WEEKLY PUBLICATION

# FX Snapshot

NATIONAL BANK

June 17th, 2013 nbc.ca/fxsnapshot

**FX Team Montreal**
**Customer Service**
**514 394 6910 1 800 286 6586**

**FX Team Toronto**
**Customer Service**
**416 869 8901 1 800 663 6673**

**Development Team**
**Fixed Income & Commodity**
**514 394 6885 1 855 394 6885**

## Major News this Week

On Friday, the International Monetary Fund lowered its forecast for growth in the U.S. in 2014 from 3% to 2.7%. The stated reason was that the Federal Reserve should be able to better control communications on its strategy to end its current monetary easing policy. Over the last few weeks there has been considerable volatility in the U.S. interest rate curve stemming from a series of rumours about monetary policy. For example, 5-year bond rates in the U.S. increased from 0.65% to 1.10% in one month! In Japan, the yen continues to surge, up 3% over last week. The main reason was the failure by Haruhiko Kuroda, Governor of the Bank of Japan, to announce additional bond purchases on Tuesday. Have a great week! *Philippe Shebib*

| | ***Canada*** | *Forecast* | *Previous* |
|---|---|---|---|
| Monday | • Foreign Securities Purchases for April | 3.00 billion | 1.19 billion |
| Friday | • Retail Sales for April (MoM)<br>• Consumer Price Index for May (MoM); the annual inflation rate is slowing, with only 0.4% growth. The latest figure, for April, was the lowest since October 2009. | 0.0%<br>0.4% | -0.2%<br>-0.2% |
| | ***United States*** | *Forecast* | *Previous* |
| Monday | • Empire Manufacturing Index; this statistic shows economic activity among 175 manufacturers in the New York region. | 0 | -1.43 |
| Tuesday | • Consumer Price Index for May (MoM);<br>• Housing Starts for May; since the beginning of 2013, housing starts have averaged 935,000 per month compared to 765,000 in 2012. These figures show strong growth in U.S. real estate. | 0.2%<br>950,000 | -0.4%<br>853,000 |
| Wednesday | • U.S. Federal Reserve's interest rate decision and press conference; we will be listening carefully to Ben Bernanke to see if the Fed may be cutting back its bond purchasing program. | 0.25% | 0.25% |
| Thursday | • Initial Jobless Claims for last week | 340,000 | 334,000 |
| | ***International*** | *Forecast* | *Previous* |
| Tuesday | • England's Consumer Price Index for May (MoM) | 0.1% | 0.2% |
| Wednesday | • Minutes of the Bank of England's meeting; Mervyn King will give his last speech on the British economy before his official departure on June 30, 2013. | - | - |
| Thursday | • Germany's Producer Price Index for May (YoY) | 0.4% | 0.1% |

## The Loonie

*"A man who wants to lead the orchestra must turn his back on the crowd."  - Max Lucado*

Since the 2008 financial crisis, the central banks have, whether they like it or not, become very sophisticated market manipulators. This is a far cry from the days when currency values were driven solely by economic forces in each country. The importance of fundamental analysis, which is based on historical economic data and data released on a pre-set schedule has been completed supplanted by geopolitics. A series of massive, repeated interventions by central banks to stimulate their economies have made financial markets exceptionally sluggish. Whether these actions were motivated by fears of inflation, such as in Japan; by a desire to remain competitive to support exports and currencies, such as in Poland, Turkey and Brazil; or even to promote employment, such as in the U.S., clearly the actors have tempered at least some of the volatility. We are constantly hearing in the news about investor uncertainty, which we believe refers to a certain restiveness caused by a high dependence on central bank decisions – the new miracle drug. In addition, the actions taken by the high-performance economic drivers (i.e., governments and central banks working together in this way) are very difficult to predict, so economic forecasts need to be revised more frequently. The forecasters change keys and do their best to follow the conductors!

Withdrawal from the broad form of control is certainly not going to be easy. The market has been reacting to the slightest sign from the Fed that it may stop or slow current asset purchases. Investors are even giving serious thought to the effects of these shocks in the medium term. Will we return to things as they were before? If so, we will finally be able to count on our benchmarks again and make informed decisions about future commitments.

