Dodging Innovation
by Benjamin Tal

It seems that Mr Dodge is not a fan of mortgage innovation. In recent comments he warned that they help overheat the Canadian real estate market. And who can blame him given the experience south of the border? In the eyes of many, the meltdown of the US subprime market has painted the mortgage market in black and white: Plain vanilla mortgages—good, all the rest—bad.

It's true that the surge in exotic mortgages since 2004 created an artificial demand in the housing market south of the border, and was primarily behind the current mess in the subprime space. A sharp deterioration in underwriting standards in those years and extremely easy ways of passing on the risks were the main catalysts there.

But what's missing from the discussion is the fact that exotic mortgages in the US existed well before 2004—and back then the market was functioning just fine. What triggered the current difficulties in the US mortgage market was not the existence of exotic mortgages, but their overuse. For example, the share of interest only mortgages in new mortgages jumped from 5% in 2003 to 20% in 2006. Ditto for the share of subprime mortgages which reached 22% in 2006—more than double the level seen in 2003.

In Canada the exotic mortgage market that Mr. Dodge is so concerned about is still in its infancy. The subprime market, at 5% of originations, is only half the size seen in the pre-2004 US mortgage market (when the market was still functioning normally). Interest-only mortgages are only one percent of originations—clearly not a factor. And passing along the risk is not as common in Canada, with less than 20% of mortgages being securitized.

Another innovation that Dodge is concerned about is the recent use of mortgages with long-term amortizations. Indeed, we estimate that between 40% and 50% of new mortgages taken over the past year have an amortization term of more than 25 years. But it is far from clear that this trend has added to house price inflation in any meaningful way. If, as we suspect, the vast majority of these home buyers would have bought a similar house regardless of the availability of the increased amortization option, then this trend is not inflationary since it does not represent additional demand.

Not only are mortgage innovations important to a normally functioning market, but their role in Canada should, in fact, grow over time.

Those new products are largely about serving under-served populations through more effective market segmentation and niche marketing. Self-employment is currently the fastest growing segment of the labour market, rising by a dazzling 7.5% over the past year—six times faster than the pace of growth seen among paid employees. Many of those self-employed don't fit into traditional credit scoring matrixes and are heavy users of new mortgages products. Ditto for new immigrants, as well as professionals with high income volatility (due to increased reliance on commissions and bonuses). Limit mortgage innovation in Canada, and you shut-out those fast growing segments of the population from the housing market.

http://research.cibcwm.com/res/Eco/EcoResearch.html
Week Ahead’s Market Call

**In the US**, our call ended up being bang on consensus for payrolls, but the market could interpret the result as light if, as we expect, a rebound in education accounts for a good share of the gains, and private sector hiring is still weak. A downside surprise here could spark a sharp rally in fixed income markets. We see risks of a soft reading for the ISM factory index, in part because such surveys can’t help be influenced by sentiment and news headlines.

**In Canada**, September employment looks set for a moderate gain, but enough to hold the jobless rate at 6%. Remember that the Bank of Canada sees the labour market as overly tight, and wouldn’t mind seeing that unemployment rate move a few ticks higher. The Bank takes its business outlook survey quite seriously, particularly in assessing whether business are operating at capacity. One of the Bank’s deputy governors may shed light on how much of the threat it sees in the current liquidity squeeze in money markets.

