

2011

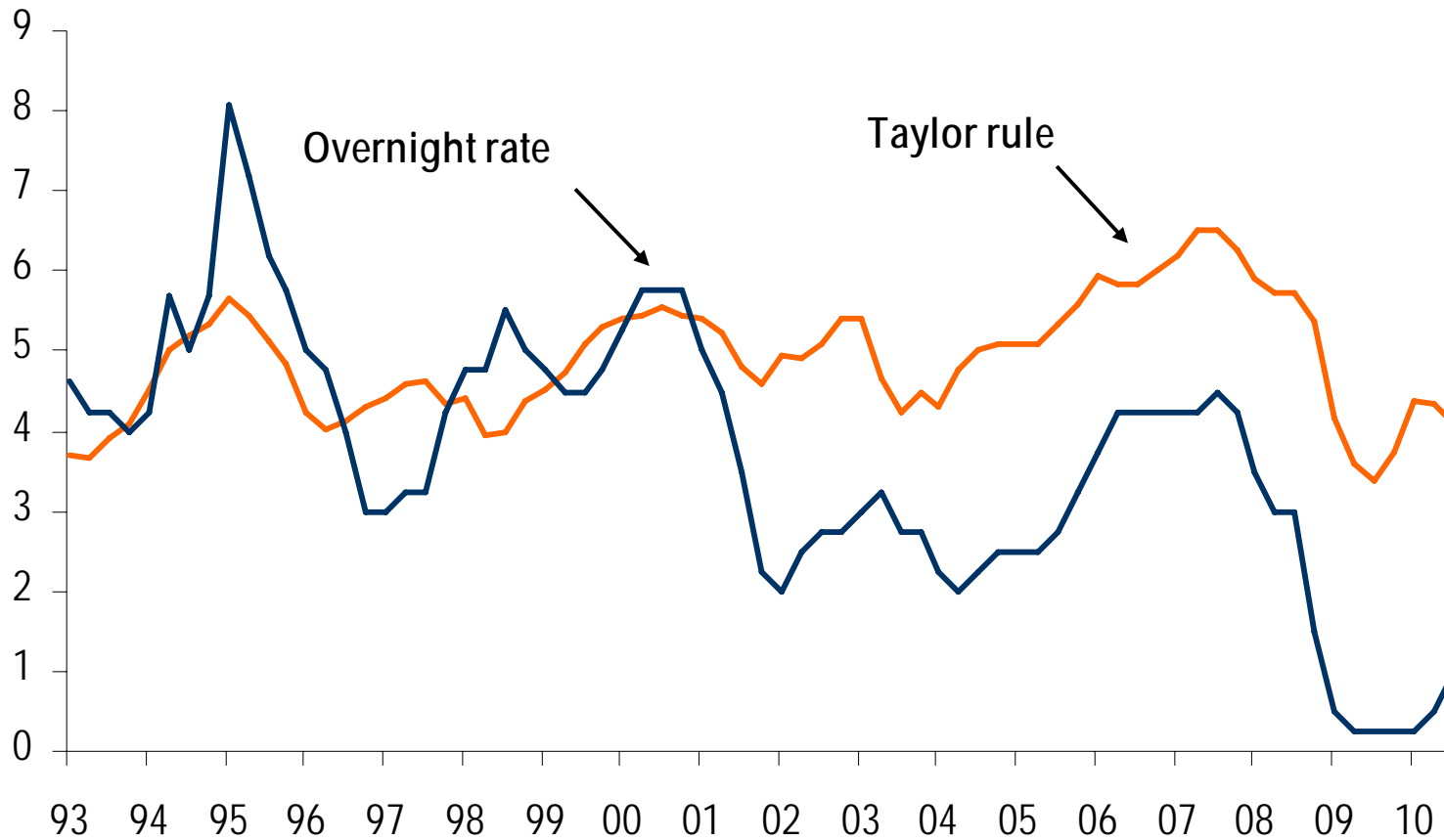
The Rise of the Machines

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Bank Employs (US-Style) Emergency Monetary Policy...

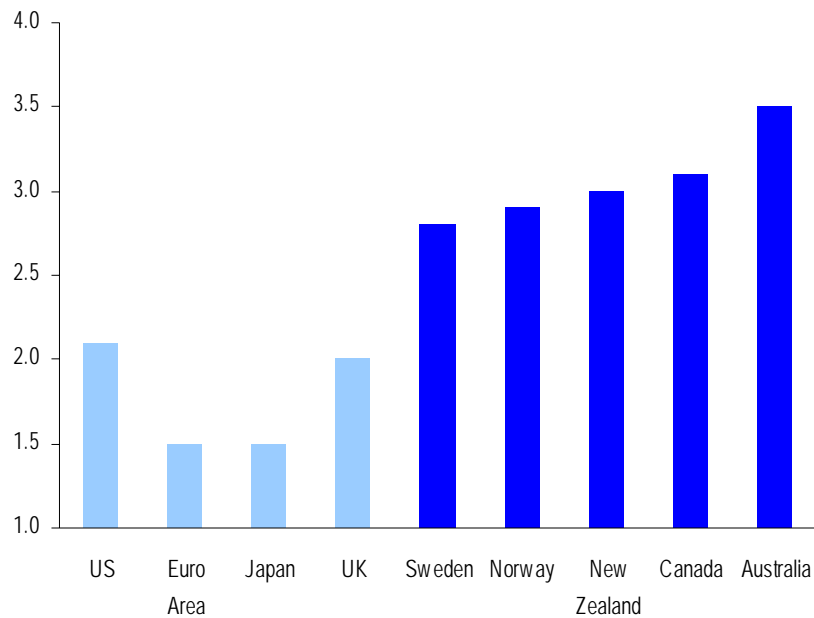
(Percent)



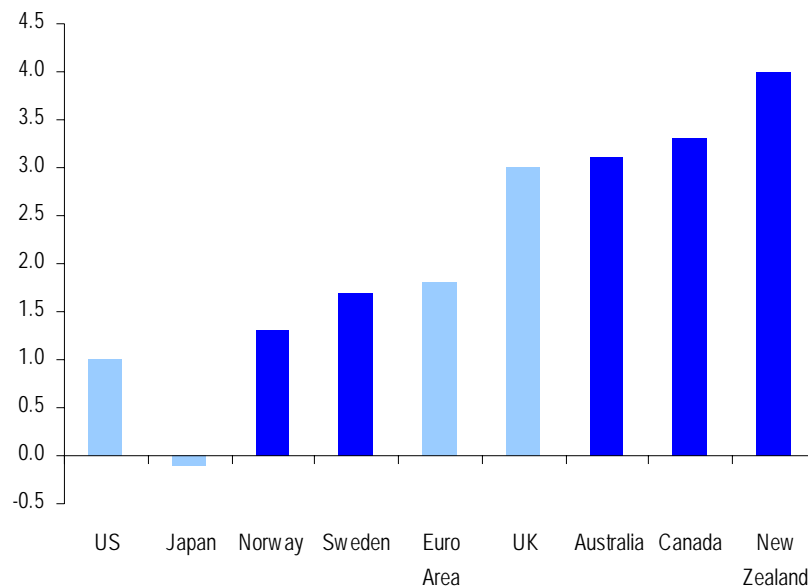
Source: Bank of Canada, Haver Analytics, BofA Merrill Lynch Global Research

The New DM Growth Leaders

2011 GDP forecast



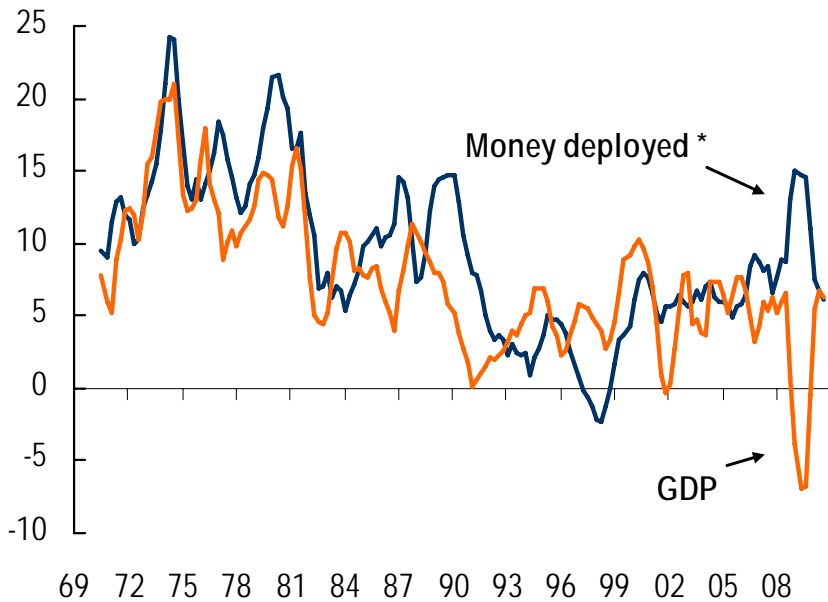
2011 CPI forecast



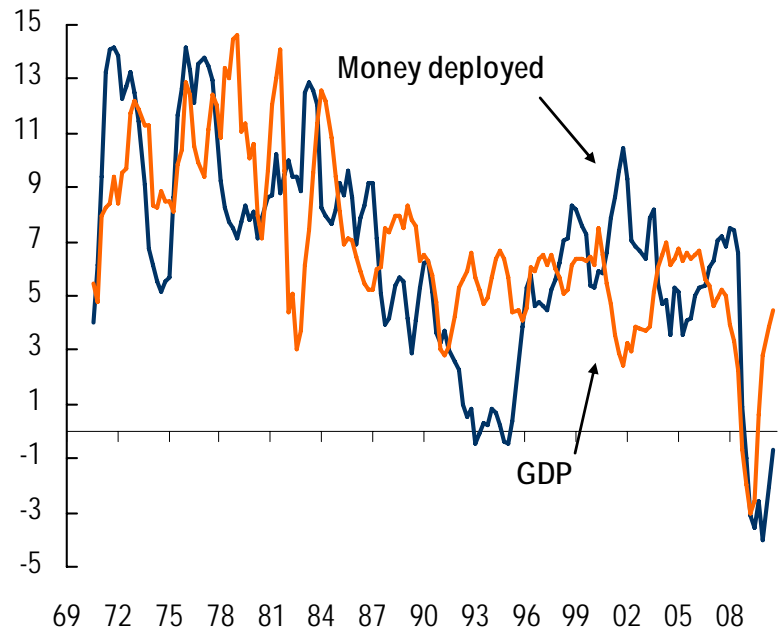
...Creating Money

Money multiplier and the economy
(Year over year percent)

