ON DECK FOR TUESDAY, DECEMBER 6

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	12/06	08:30	Merchandise Trade Balance (C$ bn)	Oct	-2.0	-1.7	-4.1
US	12/06	08:30	Productivity (q/q a.r.)	3Q F	--	3.3	3.1
US	12/06	08:30	Trade Balance (US$ bn)	Oct	-39.0	-42.0	-36.4
US	12/06	08:30	Unit Labor Costs (q/q a.r.)	3Q F	--	0.3	0.3
US	12/06	10:00	Durable Goods Orders (m/m)	Oct F	--	3.4	4.8
US	12/06	10:00	Durable Goods Orders ex. Trans. (m/m)	Oct F	--	0.5	1.0
US	12/06	10:00	Factory Orders (m/m)	Oct	2.0	2.6	0.3
US	12/06	10:00	IBD/TIPP Economic Optimism Index	Dec	--	52.0	51.4

KEY POINTS:

- Markets mixed on German data, OPEC output
- Oil prices under pressure on OPEC production surge
- German factory orders post third fastest post-crisis gain
- RBA stands pat, but A$ drops on guidance
- CDN trade deficit will shrink after import distortion…
- …but exports volumes remain the focus
- CDN bank earnings season ends with a bang
- Fed in black-out until next Wednesday
- US exports, factory orders on tap
- Colombian inflation easing, adding to central bank flexibility
- US Treasury yields may have backed up for reasons that have nothing to do with growth
- Why Trump is wrong on the yuan

INTERNATIONAL

Yesterday morning's brief sell-off in European peripheral assets continues to reverse this morning and is being buttressed by strong German data but with energy markets restraining the optimism.

- Oil prices are down a touch with WTI at US$51.50. OPEC figures showed record production in November and countries exempt from the recent deal led the way.

- Stocks have a slight positive bias on average. US and CDN equity futures are very slightly positive. European equities are in the black. The sell-off in Italy continues to reverse itself with Milan up 1.2%.

- That's also true in bonds. Italian 10 year yields are lower again this morning and only about 5bps higher than where they closed on Friday although the decline in yields was larger earlier this morning. Treasury yields are flat, and so are yields on Canadian government bonds.

- The USD is mixed with gainers led by the Mexican peso, rand, won and sterling, and decliners including the real, A$ and euro. CAD is little changed.

German factory orders soared by 4.9% m/m in October. That's the biggest gain since July 2014 and the third biggest rise of the post-crisis period. Domestic orders led the way (+6.3%) but foreign orders were up 3.9% entirely due to orders from outside the Eurozone (+6.3%) as Eurozone orders were flat following a large decline the prior month. Capital goods orders were up 7.2%, and intermediate goods were up 1.8% while orders for consumer goods were up 0.5%.

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Source: Bloomberg, BiS, China NBS, Scotiabank Economics.

The A$ is weaker because the Reserve Bank of Australia noted that "an appreciating exchange could complicate this" in reference to progress the economy is making toward adjustments. The RBA left its cash target rate unchanged at 1.5% as widely expected.

Colombia's CPI inflation rate eased to just under 6% y/y for the first time since last October. It has declined from a 9% peak in July and the trend is opening up more flexibility for the central bank.

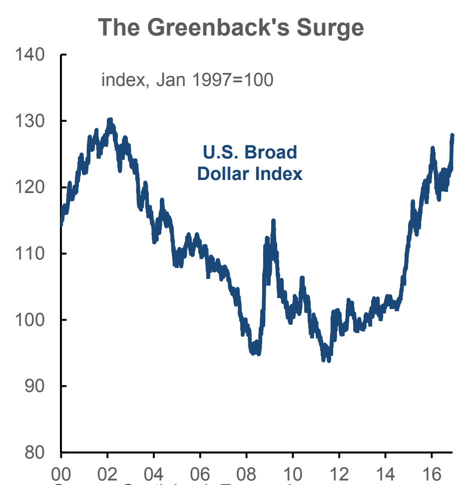
For years, US politicians have not understood the nature of China's currency challenges - or chosen not to understand. The country has lost an enormous amount of trade competitiveness due to the yuan's long-term appreciation when properly defined. The proper definition is not just the nominal managed quasi-peg against the USD which has been depreciating over time. The proper definition is the exchange value of the yuan against the trade-weighted average of its trading partners' currencies and adjusted for relative inflation at home versus abroad. This real effective exchange rate (REER) has been appreciating for the past decade. This appreciation has made current account surpluses rapidly shrink. Enter the accompanying chart. A combination of onshore-offshore market forces and policy goals have depreciated the yuan in USD terms but this has not succeeded in offsetting the massive erosion of China's trade competitiveness. The danger to policymakers not understanding this argument is to risk a wave of global protectionism, and more pork barrel politics at US$700,000 of taxpayer money for each 'rescued' job.