Avery Shenfeld

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### Week Ahead Calendar

<table>
<thead>
<tr>
<th>Day</th>
<th>Time</th>
<th>Release</th>
<th>CIBC WM</th>
<th>Consensus*</th>
<th>Prior</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CANADA</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Wed</td>
<td>20:00</td>
<td>BoC Dep. Gov. Longworth speaks in Toronto on liquidity to the investment industry</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Thu</td>
<td>8:30</td>
<td>Building Permits - Aug</td>
<td>-</td>
<td>1.6%</td>
<td>-11.3%</td>
</tr>
<tr>
<td>Thu</td>
<td>10:00</td>
<td>Ivey Purchasing Managers’ Index- Sep</td>
<td>60.0</td>
<td>60.0</td>
<td>58.5</td>
</tr>
<tr>
<td>Fri</td>
<td>7:00</td>
<td>Employment - Sep</td>
<td>17K</td>
<td>17K</td>
<td>23.3K</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Unemployment Rate</td>
<td>6.0%</td>
<td>6.1%</td>
<td>6.0%</td>
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<tr>
<td>Fri</td>
<td>10:30</td>
<td>BoC Business Outlook Survey - Autumn</td>
<td></td>
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<tr>
<td><strong>UNITED STATES</strong></td>
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<tr>
<td>Mon</td>
<td>10:00</td>
<td>ISM Manufacturing Index - Sep</td>
<td>51.0</td>
<td>52.5</td>
<td>52.9</td>
</tr>
<tr>
<td>Wed</td>
<td>8:15</td>
<td>ADP Survey - Sep</td>
<td>-</td>
<td>53K</td>
<td>38K</td>
</tr>
<tr>
<td>Wed</td>
<td>10:00</td>
<td>ISM Non-Manufacturing Index - Sep</td>
<td>54.5</td>
<td>55.0</td>
<td>55.8</td>
</tr>
<tr>
<td>Thu</td>
<td>10:00</td>
<td>Factory Orders - Aug</td>
<td>-2.8%</td>
<td>-2.5%</td>
<td>3.7%</td>
</tr>
<tr>
<td>Fri</td>
<td>8:30</td>
<td>Non-Farm Payrolls - Sep</td>
<td>100K</td>
<td>100K</td>
<td>-4K</td>
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<tr>
<td></td>
<td></td>
<td>Unemployment Rate</td>
<td>4.7%</td>
<td>4.7%</td>
<td>4.6%</td>
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<tr>
<td></td>
<td></td>
<td>Average Hourly Earnings</td>
<td>0.3%</td>
<td>0.3%</td>
<td>0.3%</td>
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<tr>
<td></td>
<td></td>
<td>Average Work Week</td>
<td>33.8</td>
<td>33.8</td>
<td>33.8</td>
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</table>

*Source: Reuters (Canada) & Bloomberg (US)*
A month ago, disappointing US payrolls results sparked talk of an American recession. In contrast, Canada was churning out a healthy employment gain, with the jobless rate signaling at a labour market that was tight as a drum. While US hiring looks to resume in September (see page 5), Canada should retain its relative outperformance, and a 17K monthly increase is seen as just enough to keep the unemployment rate at a tidy 6%.

There’s uncertainty around some large industries in September. Education had suffered a large setback in July, and while staging a partial recovery in August, could have further ground to regain in September. By no means expected to be a jobs leader, the transportation and warehousing industry registered a suspiciously large decline in the prior month. A partial recovery could be in store. The story hasn’t changed in manufacturing, with further labour-shedding a necessity.

**Forecast Implications** — The ability of Canada to continue to generate solid employment and wage growth is central to our view that domestic demand will remain firm, even as credit conditions and demand from the US has deteriorated.

**Market Impact** — Hard to know exactly what to expect from these data, they’re simply too choppy. Worse, headlines often fail to convey underlying strength, necessitating a closer look at worker class, industry performance and wage developments. Notwithstanding our forecast, there’s a risk of a slight rise in jobless rate, but even then, Canada would still boast progress compared to where things stood a year ago.
### The Week Ahead—October 1-5, 2007

#### Canadian Release and Event Dates

<table>
<thead>
<tr>
<th>Day</th>
<th>Monday</th>
<th>Tuesday</th>
<th>Wednesday</th>
<th>Thursday</th>
<th>Friday</th>
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<td>25</td>
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</tbody>
</table>

### Economic Data

- **GDP by Industry**
  - 8:30 AM (1997$)
  - GDP IND. PROD.
  - M: M
  - MAY: 0.3
  - JUN: 0.2
  - JUL: 0.2

- **Industrial Prices**
  - 8:30 AM
  - M (NSA): Y
  - JUN: -1.2
  - JUL: -0.7
  - AUG: -1.0

- **Building Permits**
  - 8:30 AM
  - (RES) (NON-RES): Y
  - JUN: 7.5
  - JUL: -6.3
  - AUG: -8.0

- **Ivey Purchasing Managers’ Index**
  - 10:00 AM

- **Employment Insurance**
  - 7:00 AM
  - AVG
  - M Y % Y
  - JUN: 0.1
  - JUL: 0.1
  - AUG: 0.2

- **International Reserves**
  - 8:15 AM
  - $BN
  - LEVEL: M
  - JUN: 0.890
  - JUL: -0.002
  - AUG: -0.002
  - SEP: -0.002

- **Interest Rate Announcement**
  - Bank of Canada
  - Monetary Policy Report

- **Labour Force Survey**
  - 7:00 AM
  - AVG
  - M Y % Y
  - JUN: 0.2
  - JUL: 0.3
  - AUG: 0.2

- **New Housing Price Index**
  - 8:30 AM

### Holidays

- **Thanksgiving Day**
  - (HOLIDAY)
  - (Markets Closed)

### Other Events

- **BoC Dep. Gov. Longworth speaks in Toronto on liquidity to the investment industry @ 8:00 PM ET**

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*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 Key US Number: Employment Situation—September
(Friday, 8:30 a.m.)

