

Global Views

Weekly commentary on economic and financial market developments

January 14, 2011

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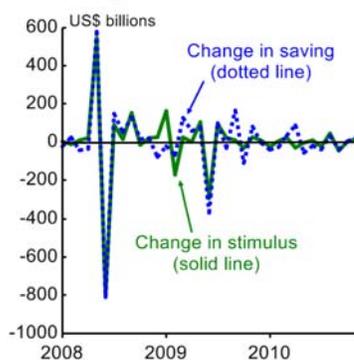
Gorica Djerić (416) 862-3080
gorica_djeric@scotiacapital.com

Derek Holt (416) 863-7707
derek_holt@scotiacapital.com

Debating Points Between Bulls And Bears on US Growth

As we embark upon a new year, Scotia Economics and our research partners across Scotia Capital introduce you to a new weekly research publication that we are confident you will come to view as insightful in its depth and breadth, and timely in its focus. The timing of our introduction early into a new year has our first issue aptly focused upon the global outlook for 2011. With this in mind, we start by flagging what we think are key debating points governing the 2011 outlook particularly applied to the US economy. While the strongest growth opportunities reside within emerging markets, the one-quarter weighting of the US in world GDP makes US fortunes critically important to assess. To this point, there is a wide variation of forecast opinions on the outlook for the US and global economies over 2011. Scotia Economics sits toward the lower end of evolving forecast opinions at 2.7% compared to the January Consensus Inc low of 2.5% and the high of 3.8%. While we don't at all rule out a more impressive performance for the US economy, we are reticent to go with a more bullish forecast at this point given the prevalence of so many persistent unsettled debates. We summarize what we think are some of the major ones below.

Saving Their Stimulus

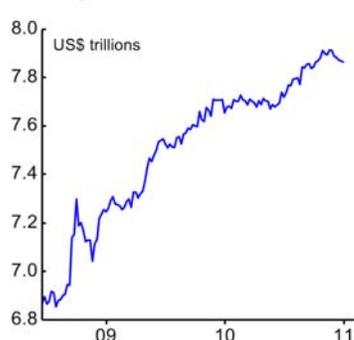


Source: BEA, Scotia Capital Economics.

1. Will US Consumers Save or Spend Stimulus?

This is perhaps among the most important sources of uncertainty. To date, US consumers have hoarded stimulus offered to them. Witness chart 1 that depicts a one-for-one correlation between changes in monthly saving done by US households, and net monthly changes in stimulus given to households in the form of changes to taxes - like tax cuts or rebate cheques - and direct transfers from governments - like jobless benefit extensions. One of the prime catalysts for upward forecast revisions at many shops was the additional stimulus introduced when President Obama signed into law extensions to jobless benefits, tax cut extensions, and payroll tax cuts. We're asked to believe the literature that speaks to how tax cuts work more powerfully in motivating growth than other forms of stimulus. But the evidence on what people do with such stimulus in a credit-induced recession is very different thus far. That's especially true given that negative real rates are less likely to influence consumers this time around because of today's very different demographics and the hit consumers are still taking to their home values. Our base assumption is that consumers perhaps spend some of the stimulus in driving a modest pace of expansion in consumer spending. More bullish views would attach stronger multipliers to the stimulus.

Deposits at U.S. Banks



Source: Federal Reserve Board, Scotia Capital Economics.

2. Where Will Consumers Continue To Find Spending Money?

Forget mortgage equity withdrawals in this cycle. That was the surprise factor that kept the last one going so long. But today, US house prices are still 30% lower than at the peak, and Home Equity Lines of Credit (HELOCs) are going nowhere. Thus, with no real housing wealth effect, cash-outs won't be significantly growth supportive. Income gains are also largely absent. The latest nonfarm payrolls report drove that point home, and so did the recent disappointment on jobless claims. Labour market income growth is proxied by growth in hours worked and growth in wages. Total hours worked in the US economy have been largely flat for two months, and are only 0.9% higher than last July. Further, average hourly earnings were only up 0.1% m/m in December, and are 1.8% higher than a year ago.

Some of the funds feeding rising retail sales have been coming from liquidity redeployment. US consumers are recently starting to spend the large amount of stockpiled cash that they put aside during the period of maximum risk aversion (chart 2). In the absence of material job growth, bullish consumer views would argue in favour of more rapid redeployment of such liquidity toward

Gorica Djerić (416) 862-3080
gorica_djeric@scotiacapital.com

Derek Holt (416) 863-7707
derek_holt@scotiacapital.com

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consumption, as well as debt reduction and investment. But there is a limit to how long this can proceed, since it occurs through reductions in the personal saving rate by consuming beyond income gains.

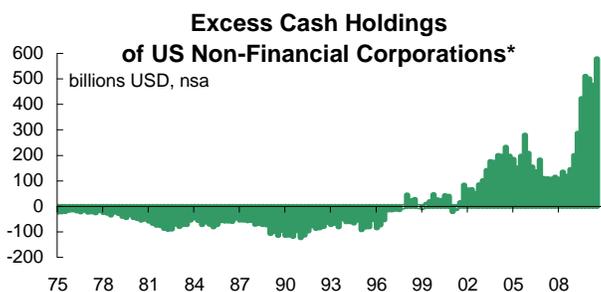
3. A Renewed Or Prolonged Housing Setback?

Housing investment may only be less than 3% of GDP now, but it still plays a vital role in shaping consumer confidence. US home prices are still down 30% from the peak. Whether they rise or fall further is important to judging whether or not consumption may get a hand-up from gradually lessened negative wealth effects on spending. Within Robert Shiller's December survey of forecasters including ourselves, the most optimistic forecaster assumes cumulative house price gains of nearly 30% by 2015, the most pessimistic is forecasting a



further 20% drop, and the median anticipates a cumulative rise of 12%. We sit at 7%. Our assumption is that US shadow housing inventories are so large—and will keep on growing—that this stock of foreclosed but unlisted homes will continue to depress house prices over the longer run. Chart 3 depicts the narrow conventional measure of months' supply that only includes listed product, but then adds back current measures of the shadow inventory that are higher relative to the size of today's housing market than ever before. The experience of most major global house price corrections is that they take many years to fully run their course. Why raise housing starts when such an inventory overhang exists? Further complicating a housing recovery is that the outlook for bond yields—and hence the critically important 30-year fixed mortgage rate—is bearish in our view due to the long-run outlook for the US fiscal position, and that suggests that buyers will be constrained by rising borrowing costs in taking advantage of depressed house prices.

4. Will Companies Redeploy Their Enormous Cash Hoards?



Excess corporate liquidity has never been this high. Chart 4 measures the excess level of cash holdings above their long-run average share of total financial assets but expressed in equivalent dollar terms. Bulls are looking forward to aggressive redeployment of such cash positions toward shareholders, hiring, and investment activity. Bears think corporate liquidity will remain structurally high for years. We're in the middle, assuming a bit of both, but that ongoing financial market frailties and memory of the credit crunch will have corporations retaining a bias toward preserving liquidity.

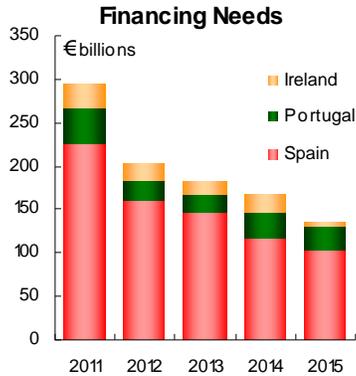
5. Can Markets Handle Rollover Risk?