Canada



United States

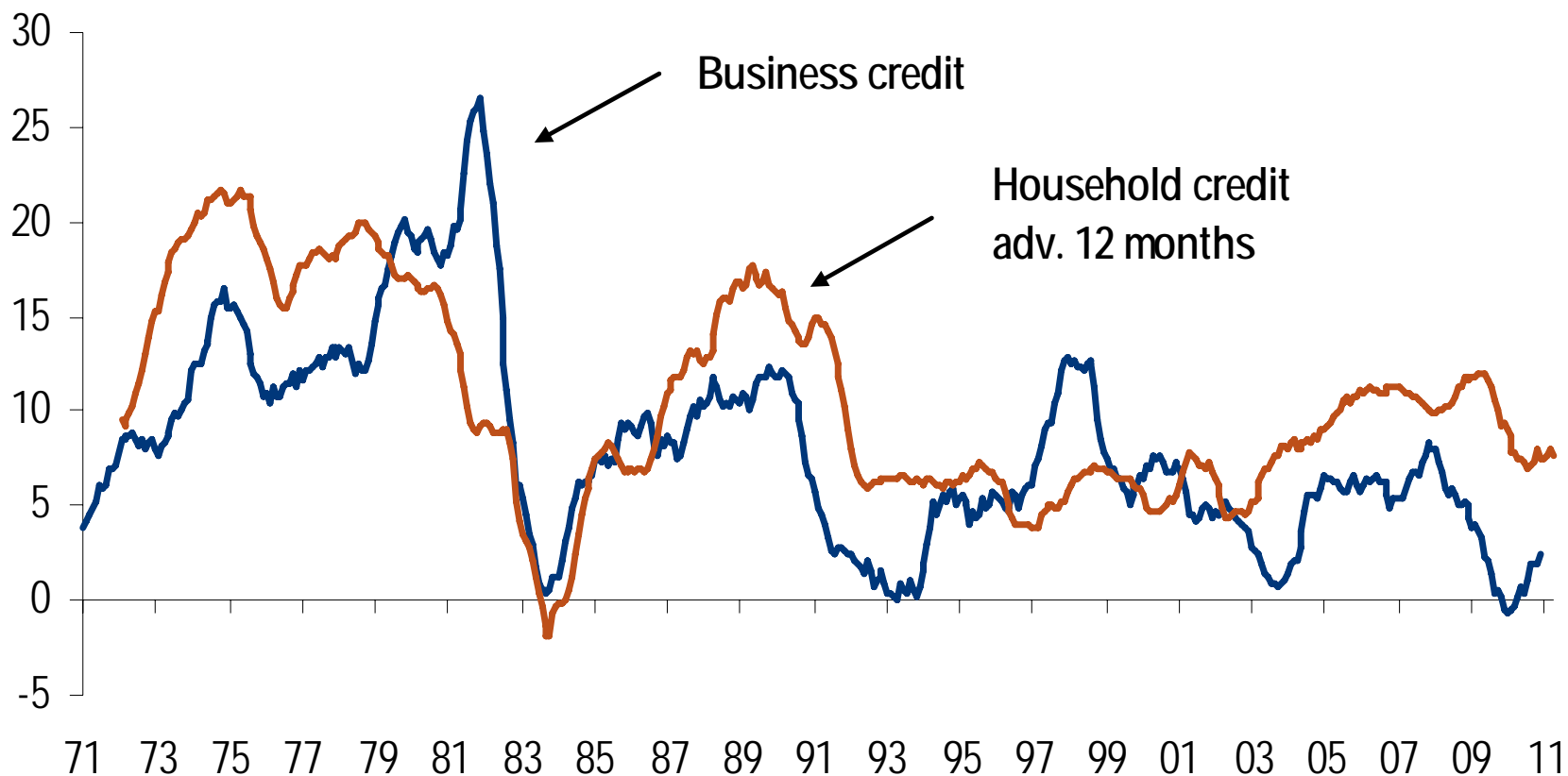


*Money deployed = M2 - monetary base

Source: Haver Analytics, BofA Merrill Lynch Global Research

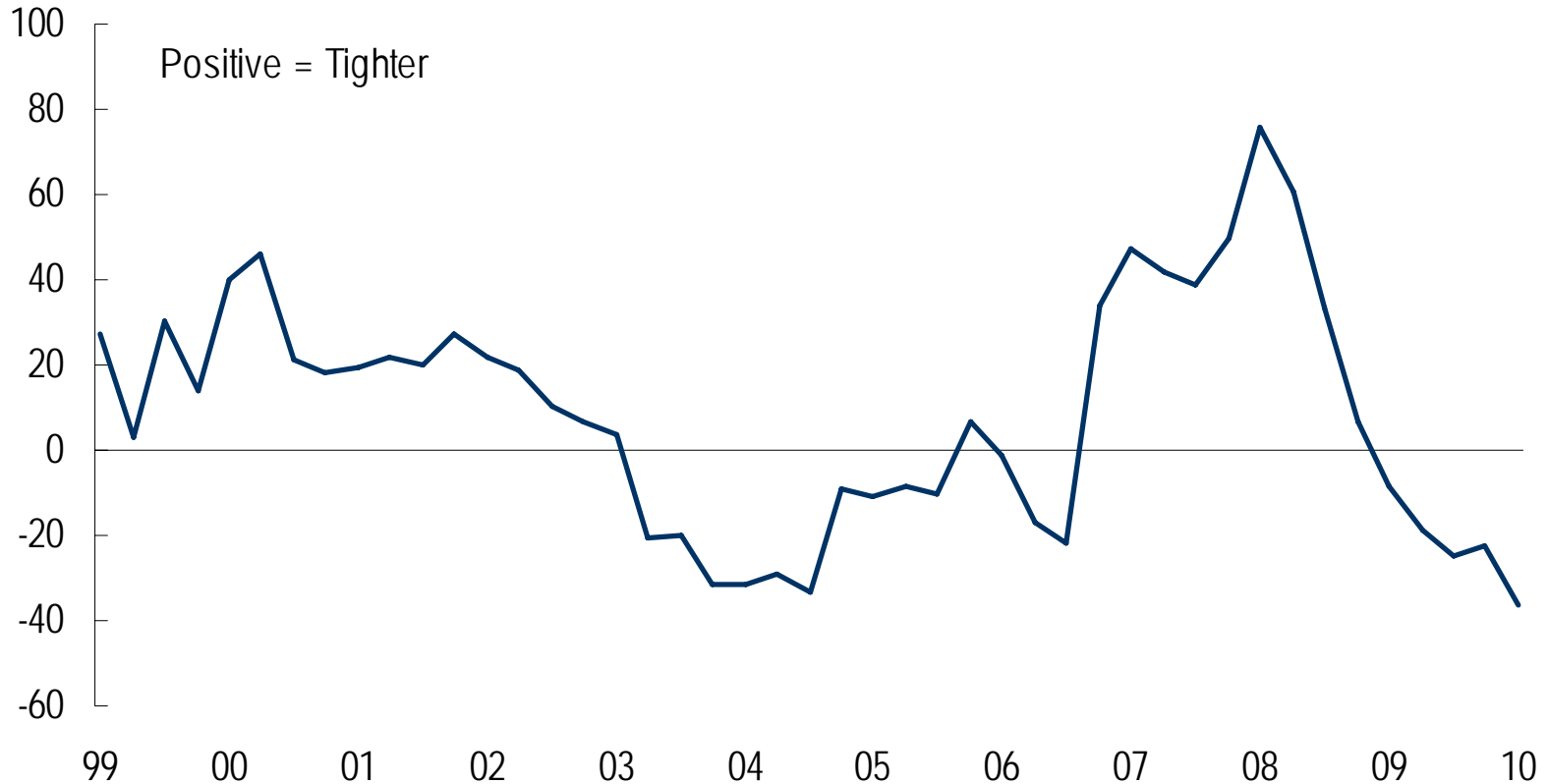
...And Credit

Household and business credit cycles
(y/y percent)



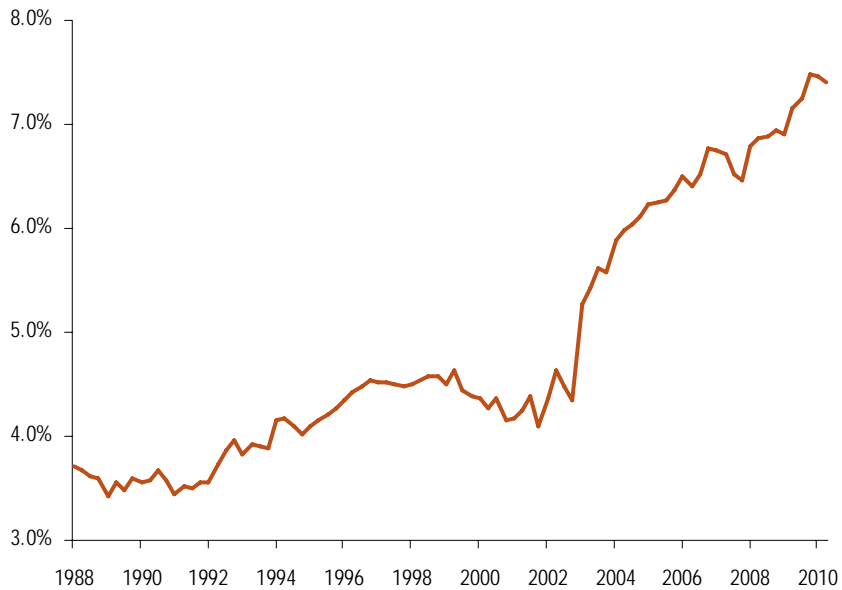
Lending Standards Easing

Senior Loan Officer Survey, Balance of opinion, % tightening vs. easing lending standards



Corporate balance sheet is strong

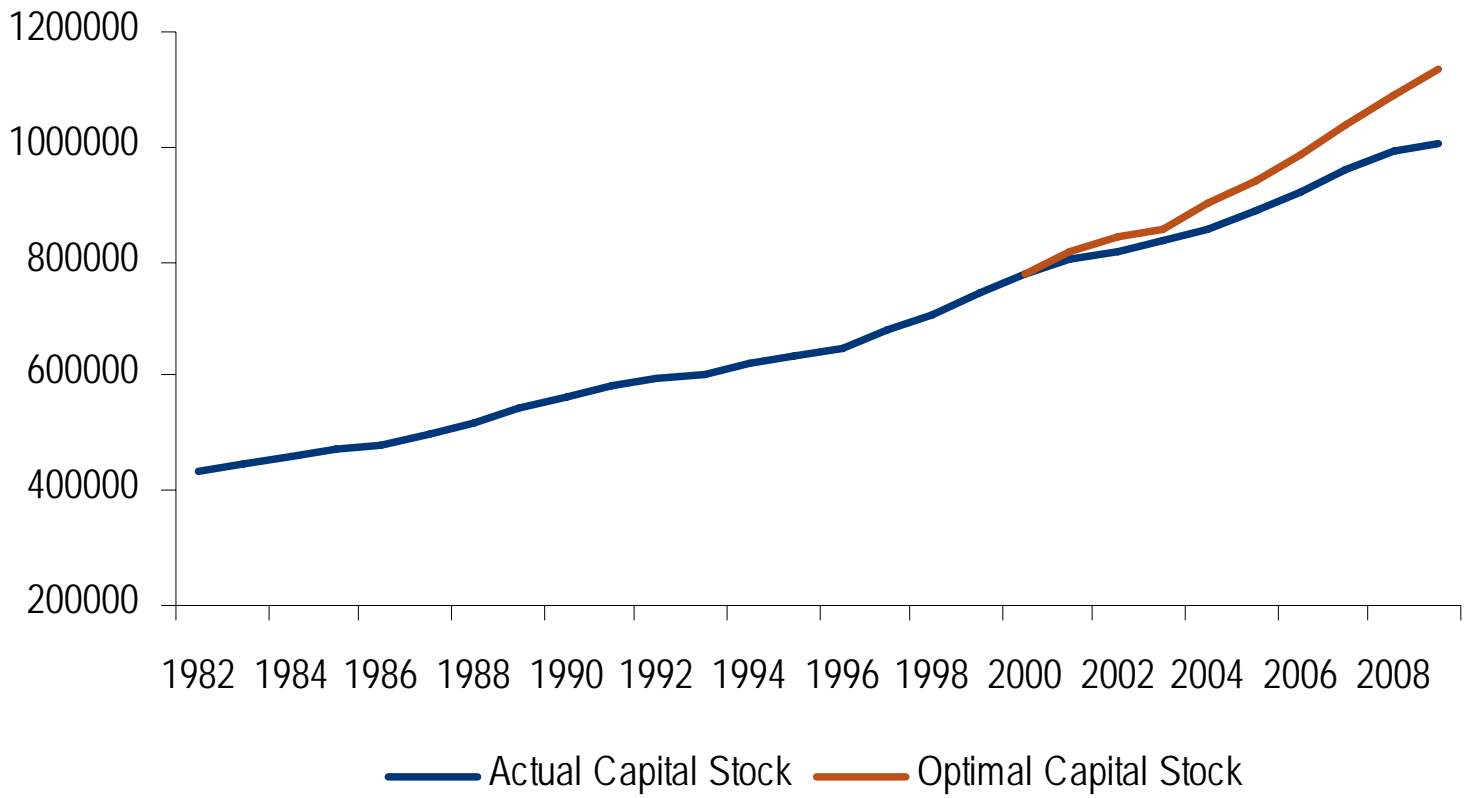
Cash as percent of total assets



Cost of debt at record low (after-tax)

