Economic Insights

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Economics

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"If Bernanke and Carney are determined to feed a rally in dividend paying equities, preferred shares, and other income-generating assets, it makes sense to be along for the ride."

Livin' Low

by Avery Shenfeld

Markets are converging to our long-stated view that we will be living in a low-rate environment right through 2010. In Canada, the economy is off to a slower start than most other major countries, and third quarter growth looks to fall well short of what the Bank of Canada forecast only a few weeks ago.

While the US, Japan and the Eurozone all fared better, none of these regions has put its various miseries far enough behind to contemplate rate hikes. Banks in the US and Europe need all the help they can get from a steep yield curve, as American regionals work through such problems as those in commercial real estate, and both look ahead to the need for more capital and lower leverage under whatever new regulatory environment emerges from the G-20. The Eurozone has its own weak banking system and the mounting drag from a strong euro to deal with (see pages 10-11).

Ultra-low interest rates are a blessing for those with huge mortgage debts in the US, and are helping that country's house prices climb from the abyss. But for investors, both institutional and individual, they present some challenges. On the institutional front, even with a steep yield curve, pension funds and insurers are forced into a riskier asset mix if they want to have any chance of meeting their liabilities.

For retail investors, the shocker is that playing it safe means accepting a near-zero yield. Canadians are still sitting on more than $100 bn in excess holdings in money market funds, short term deposits and cash in brokerage accounts where returns are negligible. One of the favourite alternatives, income trusts, are for the most part on their way out.

That will have funds shifting into common equities, preferred shares and corporate bonds, all of which still offer some yield, and in the case of equities, an opportunity for capital gains and dividend increases over time. Historically, reinvested dividends account for a sizeable share of the longer term return from holding stocks, and stable dividend payers tend to offer more downside protection in uncertain times (see pages 3-6). Canadian REITs, whose valuations may have been unduly tarnished by analogies to US real estate conditions, also look attractive as yield plays (see pages 7-9).

The benefits of low rates for the equity market have, of course, been well in evidence since March. Central banks are not shaking in fear of the resulting asset price appreciation. Improved capital market valuations, and their impact in enabling companies to raise capital for business investment, is one of the key vehicles through which low rates are supposed to work to promote growth. The Fed's own model specifically allows for such impacts in modeling the economic response to rate cuts. If Bernanke and Carney are determined to feed a rally in dividend-paying equities, preferred shares, and other income-generating assets, it makes sense to be along for the ride.

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MARKET CALL

- We were looking for a rally in the front end of the Canadian and US yield curves, judging that markets were way ahead of central banks in thinking about when we would see the first rate hike. At this point, most of the room in 2-years has now been exhausted, although our view that the first hike won't come until early 2011 is still more dovish than the consensus.

- Although investors will be tempted to reach for duration in the near term, 2010 will see a steady diet of government supply and the impact of the unwinding of quantitative easing, both of which will ultimately result in a steepening. We see Canadas outperforming through 2010, as even including the provinces, deficits and debt loads will still be lighter than those stateside.

- Recent economic news for Canada hasn't kept pace with that of other industrialized countries, but that gap is likely to close a bit in Q4 if, as we expect, our third quarter disappointments were tied to larger-than-expected inventory drawdowns. That could see the C$ continue to inch stronger, although we expect a setback for the C$ and other majors against the US$ in early 2010 as global growth slows. We've strengthened our A$ outlook a bit over the forecast horizon, given the RBA's bullish outlook and desire for tighter monetary conditions.

INTEREST & FOREIGN EXCHANGE RATES

		2009		2010				2011	
END OF PERIOD:		**25-Nov**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**	**Mar**	**Jun**
CDA	Overnight target rate	0.25	0.25	0.25	0.25	0.25	0.25	1.00	1.75
	98-Day Treasury Bills	0.22	0.23	0.25	0.30	0.30	0.30	1.15	1.90
	2-Year Gov't Bond	1.15	1.15	1.10	1.20	1.40	1.60	2.10	2.35
	10-Year Gov't Bond	3.29	3.35	3.35	3.40	3.85	3.95	4.00	4.05
	30-Year Gov't Bond	3.87	3.95	3.95	4.00	4.30	4.35	4.35	4.40
U.S.	Federal Funds Rate	0.25	0.25	0.25	0.25	0.25	0.25	1.50	2.25
	91-Day Treasury Bills	0.05	0.10	0.15	0.20	0.25	0.55	1.70	2.25
	2-Year Gov't Note	0.77	0.85	0.90	1.10	1.30	1.65	2.20	2.45
	10-Year Gov't Note	3.34	3.45	3.45	3.60	4.20	4.35	4.45	4.45
	30-Year Gov't Bond	4.30	4.35	4.40	4.65	5.00	5.00	5.05	5.05
Canada - US T-Bill Spread		0.17	0.13	0.10	0.10	0.05	-0.25	-0.55	-0.35
Canada - US 10-Year Bond Spread		-0.05	-0.10	-0.10	-0.20	-0.35	-0.40	-0.45	-0.40
Canada Yield Curve (30-Year — 2-Year)		2.71	2.80	2.85	2.80	2.90	2.75	2.25	2.05
US Yield Curve (30-Year — 2-Year)		3.53	3.50	3.50	3.55	3.70	3.35	2.85	2.60
EXCHANGE RATES	CADUSD	0.953	0.971	0.901	0.943	0.971	1.000	0.990	1.000
	USDCAD	1.050	1.030	1.110	1.060	1.030	1.000	1.010	1.000
	USDJPY	88	90	97	93	90	87	86	86
	EURUSD	1.51	1.49	1.40	1.41	1.44	1.47	1.46	1.50
	GBPUSD	1.67	1.66	1.57	1.60	1.65	1.69	1.68	1.71
	AUDUSD	0.928	0.945	0.880	0.925	0.960	1.000	0.990	0.995
	USDCHF	1.00	1.02	1.08	1.07	1.04	1.02	1.02	1.01
	USDBRL	1.73	1.71	1.84	1.75	1.70	1.64	1.65	1.64
	USDMXN	12.9	13.0	14.0	13.5	13.0	12.5	12.3	12.3

Divvying Up the Rewards

Avery Shenfeld and Peter Buchanan

It's back to Finance 101 for investors in equity markets these days. The textbooks tell us that the value of a stock is dictated by the present value of the stream of future dividends, discounted by a risk-adjusted rate. During equity booms, the value of dividends can be forgotten amidst a chase for capital gains. But in today's low rate environment, divvying up the dividends can be particularly rewarding.

The spread between TSX dividend yields and those on corporate bonds is now near the tightest in decades (Chart 1). In that sense, investors don't give up much for going into stocks rather than bonds, and unlike bonds with a fixed coupon, can benefit from increases in dividends per share down the road. Both dividend-paying equities and corporate bonds will benefit from an exodus of investor dollars from essentially zero-yielding money market instruments, reflecting the huge pick-up in dividend yields vs. those on three-month T-bills.