UNITED STATES

Data will pass the time as the Fed goes into communications black-out ahead of next Wednesday's statement that will likely advance a dovish hike.

The trade deficit is expected to widen and factory orders to post a sharp rise most of which markets already knew from the prior durable goods report.

On the back of the massive appreciation in the broad dollar index, a deterioration in export readings and a pick-up in import figures can be expected to drive a wider trade deficit into the upcoming new year (chart 2). The broad trade-weighted US dollar is at its highest level in about a decade and a half and portends a sharp widening of the trade deficit and — by corollary — greater indebtedness to foreign buyers of US securities like China and Japan as the US runs large trade and probably wider fiscal deficits.



Source: Scotiabank Economics, U.S. Federal Reserve.

A point worth emphasizing time and again since the election is that the backing up in Treasury yields may have little to do with growth expectations and may be imposing a negative growth shock when combined with a soaring USD that tightens financial conditions. Here are some of the reasons beyond growth expectations for why we have higher Treasury yields:

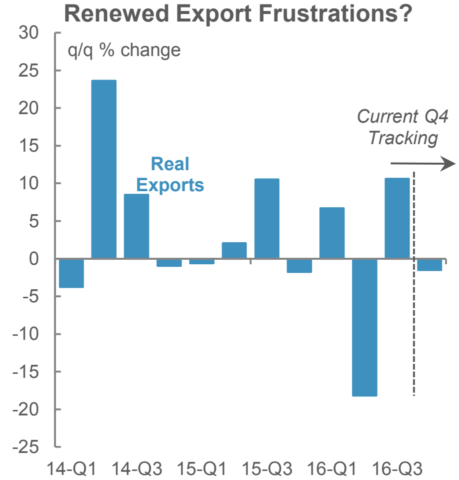
- The incoming US administration is perceived to want a more hawkish Fed by filling two vacancies and perhaps by not extending the top two spots after 2018. In the short-term, sell Treasuries on this risk even if there is a possible second trade that sees a potential policy mistake unfolding.
- More supply of Treasuries is coming down the pipeline with higher fiscal deficits and uncertain growth benefits given a) what type of fiscal stimulus is pursued, b) uncertainty over fiscal multipliers, c) crowding out effects etc.
- There could be a one-off portfolio rebalancing effect in favour of stocks and away from bonds on relative tax changes that benefit the residual claimants.
- There could be a one-off geographical market rebalancing in favour of the US$ due to an expected shift in relative tax policy compared to other jurisdictions.
- Portfolio rebalancing through covering pre-election positions could have resulted in an overshoot on both yields and the dollar.
- And of course there is also the possibility that markets are wrong in terms of another tantrum that we've seen unfold and then reverse several times in the post-GFC world.

CANADA

Bank earnings season wraps up today with **BMO reporting Q4 and full year earnings that beat expectations**. Adjusted Q4 EPS was C$2.10 versus an analyst estimate of C$1.85.

Trade figures for October will matter to the BoC and start the tracking for Q4. A sharp drop in the dollar value of imports is likely because of a one-off distortion introduced by the importation of a major component for an east coast energy project, but don't be fooled by the associated improvement in the trade balance. Export volumes were up by a low double digit percentage in Q3 over Q2 in seasonally adjusted and annualized terms. Because volumes dipped in September and also contributed to that month's deterioration in the trade deficit, the math heading into Q4 is already on weak footings with a contraction of just over 1% already in the cards before we start to get monthly Q4 data. The BoC appears confident that its heavily revised growth numbers for 2016H2 are on track with the forecasts issued in October, but **reality leaves a large question mark on the durability of export gains** into the fourth and final quarter of the year after what was the best quarter for export gains along a highly volatile path that has been marked by repeated many false starts (see chart 3).