Perhaps the biggest risk to the outlook is the sheer volume of debt maturing from the peak of the credit cycle that needs to be rolled over into global markets this year. That's true on the sovereign book, across state and local government finances, and at private corporations. Chart 5 shows that we expect up to €300 billion in financing needs for just Ireland, Portugal and Spain this year. These beleaguered peripheral economies, however, are only part of a massive global push toward rolling over maturing debt even across major economies. Chart 6 demonstrates that Europe also leads the pack in terms of the amount of corporate debt to be rolled over relative to market capitalization. Bulls would argue that the economy can grow fast enough to generate a large enough savings and liquidity buffer to absorb this crunch. We think such forces will be heavily disruptive to global bond markets throughout 2011-12. This is key to the risk trade and hence how supportive financial markets are to the recovery.

Gorica Djerić (416) 862-3080
gorica_djeric@scotiacapital.com

Derek Holt (416) 863-7707
derek_holt@scotiacapital.com

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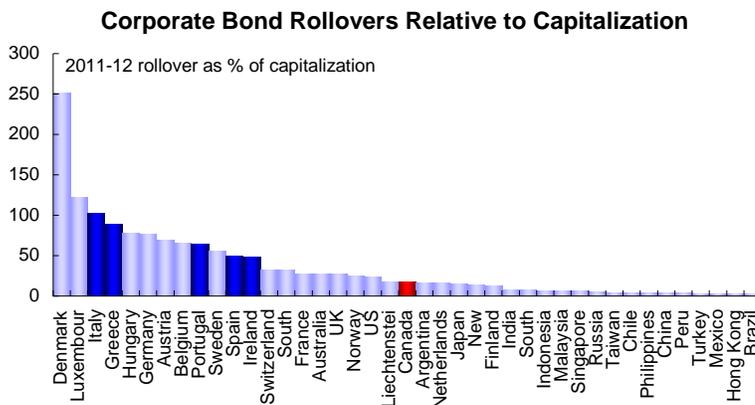


Note: Includes bonds, bills and loans including agencies. Source: Bloomberg, IMF, Scotia Capital Economics.

6. How Will Markets React To Surpassing The US Debt Ceiling?

The US government is rapidly approaching its debt ceiling of \$14.3 trillion. It is widely believed that this limit will be reached in March, before which Congress will have to approve a higher ceiling or the US government runs sharply disruptive default risk. We are assuming that after horse trading between Republicans and Democrats, Congress will approve a higher ceiling. But with the 2012 Presidential Election in sight, the debate will add to bond market volatility perhaps to the detriment of growth prospects. Longer run, we remain of the view that the US fiscal position is headed down the same path that was once faced by countries like Canada in the 1980s and 1990s. That carries bond bearish implications that will limit credit affordability and the potential growth of the US economy. The fiscal position is likely to get worse before it stabilizes. We doubt that President Obama's stimulus in the form of payroll tax cuts, extensions to jobless benefits and tax cut extensions will

be allowed to expire as planned during a Presidential election year. The stimulus is likely to become quasi-permanent at the expense of the long-run fiscal position and Treasuries. Further, our long-held view that the lagged effects of lower house prices on property tax revenues would ultimately bring state and local government finances forward as a risk to the outlook is on the cusp of materializing.



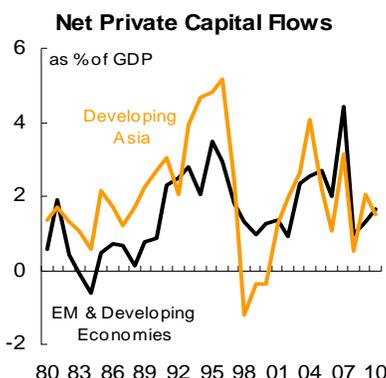
Source: Bloomberg, Scotia Capital Economics

7. Can Emerging Markets Cope With Capital Inflows?

Surging capital inflows into emerging markets began long before the Fed cut to zero, and longer yet before QE1 and

then QE2. Scaled to the size of the developing economies, these capital flows are not disproportionately large (chart 7). In absolute terms, however, they are high and rising. In order to cool inflationary pressures, developing economies are constrained by how far they can tighten monetary policy for fear of attracting even greater capital inflows into economies rife with bottlenecks that could well further ignite inflationary pressures. In order to offset the consequences, it is likely that tighter fiscal policy is required, but this will test

the resolve of governments across developing markets with possible implications for the risk trade and hence global growth. We are cautiously optimistic they can adapt to such flows, but view it as a risk to more bullish forecasts.



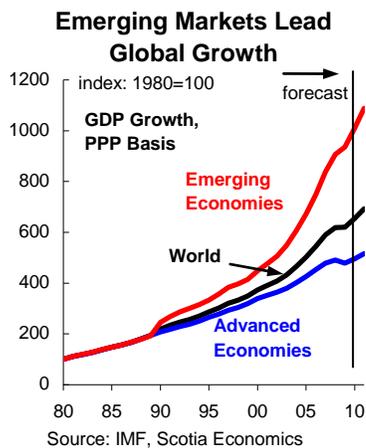
Source: IMF, Scotia Capital Economics.

Aron Gampel (416) 866-6259
aron_gampel@scotiacapital.com

Risky Business

- **More Growth, But More Risks**

This hasn't been the strongest of recoveries internationally. The primary reason is the sub-par performance in the United States, where the cumulative increase in output since mid-2009 has amounted to about 4½%, roughly two-thirds of the average 6¾% advance registered in the prior six cycles. This is not a surprising development for an economy focussed on slimming down the debt-laden balance sheets of consumers, financial institutions, and state and local governments.



But the global economy has eighteen months of restructuring under its belt, and it appears to be gaining momentum — at least for the time being. The underlying strength of the rebound largely reflects the continued above-trend growth in many of the emerging nations such as China, India, Brazil, and Indonesia — countries and regions which have repeatedly exhibited remarkable resilience during a period of unprecedented economic retrenchment and financial sector distress affecting many of the large developed countries. Efforts to date by some of the countries to rein in excess credit demands and growing inflationary pressures have yet to materially impact real growth. Moreover, another round of stimulus has provided some renewed lift to the U.S. consumer and business investment, while Germany has increasingly benefited from a weaker euro and strong machinery and transportation equipment exports to the faster growing regions around the world.

Even so, there are no shortages of concerns and risks to the outlook. Internationally, an increasingly rapid upturn in inflation, largely driven by escalating food costs and rising wage and other production costs, are pressuring emerging nations to tighten policy more aggressively. China is the bellwether here, since its non-stop inertia and rapidly expanding critical 'economic' mass have made it a key target for exports from around the world. Over the past year, Chinese officials have opted only to gradually pull on the credit reins, unwilling to jeopardize its domestic performance, or encourage capital inflows that would lead to an even stronger yuan. However, with prices already accelerating into the danger zone, policymakers appear to be leaning towards quickening the pace of raising reserve requirements and interest rate increases. The softness in local stock markets suggests that the risks are being tilted towards somewhat slower growth, a development that would have some impact on reducing the demand for commodities that have helped to reinvigorate resource-rich economies in Canada, Australia, and in Africa.

No less worrisome is the lingering sovereign-debt crisis roiling the economies of Europe. The solvency problems of first Greece and then Ireland have been addressed through massive financial support packages combining the resources of the EU, the IMF, and the ECB. However, the adjustment process associated with accelerated fiscal retrenchment involving massive spending cuts and hefty tax increases, combined with generally high borrowing costs, will have a significant negative impact on growth. The spectre of contagion runs high through the other peripheral countries burdened by debt-heavy governments and regional banks, and less receptive financial markets. While the weaker euro over the past nine months has provided some much needed relief to the export sectors of both large and small countries alike, the pervasive impact of intensifying fiscal consolidation will keep the region in the slower lane of global growth, credit risk outside of Germany and France high, and the euro soft.