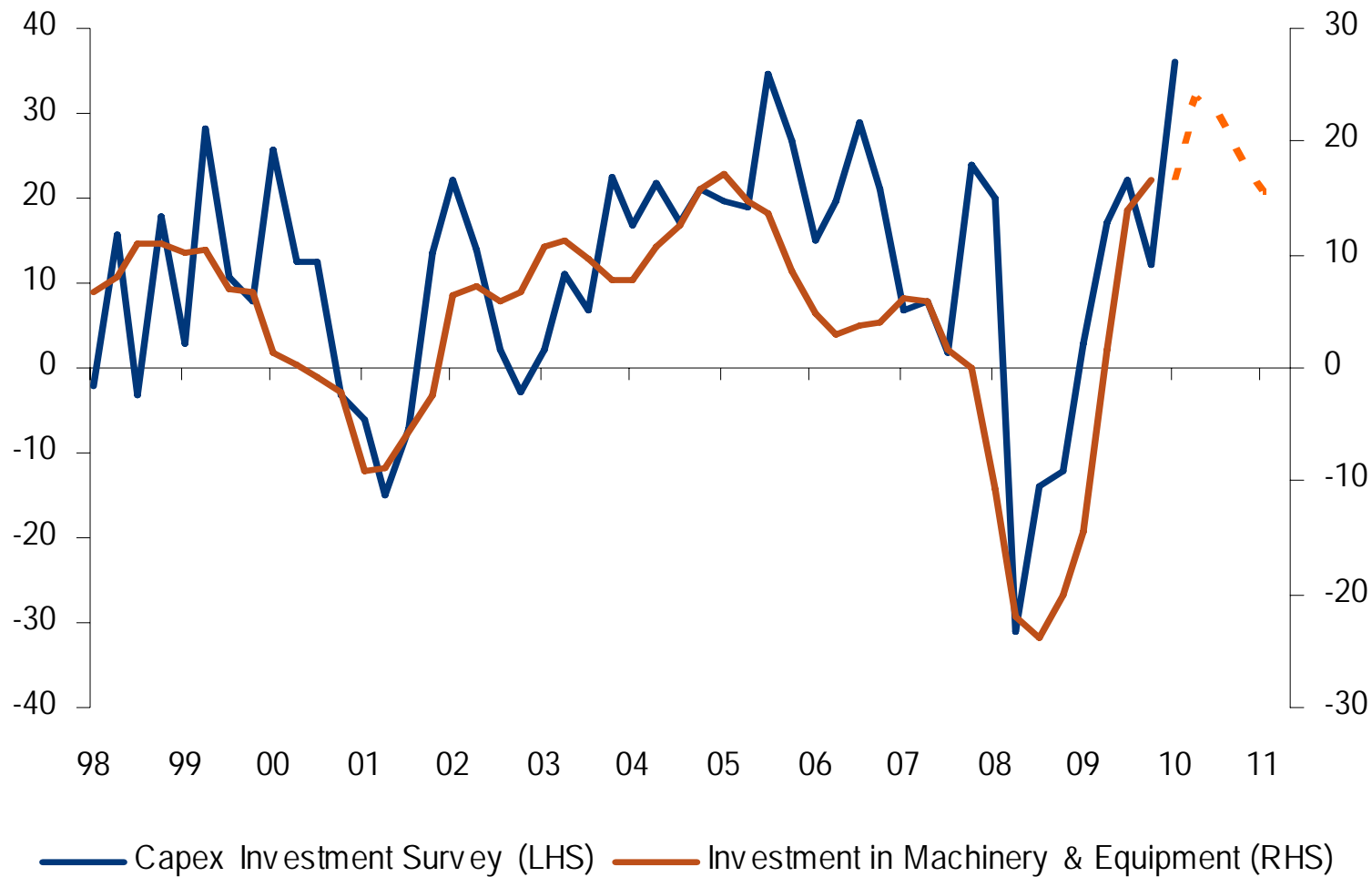


Businesses under-investing



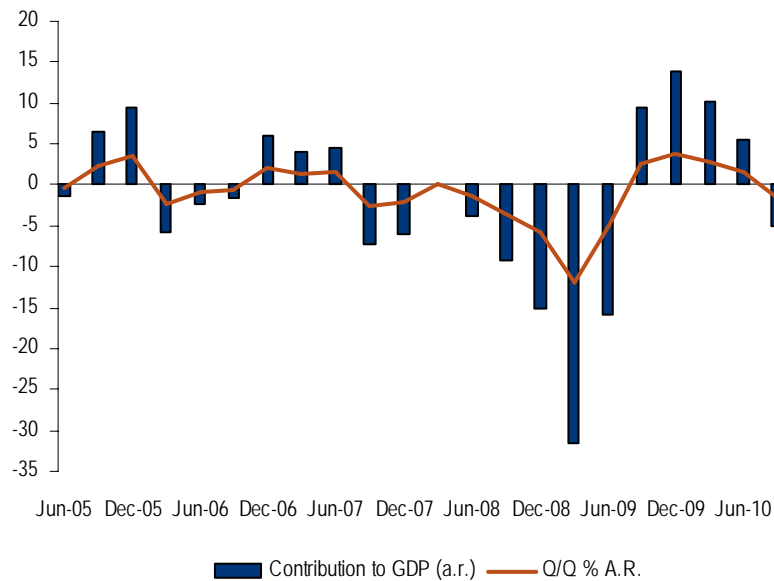
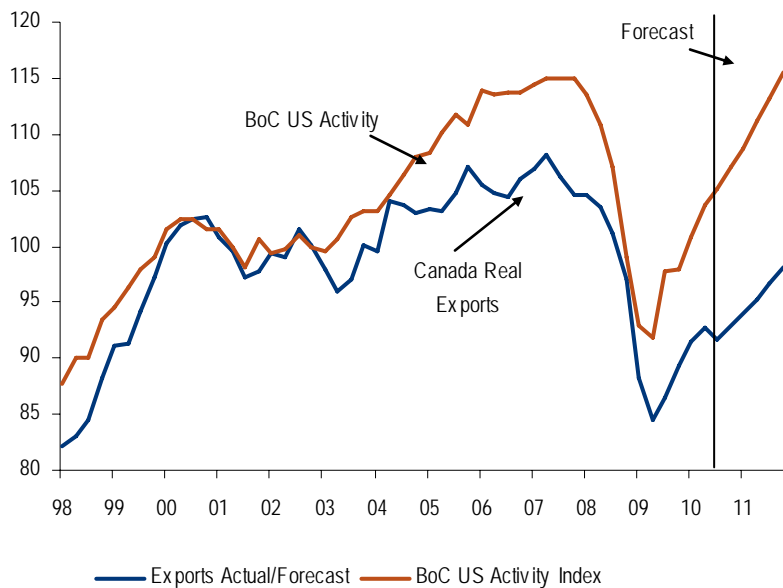
Source: Statistics Canada, BofA Merrill Lynch Global Research

Capital spending ready to lift off



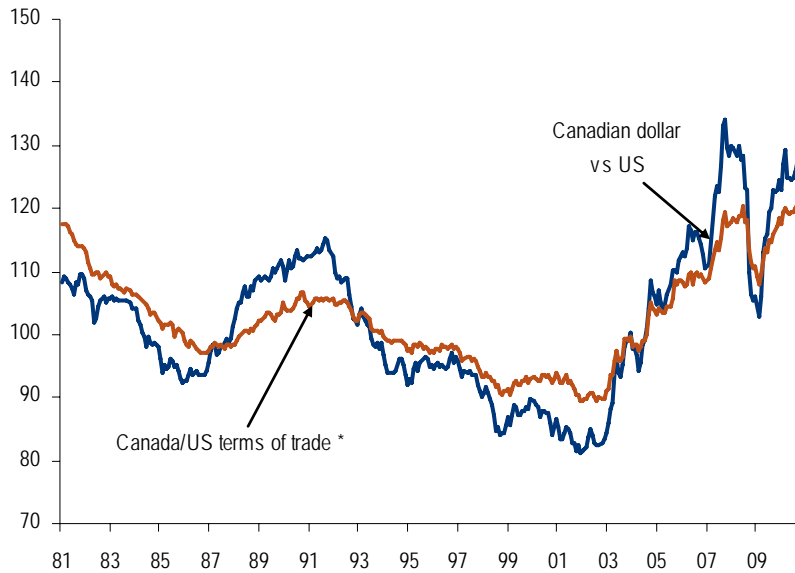
Source: Statistics Canada, BofA Merrill Lynch Global Research

Exports: Made in the USA

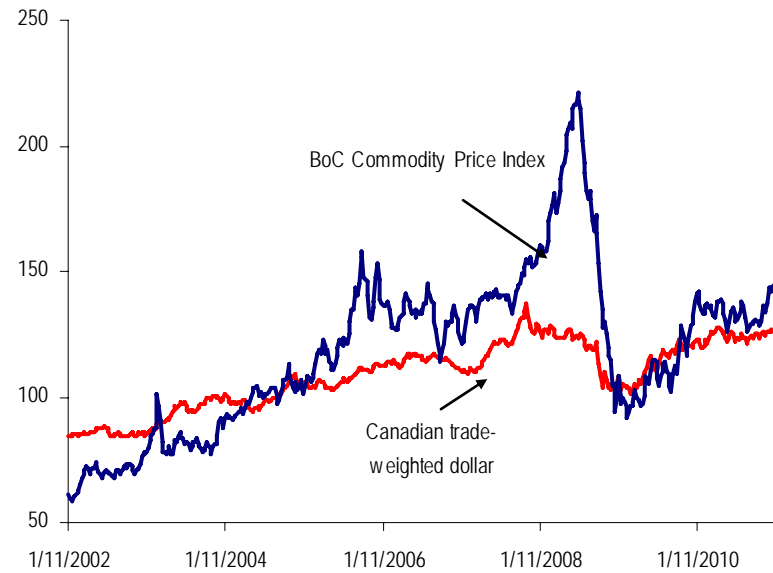


CAD In Line With Terms Of Trade

ToT on Finished Goods *
(2002=100)



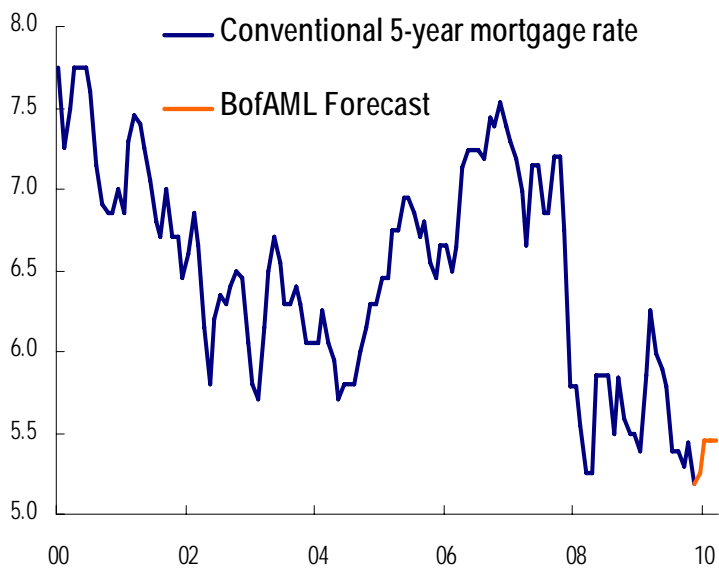
Commodities **
(2002=100)



*Ratio of US-to-Canada Industrial Product Price Index, finished goods. ** Bank of Canada commodity price index
Source: Haver Analytics, BofA Merrill Lynch Global Research

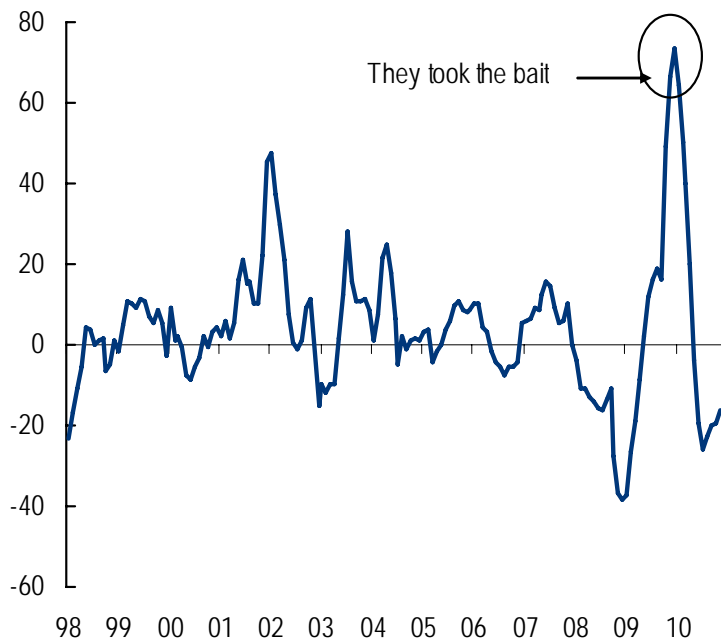
Homes Affordable

The cost of buying a new home
(percent)

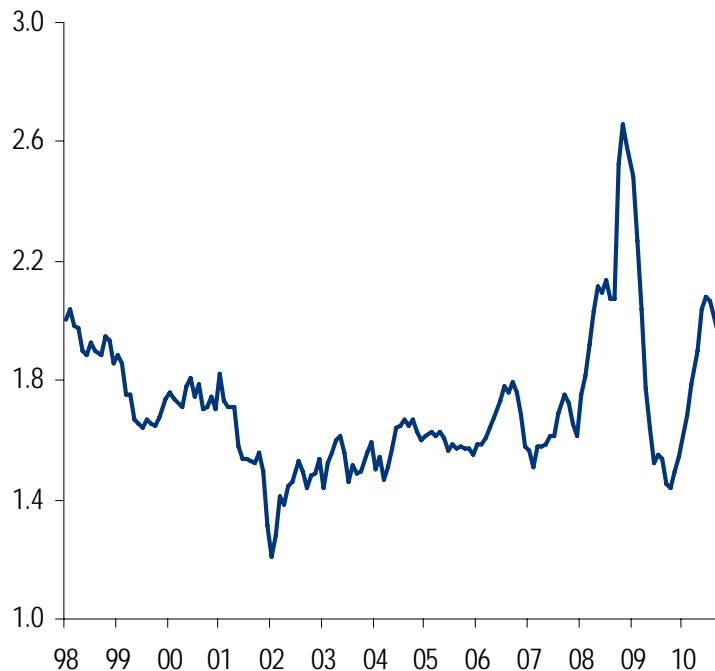


It worked!

Unit Home Sales (Y/Y Percent)

