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The Current Account Counts

by Avery Shenfeld

The Canadian dollar lost a few fans this week when markets were *shocked, shocked*, by a news report that the US tipped Canada that it will put us on notice of its intent to withdraw from NAFTA. The White House followed up that report with a statement saying that the President's view on NAFTA had not changed. Exactly. It's the worst trade deal ever, remember?

Now the foreign exchange market's attention will shift from trade matters back to capital flows, with the Bank of Canada still likely to raise interest rates a quarter-point next week. The Bank chose to put a very positive spin on its Business Outlook Survey, and give particular emphasis to results that showed the economy is running at full capacity. It's not going to be scared off yet by some Donald Trump bluster.

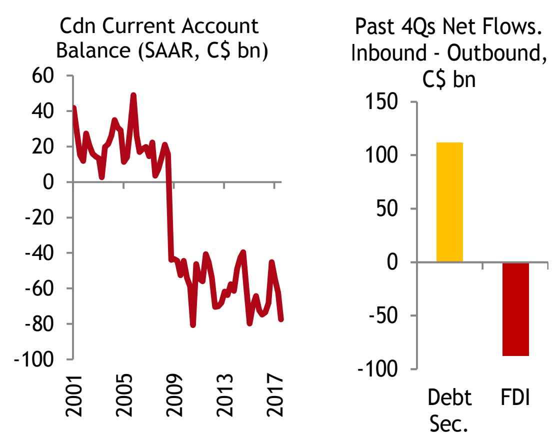
But perhaps those going long the Canadian dollar on this interest rate story should be. For one, the current account counts. Canada's stubborn trade and current account deficit with the rest of the world means that month after month we need fresh capital inflows to prevent the loonie from weakening (Chart).

A look within the capital account shows that, rather than foreign direct investment, which builds new export capacity, the net inflows have been dominated by financial flows into bonds; we've been borrowing our way to a stronger exchange rate. Given how fickle these fixed income flows can be, a pause in Canadian rate hikes could send the currency sharply weaker again if the Fed is hiking at that point.

Even if some version of NAFTA ultimately survives, the war of words on trade policy could tilt businesses to expand on the US side of the border, rather than exporting from Canada. We're at a critical juncture, with many factories running full tilt, and multinationals facing a decision on where to add capacity. Will that happen in Canada, helping to improve the current account balance? Or with risks of a trade war heating up, and the US allure of immediate expensing for tax purposes and lighter regulations, will firms opt to grow operations stateside?

Should those decisions swing the America's way, that will have two negative consequences for the Canadian dollar. First, it will see capital spending, and eventually exports, contribute less to economic growth than the Bank of Canada envisages, a reason to go slower on further rate hikes. And the trade impacts will keep the current account in the red. Both will have the invisible hand of markets finding a weaker equilibrium for the loonie.

Red Ink in the Current Account Financed by Debt



Week Ahead Calendar And Forecast

CANADA

Day	Event	Period	Sig.	CIBC	Consensus	Prior
Monday January 15	**9:00 AM**					
	EXISTING HOME SALES	(Dec)	(M)			3.9%
Tuesday January 16	**CASH MANAGEMENT BUYBACK (Feb'18 - Jun'19) - $0.5B**					
Wednesday January 17	**10:00 AM**					
	BANK OF CANADA RATE ANNOUNCE.		(H)	**1.25%**		1.00%
	10:00 BoC Monetary Policy Report Update					
	Speaker: 11:15 AM Stephen S. Poloz (Governor) & Carolyn Wilkins (Sr. Deputy Gov.)					
Thursday January 18	**AUCTION: 5-YR CANADAS $3.7B**					
Friday January 19	**8:30 AM**					
	INT'L. SEC. TRANSACTIONS	(Nov)	(M)			$20.8B
	MANUFACTURING SHIPMENTS M/M	(Nov)	(M)	**2.0%**	1.5%	-0.4%