These important country and/or regional issues are not the only substantial risks to the outlook. Inflating oil prices, a function of the steadily increasing demand of the emerging economies as well as a weaker U.S. dollar, threaten to deflate the purchasing power of consumers around the world. Recurring geopolitical

Aron Gampel (416) 866-6259
aron_gampel@scotiacapital.com

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problems have the potential to destabilize global activity. In the United States, the recent rise in mortgage rates threatens to undermine housing affordability again. The market remains on a shaky foundation, with the massive overhang of unsold homes already threatening to put additional downward pressure on prices and household wealth. At the same time, state and local governments are actively engaged in trimming their deficits as the financing from the initial round of federal stimulus winds down.

But for the time being, these largely internationally generated risks are being muted by the revival in U.S. growth, though the national debt consequence of a second round of stimulus poses its own degree of longer-term risks to both Americans and the global economy at large. Once again, the U.S. economy is being jolted by another pump-priming exercise. Last summer's flagging U.S. economic performance pushed the Federal Reserve into purchasing an extra US\$600 billion of Treasury securities, while in the aftermath of November mid-term elections, the Administration and Congress agreed to extend the Bush tax cuts, as well as enacting an additional US\$400 billion of net new stimulus comprised of payroll tax cuts, extended unemployment insurance benefits, and capital spending incentives.

Forecasts for U.S. growth in 2011 have been revised higher, building upon the improved pace of consumer spending and business investment which coincided with the latest round of confidence-engendering monetary and fiscal initiatives as last year wound down. Americans took advantage of 'deep discount' pricing and renewed stock market gains by purchasing more than their income gains. And this spending trend will likely continue in the first half of this year with the unexpected payroll tax cut providing a temporary boost to disposable incomes. Likewise, businesses will take full advantage of the accelerated depreciation allowances and profit-enriched balance sheets to purchase productivity-enhancing machinery & equipment. Alongside the steady improvement in net exports attributable to strengthening international demand and the flowthrough from a weaker U.S. dollar, the consensus has lifted this year's estimate for U.S. real GDP growth to 3.2%, half a percentage point higher than the previous estimate, and a welcome boost to prospects for two of its larger trading partners, Canada and Mexico in particular.

Nevertheless, the longer-term sustainability of this latest stimulus-induced spending, and a stronger growth trajectory for the U.S. economy, is still in doubt. The payroll tax cuts and the unemployment insurance benefits are set to wind down in 2012, setting the stage for a broader period of fiscal retrenchment, private-sector deleveraging, and below-trend growth for the U.S. economy through mid-decade.

Gorica Djerić (416) 862-3080
gorica_djeric@scotiacapital.com

Derek Holt (416) 863-7707
derek_holt@scotiacapital.com

Europe and China Will Be In The Driver's Seat Next Week

- ***Please see pages 35-40 for our full indicator, auction, event, and central bank calendars.***

A diverse array of global developments carry the potential to impact the risk trade throughout the entire week. Europe and China will dominate most of the attention of global markets, but there are key developments in markets like Canada and Brazil that will merit close attention by global economy watchers.

The tone of the week is likely to start off focused on Europe's debt difficulties yet again, and European risks will govern market tone throughout the week. Monday and Tuesday bring forward what could emerge to be key meetings of Euro-area finance ministers, given rumoured attempts at negotiating the loose terms under which Portugal could request aid through the European Financial Stability Facility. While recent auctions by Portugal and Spain were more successful than feared, they remain a pittance of the funding requirements facing both countries over the full year and their success does not by any means negate the need for a more comprehensive European solution as suggested by EU Commissioner Olli Rehn. The first test of Europe's funding challenges following the meetings of finance ministers will come quickly, as Spain and Portugal auction bills on Tuesday and Wednesday, while Spain auctions bonds on Thursday. Also on Thursday will be fresh budgetary figures from Portugal covering December data on government spending and revenues. European data risk is primarily focused upon the UK and will bring updates on stubbornly higher inflation readings, jobs, and retail sales. Auctions by other European countries are likely to be less influential.

China risk will also be front and centre in global markets throughout the week starting on the weekend with the release of property prices that may continue to cool their rate of appreciation. On Tuesday, Chinese President Hu Jintao arrives in the United States for a four day visit, and on the same day as a Chinese 10 year auction. Key on the agenda on Wednesday will be meetings with President Obama followed by a White House dinner. US pressure on China to further revalue the yuan, the bi-lateral trade deficit, and possible collaboration on the Korean Peninsula are all likely focal points. Our view on yuan revaluation remains that the nominal peg is a distraction to the real effective exchange rate that has appreciated by 20% since 2006.

China will again drive the tone of global markets on Wednesday evening through into Thursday on the heels of key releases covering Q4 GDP, retail sales, industrial production and inflation. Consensus expectations point toward a bullish print on GDP and a softening print on inflation.

Canada will be driven by more than global market tone. Much of the week's focus will be upon the Bank of Canada's latest interest rate announcement and the accompanying statement on Tuesday, followed by a full quarterly Monetary Policy Report on Thursday that will include BoC forecast revisions. See pages 13-14 for our thoughts on the BoC. Canadian data risk will be high as the final pieces of the November GDP puzzle arrive via manufacturing shipments and retail sales. We'll therefore get a better handle on how Q4 GDP growth is tracking in comparison to BoC expectations after Q3 fell short of the BoC's forecast.

For the most part, however, the US will not be in the driver's seat in determining the week's market tone as the US calendar is relatively light. Housing indicators could be mildly encouraging with an expected rise in home sales, but markets may discount this in light of concerns over the lagged impact of higher fixed mortgage rates on housing demand compared to rates last fall. The new year's first round of regional manufacturing surveys also arrives. There is only one Fed speech on the calendar, but it could be a market mover given that it is to be delivered by Philadelphia Fed President Charles Plosser who is a voting—and relatively hawkish—FOMC member this year, and given that the topic is “Thoughts on the Scope of Monetary Policy.” Only one auction is scheduled, and it's for Treasury Inflation Protected Securities (TIPS) on Thursday.

Key across other markets will be expected rate hikes by the Banco Central do Brasil, and pauses by the Banco de México and South African Reserve Bank. The Central Bank of Turkey also meets on Thursday.

Latin American Monetary Outlook

- ***Intensifying Intervention and Tightening Ahead***

Policy convergence is deepening in Latin America. Monetary regimes based on inflation targeting and floating currency arrangements, are now the norm within the most financially integrated economies (Brazil, Mexico, Chile, Peru and Colombia). Moreover, well-supervised domestic financial sectors and relatively independent central bank management practices have reinforced the structural foundations of these economies. In response to global financial shocks, a more united policy-response front is developing in the region; central banks are adopting similar tactics to adjust to an increasingly volatile external environment. Outright intervention in currency (and credit) markets as well as imposition of capital controls are no longer penalized by market participants. Even countries such as Venezuela and Argentina, which have embraced disruptive policy alternatives, official data manipulation and market isolation, may soon be compelled to opt for a more investor-friendly policy environment. Looking ahead, though, growing foreign investment inflows (caused by the relentless pursuit of high yield) might lead to asset price bubbles, disruptive currency overvaluation dynamics and widening current account deficits. If not adequately managed, these factors may undermine the sustainability of the current pace of regional economic expansion.