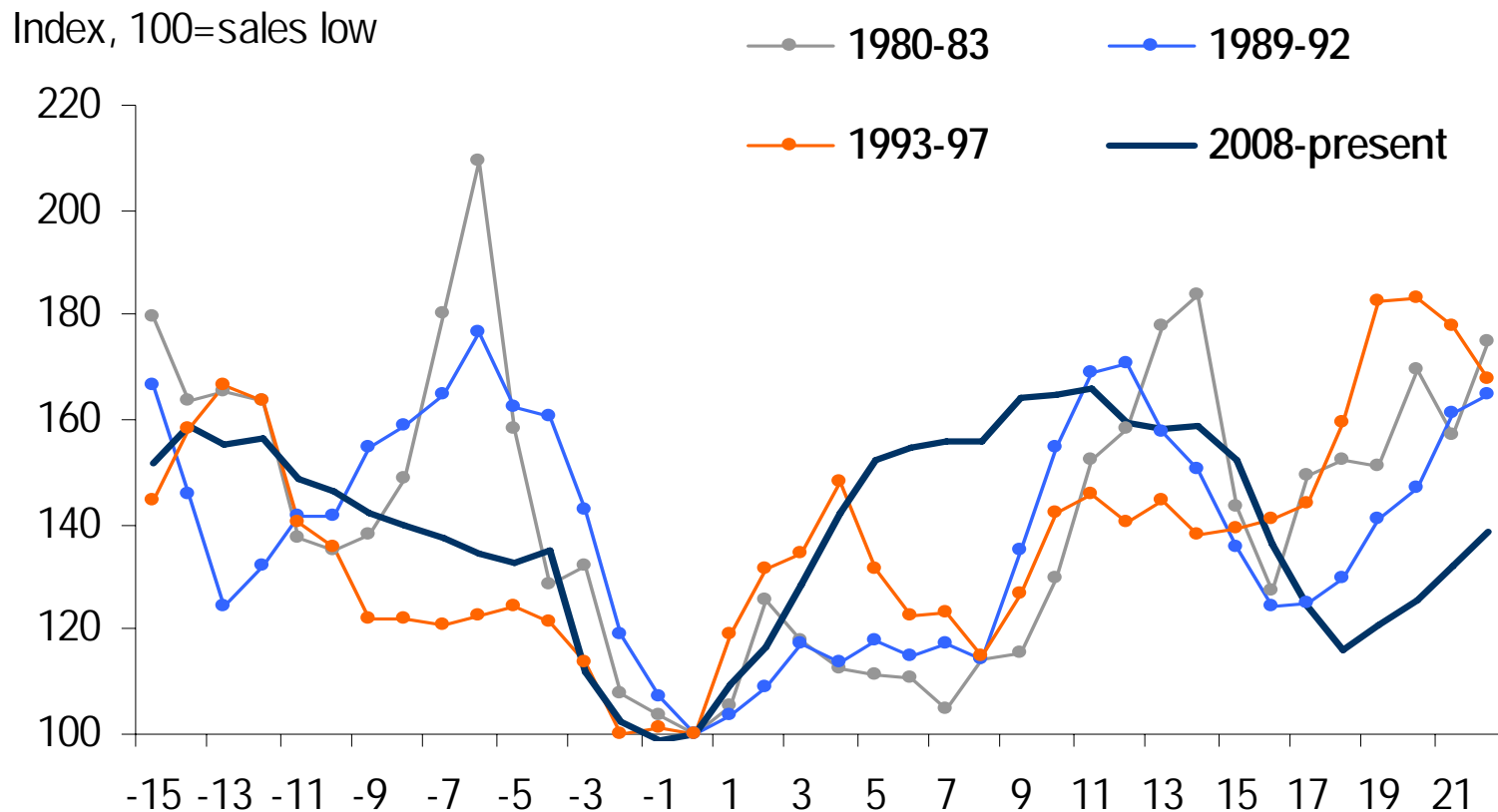


Listings To Sales



Housing extension

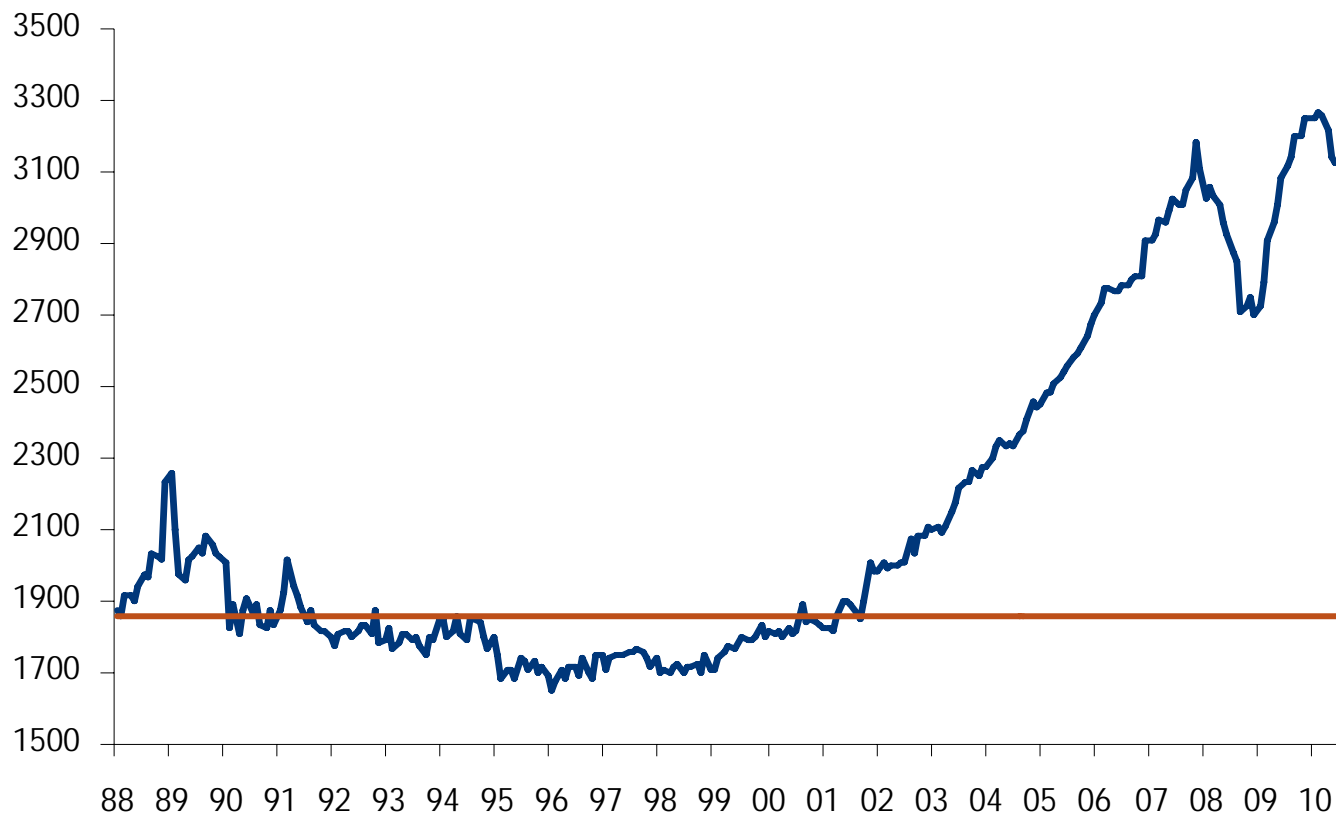
Existing home sales
(cycle trough occurs at 0-mark on X-axis)



Source: CREA, BofA Merrill Lynch Global Research

Housing Looking Bubbly

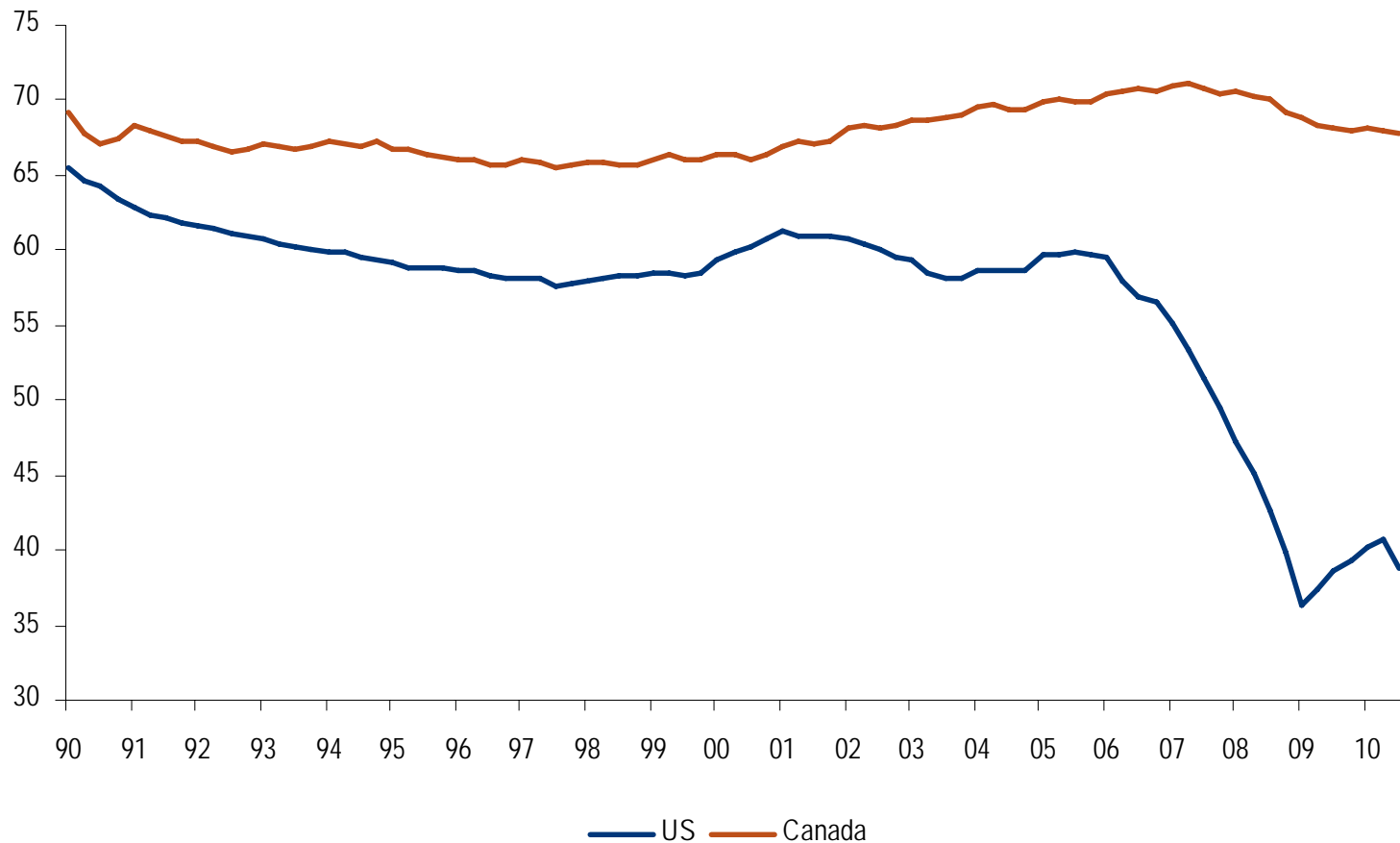
CREA Average home price to CPI rent



Source: CREA, Stats Canada, Haver Analytics, BofA Merrill Lynch Global Research

Lots of Equity Cushion

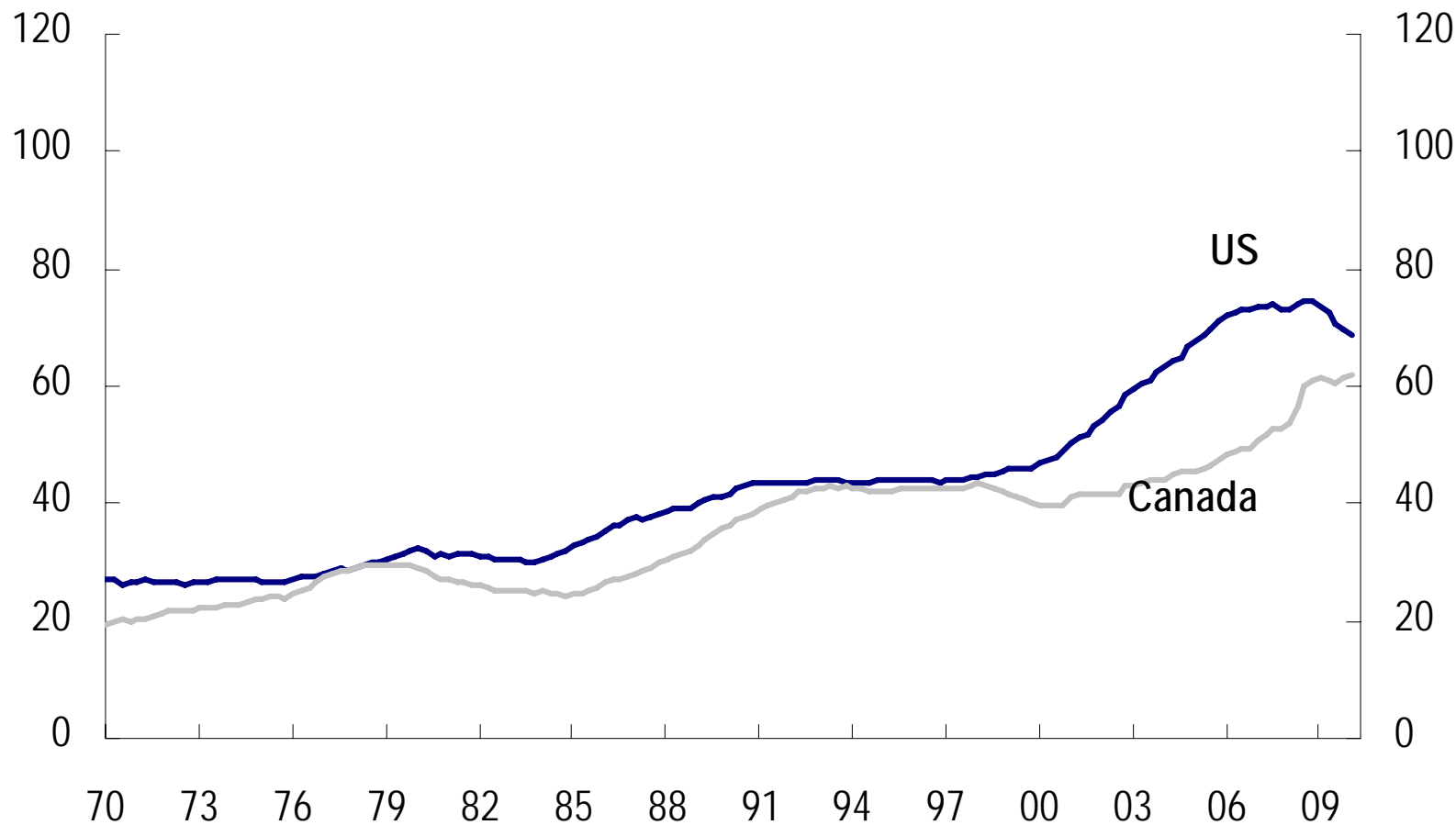
Owners Equity as a percent of Household Real Estate



Source: Statistics Canada, Federal Reserve, BofA Merrill Lynch Global Research

Mortgage Debt Low...

