



## Economics & Strategy

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*"... the recent recovery could simply reflect increased market immunity to bad news. Let's hope so—because there is still plenty of bad news coming."*

## What's in the Pipeline?

by Benjamin Tal

Market optimism is back. But if it's based mainly on expectations for a fed rate cut, then the recent stock market recovery is on shaky ground. The fed might not deliver and stay in neutral. And even if Bernanke ends up cutting, it would be an admission that the situation is really bad, with negative macroeconomic implications—hardly a positive scenario for equities.

Or the recent recovery could simply reflect increased market immunity to bad news. Let's hope so—because there is still plenty of bad news coming. While the situation extended well beyond subprime credit, the reality is that, at its core, this is a subprime crisis. And the news coming from that space will continue to dominate markets.

So let's see what's in the pipeline. The process of mortgage rate resets—the catalyst of the subprime meltdown—is far from over. Interest rates on roughly \$850 billion worth of mortgages are due to be reset during 2007 and 2008. Year-to-date only one-third have been reset. Resets will reach their peak in November this year and will start easing slowly during the course of 2008. More than three-quarters of those mortgages are securitized, and 80% of them are subprime.

But here we have to dig a bit deeper to really understand what's coming. Since the vast majority of those subprime mortgages were originated with a teaser rate that is fixed for two years, the mortgages that will be reset in 2007 and 2008 are the ones that were taken

in 2005 and 2006. How do these mortgages fare compared with the ones taken in 2004 (and were reset in 2006)? Not very well—for a few reasons: first many borrowers of the 2004 vintage were able to refinance their original mortgages since banks were still playing that game. This option is hardly available for mortgages being reset in 2007 and 2008 as banks are in no mood to offer that option. Second, despite the 400 basis-point increase in the fed funds rate between 2004 and 2006, the average teaser rate was unchanged (at around 8% for subprime borrowers). But since subprime loans are typically originated with payment caps of 250 basis points each year, the full damage for 2004 borrowers was not felt in 2006. It is, however, impacting 2007 delinquencies. And third, house prices started to fall only in 2007, and every one-percent decline in national house prices leads to an estimated 70,000 of additional foreclosures—given that currently no less than one-quarter of adjusted rate mortgages originated in 2006 are in a negative equity position.

Intricacies of mortgage mechanics aside, the bottom line is that the news coming from the subprime market will get much worse before it gets better, with delinquency rates rising to well over 20% in the coming year. We do not know how much of that bad news the market is already discounting—but the fact that the market rallied on the day that we learned that US banks' bad loans are rising at the fastest pace since the 1991 recession, might suggest that a lot of gloom is already priced in.

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

## Week Ahead's Market Call

**In the US**, it's going to be a busy week data-wise, but with markets preoccupied with the unfolding credit crunch, none of those releases will be a market mover. Existing home sales will confirm what everybody knows—that the US housing market is in recession. Growth in personal income will remain relatively solid—confirming for now that the consumer is entering this crisis on solid footing. And at the end of the week Bernanke will deliver another speech—markets will try to assess the language he uses to describe the current situation.

**In Canada**, second-quarter GDP will come in roughly in line with the Bank of Canada's expectations. But the monthly numbers will reveal that the quarter has ended on a softer note. And a solid improvement in merchandise trade will lead to a near-record current account surplus in Q2.