Avery Shenfeld (416) 594-7356

<table>
<thead>
<tr>
<th>CIBC WM</th>
<th>Mkt</th>
<th>Prior</th>
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</thead>
<tbody>
<tr>
<td>Non-Farm Payrolls</td>
<td>100K</td>
<td>100K</td>
</tr>
<tr>
<td>Unemployment Rate</td>
<td>4.7%</td>
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</tr>
<tr>
<td>Avg Hourly Earnings</td>
<td>0.3%</td>
<td>0.3%</td>
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<tr>
<td>Avg Workweek</td>
<td>33.8</td>
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Signs point to another tepid month for US employment growth in September, but a recovery in teaching jobs—which saw an implausible retreat in the prior month—will produce a less scary headline gain of 100K. Jobless benefit claims at mid-month were a bit higher than September on a 4-week moving average basis, and the Conference Board found survey respondents finding less job availability.

Private sector hiring could look quite weak, with ongoing layoffs in construction and the mortgage sector and even some caution at retailers, contributing to the soft pace. On trend results are likely for wages and hours worked, with the labour market still too tight to show up in downward pressure on pay scales.

Forecast Implications—A 100K gain would still leave the more reliable three-month average at only 55K, and decelerations to that sort of pace have historically meant either recession or a substantial slowdown that required interest rate relief. If we instead see a second consecutive drop in payrolls—not our call at this point—a torrent of recession forecasts would follow.

Market Impact—Consensus might shift ahead of this number depending on the ADP survey results earlier in the week. If not, a 100K gain would not tend to be a significant market mover, though the bond market will like the softness in private sector job gains. Bonds would be open to a big rally, and the US$ a further slide, on any major disappointment.
## U.S. RELEASE AND EVENT DATES
### September/October 2007

<table>
<thead>
<tr>
<th>MONDAY</th>
<th>TUESDAY</th>
<th>WEDNESDAY</th>
<th>THURSDAY</th>
<th>FRIDAY</th>
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<tr>
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<tr>
<td></td>
<td></td>
<td><strong>DURABLE GOODS ORDERS</strong></td>
<td><strong>GDP</strong></td>
<td><strong>PERS. INCOME &amp; OUTLAYS</strong></td>
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<tr>
<td></td>
<td></td>
<td><strong>8:30 AM M Y</strong></td>
<td><strong>8:30 AM (AR)</strong></td>
<td><strong>8:30 AM SAVING RATE</strong></td>
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<td></td>
<td></td>
<td><strong>JUL 1.8 0.3</strong></td>
<td><strong>07:Q1(F) 0.6 4.2</strong></td>
<td><strong>JUN 0.5 0.2 0.6</strong></td>
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<td></td>
<td></td>
<td><strong>JUL 6.1 8.1</strong></td>
<td><strong>07:Q1(F) 3.8 2.6</strong></td>
<td><strong>JUL 0.4 0.2 0.9</strong></td>
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<td></td>
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<td><strong>AUG -4.9 4.0</strong></td>
<td><strong>AUG 0.3 0.6 0.7</strong></td>
<td><strong>AUG 0.6 0.0 0.7</strong></td>
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<td></td>
<td></td>
<td><strong>CONSUMER CONFIDENCE</strong></td>
<td><strong>NEW HOME SALES</strong></td>
<td><strong>CHICAGO PMI</strong></td>
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<td><strong>10:00 AM</strong></td>
<td><strong>10:00 AM</strong></td>
<td><strong>9:45 AM</strong></td>
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<td></td>
<td></td>
<td><strong>EXISTING HOME SALES</strong></td>
<td><strong>5-Yr NOTE AUCTION</strong></td>
<td><strong>MICHIGAN SENTIMENT (F)</strong></td>
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<td></td>
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<td><strong>10:00 AM</strong></td>
<td><strong>5-Yr NOTE AUCTION</strong></td>
<td><strong>10:00 AM</strong></td>
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<td></td>
<td></td>
<td><strong>2-, 5-Yr NOTE ANNOUNCEMENT</strong></td>
<td><strong>INITIAL JOBLESS CLAIMS (8:30)</strong></td>
<td><strong>22 24 25 26</strong></td>
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<td><strong>2-, 5-Yr NOTE ANNOUNCEMENT</strong></td>
<td><strong>2-, 5-Yr NOTE ANNOUNCEMENT</strong></td>
<td><strong>22 23 24 25</strong></td>
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<td><strong>BOT (9:00) REDBOOK (10:40)</strong></td>
<td><strong>BOT (9:00) REDBOOK (10:40)</strong></td>
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<td><strong>BOT (9:00) REDBOOK (10:40)</strong></td>
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</table>