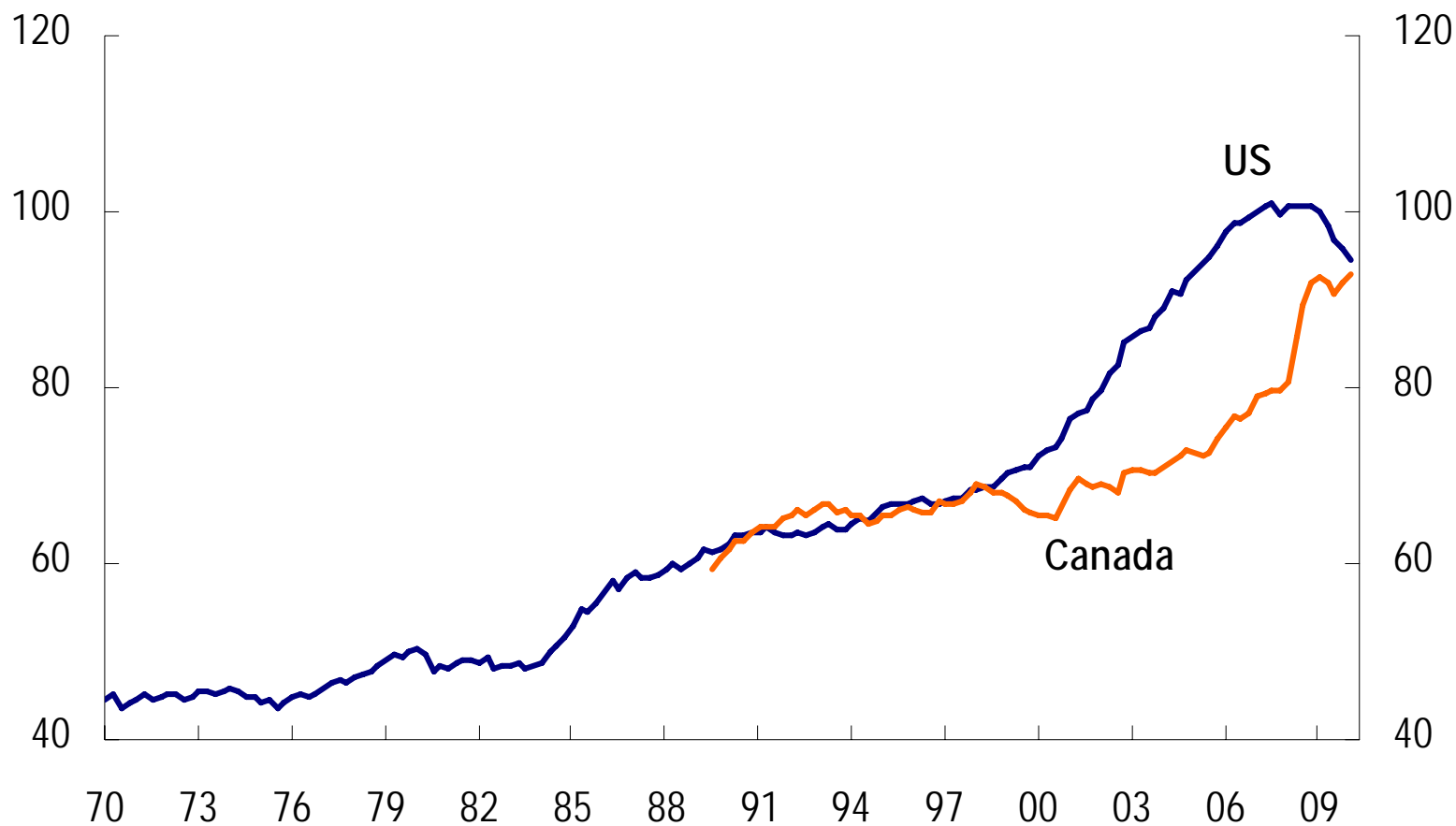
Household mortgage debt percent of GDP



Source: Statistics Canada, Federal Reserve, BofA Merrill Lynch Global Research

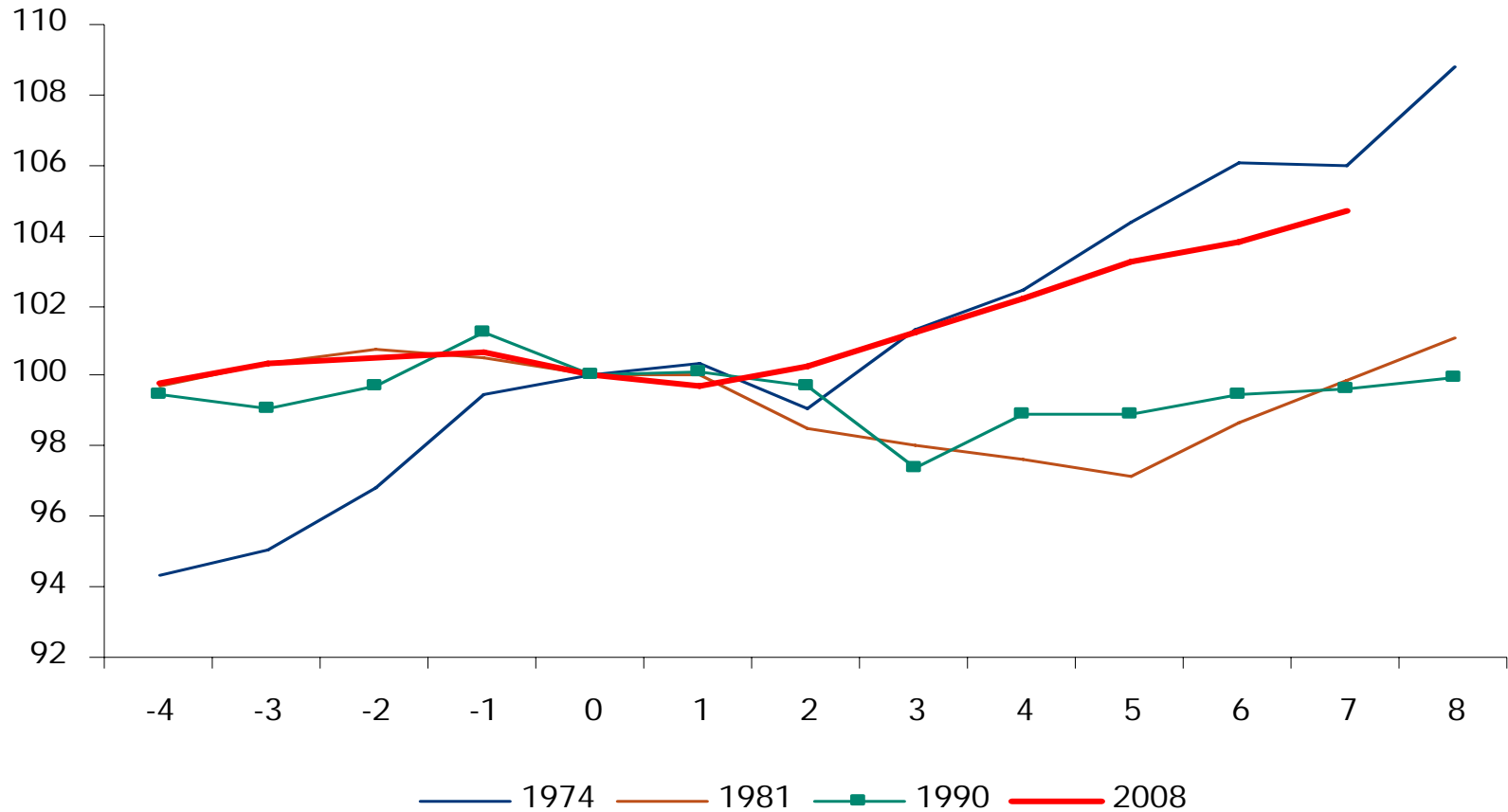
...We're No Angels

Total household debt
(Percent of GDP)



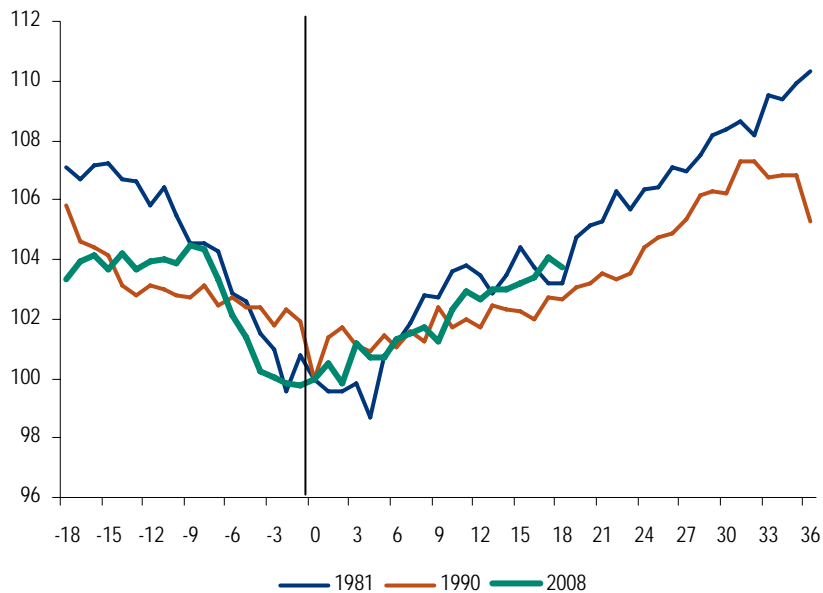
Not a Consumer Recession

Consumer spending
(Start of recession = 100)

