesale food prices, but this is poised to change over the next year only adding an extra challenge to an already challenged business.

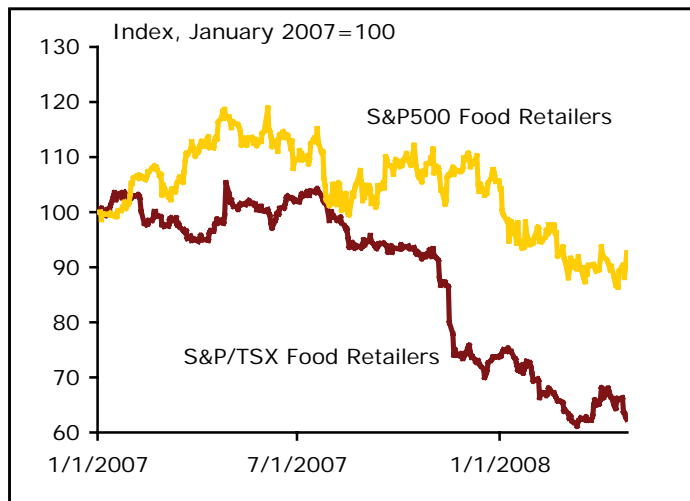
Yet Another Reason Energy Prices Are Going Up

There is no shortage of factors helping drive crude oil prices to new daily records, but a big part of the story is clearly Chinese demand. This is not a new development, but has recently been intensifying. Chinese crude oil imports have been on a steady upward trend for more than six years, but have recently spiked up by 21% to 17.3 million tons in March. This appears to be related to rising stockpiles in preparation of the Olympic Games, but coal shortages are also part of the explanation. A strong winter storm and related transportation bottlenecks helped whittle down Chinese coal supplies to very low levels boosting the need for liquid fuel replacements and giving an extra kick to oil.

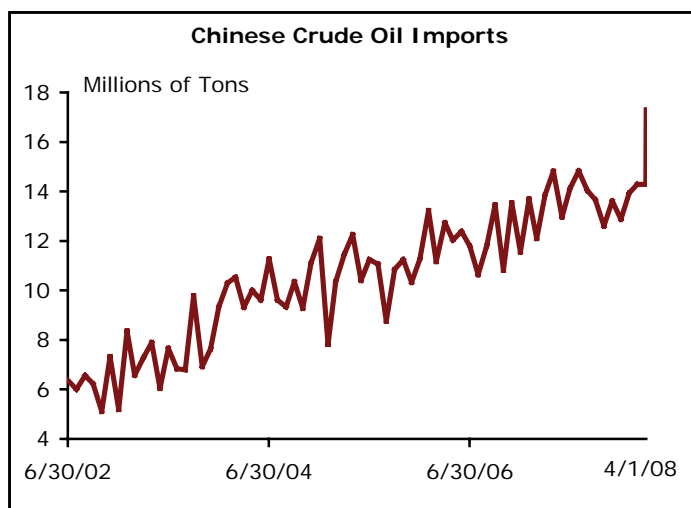
Over US\$300 bn in Three Quarters

Although first quarter bank earnings out of the United States and Europe have not seemed to weigh on equity investors at all, this reporting season has continued to include billions of dollars in additional writedowns. The scale of these writedowns does appear to be falling with the first quarter tally at around US\$102 bn, versus the close to US\$160 bn worth of announcements the previous quarter. Some may view this as a cautious buy signal for a beleaguered sector, but this conclusion may be too hasty. Although investors probably have a good handle on the extent of the losses in most financial institutions trading books, the next few months may still bring a slew of poor performances due to smaller capital bases and slowing operating results.