The following graph shows changes in two commodities and the Canadian dollar against the U.S. dollar through this period of innovative leadership by several central banks, including the Fed. Commodity prices have trended downwards: the prices of copper and a barrel of Brent crude have dropped over 12% and 7%, respectively, since the start of the year.


**Source: Bloomberg, National Bank of Canada, 2013-06-14*

In such an environment, why has the Canadian dollar performed well, while other currencies based on commodities, like the AUD and the NZD, have slipped 7% and 4.4% since April 15? In fact, Canada has simply stood apart from a pack of countries that have sought to weaken their currencies through non-conventional means. It has not participated in the currency war, nor in the interest rate war, which will be the subject of another column. But what has made the Canadian dollar shine is investors' confidence in its strength. This confidence serves as a magnet, attracting foreign capital. *Denise Dicaire and Joy A. Jamra*

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## Technical Analysis: *(Monday, June17th, 2013)*

EURCAD: It didn't take much this week for the EURCAD rate to climb back to its 2013 highs, last seen in February. Following a dramatic increase since mid-May – up in 16 of the last 22 sessions – it would appear that the EURCAD pair has lost a bit of steam. At least this is what we see in the lower section of the following graph. The RSI (Relative Strength Index) indicator reached 70 (circle), indicating that the EURCAD is ready to change direction. This is confirmed by the MACD (Moving Average Convergence Divergence) indicator, or a downward cross by the white line over the red line in the middle graph. This is an encouraging sign for the Canadian dollar, which should subsequently climb again against the European Union's single currency. Have a good week! *Xavier Villemaire, CFA*

| USD/CAD Res. levels |
|---|
| 1.0208 |
| 1.0256 |
| 1.0334 |

| Supports levels |
|---|
| 1.0130 |
| 1.0100 |
| 1.0022 |


**Source: Bloomberg, National Bank of Canada, 2013-06-14*

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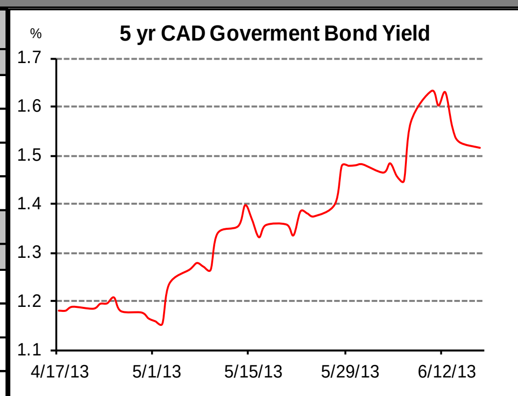
## Fixed Income

- After a rapid steepness of the U.S. swap curve over the last several weeks on speculations that the Fed will gradually withdraw its bond-purchase program (QE), the market is slowly correcting itself as investors feel that the recent hike in Treasury yields was overdone.
- Clearly, it is needless to say that the Canadian swap curve and the Canadian bond yields have also increased quickly over the same period. The 5-year and 10-year swap rates climbed by nearly 50 bps and 60 bps respectively, to reach their highest levels in 14 months.
- Although the overnight lending rate of the Bank of Canada sits at 1% since September 2010, the market is currently pricing an increase of this rate.  Timing is therefore extremely important considering the volatility that we witnessed over the past few weeks.
- We will definitely keep a very close look at the FOMC meeting taking place on June 18th and 19th with the decision of the Fed with respect to its monetary policy being released on the 19th. Mr. Bernanke's comments will undoubtedly be scrutinized by many. Here's to a great week! *Rana Karim*