Brazil continues to play a critical role in the stability and growth phase enjoyed by Latin America. The economy is positioned to grow at a sustainable rate of 5% over the next five years, following an estimated expansion of 7.6% in 2010. The second largest economy in the Americas continues to be a magnet for foreign direct and portfolio investment. Inflation remains in manageable territory (approaching the 6% mark by the end of 2011), yet the central bank is readying another phase of pre-emptive monetary tightening; indeed, the benchmark SELIC rate will be increased by 50 basis points to 11.25% at the next monetary policy committee (COPOM) meeting scheduled for January 19, 2011. Widening interest rate differentials and persistently high commodity prices have contributed to fueling fears of overvaluation in selected domestic assets, prompting the central bank and finance ministry to coordinate remedial policy actions. The newly elected administration of President Dilma Rousseff, which inherited an economy in expansion mode and rising inflationary pressures, is deepening the process of government intervention to mitigate the disruptive effects of global currency alignments. Recent measures include: an increase in the financial transaction tax (to 6%) on foreign holdings of Brazilian fixed-income securities, imposition of reserve requirements on foreign exchange “short” positions of local banks, and the authorization to use derivatives by the sovereign wealth fund. Market participants expect announcements on budget cuts in the near term. The Brazilian real (BRL), currently trading at 1.68 per USD, has appreciated by 46% since March 2009. Foreign exchange reserves are approaching the US\$300 billion mark.

Mexico’s economic outlook is showing signs of steady improvement. The economy will expand by 4% this year, following an estimated increase of 5% in 2010. The official view is that the output gap is closing, aided by the recovery in the United States, Mexico’s most relevant economic partner. The monetary authorities are cautiously monitoring global financial market conditions which translated into steady currency appreciation in top-tier emerging-market economies. As a result, the Mexican peso (MXN), which traded below 12.20 per USD early in the New Year, has experienced a stable-to-appreciating bias over the past three months. The central bank expects the headline inflation rate to range between 3.75% and 4.25% during the first quarter of the year, following an end-year rate of 4.4% in 2010. For now, price pressures remain manageable, yet they are signs of a gradual pickup in inflationary expectations. The overnight interbank rate has remain unchanged at 4.5% since July 2009; looking ahead, futures markets discount that Banco de Mexico will begin to increase its reference rate during the second half of the year. A more aggressive tightening spree in Brazil may also push rate expectations upwards in the months ahead.

Chile is on the offensive to manage the adverse economic effects of an appreciating currency. The monetary authorities remain committed to the current monetary regime which allows for temporary intervention in extraordinary circumstances. On January 3rd, the central bank announced an aggressive program of international reserve accumulation to push the central bank’s international liquidity position to 17% of GDP.

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Starting January 5th, the central bank will initiate frequent purchases of US dollars targeting a total of US\$12 billion in the year; government debt issuance to fund this intervention will total US\$6 billion this year. Based on current levels, the central bank will close the year with US\$40 billion in FX reserves (% of GDP). Government officials have stressed that this unprecedented intervention in the currency market will help to alleviate the effect that a strong peso (CLP) might have on the local economy. Market participants quickly adjusted their inflation and interest rate outlook accordingly. The central bank will most likely continue with its monetary tightening phase as a relatively weaker currency may inject temporary price pressures. In seven consecutive moves in place since June 2010, the central bank increased its monetary policy rate from 0.50% to 3.25%. The rate of consumer price inflation, which closed last year at 3%, will continue to increase towards the 3.5% mark in the coming months, prompting central bank to resume monetary tightening. Disorderly currency adjustments coupled with intensifying European sovereign debt tension contributed to a more cautious tone into policy decisions in Chile and other Latin American countries.

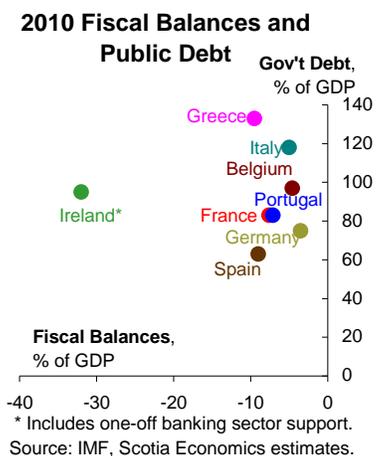
Peru remains one of the world's fastest growing economies; real GDP may have expanded by 9% in 2010. The government estimates that the Peruvian economy will grow at an annual rate of 6.5% through the year 2015. Blessed by surging energy and metal prices and by relentless demand for emerging-market assets, the Peruvian Sol (PEN) appreciated by 6.7% over the past 12 months. International reserves increased by US\$11 billion last year closing at US\$44.1 billion. The central bank is joining forces with the government's economic team to manage the disruptive impact of disorderly global currency adjustments. On January 1st, the central bank imposed reserve requirements on the overseas units of local banks in an attempt to manage speculative-driven currency gains and moderate the pace of credit expansion (growing at a 20% yearly rate). Reserve requirements on short-term external debt obligations of local banks were lowered from 75% to 60%. Inflation remains in manageable territory, having closed last year at 2.1% in line with the 2% +/- 1% target range. Nevertheless, the monetary authorities increased the benchmark policy-setting rate by 25 bps to 3.25% on January 6th; the official communiqué stressed that robust domestic demand warranted such a pre-emptive move. The next monetary policy announcement is scheduled to take place on February 10th; further rate increases are likely in line with the process of interest rate normalization.

Colombia offers a promising outlook. The economy is well positioned to post annual growth rates of 4.5% over the next five years. Massive foreign direct investment flows are eyeing the energy sector. The robust and well-developed domestic capital market, in the context of a steady quest for yield, remains an attractive point of interest to foreign portfolio investors, injecting an appreciating tone into the local currency. On the monetary front, the central bank is firmly committed to maintaining a regime composed of inflation targets (currently 2% +/- 1%) and a managed floating currency scheme with clearly defined intervention guidelines. The policy-setting "intervention rate" has remained unchanged at 3% since April 2010 in line with favourable inflation dynamics. Looking ahead, though, there appears to be an upward adjustment in price pressures (the headline inflation rate reached 3.2% y/y in December) due to rising food prices caused by recent floods. Interest rate derivatives markets are discounting a moderate tightening phase in the months ahead. In addition, the central bank stepped up intervention to moderate the pace of currency appreciation; however, the effectiveness of such measures has been quite limited so far. Monetary authorities will buy, at a minimum, US\$20 million per day through March 15, 2011. On the fiscal front, tax exemptions on new foreign debt claims were eliminated and trade tariffs were adjusted. In addition, a financial transactions tax remains in place and a wealth tax is in prospect. The Colombian peso (COP), which depreciated to a rate of 2,036 per USD in late December, has resumed an appreciating trend on the back of regional currency trends and supportive foreign capital investment flows.

Euro Zone Sovereign Debt Turmoil to Continue in 2011

- **While Portugal will be the focal point of the euro zone sovereign credit crisis this year, we expect contagion to be manageable in Spain**

We assess that the euro zone has all the necessary tools available for bringing stability to the ongoing turmoil this year. There is strong political will across the region to consolidate public finances. While technically the financial pool of the European Union (EU) and the International Monetary Fund (IMF) is large enough to provide funding to Europe's troubled economies if need be, the potential enlargement of the facility is positive for investor sentiment prospects. Moreover, a permanent financial stability mechanism will be established by the euro zone countries in 2013. The euro zone is getting a head start in bringing public finances to a sustainable path, while the US continues to add stimulus to the economy, thereby postponing its inevitable fiscal consolidation process that will eventually draw the focus of global investor attention.