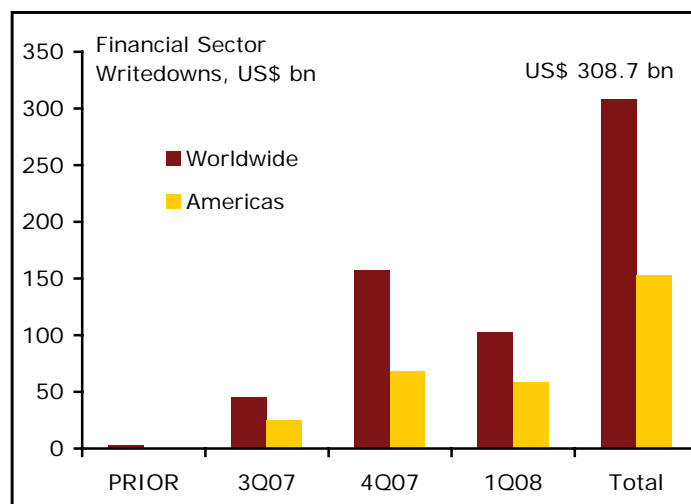
Cdn and US Food Retail Stocks



China's Thirst for Oil Growth



Writedowns Cooled in Q1



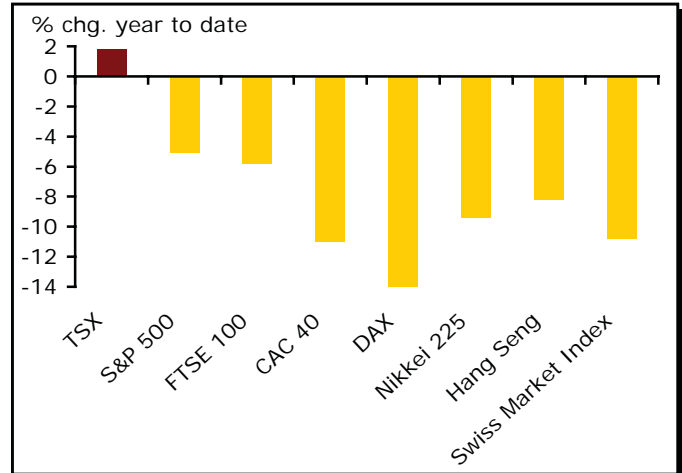
Currency Currents

Avery Shenfeld and Krishen Rangasamy

TSX Attractive to Foreign Investors

Canadian interest rates might not be that attractive for foreign investors, but the loonie might get some benefit from equity flows, particularly where the flows are from retail investors that don't hedge the currency. While most global bourses have continued to melt away this year, the TSX has been able to stay above water, thanks in no small part to the ascent of oil, metals and natural gas. Canada also offers a play on the world food price squeeze through the fertilizer sector.

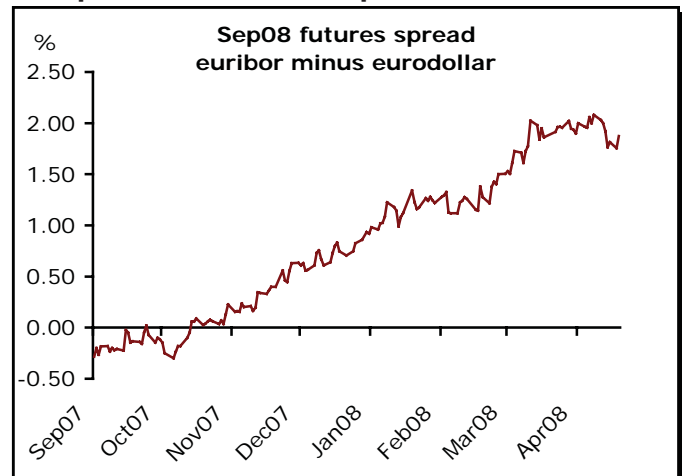
Alone Above Water



Spreads to Support Euro For How Long?

A hawkish ECB and an aggressive Fed have allowed the interest rate spread to widen significantly over the past few months, taking the Euro to new records. For now, that spread appears to have stalled out, with September euribor futures no longer climbing relative to the rising September fed funds futures yield. While its hard to take the ECB threat of rate hikes too seriously, the market may be understating the scope for additional Fed rate cuts beyond 2%. If so, there's a bit more room for the euro to explore territory above US\$1.60.

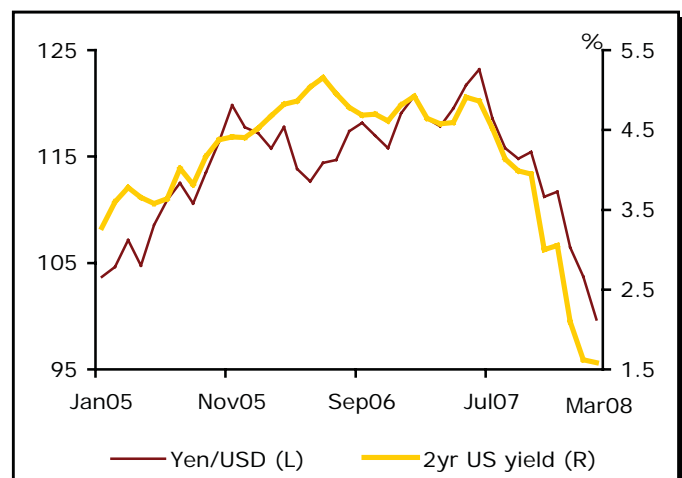
Europe-US Short Rate Spread



Yen Tracks 2-Year Treasuries

Dollar-yen traders seem to have honed in on a single idea—sell the yen when risk aversion calms and aggressive carry trades can be financed, buy it when risk fears are ignited. The result is that dollar-yen closely tracks another measure of risk preference, the 2-year US Treasury, seen as the safe asset in times of trouble. This week, the market ignored surprisingly high Japanese inflation numbers, which ought to have been bullish for the yen, and instead added to short yen positions as other measures pointed to an increase in risk tolerance, including a sell off in 2-year Treasuries.