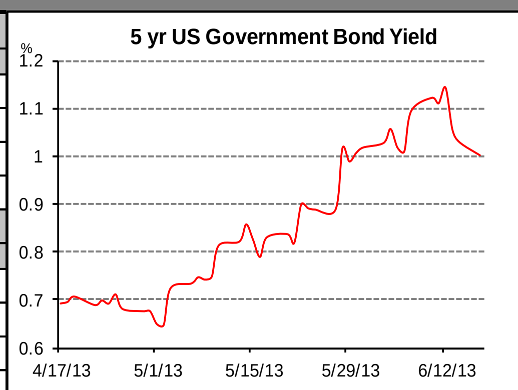
**Canada**

| Key short-term rates | Weekly change | | | | Yearly change | | |
|---|---|---|---|---|---|---|---|
| | 14-Jun-13 | 7-Jun-13 | Change (pbs) | | 14-Jun-12 | Change (pbs) | |
| Overnight Rate | 1.0000% | 1.0000% | 0.0 | - | 1.0000% | 0.0 | - |
| 3M Bill (Federal) | 1.0130% | 1.0210% | -0.8 | ↓ | 0.8910% | 12.2 | ↑ |
| 1-month CDOR | 1.2200% | 1.2200% | 0.0 | - | 1.2221% | -0.2 | ↓ |
| Prime rate | 3.0000% | 3.0000% | 0.0 | - | 3.0000% | 0.0 | - |
| **Government bonds** | **Weekly change** | | | | **Yearly change** | | |
| | 14-Jun-13 | 7-Jun-13 | Change (pbs) | | 14-Jun-12 | Change (pbs) | |
| 2 year | 1.107% | 1.134% | -2.7 | ↓ | 1.045% | 6.2 | ↑ |
| 5 year | 1.527% | 1.568% | -4.1 | ↓ | 1.291% | 23.6 | ↑ |
| 10 year | 2.120% | 2.147% | -2.7 | ↓ | 1.801% | 31.9 | ↑ |
| 30 year | 2.678% | 2.718% | -4.0 | ↓ | 2.377% | 30.1 | ↑ |




**United States**

| Key short-term rates | Weekly change | | | | Yearly change | | |
|---|---|---|---|---|---|---|---|
| | 14-Jun-13 | 7-Jun-13 | Change (pbs) | | 14-Jun-12 | Change (pbs) | |
| Fed Funds target | 0.250% | 0.250% | 0.0 | - | 0.250% | 0.0 | - |
| 3M Tbill | 0.041% | 0.041% | 0.0 | - | 0.096% | -5.6 | ↓ |
| 1-month LIBOR | 0.193% | 0.192% | 0.0 | ↑ | 0.243% | -5.0 | ↓ |
| Prime rate | 3.250% | 3.250% | 0.0 | - | 3.250% | 0.0 | - |
| **Government bonds** | **Weekly change** | | | | **Yearly change** | | |
| | 14-Jun-13 | 7-Jun-13 | Change (pbs) | | 14-Jun-12 | Change (pbs) | |
| 2 year | 0.272% | 0.304% | -3.2 | ↓ | 0.296% | -2.4 | ↓ |
| 5 year | 1.030% | 1.095% | -6.5 | ↓ | 0.738% | 29.2 | ↑ |
| 10 year | 2.130% | 2.173% | -4.3 | ↓ | 1.643% | 48.7 | ↑ |
| 30 year | 3.306% | 3.335% | -2.9 | ↓ | 2.741% | 56.5 | ↑ |



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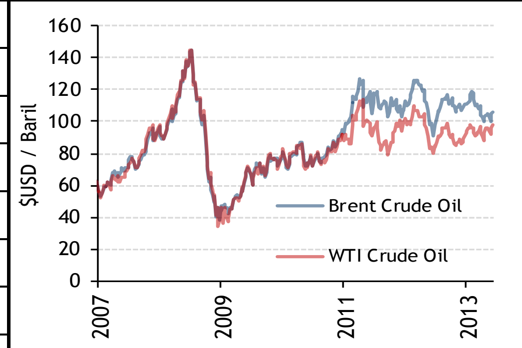
## Commodities