The sovereign turmoil in the euro zone periphery will continue to adversely impact the stability of the regional outlook through 2011. The confidence crisis has expanded to Portugal, with market participants speculating whether the country might eventually seek funding from the EU/IMF financial assistance pool. Portuguese authorities insist that Portugal does not need any help and is able to meet its 2011 financing needs of €20 billion by raising funding in international capital markets. Indeed, a successful Portuguese government bond auction on Tuesday demonstrated that the country was able to meet its immediate liquidity needs; however, as the sovereign crisis is predominantly driven by investor sentiment, the situation might change dramatically over the course of the year. Fundamentally, Portugal's sovereign debt position is relatively more sustainable than in many of its European counterparts. Its 2010 fiscal deficit is estimated to be 7.1% of GDP, less than that of France (7.6% of GDP). Moreover, the government debt level is manageable at 83% of GDP, in line with that of France, while its interest payments on public debt

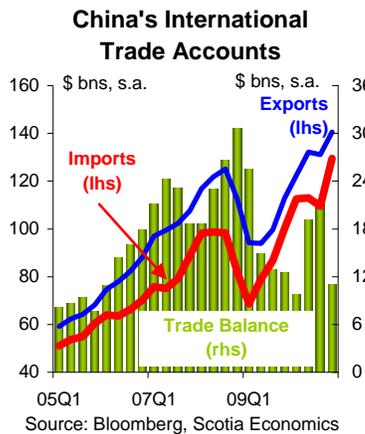
as a percentage of government revenues are 7.5%, just slightly more than the average ratio of 6.5% of Europe's four largest economies. In order to restore investor confidence, the Portuguese administration is decisively embarked on achieving fiscal sustainability. An austerity programme will reduce the general government fiscal deficit to 4.6% of GDP in 2011 through such measures as several tax hikes, including a second increase in the value-added tax rate from 21% to 23%, a 5% reduction in public sector wages and further cuts in public spending. Nevertheless, low economic growth and the lack of progress on productivity and growth enhancing reforms outline the fundamental challenge for the economy. Real GDP growth averaged 0.7% over the past ten years and similar growth rates are expected in the foreseeable future, making sustainable progress on the fiscal front challenging. Accordingly, should risk aversion spike up again, Portugal's access to capital markets might be impaired, forcing the country to seek financial help from the EU and the IMF.

If Portugal were to require a multilateral rescue package, investor attention would most likely turn to Spain. Nevertheless, we remain confident that market participants will recognize the Spanish economy's more solid fundamental position, leading to a stabilization period in the euro zone confidence crisis. Spain's public debt level is just over 60% of GDP, less than the euro zone average and lower than those of France and Germany. Moreover, at 6% its ratio of interest payments to revenue compares favourably with the average of the major European economies. Although its 2010 fiscal deficit was fairly high at 9% of GDP, Spain is proving strong commitment to fix its public finances and improve the economy's productivity. The 2011 budget targets a fiscal shortfall of 6.0% of GDP through such measures as significant reductions (of 30%) in public investment and other spending cuts as well as through privatization of government assets. In the meantime, it is endorsing a more favourable tax environment for companies, while planning to reform the pension system and increase the retirement age from 65 to 67 years. While Spain's perceived creditworthiness has suffered a setback as a result of market volatility, demand for Spanish debt securities remains strong, as indicated by a successful debt sale on Wednesday.

China-Pull Effect Intensifies During the Final Leg of 2010

- **Accelerating import flows absorbed by China a step towards global rebalancing**

Economic momentum within China will remain a key piece to the puzzle shaping world economic conditions in 2011-12. The latest Chinese customs bureau report on international trade transactions constituted further evidence of the country's contribution to global rebalancing. Moreover, next week's report on local retail sales should further corroborate signs of sequential growth in domestic demand on the back of a reacceleration of domestic credit at the end of 2010.



The value of China's commercial transactions with the rest of the world climbed to the highest level in history in the fourth quarter of 2010. Both exports and imports reached record levels in our in-house seasonally adjusted series during the December quarter, and the country's trade balance retracted back to the second-lowest average of the past five years (please refer to chart).

The value of Chinese imports rebounded during the final three months of 2010, growing at an 18% q/q rate (seasonally adjusted) as they recovered from the downtrend registered in the previous six months. The pickup represented the second largest quarterly advance since the first quarter of 2004. Exports also expanded but at a considerably lower 7% q/q rate, continuing with the trend that was only interrupted during the turn of the year 2009 as a result of the global credit crunch. In balance, the Chinese trade surplus with the rest of the world retracted back to US\$10.9 billion in the fourth quarter of 2010, a figure more in line with quarterly observations back five years ago.

Arguably, the increase in Chinese imports must be reflecting a price-driven surge as the international cost of fuel and raw materials accelerated towards the end of last year. Indeed, the widely used CRB Commodity Index registered an average 13% quarterly rise in the three months to December. Therefore, not all of the contraction in the Chinese trade surplus represents a pure pull-effect on the global economy. In what follows, as we summarize the behaviour of commercial transactions between China and its main trade partners, we make an attempt at supporting the now conventional wisdom view of an evident global pull-effect from the emerging Asian nation.

The close interaction between China and Japan has undoubtedly been saving the latter nation from falling deeper into economic depression. China continued to import most intensively from Japan during 2010, with the latter country representing almost 12% of the total value of Chinese imports. Notwithstanding the strengthening yen, Japanese net exports to China intensified during the last three months of the year and were a major contributor to Japan's 3.5% estimated GDP expansion last year, one of the largest amongst developed nations. During 2010, Japan's trade surplus with China increased to an unprecedented US\$44 billion level as China imports from Japan increased almost 30% y/y while its exports expanded 24% y/y.

Europe accounted for an estimated 16% share of China's imports in 2010, representing the single non-Asian region with which China trades most intensively. Import values from Europe picked up only slightly (1% q/q) during the final quarter of 2010, to an average value of US\$15 billion, with the small gain representing a continuation of the upward trend established throughout the year. The value of Chinese exports to the European Union remained practically flat, standing currently at a quarterly value of US\$28.4 billion, the highest value on record. As a result the Chinese trade surplus with the EU shifted back 0.7% q/q in the December quarter. This, can still constitute evidence of a pull-effect on Europe as only a few Northern European countries within the union export fuel and raw materials to China, which inflated significantly during the last leg of 2010 as established above.

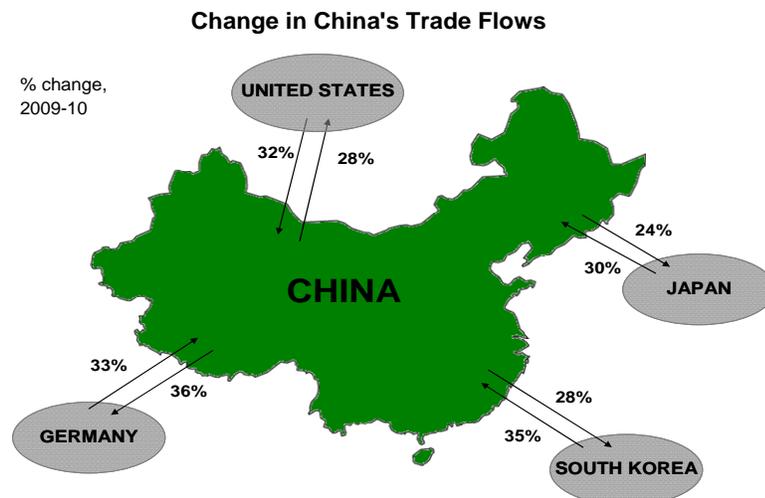
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Going down to the country level, the Chinese trade deficit with Germany did widen during the December quarter, as German imports persisted on an upward trajectory attained since the end of 2009, while exports contracted. The exchange rate between the euro and the Chinese yuan (CNY) stood at 8.9 on average during the fourth quarter of 2010, suffering a 4.1% quarterly depreciation after having strengthened during the previous three quarters. Therefore, the 5.6% rise in the Chinese deficit with Germany could well have represented an increase in the volume of net imports, supporting evidence of a pull-effect from China.

With respect to the U.S., the second major trading partnering country for China (accounting for 7% of total Chinese trade), the Chinese commercial surplus contracted by 12% on a quarterly basis, as a 13.6% q/q rise in the value of Chinese imports from the U.S. combined with a 4% fall in nominal exports. The contraction in the trade gap between the two countries in the three months to December is in line with this week's trade report for the U.S., which showed the country's overall deficit falling through November; a trend we anticipate will continue through December. It was interesting to see that analysts were caught off guard after the publication of the results, when it was already common knowledge that China's surplus with the U.S. contracted during the final three months of last year. Exchange rate fluctuations clearly played a role in this result as well, as the U.S. dollar weakened 1.6% on a quarterly basis against the CNY, lowering the cost of U.S. goods.