Retail investors are clearly part of the flight out of short term, risk-free investments that essentially offer no return. Year-to-date, data from the Investment Funds Institute of Canada shows net selling of money market funds to the tune of nearly $11 bn, against small net inflows into funds focused on dividend and income equities (Chart 2). Canadians are still sitting on above-normal levels of bank deposits and other near-cash vehicles.

Chart 1

Dividend Yields Well Above Money Markets, and Unusually Tight to Corporate Bond Yields

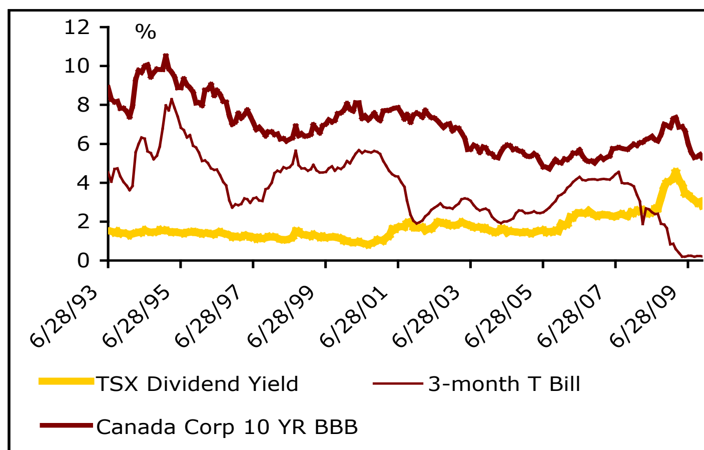
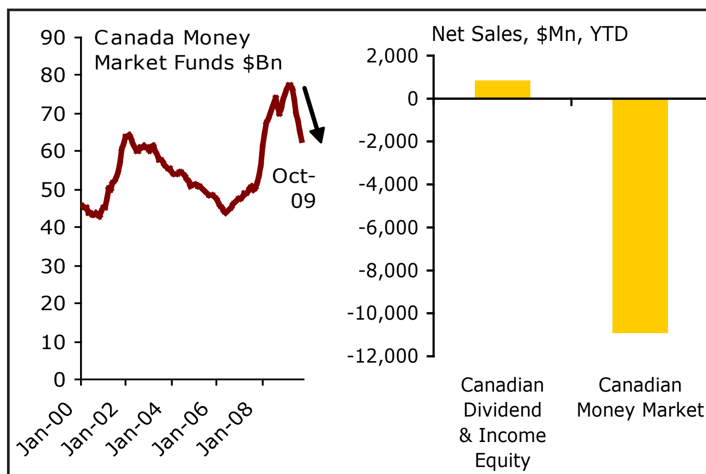


Chart 2

Investors Exiting Overweight Cash Positions (L) Changes in Canadian Fund Assets (R)



Source: Bank of Canada, Investment Funds Institute of Canada

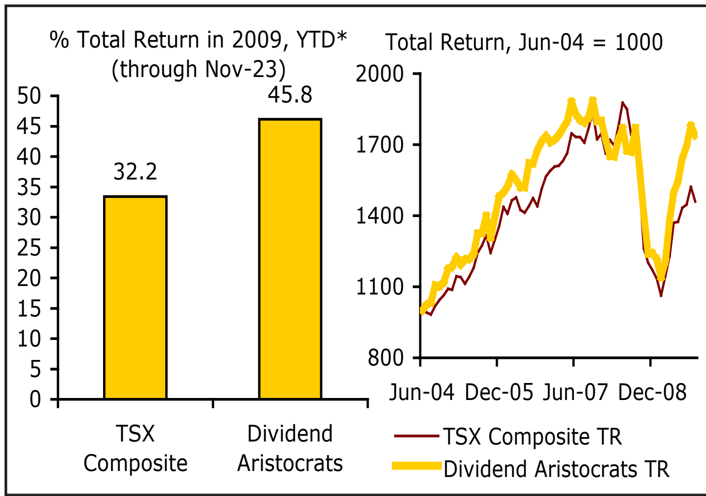
Moreover, yesterday's darling for those seeking yields, income trusts, are rapidly disappearing as they convert into corporations as the deadline to do so approaches. The recent introduction of tax free savings accounts has also helped increase investors' appetite for income products, including dividend funds.

Aristocratic Returns

History suggests that dividend-paying equities have some promising performance features that are relevant to the current, uncertain climate, particularly for those concerned about risks of economic disappointments in 2010. S&P has defined a basket of "dividend aristocrats," a changing group of TSX-listed companies that have consistently increased dividends per share in the prior five years. That group has outpaced the market not only in the last half-decade, but also in year-to-date returns during a volatile 2009 (Chart 3), even though it would include the shock impacts of a stable dividend payer announcing a cut (which then subsequently knocks it out of the basket, as its members are rebalanced annually).

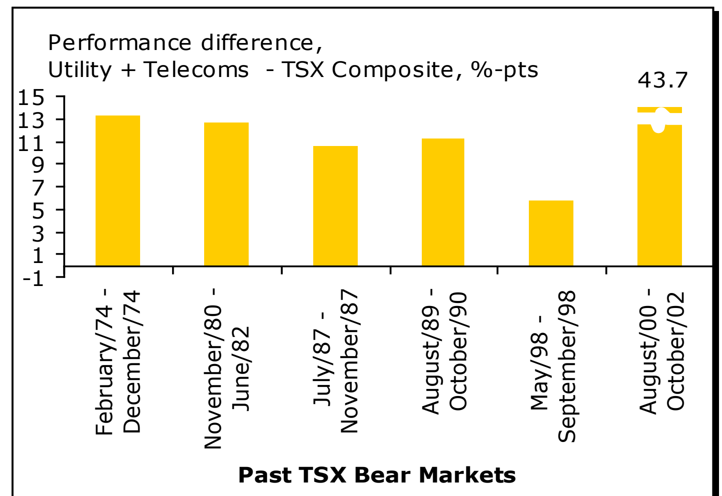
Over extended periods, while capital gains from rising index levels get a lot of the excitement, reinvested dividends provide a substantial share of the total reward for holding stocks, even for the TSX Composite as a

Chart 3
Dividend Stocks Have Done Well, Long Term (right) and Recently (left)



Source: S&P, CIBC

Chart 5
Past Canadian Bear Markets & Dividend Stocks



whole. Someone who invested $100 in the TSX back in 1975 would today have a portfolio worth roughly $1,200. But throw in the dividends accumulated over that period, and the portfolio would be approaching $3,500 (Chart 4).

Fitting With the Times

Two features of dividend-paying equities make them particularly suitable for today's uncertain economic climate.