Benjamin Tal

## Week Ahead Calendar

Day	Time	Release	CIBC WM	Consensus*	Prior
<b>CANADA</b>					
Thu	8:30	Industrial Prices - Jul	-0.7%	-0.5%	-1.3%
Thu	8:30	Current Account Balance (qr) - Q2	\$9.5B	\$8.5B	\$6.5B
Fri	8:30	GDP By Industry - Jun	0.1%	0.0%	0.3%
Fri	8:30	Real GDP - Q2	2.8%	2.8%	3.7%
		GDP Deflator	3.5%	na	6.1%
<b>UNITED STATES</b>					
Mon	10:00	Existing Home Sales - Jul	5.65M	5.70M	5.75M
Tue	9:00	S&P/Case-Shiller Composite - Jun	-	-	-2.8%
Tue	10:00	Consumer Confidence - Aug	105	105	112.6
Tue	14:00	FOMC Minutes			
Thu	8:30	Real GDP - Q2 (Preliminary)	4.0%	4.1%	3.4%
		GDP Deflator	2.7%	2.7%	2.7%
Fri	8:30	Personal Income - Jul	0.3%	0.3%	0.4%
		Personal Spending	0.4%	0.4%	0.1%
		PCE Core Price Index	0.2%	0.2%	0.1%
Fri	9:45	Chicago PMI - Aug	-	52.8	53.4
Fri	10:00	Michigan Sentiment - Aug (F)	82.5	82.7	83.3
Fri	10:00	Factory Orders - Jul	3.5%	0.7%	0.6%
Fri	10:00	Chairman Bernanke speaks in Jackson Hole, Wyoming at Fed Symposium			

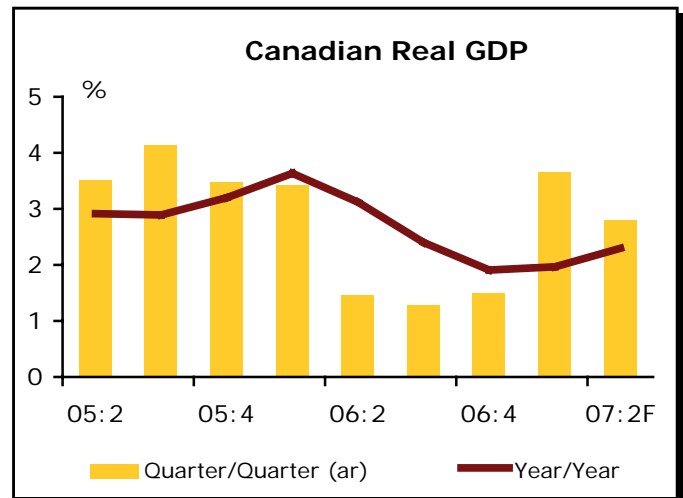
\* Source: Reuters (Canada) & Bloomberg (US)

**Week Ahead’s Key Canadian Number:  
National Accounts—Q2**

(Friday, 8:30 a.m.)

Leslie Preston (416) 956-3219

	CIBC WM	Mkt	Prior
GDP (q/q, AR)	2.8%	2.8%	3.7%
GDP Deflator (q/q, AR)	3.5%	NA	6.1%
GDP by Industry (m/m, Jun)	0.1%	0.0%	0.3%



Turmoil in financial markets may have clouded the waters for the Bank of Canada, but at least second-quarter GDP growth looks to come in around what it had bargained for. Growth of 2.8% should rely heavily on consumer spending as the challenge posed by the lofty loonie continues to crimp net exports. Residential construction has slowed and could be another source of weakness, but still pales in comparison to the downturn seen stateside. Rising energy prices should produce a healthy 3.5% increase in the GDP deflator, but well below Q1’s outsized pace.

Monthly GDP should show that a decent quarter for growth ended on a softer note. Housing starts dropped in June, both factory shipments and retail sales were down in real terms, and wholesaling was soft. Add it all up and June GDP looks to be a disappointing 0.1%.

**Forecast Implications** — Q2 growth shouldn’t give the Bank of Canada much news to chew on before its mid-September rate setting, but a soft reading for June GDP leaves the economy with less momentum heading into Q3. We foresee a downshift in growth in the second half of the year, helping core inflation ease back to the Bank’s target. But low unemployment and a relatively healthier housing market should keep growth slightly above the US pace.

**Market Impact** — Second-quarter growth should be old news for markets focused on the Bank’s next move, and our near-consensus call shouldn’t garner much notice.

**Other Canadian Releases:**

**Current Account—Q2**

(Thursday, 8:30 a.m.)