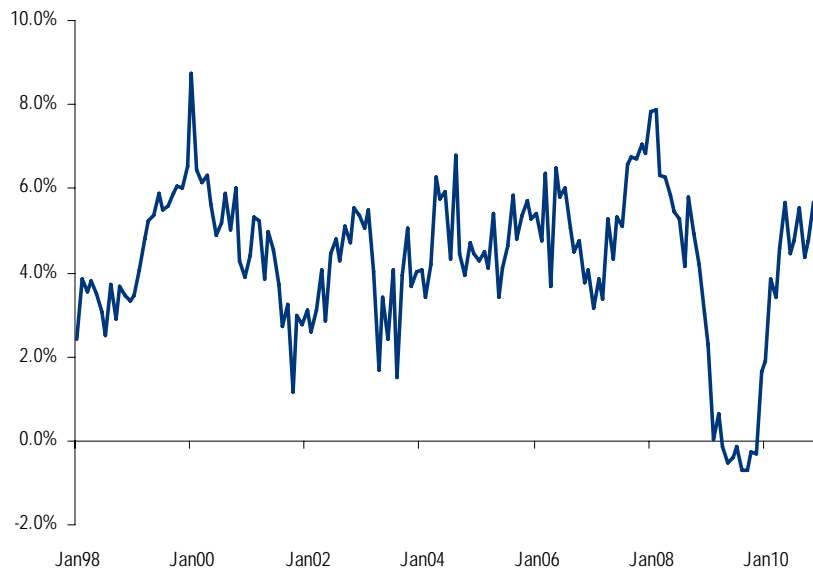


Income growth normalizes

Total hours worked

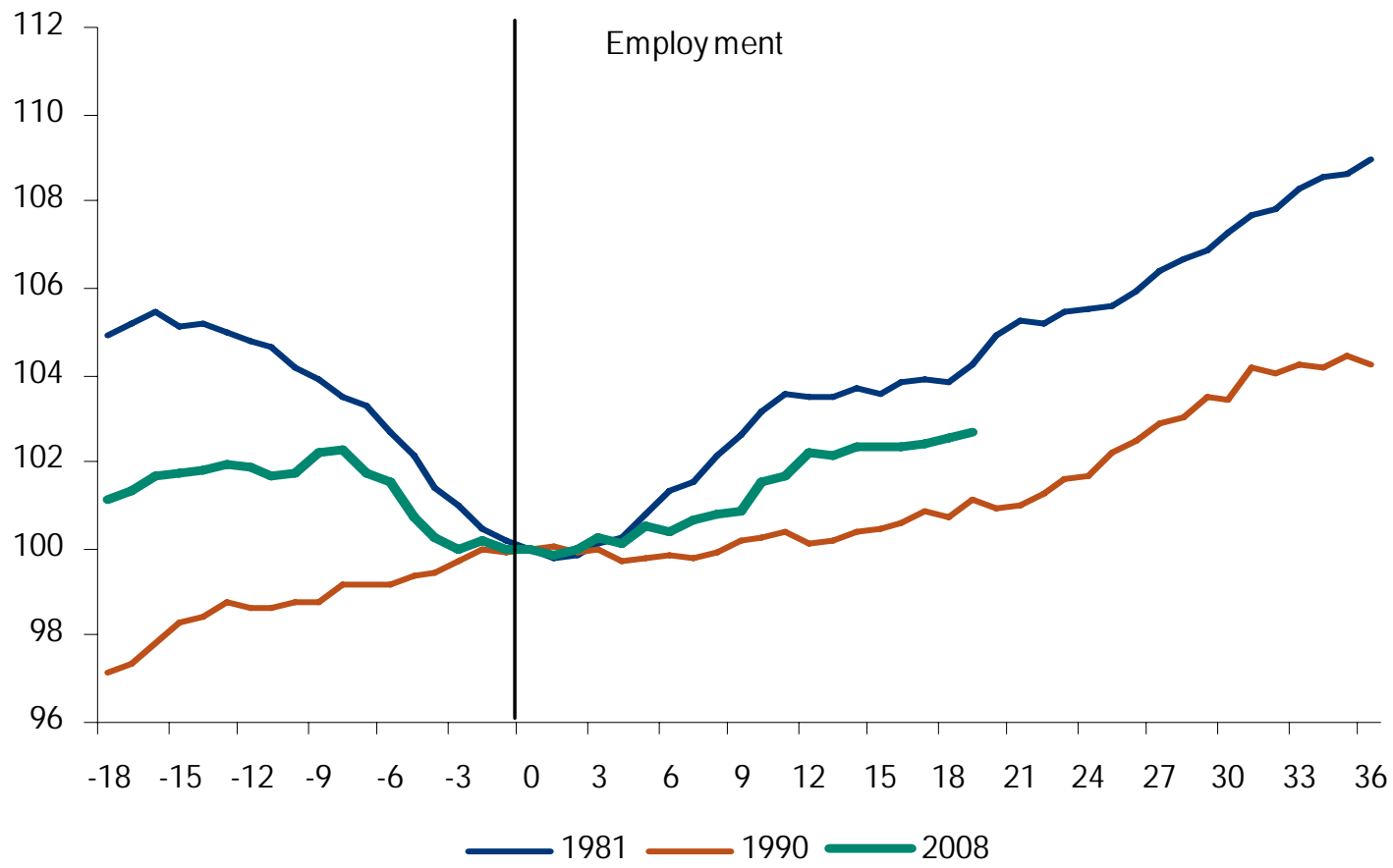


Wage income



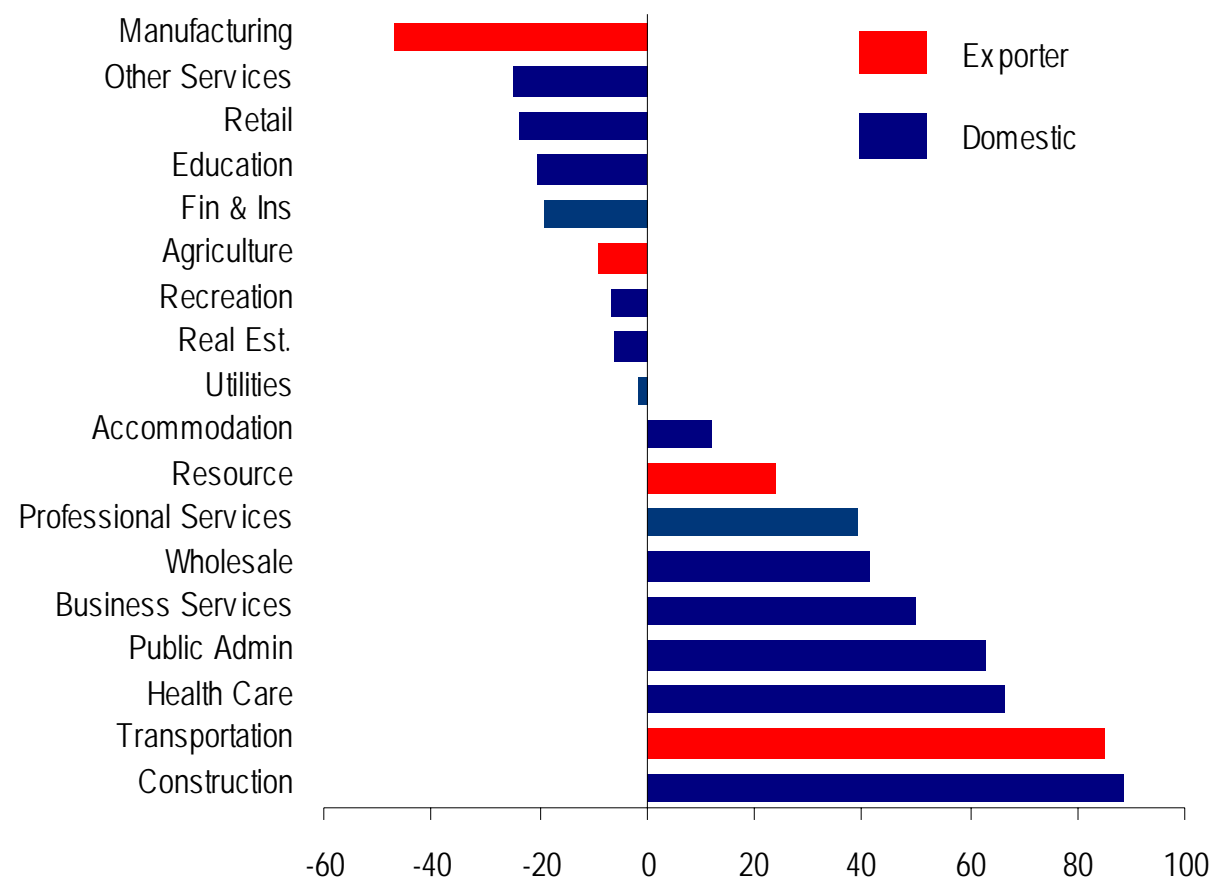
Hiring Snaps Back

100 = Recession trough



Where The Jobs Are

Change in employment over past 12 months (thousand of jobs)



Source: Statistics Canada, BofA Merrill Lynch Global Research

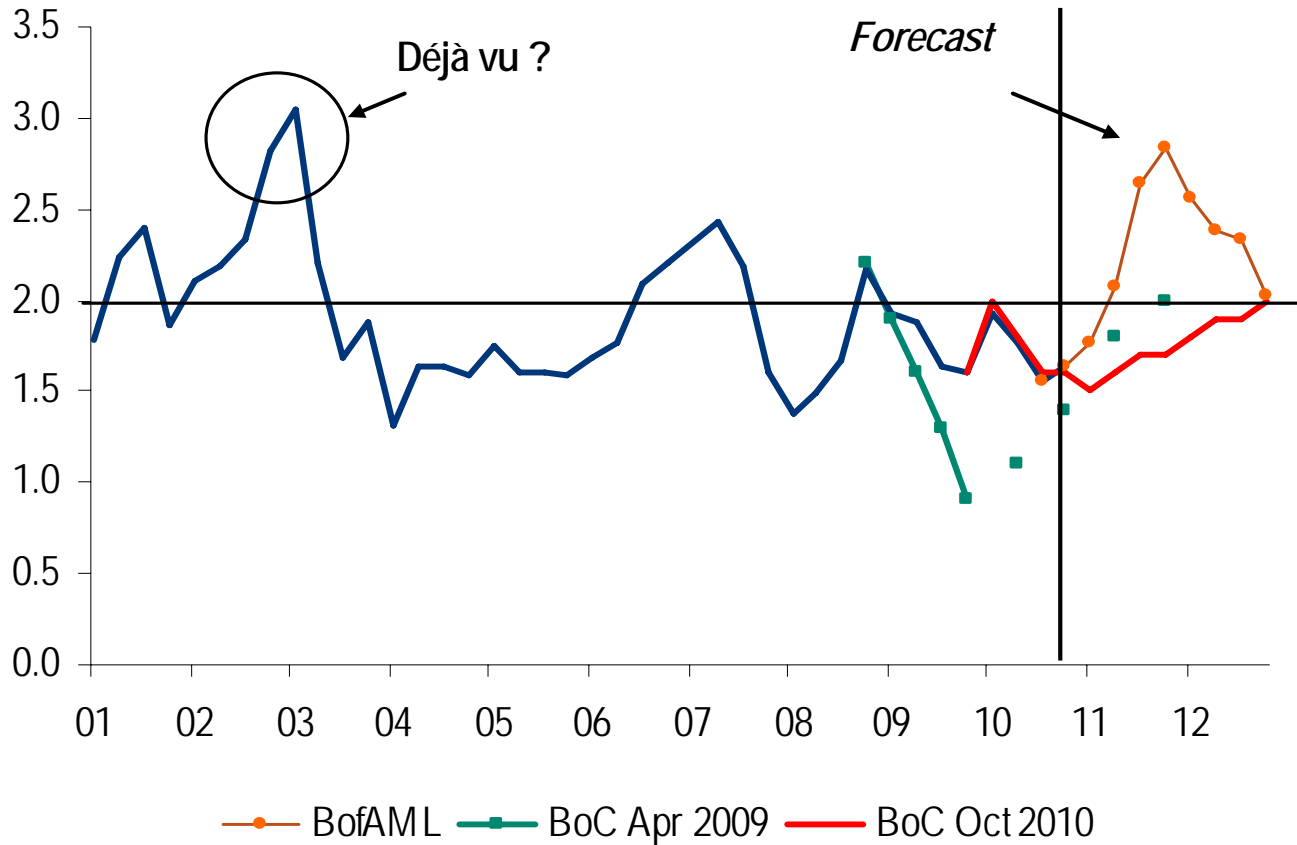
From ZIRP to AZIRP *

Where To Now?

“Reflecting all of these factors, the Bank has decided to maintain the target for the overnight rate at 1 per cent. This leaves considerable monetary stimulus in place, consistent with achieving the 2 per cent inflation target in an environment of significant excess supply in Canada. Any further reduction in monetary policy stimulus would need to be carefully considered.” *Bank of Canada, December 7 2010*

Hit 2%...And Keep Going

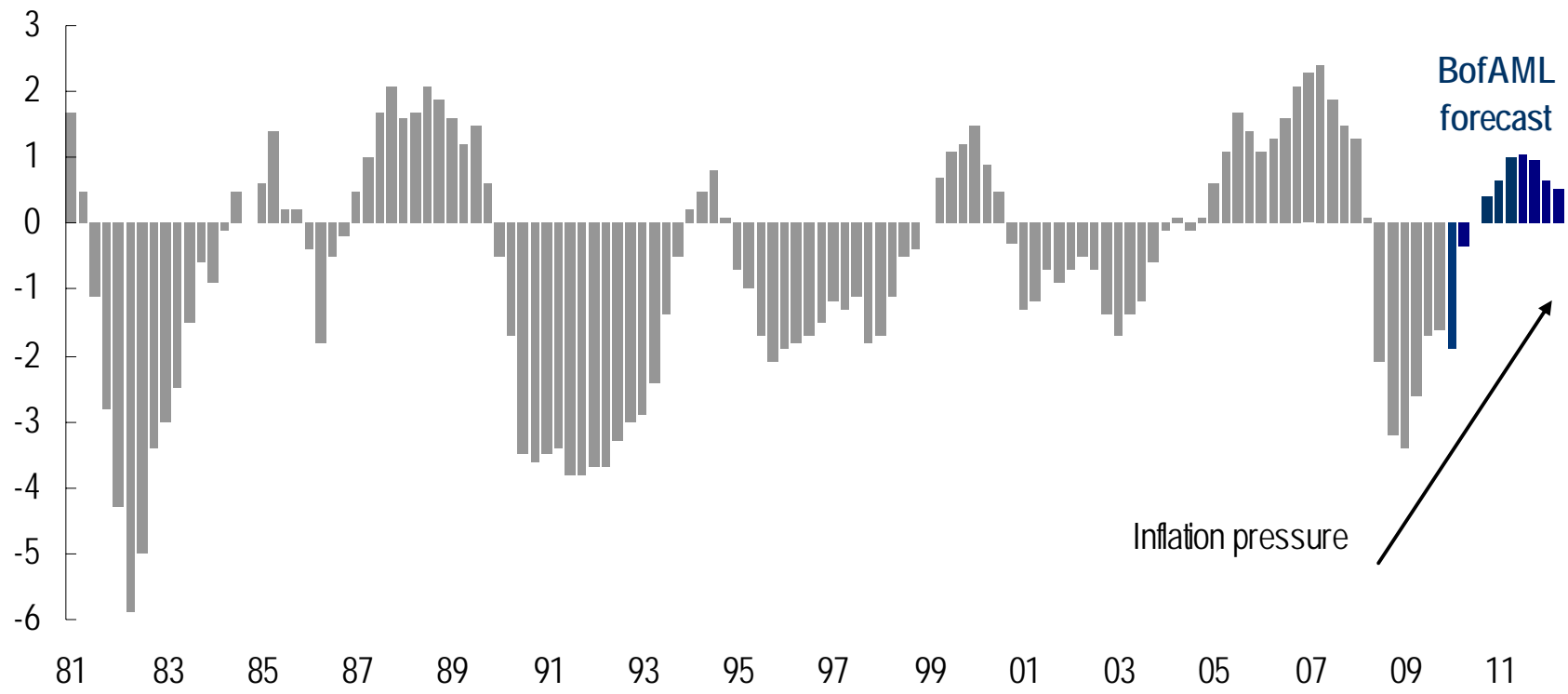
CPI excluding the 8 most volatile components & indirect taxes
(Year over year percent)



Source: Bank of Canada, Haver Analytics, BofA Merrill Lynch Global Research

Economy heads to overheating

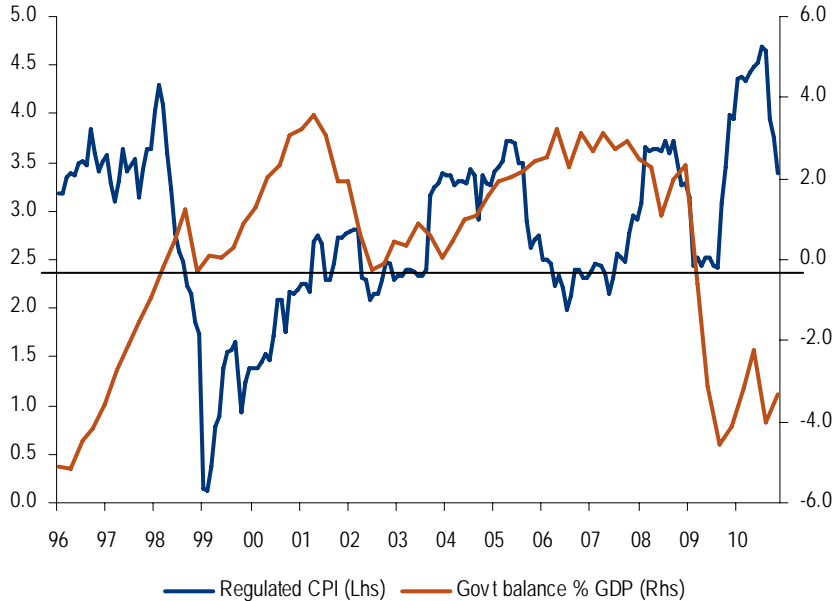
Output gap
(Actual GDP as a percent of potential GDP)