UNITED STATES

Day	Event	Period	Sig.	CIBC	Consensus	Prior
Monday January 15	**Martin Luther King Jr Day (Holiday) (MARKETS CLOSED)**					
Tuesday January 16	**AUCTION: 4-WEEK BILLS $45B**					
	AUCTION: 3-M BILLS $48B (prev) , 6-M BILLS $42B					
	8:30 AM					
	NEW YORK FED (EMPIRE)	(Jan)	(M)		18.70	18.00
Wednesday January 17	**7:00 AM**					
	MBA-APPLICATIONS	(Jan 12)	(L)			8.3%
	9:15 AM					
	INDUSTRIAL PRODUCTION M/M	(Dec)	(H)	**0.3%**	0.4%	0.2%
	CAPACITY UTILIZATION	(Dec)	(M)	**77.3%**	77.3%	77.1%
	10:00 AM					
	NAHB HOUSING INDEX	(Jan)	(L)		72	74
	2:00 PM					
	FED'S BEIGE BOOK					
	4:00 PM					
	NET CAPITAL INFLOWS (TICS)	(Nov)	(L)			$23.2B
	Speaker: 4:30 PM Loretta Mester (President, Cleveland)					
	Speaker: 3:00 PM Charles L. Evans (President, Chicago)					
Thursday January 18	**8:30 AM**					
	INITIAL CLAIMS	(Jan13)	(M)		250K	261K
	CONTINUING CLAIMS	(Jan 6)	(L)		1893K	1867K
	HOUSING STARTS SAAR	(Dec)	(M)	**1255K**	1270K	1297K
	BUILDING PERMITS SAAR	(Dec)	(H)	**1285K**	1290K	1303K
	PHILADELPHIA FED	(Jan)	(M)		23.8	27.9
Friday January 19	**10:00 AM**					
	MICHIGAN CONSUMER SENTIMENT	(Jan P)	(H)		97.0	95.9

H, M, L = High, Medium or Low Significance **SAAR = Seasonally Adjusted Annual Rate** **Consensus Source: Bloomberg**

Week Ahead's Market Call

by Avery Shenfeld

In the US, the week will be short on both trading days and data. We're only a hair below consensus on both housing starts and industrial production, suggesting nothing very market moving in either report if we're on the mark.

In Canada, markets are fairly confident, as are we, about seeing a quarter-point hike from the Bank of Canada. The accompanying statement has to be somewhat hawkish, as its main purpose will be to explain why a hike was necessary. But the BoC might do a better job than it did in September in communicating the message that it can take its time on further hikes. Its growth and inflation outlook should be little changed, but the Bank could add a note of caution on trade issues as a way of cooling the fires of the Canadian dollar. Manufacturing shipments are likely to rebound from October weakness given what we saw in the export data.

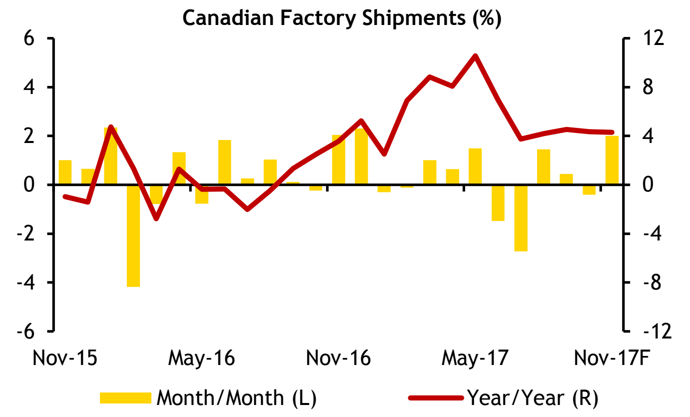
Week Ahead's Key Canadian Number:

Manufacturing Shipments—November

(Friday, 8:30 a.m.)