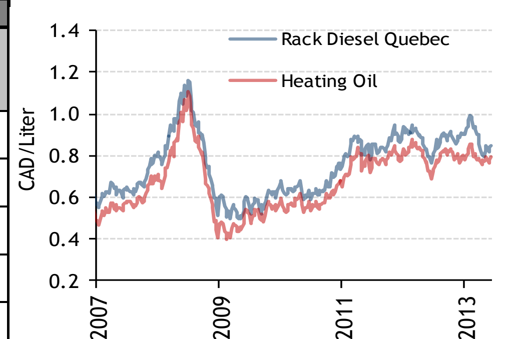
- In its latest report, the International Energy Agency (IEA) said that the opening of new refineries in Asia and the Middle East will have a major impact on the production of refined products over the next few years. These new facilities will be more efficient and this could eventually lead to the closure of less profitable refineries in developed countries. The IEA also expects faster growth over the next few quarters.
- OPEC has also raised its demand forecast for the rest of 2013. This will allow the organization to continue producing slightly more that its current production quota without creating a significant increase in inventories.
- Given the strong relation between demand for oil and global economic activity, improved growth prospects should eventually lead to increased consumption of petroleum products. It is interesting to note that global demand for oil should reach close to 91 million bpd in 2013 after bottoming out at 84 million bpd in 2008.
- While shale oil will have a noticeable impact on production levels, this should be offset by a decline in global production of conventional crude over the next few years, preventing prices from collapsing. *Emmanuel Tessier-Fleury*

| | Open 17-Jun-13 | Prior 10-Jun-13 | Variation | Year to date |
|---|---|---|---|---|
| WTI Crude Oil (USD/Barrel) | 98.2600 | 95.7700 | 2.60% | 9.62% |
| Brent Crude Oil (USD/Barrel) | 106.2400 | 103.9500 | 2.20% | -0.04% |
| Heating Oil (Cad/Liter) | 0.7983 | 0.7766 | 2.79% | -0.04% |
| Rack Diesel Quebec (Cad/Liter) | 0.8448 | 0.8391 | 0.68% | -6.61% |
| Rack Diesel, Toronto (Cad/Liter) | 0.7963 | 0.7880 | 1.05% | -7.87% |
| Rack Diesel, Vancouver (Cad/Liter) | 0.8520 | 0.8490 | 0.35% | -6.61% |
| Gasoline, Nymex (Cad/Liter) | 0.7778 | 0.7670 | 1.41% | 5.54% |
| Natural Gas (Usd/Mmbtu) | 0.0382 | 0.038 | 0.53% | 14.00% |

| Swap | Heating Oil (CAD/Liter) | Gasoline (CAD/Liter) | WTI Crude Oil (CAD/Liter) | Brent Crude Oil (CAD/Liter) |
|---|---|---|---|---|
| 3 Months | 0.8131 | 0.7881 | 0.6335 | 0.6811 |
| 6 Months | 0.8206 | 0.7705 | 0.6347 | 0.6807 |
| 9 Months | 0.8251 | 0.7639 | 0.6315 | 0.6783 |
| 12 Months | 0.8272 | 0.7733 | 0.6275 | 0.6764 |
| 24 Months | 0.8232 | 0.7598 | 0.6087 | 0.6644 |