A solid improvement in the merchandise trade surplus in Q2 should produce a super-sized current account surplus. An estimated \$9.5 billion quarterly balance would stand among the best results on record. The investment income balance is always a bit of a wild card, with foreign takeovers and healthy Canadian

earnings performance producing large outflows of late. Providing some offset, Canada had a hearty appetite for foreign securities in Q2, which should continue to improve the net flow of portfolio income. Bear in mind though, there is always uncertainty surrounding this number, and frequently noteworthy revisions as well.

# CANADIAN RELEASE AND EVENT DATES August/September 2007



MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY	
20	<b>CONSUMER PRICE INDEX</b> 21 7:00 AM M (NSA) Y MAY 0.4 2.2 JUN -0.2 2.2 JUL 0.1 2.2 <b>RETAIL TRADE</b> 8:30 AM (Current\$) M Y APR 0.2 4.8 MAY 2.6 8.0 JUN -0.9 7.5 <b>LEADING INDICATOR</b> 8:30 AM	22	<b>QUARTERLY FINANCIAL STATISTICS</b> 8:30 AM	23	24
27	28	29	<b>BALANCE OF INT'L PAYMENTS</b> 8:30 AM CURR. ACCT. BAL. \$BN(OR) \$BN(AR) 06:Q4 4.6 18.5 07:Q1 6.5 26.0 07:Q2 <b>INDUSTRIAL PRICES</b> 8:30 AM M (NSA) Y MAY -0.5 3.1 JUN -1.3 2.2 JUL	<b>NATIONAL ACCOUNTS</b> 31 8:30 AM REAL PRICE GDP DEFLATOR %ch AR %ch AR 06:Q4 1.5 0.4 07:Q1 3.7 6.1 07:Q2 <b>GDP BY INDUSTRY</b> 8:30 AM (1997\$) GDP IND.PROD. M M APR 0.0 0.0 MAY 0.3 -0.2 JUN	
3	4	5	6	7	
LABOUR DAY (HOLIDAY) (Markets Closed)		<b>Bank of Canada Interest Rate Announcement</b>	<b>INTERNATIONAL RESERVES</b> 8:15 AM M \$BN CHANGE LEVEL JUN -0.683 39.4 JUL 0.890 40.3 AUG <b>BUILDING PERMITS</b> 8:30 AM (RES) (NON-RES) MAY 5.3 55.5 JUN 7.4 -10.0 JUL <b>IVEY PURCHASING MANAGERS' INDEX</b> 10:00 AM	<b>LABOUR FORCE SURVEY</b> 7:00 AM AVG EMPLOY UNEMP HRLY (HOUSE) RATE EARN M Y % Y JUN 0.2 2.0 6.1 3.2 JUL 0.1 2.1 6.0 3.5 AUG	
10	11	12	13	14	
	<b>HOUSING STARTS</b> 8:15 AM 000's (AR) TOTAL SINGLES JUN 225 92 JUL 216 90 AUG <b>NEW HOUSING PRICE INDEX</b> 8:30 AM <b>MERCHANDISE TRADE</b> 8:30 AM \$MN 12 MO. M BALANCE MAY 5,870 54,418 JUN 5,266 55,490 JUL	<b>BoC Gov Dodge speaks in London @ Canada-UK Chamber of Commerce, 7:45 AM ET</b>	<b>CAPACITY UTILIZATION</b> 8:30 AM LEVEL (%) TOTAL MANUF. 06:Q3 83.5 82.3 06:Q4 82.4 81.1 07:Q1 83.0 81.1 <b>LABOUR PRODUCTIVITY</b> 8:30 AM	<b>SURVEY OF MANUFACTURING</b> 8:30 AM SHIPMENTS M Y MAY -0.2 2.3 JUN -1.8 -1.4 JUL <b>WAGE SETTLEMENTS</b> 10:00 AM (%) PVT. PUB. TOT. MAY 3.4 3.4 3.4 JUN 2.7 3.7 3.2 JUL	
17	18	19	20	21	
<b>INT'L TRANSACTIONS IN SECURITIES C\$BN</b> 8:30 AM NET NET NET NET BONDS MONEY STOCKS TOT MARKET MAY 0.0 0.3 -2.9 -2.6 JUN -4.5 1.5 -1.4 -4.5 JUL	<b>CAR &amp; TRUCK SALES</b> 8:30 AM 000's (AR) TOTAL DOM.BUILT CAR SALES MAY 1,748 561 JUN 1,727 565 JUL	<b>CONSUMER PRICE INDEX</b> 7:00 AM M (NSA) Y JUN -0.2 2.2 JUL 0.1 2.2 AUG <b>LEADING INDICATOR</b> 8:30 AM	<b>WHOLESALE TRADE</b> 8:30 AM	<b>RETAIL TRADE</b> 8:30 AM (Current\$) M Y MAY 2.6 8.0 JUN -0.9 7.5 JUL	