Nick Exarhos (416) 956-6527

	CIBC	Mkt	Prior
Mfg Shipments m/m SA	2.0%	1.5%	-0.4%



Source: Statistics Canada, CIBC

Factory output didn't get the expected lift from October's near-3% gain in related exports. But there's hope that November's 4.8% jump in outbound manufacturing shipments will do the trick in getting factories humming again.

In addition to the lift provided by overall export demand, a return to more normal production in the auto sector during the month should have lifted a key sub-sector. New orders also have had strong showings in recent reports, a positive for the near-term factory outlook. Look for manufacturing output to climb by 2%, a major plus for the monthly GDP outlook.

Forecast Implications—Manufacturers have been growing production volumes in the 2-3% range over the past year. It's going to be hard to sustain that pace in the year ahead, with the turn in business investment needed to grow capacity unlikely to come in the near-term.

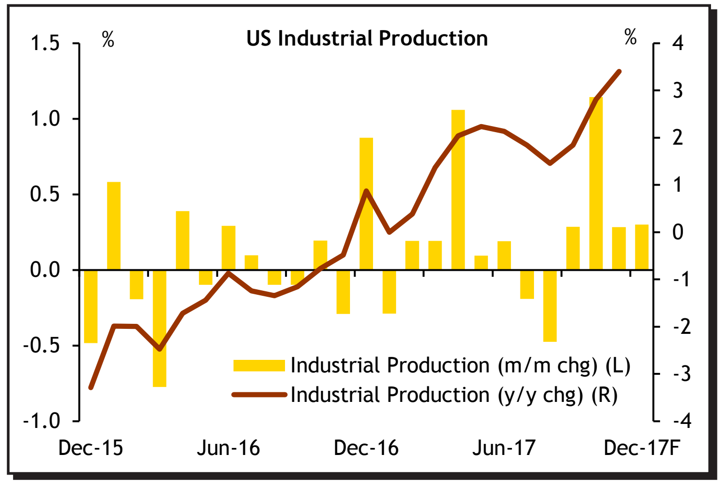
Week Ahead's Key US Number:

Industrial Production & Capacity Utilization—December

(Wednesday, 9:15 a.m.)

Royce Mendes (416) 594-7354

	CIBC	Mkt	Prior
Industrial Production	0.3%	0.4%	0.2%
Capacity Utilization	77.3%	77.3%	77.1%



A strong run of manufacturing production had been the driving force behind an acceleration in total industrial production. However, growth in that sector appears to have cooled in the latest month. Despite a solid increase in the ISM Manufacturing production sub-index, the more reliable employment figures on hours worked point to an only modest gain during the month.

A healthy increase in mining activity, on the back of higher oil prices and a tick higher in rig counts, will be offset to a degree by muted utility usage. Seasonal temperatures for most of December likely left utility output only a touch higher on the month.

Forecast Implications—Industrial production should continue to rise in 2018 with GDP growth numbers set to post another solid year. In the near term, that should see slack measured by capacity utilization continue to diminish, but a rise in fixed investment spurred by recent corporate tax cuts could open up room for production growth later in the year.

Market Impact—We're too close to consensus to see any material market reaction.

Other U.S. Releases:

Housing Starts—December

(Thursday, 8:30 a.m.)

Temperatures in December were near long-term averages for the season, but significant snowfall in some parts of the country likely delayed building activity. As a result, look for housing starts to decelerate more than expected from a pace of 1297K in November to 1255K in December. Building permits likely held up better during the month, something that should continue to support activity early in the year. However, we still believe that demographic forces combined with higher interest rates will begin slow growth in residential investment later in the year.