The longer-term history for sectors of the TSX known for high dividend payouts is also encouraging, particularly during precarious times. While we aren't equity bears, for those concerned about downside risks, dividend stocks should have appeal. In five historical bear markets between 1974 and 1998, a portfolio of utility and telecom stocks outpaced the TSX Composite by 6-13%-pts (Chart 5). The gap was a much greater 44%-pts in returns in the 2000-02 tech meltdown.

Indeed, to the extent that reliable dividend payers outperform the broad market, that excess return is more alpha than beta, i.e., not simply a reward for additional risk. The dividend aristocrats tracked by S&P have had lower realized volatility than that experienced by the market as a whole (Chart 6).

The other feature of our current investment climate, and one we expect to persist through 2010, is that short term

Chart 4
Value of $100 Invested in TSX Comp. in 1975

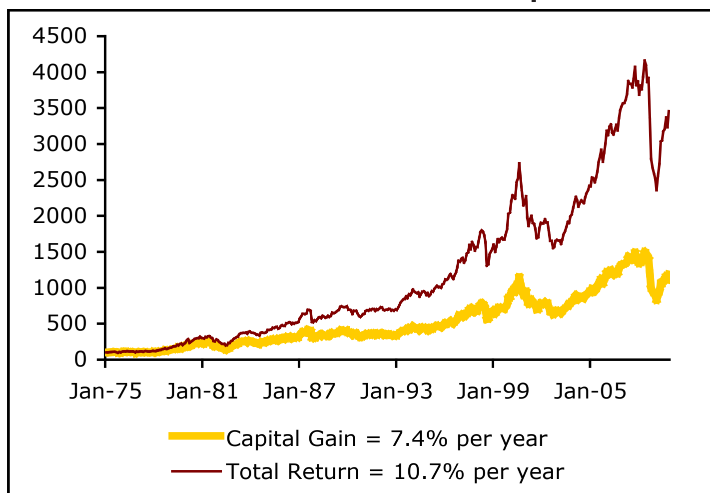


Chart 6
Dividend Stocks Can Reduce Portfolio Volatility

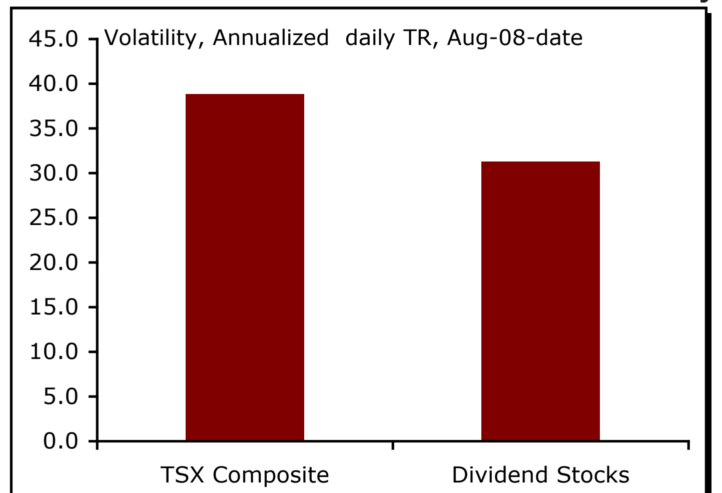


Table 1

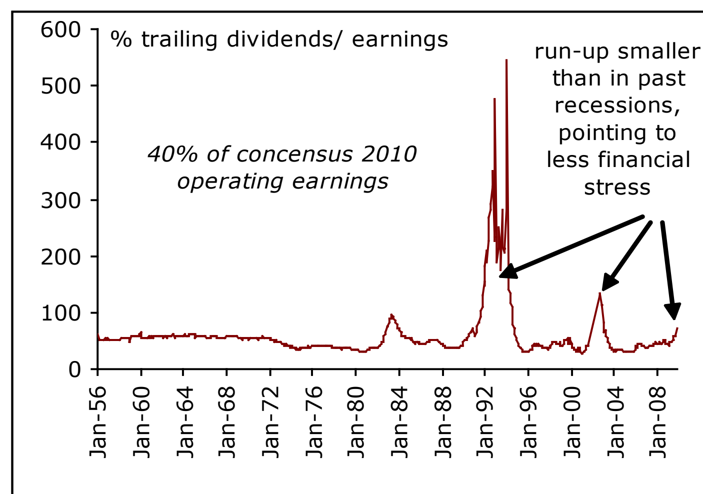
Eight Highest Yielding TSX Industry Groups

	Indicated Dividend Yield (%)
Telecommunication Services	5.5
Utilities	5.1
Real Estate	5.0
Media	4.7
Diversified Financials	4.2
Health Care Equipment & Services	4.0
Banks	4.0
Insurance	3.8

Source: Bloomberg, CIBC

Chart 7

Payout Ratio's Modest Rise Leaves Room for Increases as Earnings Improve



interest rates are extremely low. Although much of that is now priced into the yield curve, if anything, the era of near-zero short rates is likely to hang around longer than the market now expects. Given the drag on growth and inflation from an overvalued loonie, and fiscal restraint in waiting for 2011, the Bank of Canada could leave rates on hold right through next year.

Where to Hunt

Traditionally, dividend seekers have looked to telecoms and utilities for healthy dividend yields, and those two sectors indeed top the pack in terms of TSX payout ratios (Table 1). But there are other groups where dividends now pay out 4% or more of the share price, including real estate, media, banks, and healthcare.

Where the big prize is the dividend, it's important to avoid the unpleasant surprise associated with unanticipated dividend cuts. CIBC's Portfolio Strategy and Quantitative Research team has screening tools that can be used to filter for ROE, leverage, and other characteristics at the individual stock level.

From an aggregate perspective, although the TSX payout ratio rose over the course of the recession, this needn't indicate that companies will be hard pressed to maintain their dividends in the coming year. Dividend payout ratios always rise during recessions, as companies try to keep dividends stable in the face of declines in earnings, having typically set them at levels that allow them to be carried through the earnings dip. If anything, this past recession saw a milder rise in the TSX payout ratio than what we've seen in past economic downturns (Chart 7). Indeed, firms are paying out only 40% of consensus 2010 operating earnings.

