

Its a virtuous country in a wicked world.

Canada's LEI (Apr) a better than expected 0.9% m/m.

Canada's leading indicators for the month of April was better than expected at 0.9% m/m, besting the market median at 0.7% and our own slightly more pessimistic forecast for 0.6% m/m. Typically a third tier number on a good day, current events have crowded the field and sent the LEI straight to DVD. Still, the number falls in line with that impression of Canada as a virtuous country in a wicked world...or at the very least, a good news story in a news stream full of woe.

Underneath the headlines, the bulk of the surprise came in the durable goods new orders category which continued to post positive growth, albeit modest (+0.2% m/m), despite significant gains in the previous two months. In April, we had expected to see some of this strength from previous months dissipate.

Looking for the Canadian housing market to come off the boil? Look no further than the LEI housing market index. From June to December 2009, the housing index was averaging a rate of growth of 4.6% m/m. Year to date, the index is averaging monthly gains of 1.0% m/m. Still strong and brag worthy, but a significant decline in the second derivative (rate of change). For March and April, the rate of growth dipped to 0.1% m/m and 0.8% m/m respectively.

While this is a sizeable deceleration in the rate of growth, the month over month changes are standing on top of a mountain of pre-existing activity. In absolute terms, home resale activity continues to run at or near to historical highs while housing starts are sitting at cyclical highs. Most including ourselves are looking for housing sector activity to moderate significantly on the back of both administrative and tax changes along with the higher interest rates expected to flow from monetary policy.

In other areas of the report, stocks were a big contributor to the index, gaining 1.3% m/m. Retail trade furniture and appliances strong, rising 1.1% m/m, although in the other durables category, sales softened dropping -0.7% m/m.

Markets continue to wrestle with the June 1 BoC rate meeting with the current pricing profile looking at the potential for a 25bp rate hike as a 50/50 proposition. Was not that long ago that the market was pricing towards the potential for a 50bp rate hike on June 1. Unfortunately there is little in the way of policy salient information in this report - more filler than form - to provide direction for those tasked with pricing the cost of money. For Canada, we would suggest remaining focused on the fundamentals. A few of which are listed here.

I) Canada's main point of economic attachment remains the US economy - an economy that has continued to outperform EU economies and throw off its fair share of upside economic surprises. II) The Canadian economy is performing well ahead of plan, throwing off sizeable growth rates in Q4/09 (+5.0% q/q ann.) along with the expectation for and equally impressive Q1/10 GDP report on May 31. III) The growth profile, while not ideal, has been better balanced than is the case in the US GDP that leans heavily on the positive contribution associated with changes in inventory. IV) the current monetary policy profile continues to encourage consumer consumption of debt to their own detriment. In the absence of any move to change the rate structure, the BoC threatens to further destabilize the Canadian consumer's household balance sheet. Money is cheap and when a good is cheap the tendency in a market clearing model is to consume more of it. With overnight rates at 0.25% there is virtually no financial incentive to save. V) Finally, while we don't fear a breakout of inflation in Canada (the collective historical experience of the last 24 months has taught one and all, that a benign inflation environment is not a free pass to

maximizing rates policy) the BoC may have become concerned about the findings of their business outlook survey that saw the 2-year inflation expectations of a sizeable cluster of respondents gravitate from 1 - 2% on into the 2 - 3% range which forms the upper end of the BoC's operational inflation band of 1 - 3%. Again, we would tend to play down this move as the survey coincided with a sizeable pick up in gasoline prices.

None the less, changes in the inflation expectations component of the BoC business outlook survey have tended to dovetail rather nicely with changes in monetary policy. Beyond the market story, there is a fundamental story that supports a BoC move to raise rates by 25bps. To date, a Bloomberg survey of rate forecasts shows 12 of 12 respondents looking for a 25bp rate hike on June 1st which would push the overnight rate up to 0.50%. HSBC is also forecasting a rate hike of 25bps on June 1st.

Disclosure appendix

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