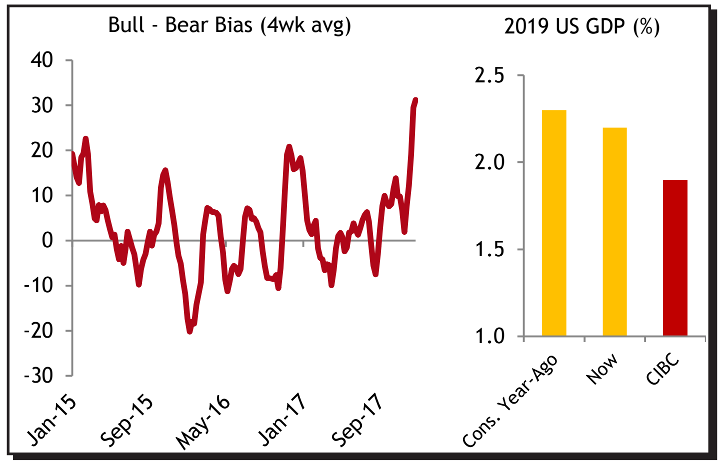
Equity Insights

Nick Exarhos and Avery Shenfeld

S&P's Strong Start

An upgraded growth outlook driven by a more generous tax cut plan is a good reason to be optimistic on stocks. And investors are now more bullish on equities than they were at any time over the past few years. But the end of the year may not look as rosy as the start. That's because expectations for 2019 growth may have some room to move lower, particularly if spending restraint starts to counter the recent lift provided by Washington. As a result, the strong start we've seen to the S&P 500 this year might not be indicative of what the full year will look like once 2019 earnings prospects come into sharper focus.

Bullishness Spikes (L), But Consensus Too High on 2019 Growth (R)

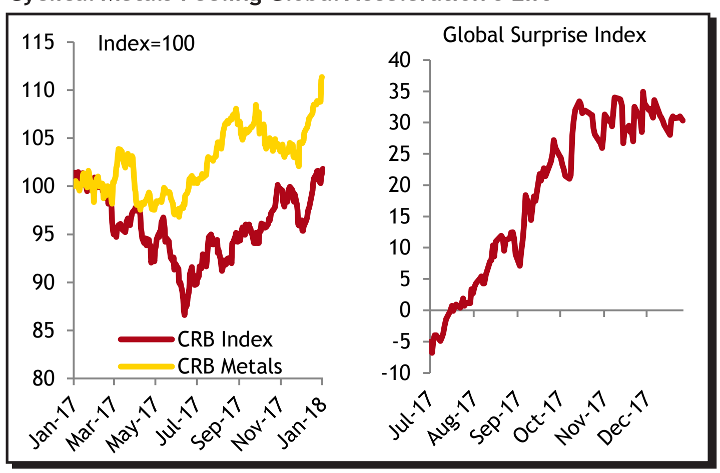


Source: AAII, Bloomberg, CIBC

Metals Driving CRB Gains

Although a big chunk of airtime—and tweet-time—at the start of this year has been dedicated to economic optimism coming from the US, the rest of the globe has continued beating expectations to the upside. Indeed, the global surprise index continues to track solidly in the black, a reason we're turning a bit more optimistic on average commodity pricing for this year. Cyclical metals have been setting the trend, and a bit more momentum would be a positive for materials stocks on the TSX.