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.

**Week Ahead's US Number:  
Consumer Confidence—August**

(Tuesday, 10:00 a.m.)

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All of the grim news coming from financial markets in recent weeks has weighed on consumers' moods, with the Michigan sentiment and ABC consumer comfort indexes already registering declines. We expect the Conference Board's consumer confidence index to follow suit and give back all of July's optimistic bounce,

falling to 105. However, with markets on a more even keel recently, falling gasoline prices and a still-low unemployment rate should help prevent sentiment from taking an even bigger dive as it did in the corporate malfeasance scandals of a few years ago.

# U.S. RELEASE AND EVENT DATES August/September 2007



MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
<p>20</p> <p>LEADING INDICATOR 10:00 AM</p>	<p>21</p> <p>BOT (9:00) REDBOOK (10:40)</p>	<p>22</p>	<p>23</p> <p>INITIAL JOBLESS CLAIMS (8:30)</p>	<p>24</p> <p>DURABLE GOODS ORDERS 8:30 AM M Y MAY -2.4 1.1 JUN 1.9 -0.2 JUL 5.9 8.1</p> <p>NEW HOME SALES 10:00 AM</p>
<p>27</p> <p>EXISTING HOME SALES 10:00 AM</p> <p>2-, 5-Yr NOTE ANNOUNCEMENT</p>	<p>28</p> <p>S&amp;P/CASE-SHILLER HOUSE PRICE INDEX 9:00 AM</p> <p>CONSUMER CONFIDENCE 10:00 AM</p> <p>FOMC Minutes</p> <p>BOT (9:00) REDBOOK (10:40)</p>	<p>29</p> <p>2-Yr NOTE AUCTION</p>	<p>30</p> <p>GDP (AR) 8:30 AM REAL IMPLICIT GDP DEFLATOR</p> <p>07:Q1(F) 0.6 4.2 07:Q2(A) 3.4 2.7 07:Q2(P)</p> <p>5-Yr NOTE AUCTION</p> <p>INITIAL JOBLESS CLAIMS (8:30)</p>	<p>31</p> <p>PERS. INCOME &amp; OUTLAYS 8:30 AM SAVING INCOME CONS RATE MAY 0.4 0.6 0.4 JUN 0.4 0.1 0.6 JUL</p> <p>CHICAGO PMI 9:45 AM</p> <p>MICHIGAN SENTIMENT (F) 10:00 AM</p> <p>FACTORY ORDERS 10:00 AM M Y MAY -0.5 -0.1 JUN 0.6 -0.7 JUL</p> <p>Fed Chairman Bernanke speaks at Fed Symposium in Jackson Hole, Wyoming @ 10:00 AM ET</p> <p>2-, 5-Yr NOTE SETTLE.</p>