Finally, as has by now become probably evident, trade data in volume terms for China is difficult to come by, therefore it is important to consider the role of real exchange rate fluctuations in the above described process. Inflation within China is currently running at more than double the rate of Europe and the U.S., and nearly five times as high as that of Japan. Therefore a fall in the Chinese trade surplus in nominal terms implies that China's import values are rising more than exports. A lower inflation rate in the source country for the latter further supports the argument of a favourable net trade effect in volume terms. We must consider, however, that China's latest inflationary spur has been routed in rising food costs which are for the most part locally supplied. Moreover, non-food price inflation within China stands at around 1.9%, in line with price growth in the country's here considered with the exception of Japan.

In summary, China's commercial transactions with the rest of the world depicted an accentuation of the pull-effect that the Asian giant is exerting on the global economy during the final quarter of 2010. Moreover, when viewing annual trade figures, the evidence points in favour of the effect being present throughout 2010 (please refer to adjacent diagram). Under this light, the value of China's imports from all major trading partnering countries, except Germany, increased more than exports. This we would argue is likely a preview of things to come in 2011-12 as China smoothly accommodates further CNY strength.



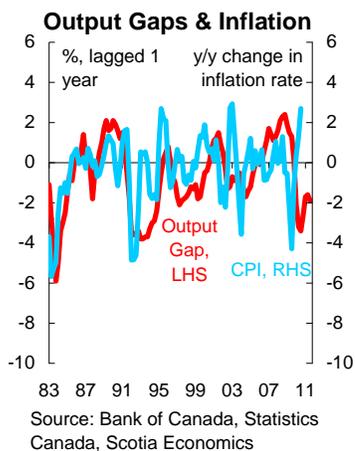
Source: Bloomberg, IMF, Scotia Economics

Gorica Djeric (416) 862-3080
gorica_djeric@scotiacapital.comDerek Holt (416) 863-7707
derek_holt@scotiacapital.com**Bank of Canada To Continue Pause Next Week**

- **We think the BoC's next rate move won't come until October, six months later than market pricing.**

We think that the market and consensus are being too hasty in pricing in resumed rate hikes by the Bank of Canada, and believe that the view in favour of earlier hikes is rooted in somewhat specious logic. Look to the BoC to stick largely to a mildly dovish script in Tuesday's rate announcement and Thursday's Monetary Policy Report. There are at least six key debating points in this regard.

One is that considerable recent debate has been focused on differences of opinion on the size of the output gap that measures broad economy-wide excess supply and what role that may play in guiding the inflation outlook. It's key to recognize, however, that output gaps don't play quite the same role in shaping inflation views in Canada as they may abroad. Even in other countries there is considerable debate regarding the usefulness of output gaps in forecasting inflation.¹ The BoC anchored inflation expectations more



successfully and earlier than other countries did when it shifted to inflation targeting in the early 1990s, so the connection between output gaps and inflation that existed in the 1980s largely broke down over the past twenty years. Thus, chart 1 shows at best a loose correlation between sticky prices and wild swings in output gaps — and with plenty of divergences. Astute observers of BoC speeches are well aware of the BoC's views on sticky prices and wages in this regard, and we think inflation remains well anchored over 2011 such that the BoC can err on the side of monitoring risks to sustainable domestic and foreign growth. As an additional aside, it's mostly how the BoC views output gaps that matters in gauging its reaction function (or how it reads the economy), not what private analysts think. Regardless, we think the output gap is likely to close only slowly over 2011-12 given our forecast for Canadian real GDP growth of 2.4% in 2011 that only modestly outpaces the economy's potential growth rate that the BoC estimates to be in the 1.8% range.

A second key debate concerns the extent to which growth in Canadian exports could be leveraged off momentum in the US economy. Alex Koustas and Sarah Howcroft discuss the outlook for Canadian exports on pages 19-20. A key consideration is that a strong CAD is motivating high import leakage effects during this export recovery cycle. When combined with CAD's negative impact on export competitiveness, the gains to Canada from a recovery in the US are limited. Even long-run IMF estimates would suggest that for every one percentage point lift to US growth, Canadian growth is impacted by half as much, and today's circumstances are likely more limiting. To that effect, Scotia Economics assumes that net trade is a trend drag on GDP growth throughout 2011.

Against the back drop of the debate over the role of output gaps, growth in unit labour costs (productivity-adjusted wages) has decelerated, and so has hourly compensation, while inflation lies in the lower bound of the BoC's target. In fact, core inflation has softened compared to the last MPR. At 1.4% y/y, it remains considerably below target and headline inflation (2.0%) is unlikely to diverge as strongly from core inflation as the pace of commodity price gains cools off over the next year compared to higher base effects.

Third, we think the BoC is using its moral suasion powers in commenting about the risks associated with household debt growth in a low-rate environment. Such warnings are not to be mistaken as an imminent signal of further rate hikes. Rather, we think Finance has a bias toward employing macroprudential tools in managing mortgage growth versus relying upon the BoC to use the blunt instrument of monetary policy.

¹ See, for example, "The Reliability of Inflation Forecasts Based On Output Gap Estimates In Real Time," Journal of Money, Credit and Banking, 2005, vol. 37, issue 3, pages 583-601.

Gorica Djeric (416) 862-3080
gorica_djeric@scotiacapital.com

Derek Holt (416) 863-7707
derek_holt@scotiacapital.com

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Fourth, the recoveries in Canada and the US are likely to be markedly dissimilar. For one thing, Canada lacks material pent-up demand in its housing and consumer sectors — unlike the United States. In fact, as we've argued many times, Canadian housing variables including the home ownership rate are at or beyond cycle tops and this points to growth underperformance in Canada versus the US over 2011-12. Another distinction compared to the US is that the US may have postponed fiscal adjustments into next year, but Canada is allowing stimulus to fall off the books such that fiscal drag will likely knock more than a percentage point off Canadian GDP growth in 2011. Canadian growth will come from business investment on tax incentives and CAD import cheapening effects, and natural resource strengths that reflect improved terms of trade, but there are enough offsets to such strengths to limit growth and thus merit a cautious BoC. What will add to this caution is an uncertain outlook for the US economy over 2012-13 when we think bond market concerns over the US fiscal position become more prevalent at the same time that necessary fiscal adjustments come into focus.

Fifth, we assume that the Fed is sidelined throughout 2011 and this will play a role in handicapping the BoC's moves for fear of further spread movements igniting CAD to even greater levels than we are assuming in our forecast.

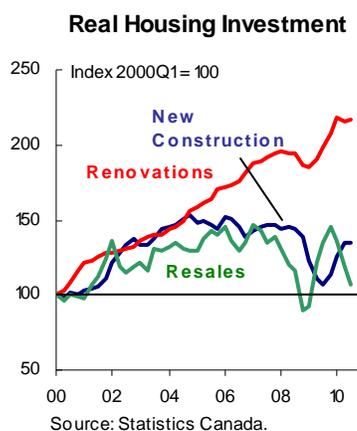
Sixth, global funding frailties will constrain many global central banks from heading toward the exits this year. To this effect, the BoC need also be concerned about the role of market tightening on borrowing costs in Canada given our views on risks to base sovereign yields in a year marked by massive global competition for capital on maturing sovereign and corporate debt combined with sovereign deficit financing requirements. Such financial market frailties are likely to keep many central banks sidelined throughout the year.