Cyclical Metals Feeling Global Acceleration's Lift

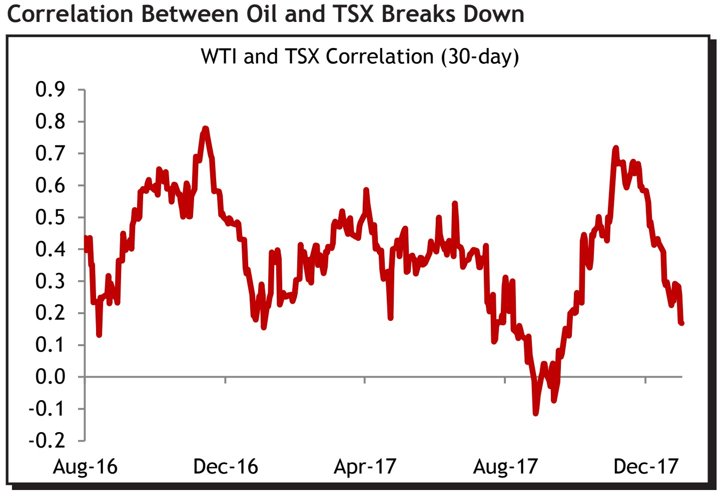


Source: Bloomberg, CIBC

TSX Disconnected from Oil

Typically, a global upturn would mean some meaningful outperformance for the more globally levered TSX, particularly with oil prices continuing to nudge higher. That hasn't been the case recently, with the correlation between the TSX and crude prices breaking down. Our bet is that the trend continues—but in a direction that's more favourable for the Composite. Having not ridden the oil wave higher, the TSX shouldn't be too vulnerable to a moderation in WTI ahead.

Correlation Between Oil and TSX Breaks Down



Source: Bloomberg, CIBC

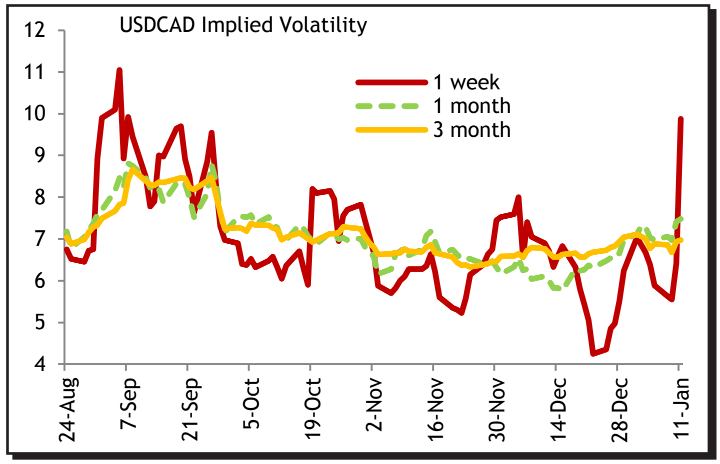
Currency Currents

Andrew Grantham and Royce Mendes

C$: Protection Against NAFTA Risk Still Cheap

A mid-week story suggesting the US was on the verge of pulling out of NAFTA led to a one-day retreat in CAD as investors woke up to the threat of weaker trade links between the two countries. However, the rise in implied volatility was primarily focused on the very short term, as people questioned whether the headline would derail a rate hike from the Bank of Canada next Wednesday. But even if Poloz does still deliver a rate increase as we expect, the threat to CAD from NAFTA negotiations won't go away and would justify a lengthy pause in interest rates. As such, taking protection against volatility over the next 3 months still looks cheap, and the C$ looks set to fall back towards the mid-70 cent range.