<p>3</p> <p>LABOUR DAY (HOLIDAY) (Markets Closed)</p>	<p>4</p> <p>ISM MFG SURVEY 10:00 AM COMP. PRICES INDEX INDEX JUN 56.0 68.0 JUL 53.8 65.0 AUG</p> <p>DOMESTIC AUTO SALES BOT (9:00) REDBOOK (10:40)</p>	<p>5</p> <p>Beige Book</p>	<p>6</p> <p>NON-FARM PRODUCTIVITY 8:30 AM Q/Q (AR) Y/Y 07:Q1 (R) 0.7 0.4 07:Q2 (P) 1.8 0.6 07:Q3 (R)</p> <p>ISM NON-MFG SURVEY 10:00 AM</p> <p>INITIAL JOBLESS CLAIMS (8:30)</p>	<p>7</p> <p>EMP. SITUATION 8:30 AM NON- CIV AVG FARM UNEMP HRLY PAYROLL RATE EARN (000s) M % Y JUN 126 4.5 3.9 JUL 92 4.6 3.9 AUG</p> <p>WHOLESALE INVENTORIES 10:00AM</p>
<p>10</p> <p>10-Yr (r) NOTE ANNOUNCEMENT</p>	<p>11</p> <p>GOODS &amp; SERVICES BALANCE (BOP) 8:30 AM GDS SERV TOT MAY -68.5 9.3 -59.2 JUN -67.5 9.4 -58.1 JUL</p> <p>BOT (9:00) REDBOOK (10:40)</p>	<p>12</p> <p>10-Yr (r) NOTE AUCTION</p>	<p>13</p> <p>TREASURY BUDGET 2:00 PM</p> <p>MONEY SUPPLY M-2 4:30 PM M Y JUN 5.0 9.2 JUL 4.7 9.3 AUG</p> <p>INITIAL JOBLESS CLAIMS (8:30)</p>	<p>14</p> <p>RETAIL SALES 8:30 AM M Y JUN -0.7 4.0 JUL 0.3 3.2 AUG</p> <p>CURRENT ACCOUNT BALANCE 8:30 AM</p> <p>CAPACITY UTIL/IND. PROD. 9:15 AM LEV M Y JUN 81.8 0.6 1.4 JUL 81.9 0.3 0.0 AUG</p> <p>MICHIGAN SENTIMENT (P) 10:00 AM</p>
<p>17</p> <p>10-Yr (r) NOTE SETTLEMENT</p>	<p>18</p> <p>PRODUCER PRICE INDEX 8:30 AM M (SA) Y (NSA) JUN -0.2 3.3 JUL 0.6 4.0 AUG</p> <p>NET CAPITAL INFLOWS TICS 9:00 AM</p> <p>FOMC Rate Decision</p> <p>BOT (9:00) REDBOOK (10:40)</p>	<p>19</p> <p>CONSUMER PRICE INDEX 8:30 AM M (SA) Y (NSA) JUN 0.2 2.7 JUL 0.1 2.4 AUG</p> <p>HOUSING STARTS 8:30 AM MIL (AR) M JUN 1.470 2.1 JUL 1.381 -6.1 AUG</p>	<p>20</p> <p>LEADING INDICATOR 10:00 AM</p> <p>PHILADELPHIA FED INDEX 12:00 PM</p> <p>INITIAL JOBLESS CLAIMS (8:30)</p>	<p>21</p>

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## Currency Currents

Leslie Preston

### The Last are Now First

If you don't like what you see these days in currency markets, wait a week and they will change. The past week saw all the old recipients of the "carry trade", such as Kiwi, Aussie and Sterling starting to recoup the ground lost during the prior week's flight to safety. With hindsight, were we premature in weakening our forecasts for those "high-yielders" last week? For now at least, the answer is no, with enough headroom in our near-term targets to be comfortable with the past week's correction. Moreover, bad news from the subprime market likely isn't over yet, which could see more see-saw volatility in the carry-trade influenced currencies.