### Monday
- **S&P/CASE-SHILLER HOUSE PRICE INDEX**: 9:00 AM
- **CONSUMER CONFIDENCE**: 10:00 AM
- **EXISTING HOME SALES**: 10:00 AM

### Tuesday
- **ISM MFG SURVEY**: 10:00 AM
  - **COMP. PRICES INDEX**: 53.8 65.0
  - **JUL**: 53.8
  - **AUG**: 52.9
  - **SEP**: 63.0
- **DOMESTIC AUTO SALES**: 10:00 AM
- **2-, 5-Yr NOTE SETTLEMENT**: 2:00 PM

### Wednesday
- **ADP SURVEY**: 8:15 AM
- **ISM NON-MFG SURVEY**: 10:00 AM
- **FACTORY ORDERS**: 10:00 AM
  - **JUN**: 1.0 -0.3
  - **JUL**: 3.7
  - **AUG**: 4.2
- **DOMESTIC AUTO SALES**: 10:00 AM

### Thursday
- **GOODS & SERVICES BALANCE (BOP)**: 8:30 AM
  - **CDS SERV TOT**: -68.4 9.0 -59.4
  - **JUL**: -68.4
  - **AUG**: 8.9 -59.2
- **CONSUMER PRICE INDEX**: 8:30 AM
  - **M (SA) Y (NSA)**: 0.6 4.0
  - **JUL**: 0.6
  - **AUG**: -1.4
  - **SEP**: 2.2
- **HOUSING STARTS**: 8:30 AM
  - **MIL (AR)**: 1.367 -6.9
  - **JUL**: 1.367
  - **AUG**: 1.331 -2.6

### Friday
- **LEADING INDICATOR**: 10:00 AM
- **PHILADELPHIA FED INDEX**: 12:00 PM
- **MICHIGAN SENTIMENT (F)**: 10:00 AM

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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: U.S. Department of Commerce, U.S. Department of Labor and U.S. Federal Reserve Board.
M&A Deal Inflows Helping to Fuel Loonie’s Parity Drive
M&A activity, specifically a growing imbalance between deal inflows from abroad and outflows, appears not only to have provided support for the TSX but also the high-flying loonie. M&A announcements targeting Canadian firms and other assets (e.g. a plant or an oilfield) have totaled a staggering C$183 billion so far this year. That readily surpasses the $90 billion of deal flow the other way. While a sharp downturn in deal flows could potentially create some turbulence for the loonie, private equity-financed transactions have been nowhere near as important to the Canadian M&A market as in the US, accounting for 17% of activity in the last 2 years versus a 27% share stateside. Our generally bullish forecast for resource prices moreover points to a continuing healthy appetite for Canadian mining and oil & gas assets.

Where's the Growth
Growth-levered currencies and commodities are looking solid, but with the US sluggish and Europe giving mixed messages, where's the beef? Further east, as China continues to see its economy as too hot for its liking, and Japan showing signs of bouncing back from a poor quarter. The past week's news saw reports of an outsized gain in Japanese industrial production, and retail sales, recovering from a sharp prior-month dip. Developing Asia has accounted for half of the world's real GDP growth in the last three years, and that share could increase given the slower pace stateside. The strength in the commodities currencies like the loonie and the Aussie dollar owe much to the East Asian boom.

The Other Fuel
Oil has grabbed the attention of C$ trackers, many of whom now have West Texas crude prices flashing on their foreign exchange trading screens. But fueling the body, as well as the car, is also becoming a source of support for the Canadian currency. The Bank of Canada's commodity price index includes a 17% weighting for foods. Strong demand for grains (partially for ethanol), and related upward pressure on meats, has that component up more than 25% since the start of the year. Not only does that boost the value of grain exports, but it creates upward pressure on headline CPI, reducing the odds that the Bank of Canada will turn to rate cuts to halt the C$ climb.