Wave of Cuts Abates, Reducing "Dividend Trap" Risk

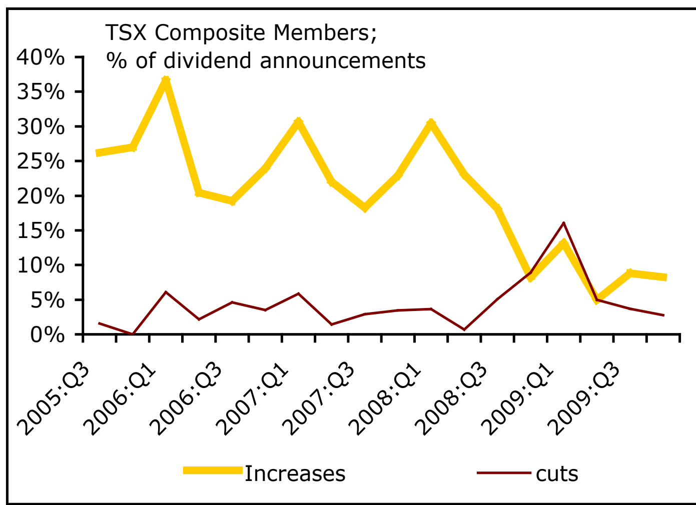
Dividend changes also provide a window on the thinking of one key group that is usually well informed on the long term profit outlook, corporate management. Recent policy shifts suggest firms themselves are more optimistic on their financial health and earnings prospects than 6-8 months ago, though still more cautious than at the height of the recent boom.

The number of firms paring or eliminating dividends has fallen sharply from early 2009's peaks. That's a likely sign of improved boardroom expectations—or at least easing anxieties. In some cases, it may also reflect the feeling that earlier payout cuts leave corporations adequately positioned to meet their longer term financial commitments. Just 3% of the firms setting dividends so far in Q4 have announced reductions from previous levels (Chart 8). That's down from the cyclical peak of 16% that cut payouts in the first quarter of the year. Conversely, 8%, or so, of firms setting dividends this quarter have announced increases.

While that is up appreciably from the second quarter, it is only a fraction of the number that were raising dividends during the expansion's peak years. That caution could,

Chart 8

Dividends: Still Not Many Increases But a Lot Fewer Cuts

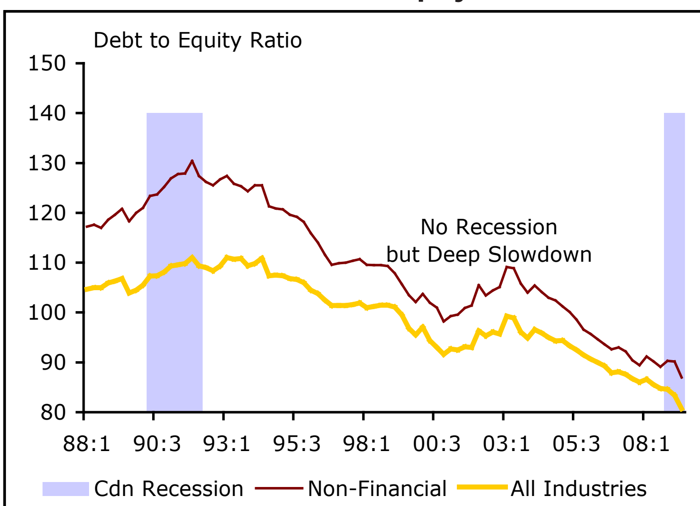


however, leave room for future increases in dividends even if earnings in the next two years grow at less than the ebullient pace expected by the "bottoms up" consensus.

The decline in dividend cuts—a sign that payouts are better aligned with firms' longer term financial capacity—has also reduced the risk from one of the potential perils of dividend investing. This is the so-called "dividend trap"—companies that offer a generous yield today, but may not be able to pay such high dividends or indeed any dividends in the future.

Chart 9

Healthy Balance Sheets Mean More Cash for Dividends, Less for Debt Repayment



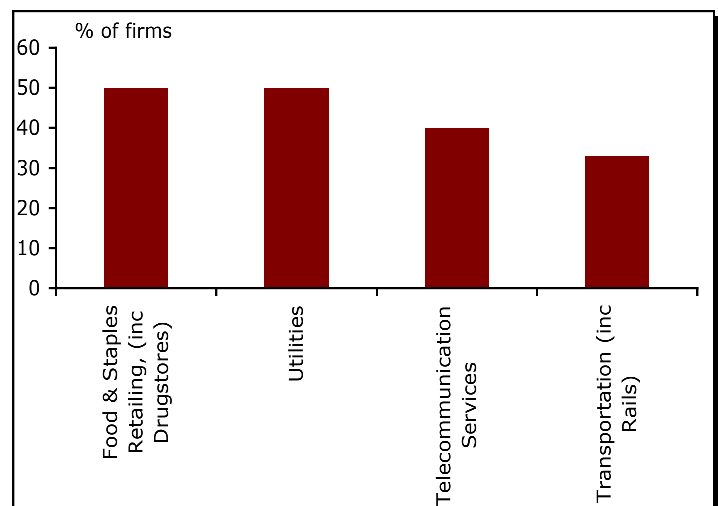
One reason why dividend cuts have abated since early 2009 is that corporate Canada emerged from this recession with more solid balance sheets than after the 1990-91 recession and the 2001 slowdown (Chart 9). That leaves companies under considerably less pressure to cut dividends further for debt repayment purposes than at the same point in past cycles.

Despite the recession's sweeping financial toll, some TSX firms have actually increased dividends in the last year. The list not surprisingly includes firms in highly capital-intensive sectors like telecoms/utilities, which benefit from lower rates and provide vital or nearly indispensable services (Chart 10). It also includes some consumer staples providers and companies involved in resource transportation and shipping, levered to Asian growth.

A single day's rally can, in some cases, give investors a capital gain equivalent to a full year's dividends. But over the long haul, and particularly when investors are motivated to find yield where fixed income assets don't provide it, those unexciting dividends can be an important engine of investment performance.

Chart 10

Percent of TSX Companies That Have Announced Dividend Hikes in 2009



American vs Canadian REITs: Where Should You Be?

Benjamin Tal

American and Canadian commercial real estate markets are still on a downward trend, but REITs in both countries are already rebounding. While the 70% increase in US REITs since the trough of early 2009 appears to be overdone, the 40% advance in Canada has brought REIT prices more or less in line with fundamentals. Against a backdrop of a virtual drought in commercial real estate financing south of the border, the availability of capital in the Canadian space suggests that commercial real estate on this side of the border will be the first to capitalize on improving economic conditions. While waiting, investors in Canadian REITs can collect dividends almost twice what US REITs have to offer.

On the Rebound

Canadian REITs are still 35% below their pre-recession levels, but are already up by almost 40% from their February 2009 bottom. The recovery in Canada, while impressive, is roughly half the size of the upturn seen in the US (Chart 1). Granted, the overall correction in US REITs was deeper than in Canada, but after all, the US is the country that experienced a full-blown housing meltdown, not Canada.

Note that the recent rebound in both American and Canadian valuations has occurred in an environment of still-falling non-residential real estate markets, with overall investment in both countries declining by 4-5% (annual rate) in recent quarters. And with commercial real estate markets lagging residential activity by a full year (Chart 2), look for non-residential investment activity to continue to decline in the immediate future. Nevertheless, encouraged by the recent signs of stabilization in US residential markets and the rebound in Canadian resale activity, REITs in both countries are already seeing the light.