Adrienne Warren (416) 866-4315
adrienne_warren@scotiacapital.com

Canada's Renovation Market Set To Cool

- **A slowdown in renovation activity will reinforce a softer outlook for Canadian housing markets in 2011, with important spillovers to employment, retail sales, manufacturing and credit demand.**

We expect 2011 will mark the beginning of a cyclical transition to a more subdued, sustainable pace of housing activity in Canada. While continued ultra-low mortgage rates remain highly supportive, sales and pricing should be tempered by a more moderate pace of employment and income growth and increased housing supply. Overall, we anticipate relatively flat resale volumes and average prices this year. Housing starts, in turn, are forecast to drop about 8% to 175,000 units, in line with underlying replacement demand.



A potentially bigger risk to the outlook in 2011 and beyond is a sharper pullback in renovation spending. Most of the contribution of the housing sector to Canadian output growth over the past decade has come from the renovation activity, not from the construction of new homes or from the transfer costs and services associated with resale transactions (chart 1). Expenditures on home improvements and alternations have expanded at close to an 8% inflation-adjusted annual rate over the past decade, easily eclipsing the 3% yearly rise in new construction or 4% yearly direct contribution from resale transactions. The \$44 billion renovation industry now accounts for a record share of housing investment (roughly 40%) and overall GDP (2.8%).

The renovation boom reflects in part the continuing high level of home sales. Homeowners typically undertake their largest renovation expenditures in the first three years following a resale home purchase.

With home sales having peaked in 2007, the largest share of these 'new buyer' renovations should be winding down. At the same time, outlays in recent years have been considerably higher than would be expected simply given overall sales (chart 2). A return to more typical spending levels per household/resale transaction would entail a dramatic slowdown in overall renovation expenditures.

A number of other factors are likely behind the increasing drive to renovate. For one, historically low interest rates and rising home values have facilitated household borrowing. While household savings remain the dominant source of funds for home renovations, lines of credit and home equity extraction are also popular, especially for larger renovation projects. According to CMHC, the average expenditure by households undertaking home renovations in 2009 was just over \$12,000.

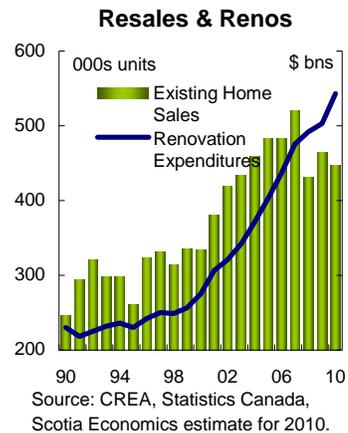
Second, a persistent shortage of listings and high home prices have made renovating an attractive alternative to moving for households seeking larger or more updated accommodations. Third, rising homeownership rates support rising renovation outlays, with owner-occupiers far more likely to make big-ticket upgrades than landlords and/or tenants. Fourth, lifestyle trends, or 'keeping up with the Joneses', are a consideration if the proliferation of television programs and magazines geared to would-be home renovators are any indication. And finally, many homeowners may view renovations as a form of longer-term saving when traditional equity and fixed-income investments are providing modest returns.

It is also likely that many home renovations were brought forward to 2009 and early 2010 as a result of the temporary federal Home Renovation Tax Credit (HRTC) and the implementation of the Harmonized Sales Tax (HST) in Ontario and British Columbia. The HRTC provided a non-refundable tax credit of up to \$1,350 for eligible expenses incurred between January 27, 2009 and February 1, 2010, while the HST added 8% (in Ontario) and 7% (in B.C.) to contracted renovation projects completed after the June 30, 2010 cutoff.

Adrienne Warren (416) 866-4315
adrienne_warren@scotiacapital.com

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Looking ahead, the economic and financial landscape is becoming less conducive to continued strong expansion in renovation spending. This includes moderating home sales and prices, a leveling off in homeownership rates, high household debt loads, (eventually) rising interest rates, and more stringent mortgage refinancing rules in effect since April 2010 (lowering the home equity withdrawal limit from 95% to 90%). While there is a risk of retrenchment after multi-year growth, continued, if more moderate, job gains and still attractive borrowing costs should support modest growth for the industry.



The tide already appears to be shifting. According to a recent survey from Altus Group/Ipsos-Reid, renovation intentions for 2011 have fallen to their lowest level in almost a decade. Less than 10% of households are planning a major renovation, defined as costing \$5,000 or more, in the coming year, compared with a peak of almost 18% in mid-2009. Additional insight on renovation intentions will come from upcoming surveys from Statistics Canada (in February) and CMHC (in June).

The potential impact on the broader economy is far reaching, extending from employment to retail sales and manufacturing, to credit demand. The renovation industry is labour intensive, and a large share of its materials are sourced domestically. The broad construction sector has accounted for 18% of all jobs created in Canada over the past decade, more than double the sector's share of overall employment. A range of retailers (and related manufacturers) are geared toward the industry, including hardware & building materials stores, home & garden centres, and furniture & appliance dealers.

Nathan Joshua (416) 866-5338
nathan_joshua@scotiacapital.com

Mary Webb (416) 866-4202
mary_webb@scotiacapital.com

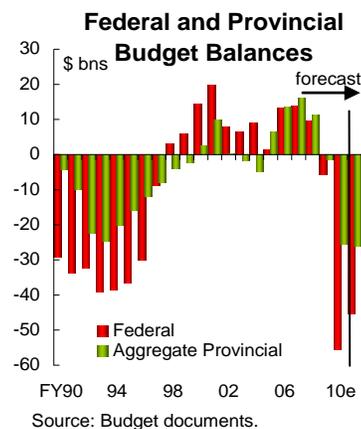
The Provinces' Spring Budgets — Focusing on Fiscal Repair

- **Even with some encouraging news in the FY10 final results and to date in FY11, for the Provinces in FY12 fiscal repair is an opportunity not to be missed.**
- **For the Provinces, as federal funding related to stimulus fades, the slated rise in Ottawa's major transfers plus its one-year extension of "Total Transfer Protection" are set for FY12.**

With the second year of Canada's discretionary fiscal stimulus scheduled to end this March, the Provinces' plans for fiscal 2011-12 (FY12) necessarily revolve around strengthening their fiscal positions. While a number of Provinces have started rebalancing their operations, their plans to achieve their deficit reduction targets range from Quebec's itemized multi-year strategy to more general intentions requiring specific details this spring. Mirroring market sentiment is the IMF's forecast that Canada will again undertake expeditious fiscal repair, trimming its general government deficit from the 2009 peak of 5½% of GDP to 1½% by 2013.

Better-than-expected final results for FY10 lessened somewhat the surge in provincial net debt. Audited reports to date indicate a combined \$25.5 billion provincial deficit, \$4.6 billion narrower than the Provinces' estimates in their spring 2010 *Budgets* (see table below). If balances before major transfers from reserves are included, the improvement from the spring forecasts expands to \$7½ billion. Major factors contributing to this improvement include: the Canadian economy's post-recession rebound, the pick-up in global commodity prices, the benefit of extremely low interest rates for debt service and emerging restraint in several Provinces.

For FY11, before transfers from reserves, the aggregate provincial deficit is expected to be wider than the Provinces' final FY10 shortfall. Mindful of elevated global economic and financial market uncertainty, mid-year updates indicate a cautious \$1½ billion advance on *Budget* estimates. Nevertheless, Saskatchewan, Newfoundland and Labrador and Nova Scotia now project surpluses for FY11, with no helping boost from reserves. Although Nova Scotia cites a one-time adjustment behind its positive FY11 balance, for the other two jurisdictions Scotia Economics' upbeat price outlook for commodities such as oil and potash underlines their potential for further black ink.