Yen and Treasuries Both Track Risk Perceptions



CANADIAN RELEASE AND EVENT DATES April/May 2008



MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
21 INT'L TRANSACTIONS IN SECURITIES C\$BN 8:30 AM NET NET NET NET BONDS MONEY STOCKS TOT MARKET DEC -0.2 0.7 1.3 1.8 JAN 6.3 -2.1 -3.3 0.9 FEB 3.7 -1.2 1.3 3.8	22 Bank of Canada Interest Rate Announcement Prince Edward Island Budget Alberta Budget	23 RETAIL TRADE 8:30 AM (Current\$) M Y DEC 0.5 5.7 JAN 1.4 7.8 FEB -0.7 5.7	24 Bank of Canada Monetary Policy Report	25
28	29 BUSINESS CONDITIONS SURVEY 8:30 AM	30 GDP BY INDUSTRY 8:30 AM (2002\$) GDP IND.PROD. M M DEC -0.7 -2.5 JAN 0.6 1.1 FEB INDUSTRIAL PRICES 8:30 AM M (NSA) Y JAN 1.0 0.0 FEB 0.1 -0.8 MAR BoC Gov. Carney appears before Standing Committee on Finance @ 3:30 PM ET	1 BoC Gov. Carney appears before Senate Committee on Banking, Trade, Commerce @ 11:45 AM ET	2
5 INTERNATIONAL RESERVES 8:15 AM \$BN \$BN CHANGE LEVEL FEB 1.352 43.6 MAR -0.556 43.1 APR	6 BUILDING PERMITS (\$) 8:30 AM M M (RES) (NON-RES) JAN -15.0 16.7 FEB 18.2 -25.6 MAR IVEY PURCHASING MANAGERS' INDEX 10:00 AM	7	8 HOUSING STARTS 8:15 AM 000's (AR) TOTAL SINGLES FEB 244 83 MAR 243 81 APR	9 LABOUR FORCE SURVEY 7:00 AM AVG EMPLOY UNEMP HRLY (HOUSE) RATE EARN M Y % Y FEB 0.3 2.2 5.8 4.7 MAR 0.1 1.9 6.0 4.7 APR MERCHANDISE TRADE 8:30 AM \$MN 12 MO. BALANCE JAN 2,780 47,002 FEB 4,935 47,859 MAR
12 NEW HOUSING PRICE INDEX 8:30 AM	13	14	15 SURVEY OF MANUFACTURING 8:30 AM SHIPMENTS M Y JAN 1.3 -3.6 FEB 1.6 -2.3 MAR WAGE SETTLEMENTS 10:00 AM (%) PVT. PUB. TOT. JAN 4.5 2.9 3.3 FEB 3.9 3.1 3.4 MAR	16 CAR & TRUCK SALES 8:30 AM 000's (AR) TOTAL DOM.BUILT CAR SALES JAN 1,853 644 FEB 1,793 606 MAR
19 VICTORIA DAY (HOLIDAY) (Markets Closed)	20 WHOLESALE TRADE 8:30 AM INT'L TRANSACTIONS IN SECURITIES C\$BN 8:30 AM NET NET NET NET BONDS MONEY STOCKS TOT MARKET JAN 6.3 -2.1 -3.3 0.9 FEB 3.7 -1.2 1.3 3.8 MAR	21 CONSUMER PRICE INDEX 7:00 AM M (NSA) Y FEB 0.4 1.8 MAR 0.4 1.4 APR LEADING INDICATOR 8:30 AM	22 RETAIL TRADE 8:30 AM (Current\$) M Y JAN 1.4 7.8 FEB -0.7 5.7 MAR QUARTERLY FINANCIAL STATISTICS 8:30 AM	23

All data seasonally adjusted except where noted "NSA". M: per cent change from previous month. Q: per cent change from previous quarter at annual rates. Y: per cent change from year earlier. AR: Annual Rate. YTD: Year to date. Release dates are provided by sources outside CIBC World Markets. Dates are subject to change. Sources for historical data: Statistics Canada, CMHC, Human Resources Development Canada and the Bank of Canada.

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