The Refinancing Issue

After the rebound to date, is their anything left on the table for REIT investors in Canada or the US? A quick glance at the fundamentals of the two markets reveals two totally different realities.

The key here is the issue of financing. In the US the main concern for the next few years is the overhang of maturing debt that won't qualify for refinancing. While the volume of maturing debt over the past two years has been relatively low, refinancing demand will pick up dramatically over the coming years—rising gradually from just over $200 bn this year to $340 bn by 2013 (Chart 3). In Canada the refinancing problem is much less dramatic, with a maturing balance of underlying loans estimated at only $5 bn per year for 2009 through 2011.

Chart 1

REITs—Canada vs. US

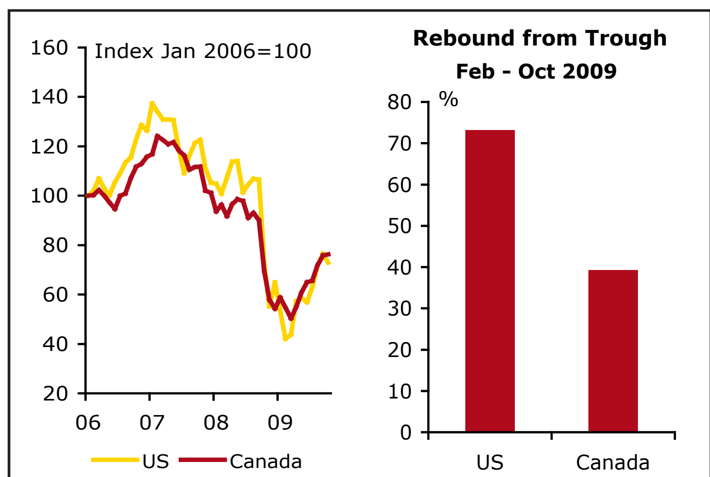
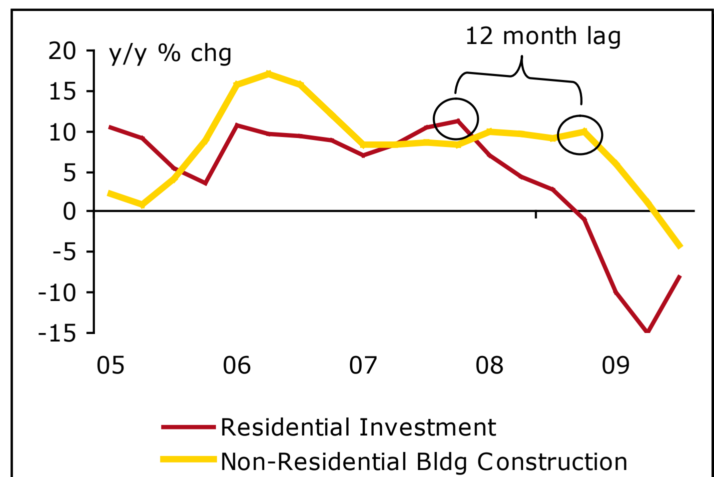


Chart 2

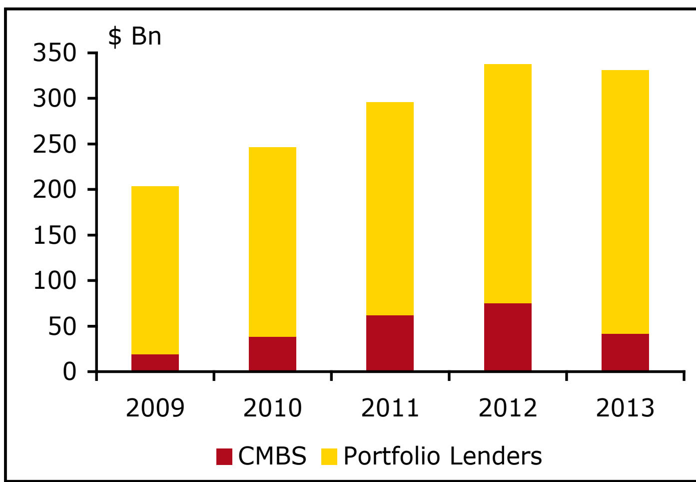
Commercial Construction Lags Residential (Canada)



Source: Statistics Canada, CIBC

Chart 3

Maturing Commercial Mortgages (US)



Source: Commercial Mortgage Alert

And as it stands now, refinancing in Canada will be much easier. After all, the CMBS market in Canada has never been as important a financing vehicle as it was in the US, with balance-sheet lenders playing a much more significant role. Furthermore, even at the height of the credit crunch, Canadian lenders did not stop lending, and in fact, in recent months have been expanding their client base. The real value of non-residential mortgages in Canada, while no longer rising by a double-digit rate, is still expanding by just under 8% on a year-over-year basis, a rate that is higher than during most of the past decade (Chart 4, left). Furthermore, equity and bond issues by REITs and real estate operating companies have skyrocketed in recent months. With the proceeds being used to repay outstanding balances on credit facilities, to fund maturing debt obligations and as capital for committed development expenditure, Canadian REITs, as opposed to their American counterparts, do not face an abnormal liquidity problem. In fact, as it stands now, REITs are among the most creditworthy of business borrowers in Canada.

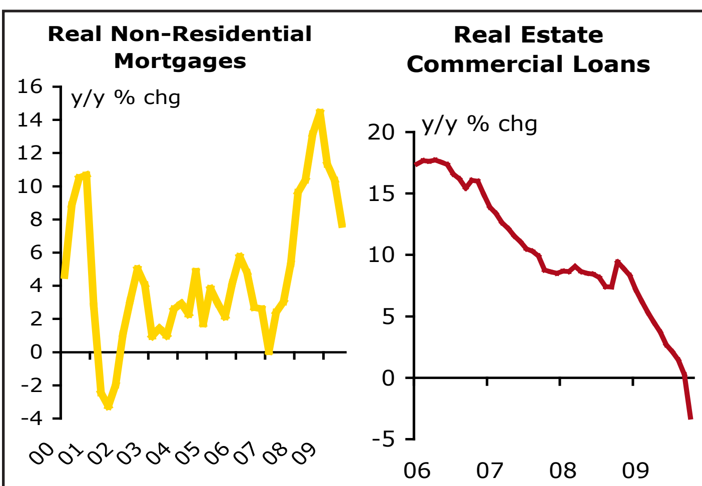
In the US the situation is very different. Balance-sheet lending is still in negative territory falling by 4% in the third quarter (Chart 4, right). And these reluctant lenders are not only facing larger refinancing pools, but also lower quality ones—reflecting years of loose underwriting standards. Accordingly, a rising proportion of maturing CMBS loans are facing difficulties getting refinanced. That phenomenon is not being observed in Canada. Note, for example, that Canadian CMBS were structured to pay off more than 18% of the principal amount over the course of the term—that is three times the rate seen in the US—resulting in a much larger valuation cushion in Canada (Chart 5). No surprise then that the delinquency rate in Canada in the CMBS market is only 1.3% vs. close to 4% stateside.