Energy charts



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## Last Week at a Glance

**Canada –** In May, housing starts rose to a consensus-topping seasonally adjusted annual rate of 200.2K, up 13.8% from the upwardly revised 175.9K pace set in April. The increase was supported in both rural (+7.6%) and urban areas (+14.6%). Urban residential construction was driven primarily by multiple units (+22.2%), though singles added thrust as well (+3%). On a regional basis, urban starts more than doubled in Atlantic Canada (+112%) and sprang 46.4% in Ontario, dwarfing declines in BC (-7.4%), the Prairies (-0.3%) and Quebec (-5.6%). May's results were stronger than expected, setting overall housing starts on course for an annualized growth rate of 35% in Q2. Thus, residential construction should contribute to Canadian GDP in Q2 for the first time in four quarters. However, while multis are doing some heavy lifting here (+70% annualized after shrinking 62% the quarter before), single starts are set to retreat 0.4% in Q2 after pulling back 17.6% in Q1. Consequently, as singles contribute more to GDP per unit than multis do, the net impact on Q2 GDP should be muted somewhat. To our eyes, May's jump in housing activity does not mark the onset of an uptrend. Though real permits for the construction of multiple units were at their top since 2005, Realnet reported unsold new condos (including on presale or under construction) in the GTA struck a record high in April. The surge in starts in the Atlantic Provinces, which occurred in the multiples segment, is not sustainable either. According to the CREA, the ratio of sales to new listings indicates a buyers' market in New Brunswick and Nova Scotia. Moreover, the latest CMHC stats indicated vacancy rates for rental units were high in Charlottetown (5.7%) and St. John (9.7%). All this suggests residential construction will remain soft in the quarters ahead. Still in May, the Teranet–National Bank National Composite House Price Index™ climbed 1.1% month-on-month and 2% year-on-year. Though stronger than expected, the monthly increase was not exceptionally large. Indeed, over the past 12 years, which include a recession year, increases in May have averaged 1.2%. Industries operated at 81.1% of their capacity in Q1, compared to 80.5% in the previous quarter. Manufacturing shipments contracted 2.4% in April, the worst monthly drop since August 2009. That was also much worse than consensus expectations which were at +0.3%. Adding to the bad news was a downward revision to the prior month to -0.6% from -0.3%. In April, there were weaker sales in 13 of the 21 industries, including the 1.7% declines in sales of transportation equipment. Sales of both autos and aerospace products were down in the month. In real terms, factory sales decreased 1.6%. The real inventory-to-sales ratio jumped to 1.47, the highest since August 2009. The Canadian factory report was very weak and is a reflection of the observed moderation in economic activity south of the border. The slump in volumes will likely weigh on Canada's April GDP. Assuming no change in May and June, Q2 real shipments are currently tracking -2.8% annualized after a 2.1% drop in the prior quarter.

**United States** – In May, retail sales rose 0.6%, two ticks above consensus expectations. On a year-to-date basis, retail sales have grown 1.6% (or 3.6% annualized) so far in 2013, compared with 2.4% the same period the year before. Auto sales sprang 1.8%, their largest month-on-month increase in six months. Excluding autos, sales were up 0.3% in line with consensus expectations. Sales at restaurants were down 0.4%.

Gasoline stations, clothing stores and department stores registered lower sales as well (-0.2% each). For gasoline stations, this marked a third straight monthly drop. However, core retail sales (which exclude cars, gas stations and building materials) advanced 0.3%, bringing their gains so far this year to 2.6% on an annualized basis. Again in May, the U.S. National Federation of Independent Business Index (NFIB) rose more than two points to 94.4, its highest level since April 2012. Businesses were slightly more optimistic about the economy, though the index remained negative. The sales outlook was deemed brighter, with the index reaching +8, its highest since March 2012. Ease of credit improved as well, though hiring plans remained unchanged. As the NFIB pointed out, "the index does not signal strong economic growth" as it remains well below pre-recession levels. Hence, while improving, the economic outlook continues to be of concern among small businesses. Still in May, import prices fell for a third month running (-0.6%), pulling prices 1.9% lower than a year earlier. Both fuel and non-fuel price declines contributed to the drop. Export prices were down as well (-0.5%), leaving the 12-month percentage change at -0.9% as in April. In May, the Producer Price Index for finished goods rose 0.5%. More than 60% of the rise can be attributed to higher prices for finished energy goods (1.3%). The 12-month percentage change in finished goods reached 1.7% in May, compared to 0.5% in April. Prices for finished goods less food and energy rose 0.1% in the month, leaving the core index also 1.7% above its May 2012 level. Core intermediate prices fell 0.4% in May. US industrial production was unchanged in May from the previous month. Consensus expectations were for a gain of 0.2%. The prior month was revised up to -0.4% (was previously reported at -0.5%). In May, a drop of 1.8% in utility production offset gains in motor vehicles and parts (+0.7%) and mining (+0.7%). With the soft industrial output, capacity utilization fell 1-tick to 77.6%, the lowest since last October. The US economy is clearly decelerating in the current quarter. With two months of data, Q2 industrial production is tracking roughly flat, held down by the manufacturing sector which is contracting for the first time since the third quarter of last year. The increase in US auto output, however, is a positive. Separately, the preliminary read on the Michigan consumer sentiment indicator for June came in at 82.7, well below consensus expectations for no change at 84.5.

*Paul André Pinsonnault, Strategy and Economic department NBC*

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