Implied Volatility Spiked Only For the Very Short Term

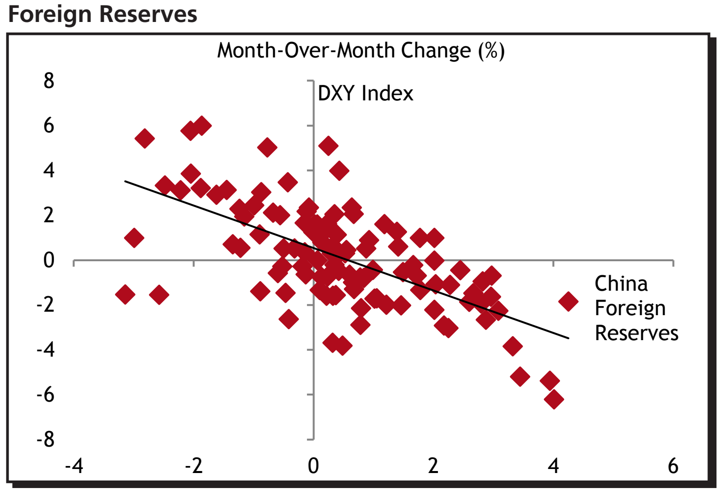


Source: Bloomberg, CIBC

Scare Tactics

Rumours circulated earlier this week that top Chinese officials were recommending halting further purchases of US Treasuries. The news had both the US dollar and Treasuries sell off on the day. But the reaction was probably overkill. Changes in China's foreign reserves (which are largely made up of US assets) don't have a strong correlation with Treasury yields. Moreover, changes in reserves actually have a negative relationship with the US dollar index. That's because China uses the portfolio to counteract movements in its exchange rate, so US$ moves actually cause changes in reserves, not the other way around. Unless Beijing's top officials have also decided to let the renminbi float freely, this week's headlines sound more like a scare tactic than anything else.

The US Dollar Actually Has An Inverse Relationship with China's Foreign Reserves

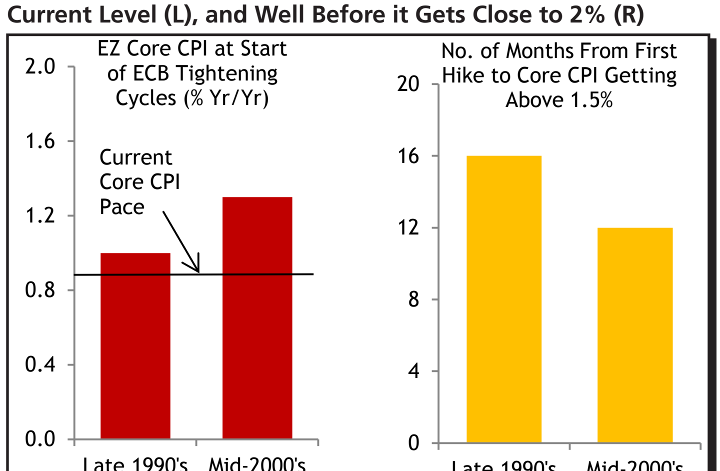


Source: Bloomberg, CIBC

Euro Strength to Last Longer than a Frankfurt Minute

The euro got a boost this week as minutes from the ECB's last meeting suggested that policymakers may not wait long before changing tone and priming markets for an earlier hike than "well past" the end of QE. Even though an actual hike will be dependent on inflation moving higher, history has shown that the ECB doesn't need to see much before starting policy tightening. Indeed, at the start of hiking cycles in the late 1990s and mid-2000s, core inflation was only slightly above its current muted pace, and in both cases it was more than a year before it moved sustainably above 1.5%. We still see the withdrawal of stimulus in Europe leading the euro higher against both the US$ and sterling this year.

ECB Has Hiked Previously With Core CPI Only Slightly Above Current Level (L), and Well Before it Gets Close to 2% (R)



Source: Bloomberg, ECB, CIBC

CANADIAN RELEASE AND EVENT DATES
January/February 2018

Monday 8

Bank of Canada Business Outlook Survey

Tuesday 9

HOUSING STARTS

8:15 AM	000's (AR) TOTAL	SINGLES
OCT	222	55
NOV	252	60
DEC	217	63

Wednesday 10

BUILDING PERMITS ($)