True, we are seeing some new capital flowing into the US market. Property and debt funds were able to raise some $135 bn over the past year, while US REITs have issued $15.1 bn of stocks this year and have floated another $9 bn in unsecured debt. Even the CMBS market (thanks in part to TALF) is starting to show some sign of life, including a recent transaction of $400 mn.

But those numbers pale in comparison to the amount needed. If all the mortgages originated between 2005

Chart 4

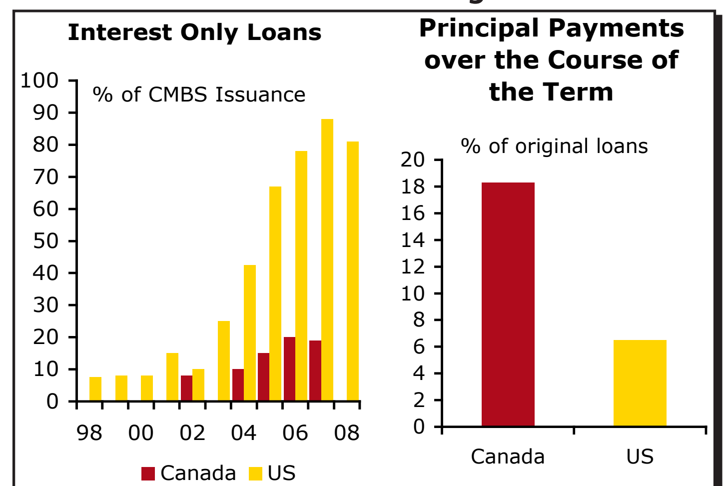
REITs Financing (Canada left, US right)



Source: DBRS, Statistics Canada, CIBC

Chart 5

Less "Innovative" Underwriting in Canada



Source: Commercial Mortgage Securities Association

and 2008 had to be refinanced today, the value of the underlying properties would qualify them for as little as $2 trillion of debt, creating a funding gap of up to $825 bn that represents either writedowns or the need for fresh equity.

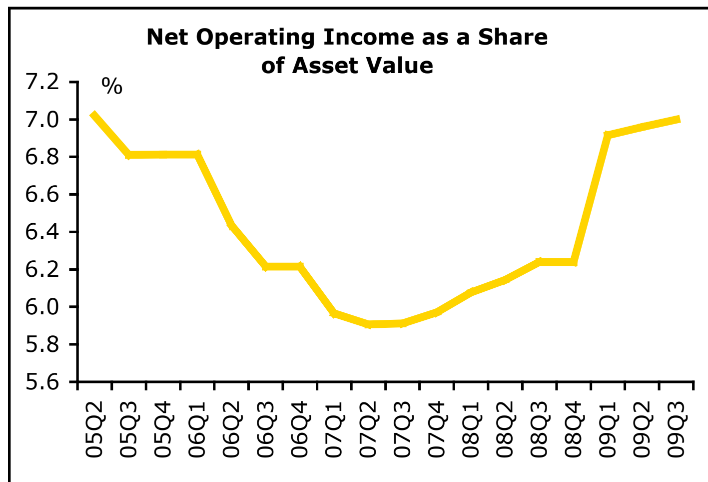
Are Canadian REITs a Buy?

So it appears that Canadian REITs are in a much better position than their US counterparts, but are they a good buy in absolute terms? Following the 40% rebound of the past six months, and when evaluated in relation to current net value of their assets, Canadian REITs appear to be fairly valued (Chart 6). But the net value of these assets can change very quickly. Note that the cap rate (net operating income as a share of asset prices) is in early stages of stabilization after rising by almost 100 points during the recession (Chart 7). The current cap rate of just over 7% is consistent with a market that is still in a recessionary mode and reflects US-flavoured credit crunch fears.

But as we have demonstrated, these fears are overblown. The healthy financial position of Canadian REITs along with improved financial capacity among potential buyers, as well as limited supply of high-quality properties (due to lack of excessive speculative development), and the continuing low interest rate environment suggests that the cap rate will start trending lower in 2010. An analysis done by our equity research group suggests that a 50-point decline in the cap rate will lift net assets by 17%—a move that will put current REIT valuations at a discount to their net asset value.

Chart 7

Cap Rate



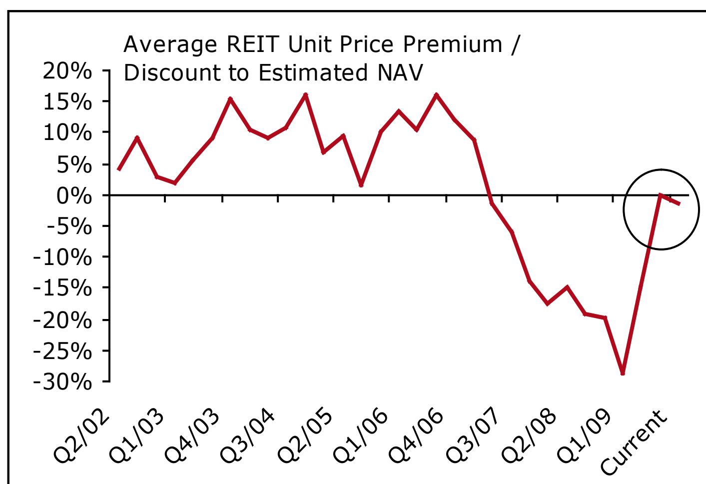
Source: CB Richard Ellis, CIBC

It Pays to Hold

The second leg of the REITs' rally cannot occur before we get more consistent signs that the economy is on a sustainable recovery pace. While that rally might then not arrive until the latter part of 2010, even if REIT prices are flat, total returns won't be. With a current dividend/distribution yield of well over 7%, Canadian REITs are not only twice as generous as their US counterpart but are, by far, the highest dividend sector in the TSX—paying a full 250 points above the average dividend yield of the utility sector, and close to 500 basis points above the TSX average (Chart 8).