Renewed Export Frustrations?



Source: Scotiabank Economics, Statistics Canada.

Fixed Income — Government Yield Curves (%):

	2-YEAR Last	2-YEAR 1-day	2-YEAR 1-wk	5-YEAR Last	5-YEAR 1-day	5-YEAR 1-wk	10-YEAR Last	10-YEAR 1-day	10-YEAR 1-wk	30-YEAR Last	30-YEAR 1-day	30-YEAR 1-wk
U.S.	1.12	1.12	1.09	1.84	1.85	1.78	2.40	2.39	2.29	3.07	3.06	2.95
CANADA	0.73	0.74	0.67	1.03	1.03	0.95	1.63	1.63	1.51	2.23	2.22	2.09
GERMANY	-0.71	-0.70	-0.75	-0.36	-0.38	-0.46	0.35	0.33	0.22	1.01	1.00	0.87
JAPAN	-0.19	-0.18	-0.17	-0.09	-0.10	-0.10	0.05	0.04	0.02	0.63	0.60	0.57
U.K.	0.13	0.11	0.10	0.60	0.58	0.58	1.41	1.40	1.37	2.04	2.03	2.02
Spreads vs. U.S. (bps):												
CANADA	-38	-38	-42	-81	-82	-83	-77	-77	-79	-84	-85	-86
GERMANY	-182	-183	-184	-220	-223	-223	-204	-206	-207	-206	-207	-208
JAPAN	-131	-130	-126	-194	-195	-187	-235	-235	-227	-245	-247	-237
U.K.	-99	-101	-99	-125	-126	-120	-98	-99	-92	-103	-104	-93

	Level: Last	Change	% change: 1 Day	1-wk	1-mo	1-yr
Equities						
S&P/TSX	15095	42.6	0.3	0.5	4.0	13.0
Dow 30	19216	45.8	0.2	0.6	7.4	7.7
S&P 500	2205	12.8	0.6	0.1	5.7	5.4
Nasdaq	5309	53.2	1.0	-1.1	5.2	3.2
DAX	10710	25.4	0.2	0.8	4.4	-0.4
FTSE	6760	13.6	0.2	-0.2	1.0	8.4
Nikkei	18361	85.5	0.5	0.3	8.6	-5.9
Hang Seng	22675	169.6	0.8	-0.3	0.1	2.0
CAC	4591	16.8	0.4	0.9	4.9	-2.6
Commodities						
WTI Crude	51.11	-0.68	-1.3	13.0	16.0	27.9
Natural Gas	3.71	0.06	1.6	11.9	34.1	69.8
Gold	1172.84	2.47	0.2	-1.3	-10.1	7.9
Silver	16.79	0.17	1.0	1.5	-8.3	18.8
CRB Index	193.48	1.78	0.9	3.0	6.0	5.6
Currencies						
USDCAD	1.3262	-0.0009	-0.1	-1.3	-0.8	-1.8
EURUSD	1.0738	-0.0026	-0.2	0.8	-2.7	-0.9
USDJPY	113.89	0.0400	0.0	1.3	9.0	-7.7
AUDUSD	0.7454	-0.0018	-0.2	-0.4	-3.5	2.6
GBPUSD	1.2740	0.0008	0.1	2.0	2.8	-15.4
USDCHF	1.0091	0.0027	0.3	-0.3	3.6	0.9

Central Banks

	Current Rate	Next Meeting Date
Canada - BoC	**0.50**	**Dec 07, 2016**
US - Fed	**0.50**	**Dec 14, 2016**
England - BoE	**0.25**	**Dec 15, 2016**
Euro zone - ECB	**0.00**	**Dec 08, 2016**
Japan - BoJ	**-0.10**	**Dec 20, 2016**
Mexico - Banxico	**5.25**	**Dec 15, 2016**
Australia - RBA	**1.50**	**Dec 05, 2016**
New Zealand - RBNZ	**1.75**	**Feb 08, 2017**

Source: Bloomberg. All quotes reflect Bloomberg data as at the time of publishing.

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