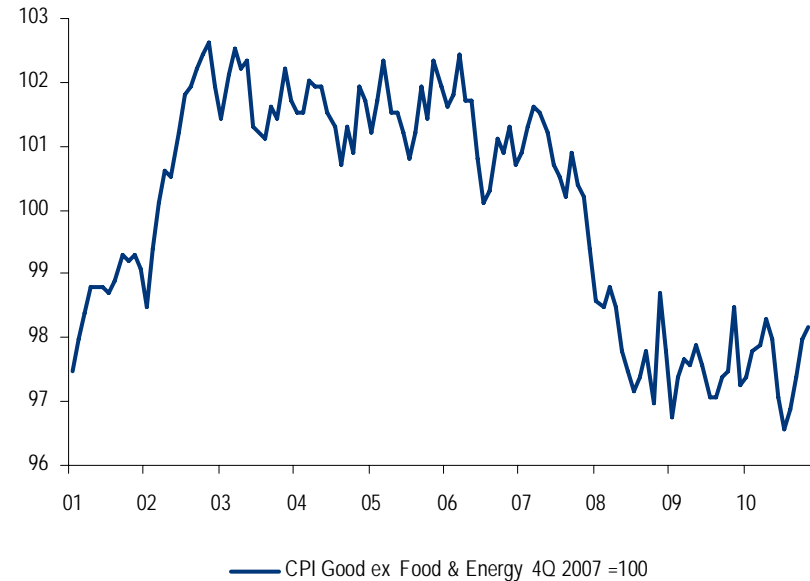
Forecast based on BofAML GDP growth estimates and Bank of Canada potential growth estimates (1.2% in 2009, 1.5% in 2010)
Source: Bank of Canada, Haver Analytics, BofA Merrill Lynch Global Research

Fees & Cross-Border Shopping Sprees

Fees Rising *



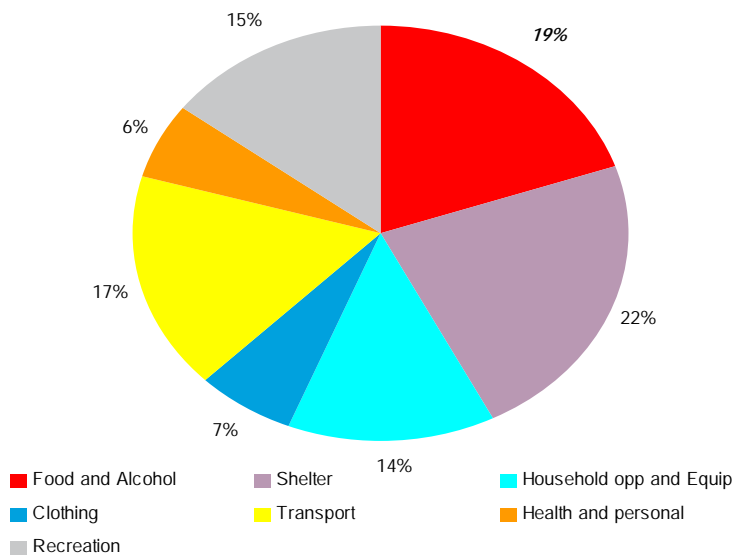
Dollar Parity Already in CPI



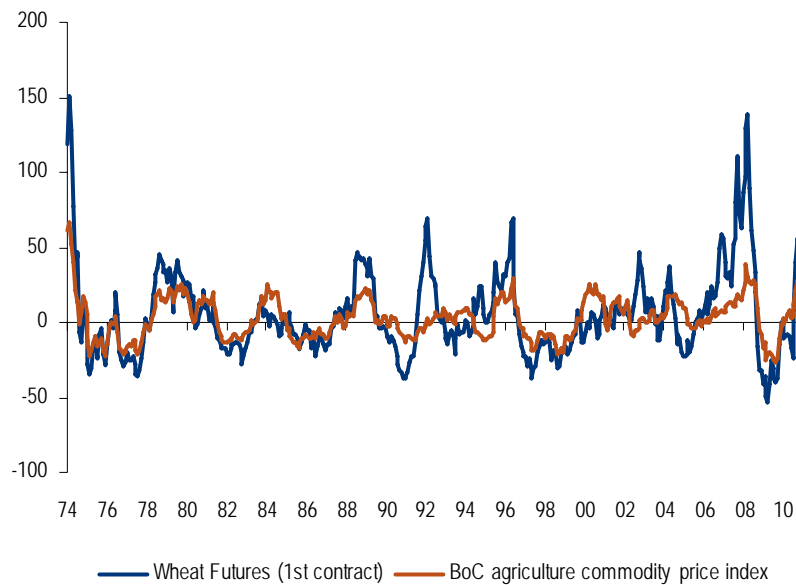
Source: Haver Analytics, BofA Merrill Lynch Global Research, * 13% of CPIX, Regulated core CPI comprises, property tax, telephone services, postal services, vehicle licenses and registration, parking, commuter transportation, health care, education.

Food fight

CPIX8 is 1/5 food

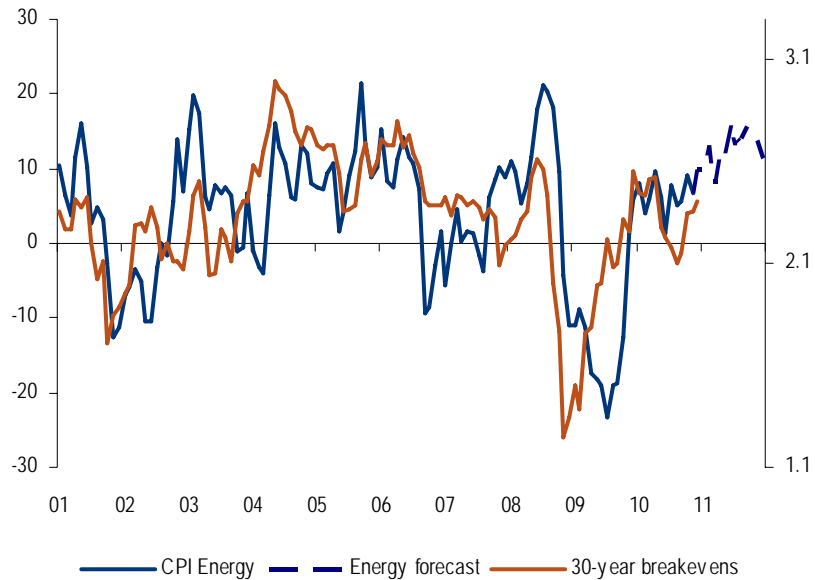


Aggs up 25% y/y

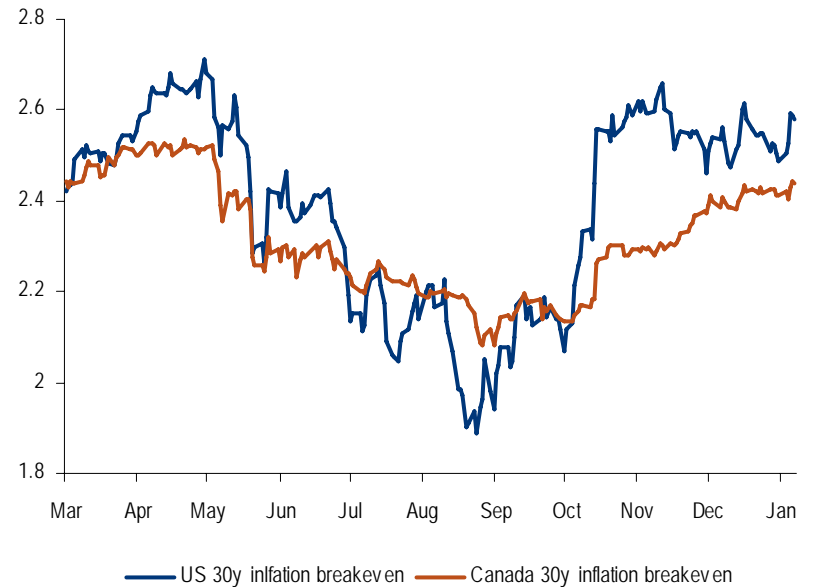


Energy prices also on the move

30-Year RRB breakeven vs CPI energy

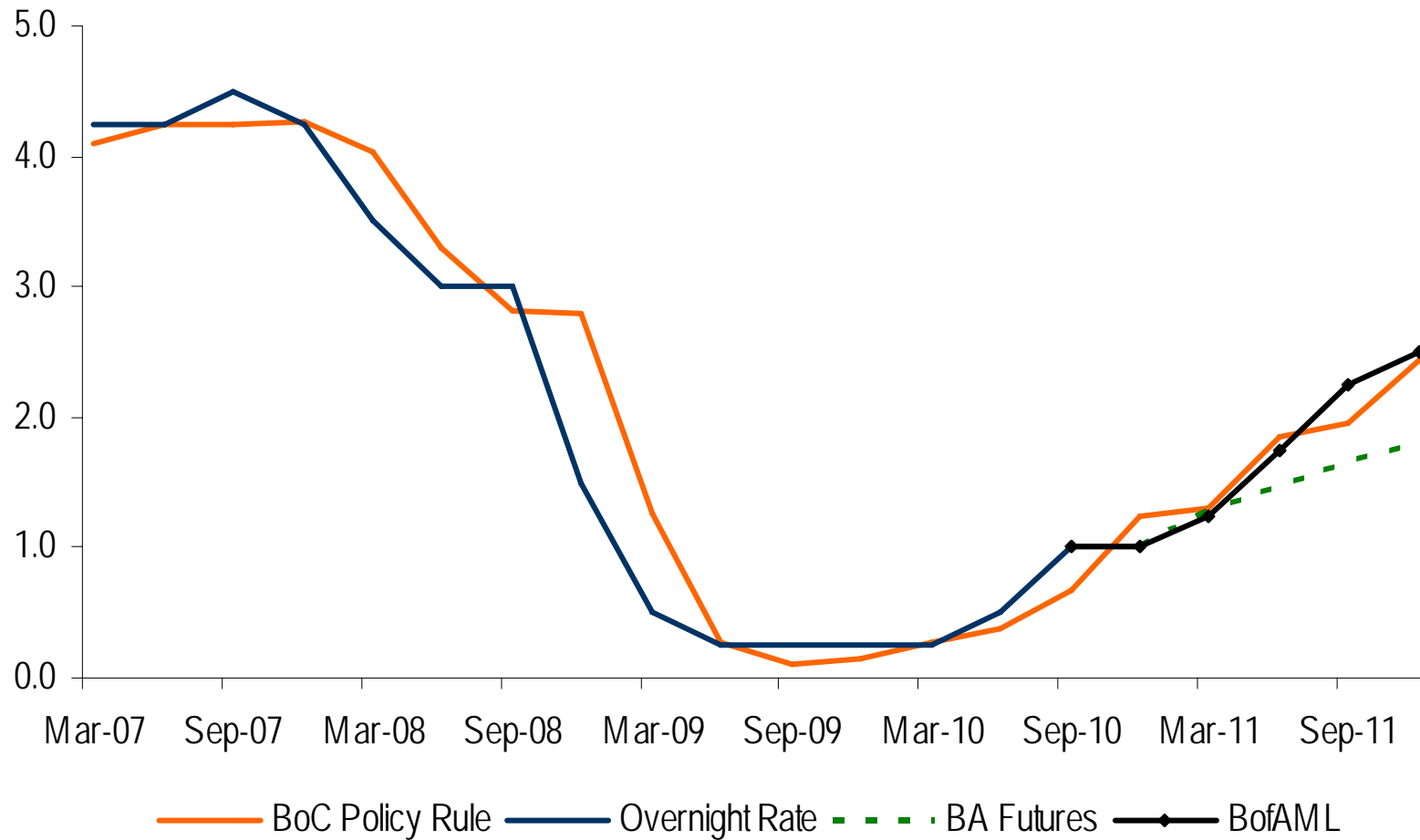


Canada RRB BE's cheap to US



Source: BofA Merrill Lynch Global Research, Haver Analytics

BoC forecast advises rate rise

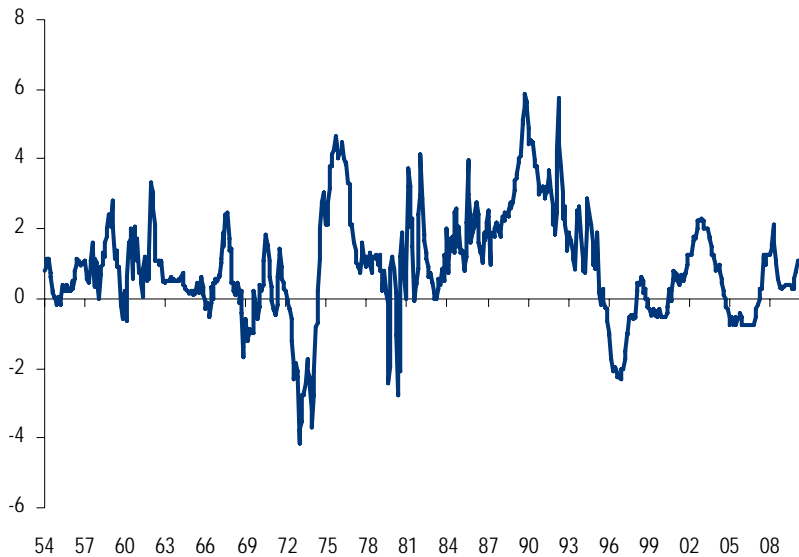


* Policy Rule from BoC working paper 2006-41 "An Optimized Monetary Policy Rule for ToTEM. Points from 4Q 2010 to 4Q 2011 are based on CPIX8 and GDP forecasts from October 2010 Monetary Policy Report.

Source: Haver Analytics, BofA Merrill Lynch Global Research

Bank hikes without Fed, Often

Bank of Canada Rate - Fed funds
(%)



BoC often first mover

BoC	Fed	Diff (months)
Oct 1960	Feb 1961	5
Dec 1961	Feb 1962	2
Apr 1973	May 1973	1
Sep 1975	May 1976	8
Mar 1978	May 1978	3
Nov 1983	Mar 1984	4
Jul 1997	easing	
Apr 2002	Jul 2004	15
Jun 2010	?	