8:30 AM	M (RES)	M (NON-RES)
SEP	-1.2	16.0
OCT	3.2	6.4
NOV	-4.6	-12.3

Thursday 11

NEW HOUSING PRICE INDEX

8:30 AM

Friday 12

Monday 15

Tuesday 16

Wednesday 17

Bank of Canada Interest Rate Announcement

Bank of Canada Monetary Policy Report

Bank of Canada Governor Poloz speaks

Thursday 18

Friday 19

INT'L TRANSACTIONS IN SECURITIES C$BN, NET

8:30 AM	BONDS	MONEY MARKET	STOCKS	TOT
SEP	18.7	-6.0	3.9	16.7
OCT	27.9	-8.8	1.7	20.8
NOV				

SURVEY OF MANUFACTURING

8:30 AM	SHIPMENTS M	Y
SEP	0.4	4.5
OCT	-0.4	4.3
NOV		

Monday 22

WHOLESALE TRADE

8:30 AM

Tuesday 23

Wednesday 24

Thursday 25

PAYROLL EMPLOYMENT, EARNINGS & HOURS

8:30 AM

RETAIL TRADE

8:30 AM	(Current$) M	Y
AUG0	0.0	7.3
SEP	0.2	6.5
OCT	1.5	6.7

Friday 26

CPI

8:30 AM	M	Y
SEP	0.2	1.6
OCT	0.1	1.4
NOV	0.3	2.1

Monday 29

Tuesday 30

Wednesday 31

GDP BY INDUSTRY

8:30 AM (2002$)	GDP M	IND.PROD. M
SEP	0.2	0.6
OCT	0.0	-0.5
NOV		

INDUSTRIAL PRICES

8:30 AM	M (NSA)	Y
OCT	1.1	1.7
NOV	1.4	2.7
DEC		

Thursday 1

Friday 2

Monday 5

INTERNATIONAL RESERVES

8:15 AM	$BN CHANGE	$BN LEVEL
NOV	3.418	86.8
DEC	-0.180	86.6
JAN		

Tuesday 6

MERCHANDISE TRADE

8:30 AM	$MN	12 MO. BALANCE
OCT	-1,551	-16,865
NOV	-2,540	-20,545
DEC		

IVEY PURCHASING MANAGERS' INDEX

10:00 AM

Wednesday 7

BUILDING PERMITS ($)

8:30 AM	M (RES)	M (NON-RES)
OCT	3.2	6.4
NOV	-4.6	-12.3
DEC		

Thursday 8

HOUSING STARTS

8:15 AM	000's (AR) TOTAL	SINGLES
NOV	252	60
DEC	217	63
JAN		

NEW HOUSING PRICE INDEX

8:30 AM

Friday 9

LABOUR FORCE SURVEY

8:30 AM	EMPLOY (HSHOLD) M	EMPLOY (HSHOLD) Y	UNEMP RATE %	AVG HRLY EARN Y
NOV	0.4	2.1	5.9	2.7
DEC	0.1	2.3	5.7	2.9
JAN				

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 Inc. Dates are subject to change. Sources for historical data: Statistics Canada, CMHC, Human Resources Development Canada and the Bank of Canada.

U.S. RELEASE AND EVENT DATES
January/February 2018

Week of January 8

MONDAY 8

CONSUMER CREDIT
3:00 PM

TUESDAY 9

3-Yr NOTE AUCTION
BOT (9:00) REDBOOK (8:55)

WEDNESDAY 10

10-Yr NOTE AUCTION

THURSDAY 11

PPI

8:30 AM	M (SA)	Y (NSA)
OCT	0.4	2.7
NOV	0.4	3.0
DEC	0.2	2.7

TREASURY BUDGET
2:00 PM

30-Yr BOND AUCTION
INITIAL JOBLESS CLAIMS (8:30)

FRIDAY 12

RETAIL SALES

8:30 AM	M	Y
OCT	0.7	5.0
NOV	0.9	6.0
DEC	0.4	5.4

CPI

8:30 AM	M(SA)	Y (NSA)
OCT	2.0	4.5
NOV	2.2	4.3
DEC	2.1	3.7

BUSINESS INVENTORIES
10:00 AM

Week of January 15

MONDAY 15

MARTIN LUTHER KING JR. DAY (HOLIDAY) (Markets Closed)

TUESDAY 16

3, 10-Yr NOTE SETTLEMENT
30-Yr BOND SETTLEMENT

WEDNESDAY 17

CAPACITY UTIL/IND. PROD.