Chart 6

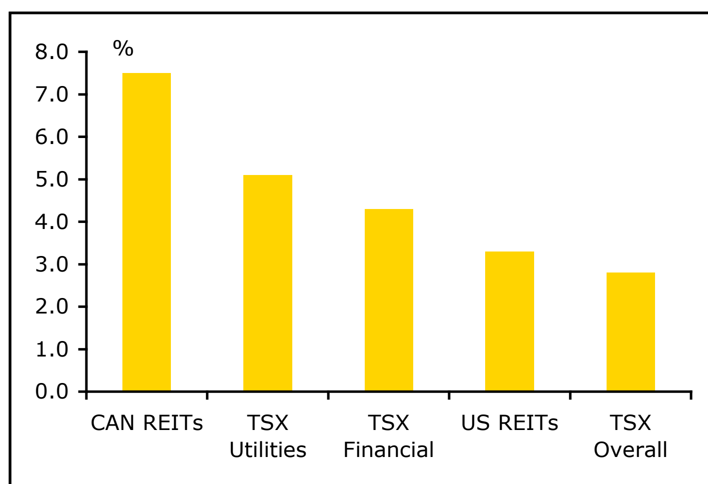
REITs—Fairly Valued



Source: CIBC

Chart 8

Dividend Yields



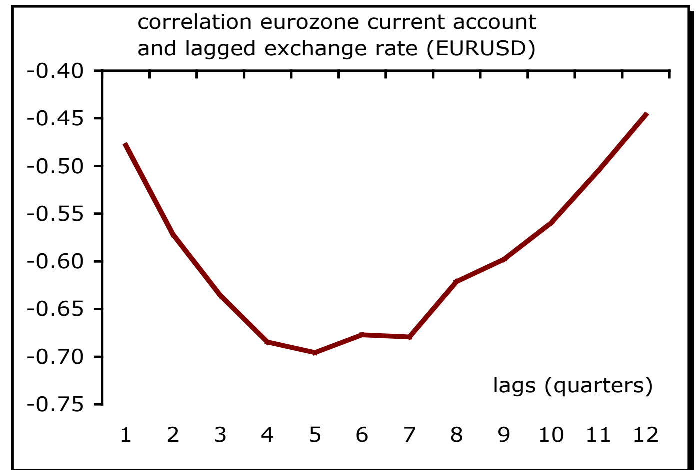
Has Sterling Been Pounded Enough?

Meny Grauman and Krishen Rangasamy

Since the start of the financial crisis in late 2007 the British pound has lost roughly 20% against the euro as investors appear increasingly convinced that the UK is the sick-man of Europe. But while market sentiment is firmly against the pound, the economic fundamentals are not so one-sided. There is no denying that the British economy is currently struggling under the weight of a hobbled banking sector and a deteriorating fiscal outlook, but a closer look at the eurozone reveals that it is facing a surprisingly similar slew of fiscal and economic challenges. The UK might initially underperform the eurozone as both economies recover from recession, but policy differences and the heavier burden of exchange rate drag could help the UK catch up, aiding the pound regain some lost ground.

Chart 1

Euro Gains Hit Zone's Current Acc't with a Lag



Eurozone Growth Outlook Cloudy

Recent reports showing that the 16-member eurozone economy resumed growing in Q3, even as the UK's economy continued to contract, have further cemented the view that the UK will remain a laggard in this recovery. But it is unclear whether that result is sustainable. After all, the eurozone actually witnessed a deeper recessionary slide in industrial production than the UK, and the easier rebound after that larger drop in output may be a major reason why the eurozone outperformed last quarter.

At the same time, with domestic demand continuing to remain flat, it is unclear whether trade alone can keep driving the eurozone economy along into next year. World trade is reviving, but the nearly 20% appreciation in the trade-weighted euro since 2008 should increasingly begin to hurt the region's net export performance, since it usually reacts with a lag (Chart 1).

The British consumer certainly got hit during the recession, as both UK household wealth and consumption spending dropped faster than in the eurozone. However, retail sales in the UK have been quicker to recover than in other parts of Europe, as has consumer confidence (Chart 2). No doubt, much of that improvement appears to be tied to the revival in the UK housing market, which has seen prices rise roughly 7% over the past six months. Although transaction volumes are still low, the wealth effects associated with a renewed upswing in housing should help provide support to households even as taxes are set to go up on January 1st.

Historically low interest rates are proving to be crucial to the consumer upturn. However, not only have borrowing costs, including average mortgage rates (Chart 3 left), dropped by more in the UK than in the eurozone, but households there are also much more sensitive to rate declines than on the continent. In fact, the share of variable rate mortgages in the UK is about double the eurozone average (Chart 3 right).

Chart 2

Sentiment Suggests Better UK Consumer Outlook

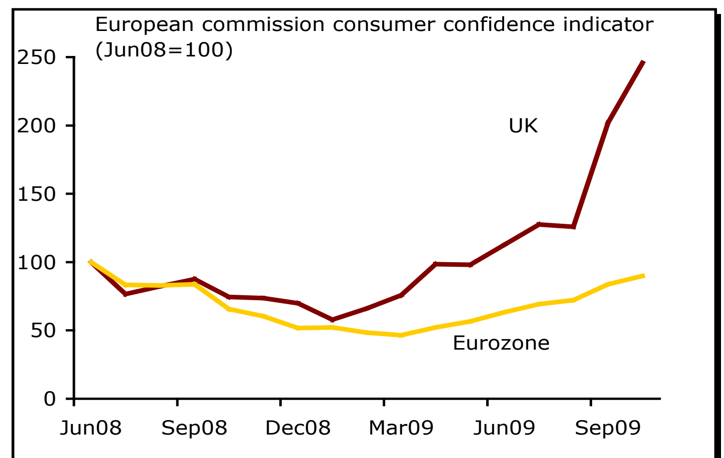
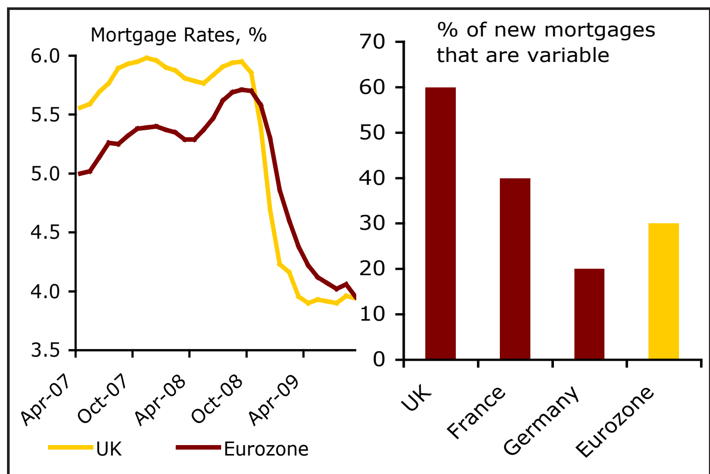