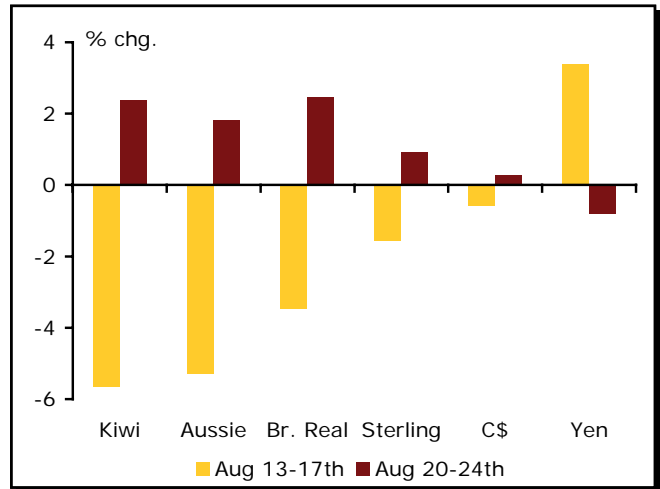
### BoJ Pause Only Temporary

As expected, the Bank of Japan took a pause on hiking interest rates this week, but maintained their hawkish rhetoric that rate hikes are still very much on the table. While the BoJ has now proven its willingness to wait out the current market turmoil, which could mean no move in September depending on the situation, a hawkish stance is well justified. Another sign of a pick up in inflation pressures was seen this week in continued heating up of the corporate services price index in July, a measure which includes items such as rents and transportation. So far this year core inflation has remained in negative territory as companies absorb higher costs, but we expect a return to inflation later this year will enable the Bank to hike rates, and underpin stronger levels from yen ahead.

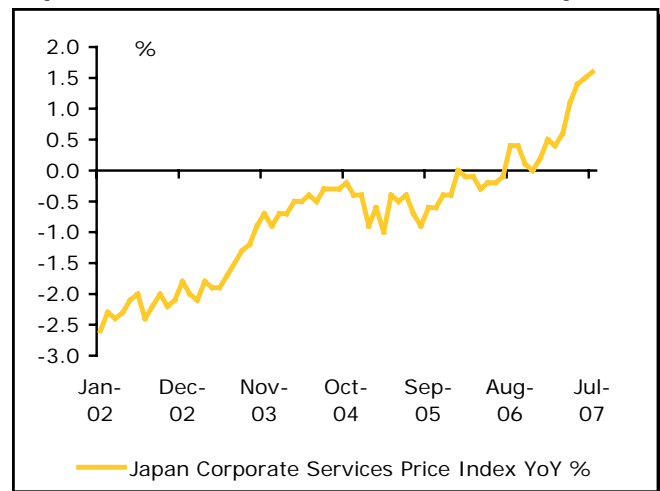
### ECB Hikes Still Ahead

Sturdy fundamentals in the Eurozone should also see the ECB hiking rates again this fall, once subprime-related volatility calms down, while markets stateside are deliberating on how much of a rate cut to price in. That ocean of difference lies in the fact that growth on the continent is forecasted to beat the US in 2007, after a nearly matching pace last year, and an inflation-wary ECB. That disparity also supports our forecast for further euro strength versus the greenback, and was borne out by markets undoing all of the prior week's euro weakness this week. Again, we haven't seen the end of subprime-related volatility, but our call for 1.40 US\$/Euro remains intact.

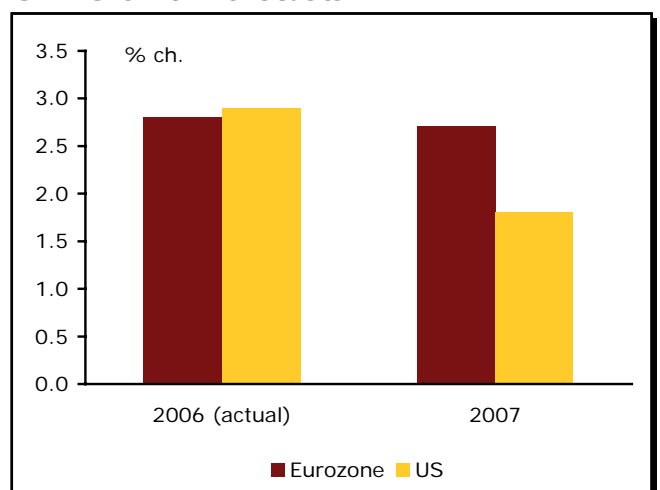
### Last Week's Trash, This Week's Treasure



### Japanese Inflation Pressures to Prompt Hike



### GDP Growth Forecasts



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