9:15 AM	LEV	M	Y
OCT	77.0	1.2	2.8
NOV	77.1	0.2	3.4
DEC			

Beige Book

NET CAPITAL INFLOWS TICS
4:00 PM

BOT (9:00) REDBOOK (8:55)

THURSDAY 18

HOUSING STARTS

8:30 AM	Mn.	M/M
OCT	1.256	8.4
NOV	1.297	3.3
DEC		

PHILADELPHIA FED INDEX
8:30 PM

2, 5-, 7-Yr NOTE ANNOUNCE.
INITIAL JOBLESS CLAIMS (8:30)

FRIDAY 19

MICHIGAN SENTIMENT (P)
10:00 AM

Week of January 22

MONDAY 22

TUESDAY 23

2-Yr NOTE AUCTION
BOT (9:00) REDBOOK (8:55)

WEDNESDAY 24

EXISTING HOME SALES
10:00 AM

5-Yr NOTE AUCTION

THURSDAY 25

ADV. TRADE IN INTERNATIONAL GOODS
8:30 AM

LEADING INDICATOR
10:00 AM

NEW HOME SALES
10:00 AM

7-Yr NOTE AUCTION
INITIAL JOBLESS CLAIMS (8:30)

FRIDAY 26

GDP

8:30 AM (AR)	REAL GDP	IMPLICIT DEFLATOR
17:Q2(F)	3.1	1.0
17:Q3(P)	2.1	3.3
17:Q3(F)	3.2	2.1

DURABLE GOODS ORDERS

8:30 AM	M	Y
SEP	2.4	8.6
OCT	-0.4	1.9
NOV	1.3	8.2

Week of January 29

MONDAY 29

PERS. INC & OUT.

8:30 AM	INCOME M	CONS M	SAVING RATE AR
OCT	0.4	0.2	3.2
NOV	0.3	0.6	2.9
DEC			

TUESDAY 30

S&P CORE LOGIC/ CASE-SHILLER HOUSE PRICE INDEX
9:00 AM

CONSUMER CONFIDENCE
10:00 AM

BOT (9:00) REDBOOK (8:55)

WEDNESDAY 31

ADP SURVEY
8:15 AM

ECI

8:30 AM	TOTAL	WAGES & SALARY	BEN.
17:Q2	0.5	0.5	0.6
17:Q3	0.7	0.7	0.8
17:Q4			

CHICAGO PMI
9:45 AM

FOMC Rate Decision

THURSDAY 1

NON-FARM PRODUCTIVITY

8:30 AM	Q/Q (AR)	Y/Y
17:Q2 (F)	1.5	1.3
17:Q3 (F)	3.0	1.5
17:Q4 (P)		

ISM MFG SURVEY

10:00 AM	COMP. INDEX	PRICES INDEX
NOV	58.2	65.5
DEC	59.7	69.0
JAN		

LIGHT VEHICLES

	SALES MIL (AR)	Y
NOV	17,403	-0.9
DEC	17,765	-1.6
JAN		

INITIAL JOBLESS CLAIMS (8:30)

FRIDAY 2

EMPLOY. SITUATION

8:30 AM	NON-FARM PAYROLL	CIV UNEMP RATE	AVG HRLY EARN
NOV	252	4.1	2.3
DEC	148	4.1	2.3
JAN			

FACTORY ORDERS

10:00 AM	M(SA)	Y(NSA)
OCT	0.4	4.2
NOV	1.3	8.0
DEC		

MICHIGAN SENTIMENT (F)
10:00 AM

Week of February 5

MONDAY 5

ISM NON-MFG SURVEY
10:00 AM

TUESDAY 6

GOODS & SERV. BALANCE (BOP) $B

8:30 AM	GDS	SERV	TOT
OCT	-69.2	20.3	-48.9
NOV	-70.9	20.4	-50.5
DEC			

BOT (9:00) REDBOOK (8:55)

WEDNESDAY 7

CONSUMER CREDIT
3:00 PM

THURSDAY 8

INITIAL JOBLESS CLAIMS (8:30)

FRIDAY 9

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