Chart 3

Rate Cuts Give Greater Boost to UK



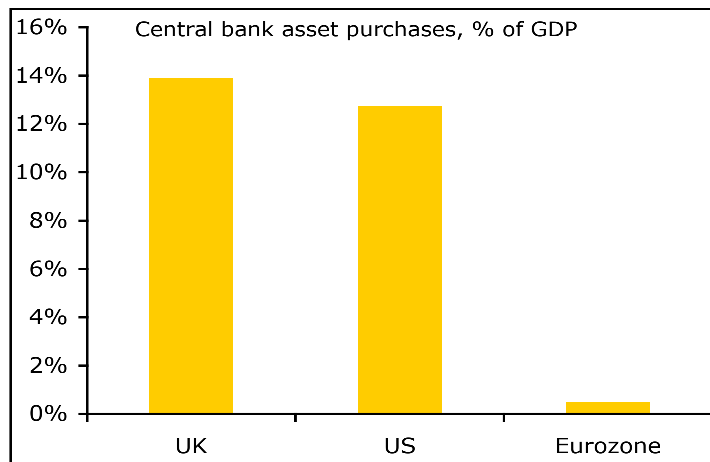
Rates dropped faster in the UK because the BoE has taken a more aggressive policy stance. The Bank of England has gone further than any other central bank in utilizing unconventional policy tools in an attempt to unfreeze credit markets and spur economic growth. While the ECB is supplying unlimited liquidity through fixed rate tenders, it has largely avoided making direct purchases of assets in the open market, save €60 bn in covered bonds. In sharp contrast, the Bank of England just expanded its asset purchase program to £200 bn, slightly higher as a percentage of GDP than the $1.825 trillion being spent by the Fed (Chart 4).

UK Has Outspent the Eurozone on Recovery

Besides doing more than the eurozone to ease monetary conditions, the UK also committed significantly more resources to stabilizing its financial sector. In fact, while the UK spent roughly 15% of 2008 GDP on bank rescue measures, the eurozone spent less than 3%. The UK may be more dependant than Europe on its financial sector, but also did more to help bail it out. Despite this support, lending growth did indeed slow sharply in the UK over the past year, but the eurozone has not fared much better. In the UK, the slowdown has been particularly acute in the non-financial corporate sector, but household lending is now actually in worse shape in the eurozone.

Chart 4

UK Has Seen Most Aggressive Quantitative Easing

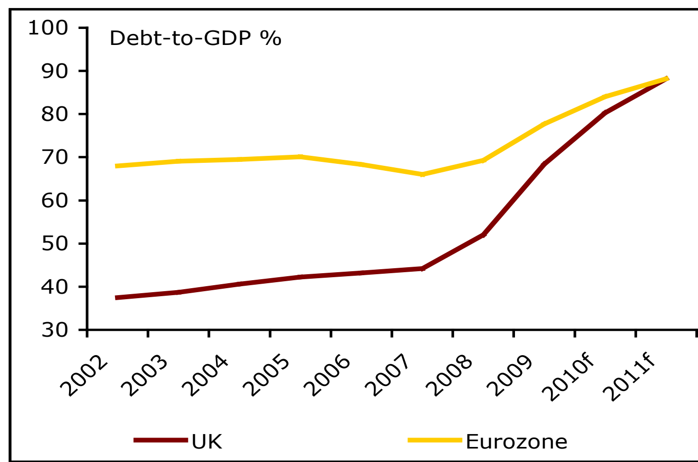


When it comes to fiscal stimulus, both regions continue to underspend other jurisdictions, but that is only because they have more generous social safety nets which automatically trigger higher government expenditures during downturns. A spike in spending, coupled with a sharp drop in tax revenue, has hit budgets hard in both London and continental capitals, but the deterioration in the UK's books has been more dramatic. Nevertheless, despite very large budget deficits projected for both this year and next year, the UK's debt-to-GDP ratio is only now approaching the eurozone's (Chart 5). The UK has been more explicit in announcing tightening measures ahead, but they'll not be long in coming in the eurozone as well.

The eurozone may have exited this latest recession ahead of the UK, but it is not clear that it will be able to hold on to its lead over the coming year. Heavy short spec interest in the pound suggests that investors overwhelmingly believe that sterling will continue to lose ground to the euro as the need for massive quantitative easing keeps rates lower there for longer than on the continent. However, with eurozone consumers still very cautious and credit markets still tight, the UK's greater stimulus raises the odds that the currency market has it wrong.

Chart 5

Both Sides of Channel Face Fiscal Tightening



ECONOMIC UPDATE

CANADA	09Q2A	09Q3F	09Q4F	10Q1F	10Q2F	10Q3F	10Q4F	2008A	2009F	2010F	2011F
Real GDP Growth (AR)	-3.4	0.2	4.3	1.9	2.2	2.4	2.6	0.4	-2.5	2.0	3.8
Real Final Domestic Demand (AR)	0.4	5.8	1.7	2.1	2.7	3.3	3.2	2.6	-1.5	2.7	3.5
All Items CPI Inflation (Y/Y)	0.1	-0.9	0.5	1.2	1.6	1.7	1.6	2.4	0.2	1.5	2.2
Core CPI Ex Indirect Taxes (Y/Y)	1.9	1.6	1.4	1.5	1.4	1.5	1.6	1.7	1.7	1.5	1.9
Unemployment Rate (%)	8.4	8.6	8.6	8.7	8.6	8.7	8.7	6.1	8.3	8.7	8.2
U.S.											
Real GDP Growth (AR)	-0.7	2.8	2.4	1.8	0.9	2.3	1.7	0.4	-2.6	1.8	3.4
Real Final Sales (AR)	0.7	1.9	1.9	0.9	1.2	1.6	0.8	0.8	-1.7	1.3	2.8
All Items CPI Inflation (Y/Y)	-1.2	-1.6	1.0	1.4	1.5	1.8	1.8	3.8	-0.5	1.6	3.2
Core CPI Inflation (Y/Y)	1.8	1.5	1.8	1.8	1.6	1.7	1.9	2.3	1.7	1.8	2.5
Unemployment Rate (%)	9.3	9.6	10.4	10.6	10.8	10.8	10.7	5.8	9.4	10.7	10.3

CANADA

The global recovery hasn't offered the much-anticipated and immediate lift to Canada's GDP, which is now heading for a roughly flat Q3, prompting us to downgrade our call for the quarter. While exports have picked up in line with the global recovery, factories have been shipping from inventories, explaining Canada's sluggish start to this up-cycle. But there is a limit how low inventories can go. Increased demand in Q4 will more likely come from production lines rather than from inventory storerooms, something that should provide a significant, albeit temporary, lift to GDP. Next year will likely revert to below-trend growth, as exports fall back in light of anemic US growth and the overvalued C$.

UNITED STATES

The third quarter marked the end of the longest and deepest US recession since World War II. But despite an initial jump in economic activity, this recovery is expected to be both long and slow. The pace of job losses does appear to be easing, but hiring has yet to show any signs of life. The unemployment rate just crossed the 10% mark for the first time since the early 1980s, and is expected to remain above that mark until well into 2011. Year-over-year inflation is moving back into positive territory as we pass the anniversary of last year's steep drop in energy prices, but core inflation should continue to be weighed down by significant economic slack throughout next year.

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