Source: National Bank, BofA Merrill Lynch Global Research, Haver Analytics

More curve flattening ahead

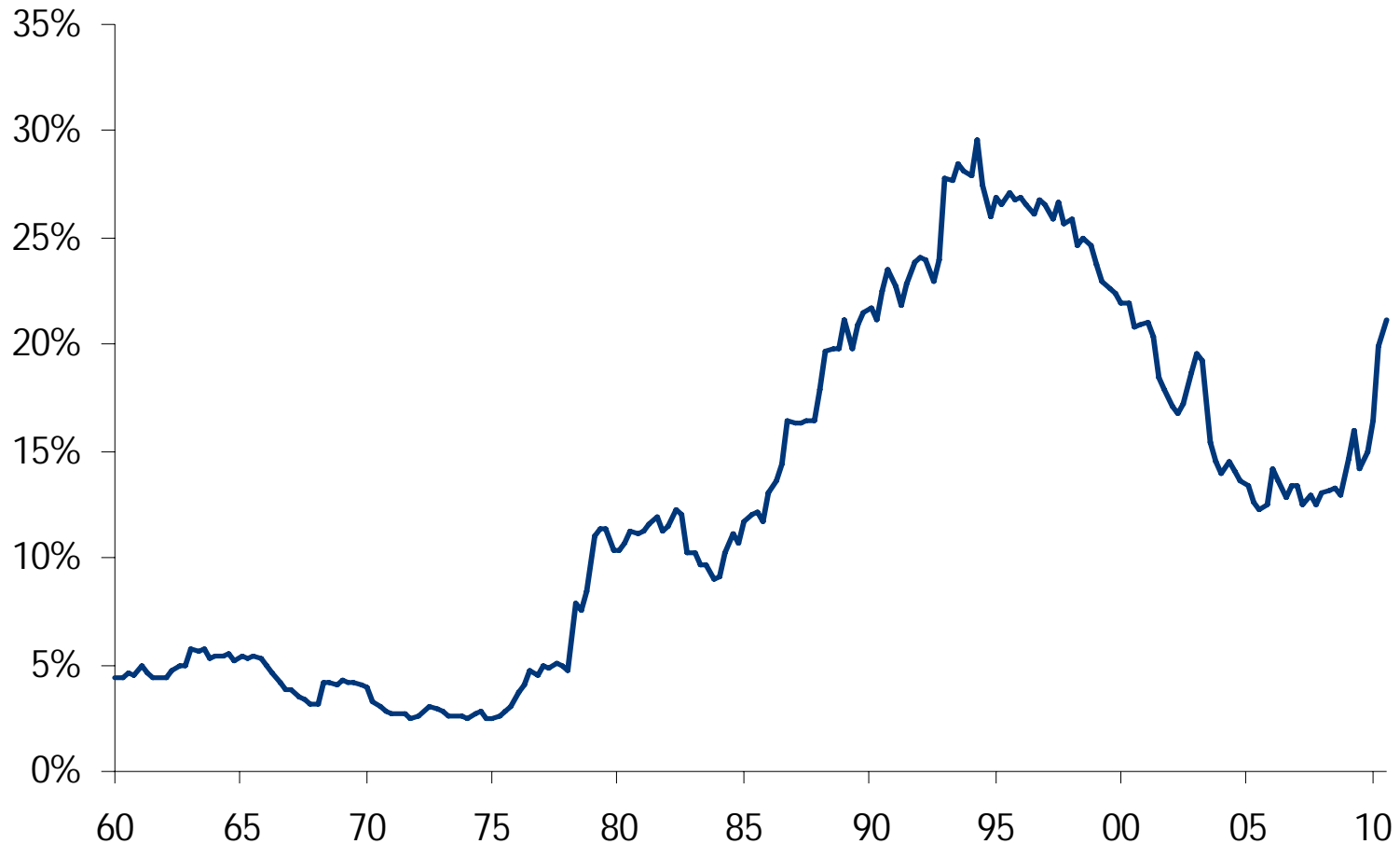
Government of Canada 2-year / 10-year curve
(Percentage points)



Source: Bank of Canada, Haver Analytics, BofA Merrill Lynch Global Research

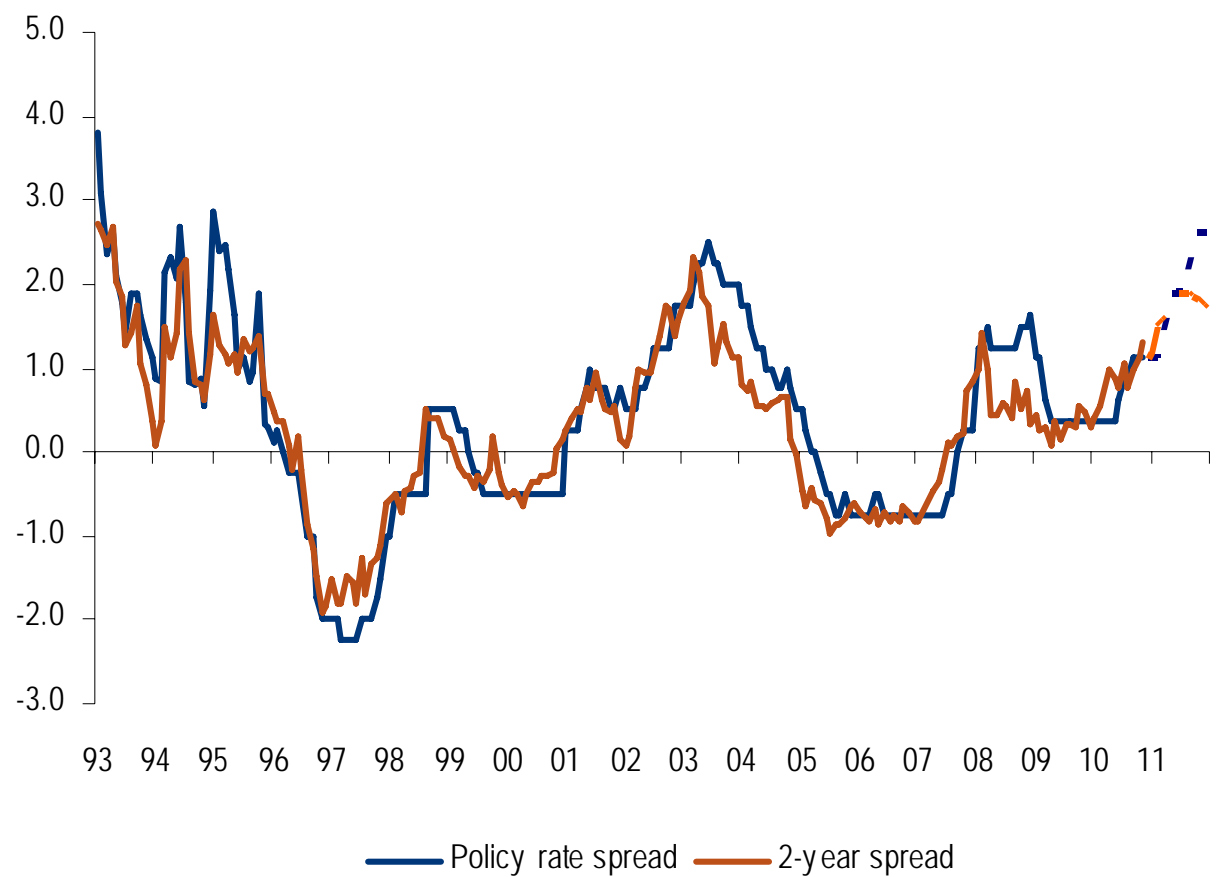
Foreign investment on the rise

Non-resident holdings of Gov't of Canada securities
(percent of total Gov't of Canada securities)



Spread Widening in Front End

Canada / US Rate Spreads (Percent)



Source: Bank of Canada, Federal Reserve, Haver Analytics, BofA Merrill Lynch Global Research

More foreign buying = GoC Outperforms

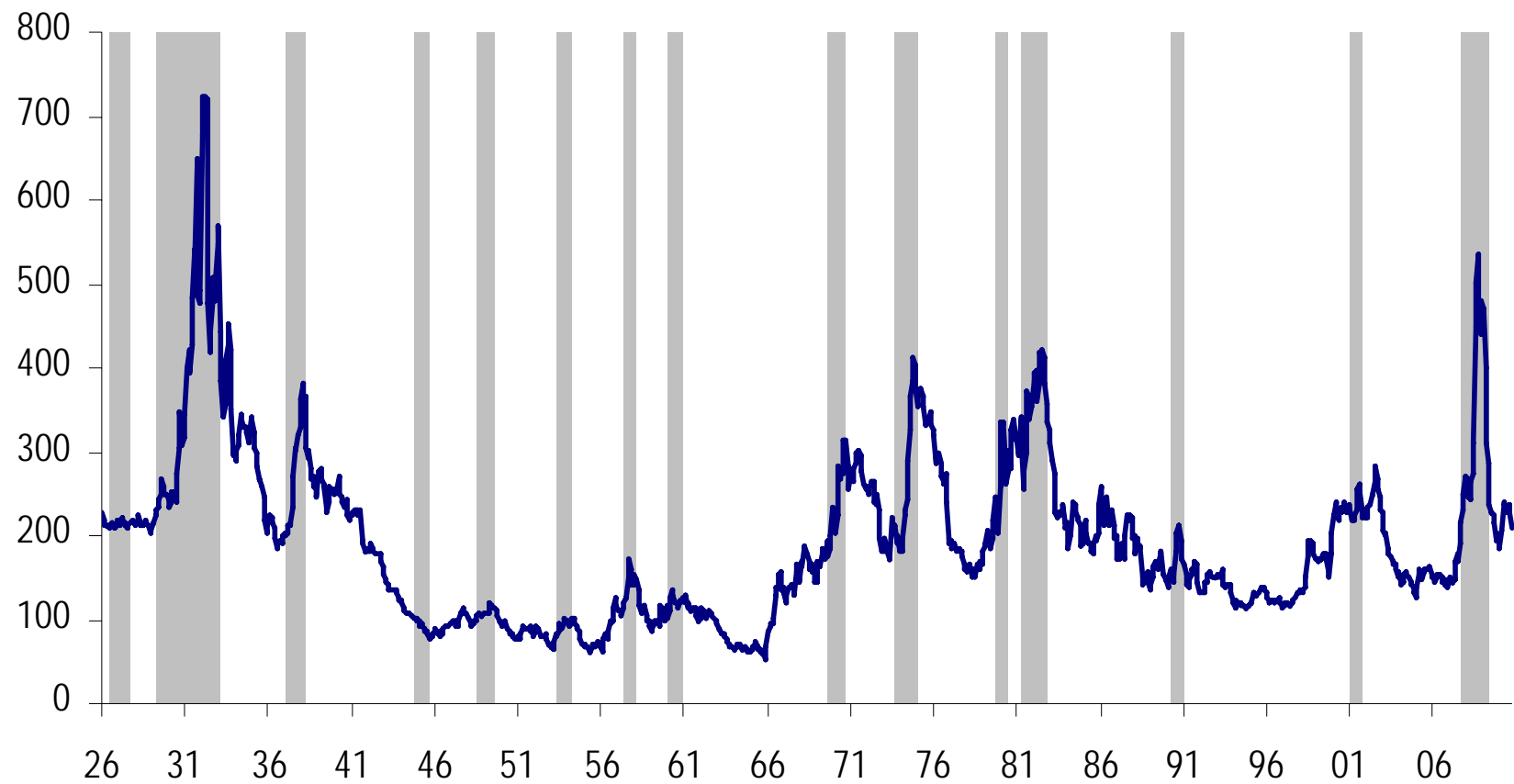
Govt of Canada 10-year note - US Treasury 10-year note
(Percent)



Source: Bloomberg, Haver Analytics, BofA Merrill Lynch Global Research

An Epic Credit Event

Baa corporate spreads
(basis points)



Shaded region represents period of US recession
Source: Haver Analytics, BofA Merrill Lynch Global Research

Economic and Rate Forecasts

	Q310	Q410	Q111	Q211	Q311	2010	2011	2012
Real GDP (q/q % ann)	1.0	3.2	3.6	3.9	3.1	3.0	3.1	2.5
Consumption	3.5	3.5	3.0	2.8	2.5	3.5	2.9	2.4
Government	0.9	4.0	3.0	0.3	-1.5	4.1	1.5	0.0
Housing Investment	-5.3	-2.0	-12.0	-15.0	-10.0	10.2	-8.0	-0.4
Business Investment	19.8	12.1	9.6	12.0	14.0	7.4	13.5	7.1
Exports	-5.0	11.0	5.0	5.8	6.5	6.1	5.2	6.7
Imports	6.4	4.5	4.5	3.0	2.8	13.4	5.0	5.7
Inventory (C\$bn)	17.5	7.8	9.5	11.5	11.0	11.3	10.8	11.2
Nominal GDP (q/q % ann)	2.8	7.4	7.5	5.9	3.2	6.1	5.6	4.7
CPI (y/y%)	2.4	2.2	2.6	3.3	3.9	2.2	3.5	2.8
CPI-X (y/y%)	1.1	1.6	1.7	2.0	2.6	1.4	2.3	2.3
Overnight Target (eop. %)	1.00	1.00	1.25	1.75	2.25	1.00	2.50	3.25
2-yr GoC	1.36	1.67	2.10	2.65	2.85	1.67	2.95	3.25
10-yr GoC	2.75	3.11	3.10	3.15	3.20	3.11	3.20	3.50
USD-CAD *	1.04	1.08	1.10	1.11	1.13	1.08	1.15	
TSX Composite						12,950	14,200	14,800
TSX Calendar EPS						700	860	940
US forecasts:								
US GDP	2.5	2.5	2.0	2.2	2.4	2.8	2.3	3.0
US Core CPI (y/y %)	0.8	0.7	0.9	0.7	0.6	1.4	0.8	0.6
Fed Funds (eop. %)	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25	0.0-0.25
2-yr UST	0.43	0.35	0.40	0.45	0.55	0.35	0.65	
10-yr UST	2.51	2.40	2.50	2.75	3.00	2.40	3.25	

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BAS-ML Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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