	Provincial Budget Balances							% of GDP	
	Fiscal 2009-10 (FY10)			Fiscal 2010-11 (FY11)			FY10 Final FY11 MY		
	Spring 2010	Final	Final-Spring	Budget	Mid-Yr	MY-Bud	per cent	per cent	
	\$ millions			\$ millions					
NL	-295	n.a.	n.a.	-194	12	207	n.a.	0.0	
PEI	-84	-74	10	-55	-55	0	-1.6	-1.1	
NS	-488	-330	159	-222	97	319	-1.0	0.3	
NB	-743	-738	5	-749	-820	-72	-2.7	-2.9	
QC	-4,257	-3,174	1,083	-4,506	-4,606	-100	-1.0	-1.5	
ON	-21,330	-19,262	2,068	-19,690	-18,656	1,034	-3.3	-3.0	
MB	-555	-201	354	-545	-471	74	-0.4	-0.9	
SK	425	425	0	20	69	49	0.8	0.1	
AB	0	0	0	0	0	0	0.0	0.0	
BC	-2,775	-1,812	963	-1,715	-1,695	20	-0.9	-0.8	
All Prov.¹	-30,103	-25,461	4,642	-27,656	-26,125	1,531	-1.7	-1.6	
Budget Balances Before Major Transfers from Reserves									
QC	-4,690	-3,607	1,083	n.a.	n.a.	n.a.	-1.2	n.a.	
SK	-86	168	253	-174	137	311	0.3	0.2	
AB	-3,624	-1,032	2,592	-4,748	-5,005	-257	-0.4	-1.9	
Adj. Prov.¹	-34,670	-27,183	7,487	-32,598	-31,062	1,536	-1.8	-1.9	
Fed. Gov't	-53,800	-55,598	-1,798	-49,200	-45,400	3,800	-3.6	-2.8	

¹ Sum of FY10 final balances includes NL's Spring 2010 estimate.
 Source: Government documents, Statistics Canada, Scotia Economics.

Nathan Joshua (416) 866-5338
nathan_joshua@scotiacapital.com

Mary Webb (416) 866-4202
mary_webb@scotiacapital.com

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Beyond FY11, and acknowledging the fragile aspects of the current economic recovery, the euro zone's accelerated fiscal repair still underscores the advantages of sustainable deficit elimination sooner rather than later. Notable benefits for the Provinces include the cumulative savings in interest costs, a head start on the restructuring required for the retiring baby boom generation, and the flexibility gained to better protect past investments in social programs and competitiveness. The latter is a key issue, with eight Provinces persevering with capital or corporate income tax reductions from 2010 to 2012.

Several factors, in fact, should facilitate provincial fiscal repair in FY12. Although some headwinds are anticipated, including a stronger Canadian dollar and moderating growth, Canada's real GDP in 2011 is still expected to advance a solid 2.4%, alongside nominal GDP growth of 4½%. In many regions, provincial infrastructure dollars will continue to be stretched by moderate non-residential construction prices relative to the peaks in 2008. The pre-recession tilt in income and output growth towards the resource-rich provinces has resumed, with buoyant global prices for most commodities backfilling the \$10 billion FY10 drop in their resource receipts and spurring new investment. One more year of relatively subdued interest rates will help to restrain the debt service impact of the Provinces' elevated financing requirements. As well, major fiscal restraint across the U.K., much of continental Europe and most U.S. States will offer a constructive backdrop for the Provinces' to present tough trade-offs that include scaling back, over the next couple of years, annual increases in health care budgets to a more sustainable pace below 5%.

As federal stimulus-related transfers to the Provinces and targeted funding dissipate over the next year, Ottawa's commitment to maintain scheduled annual growth in its major transfers to the Provinces (the Canada Health Transfer (CHT), the Canada Social Transfer (CST) and Equalization) will push these transfers \$2.4 billion (+4.7%) higher in FY12 to \$54.6 billion (*see table below*). This increase includes the slated 6% annual rise in the CHT as well as Ottawa's one-year extension of its FY11 "Total Transfer Protection" (TTP). This program reimburses any Province for a decline in its total major transfers from the prior year. Details of the major FY12 transfers for each Province, such as Ontario's Equalization gain, illuminate the ongoing shifts in Canada's regional fundamentals. The Provinces' gain from major transfers in FY12 contrasts with Ottawa's \$6.4 billion (-24%) cut in transfers to the Provinces and the Territories from FY95 to FY98 during its prior round of substantial fiscal repair. With the current CHT and CST agreements expiring as of March 2014, and Ottawa's ambitious deficit reduction agenda through FY15, sizeable increases in major federal transfers matching the FY12 hike are unlikely to persist indefinitely.

Major Federal Transfers to the Provinces and Territories¹, FY12p

	CHT		CST ²		Equalization/TFF ³			Offshore		Total	
	\$ mn	% ch	\$ mn	% ch	\$ mn	% ch	per capita,\$ ⁵	Accord \$mn	TTP ⁴ \$ mn	\$ mn	% ch
NL	452	3.4	170	1.8	0	0	0	325	0	947	-5.5
PE	115	4.5	48	2.1	330	0	2,293	-	0	492	0.4
NS	759	4.1	315	1.9	1,176	5.9	1,241	168	149	2,566	-2.3
NB	606	4.3	251	2.0	1,488	-5.9	1,971	-	145	2,490	0
QC	6,408	4.9	2,660	2.6	7,639	-10.7	953	-	545	17,252	0
ON	10,746	7.0	4,461	3.0	2,350	141.8	175	-	0	17,557	13.3
MB	1,002	5.0	416	2.7	1,677	-8.2	1,336	-	265	3,360	0
SK	866	5.1	360	2.9	0	0	0	-	0	1,226	3.7
AB	2,114	6.8	1,266	3.9	0	0	0	-	0	3,380	5.7
BC	3,799	6.0	1,537	3.5	0	0	0	-	0	5,336	5.3
All Prov.	26,867	6.0	11,484	3.0	14,659	2.0	598	492	1,104	54,606	4.7
Territories	85	6.3	38	5.6	2,876	8.0	25,262	-	-	2,998	7.8
Total	26,952	6.0	11,522	3.0	17,535	2.9	712	492	1,104	57,604	4.8

¹ Components may not sum to totals because of rounding. ⁴ Children, Post-Secondary Education and Social Programs.

² Territorial Formula Financing. ³ Total Transfer Protection. ⁵ For recipient jurisdictions only.

Source: Finance Canada, Statistics Canada, Scotia Economics.

Sarah Howcroft (416) 607-0058
sarah_howcroft@scotiacapital.com

Alex Koustas (416) 866-4212
alex_koustas@scotiacapital.com

Evolving Trade Patterns in a High Dollar Climate

• **Export Growth De-Coupling from Dollar Volatility**

Canadian exporters are showing cautious optimism as the global recovery slowly gains momentum in 2011. Signs of improvement in the United States and continued strength from emerging markets point to another year of export gains, but several risks and issues still weigh on the minds of exporters.

One of the most talked about issues in the public forum is the strong Canadian dollar. However, evidence points to the dollar becoming less of a concern for Canadian exporters and manufacturers over the past five years. Export Development Canada’s (EDC) Trade Confidence Index slipped in the fall of 2010, but still remains at a healthy level, with concerns weighted to global and domestic economic conditions, as opposed to currency fluctuations. Likewise, the Canadian Federation of Independent Business’ Outlook survey found that currency appreciation was a minor concern to many businesses.

The Canada dollar has seen unprecedented appreciation over the past eight years, rising by 50% relative to its U.S. counterpart. While exports have traditionally been quite sensitive to dollar appreciation, they have actually shown considerable resilience since 2002. Chart 1 plots export volumes against the Canadian dollar, removing any of the positive price effects of booming commodity prices over this period. After a sudden spike in the dollar shook exporters in 2003, export volumes then proceeded to rise in sync with the surging dollar.

Canadian Dollar & Exports

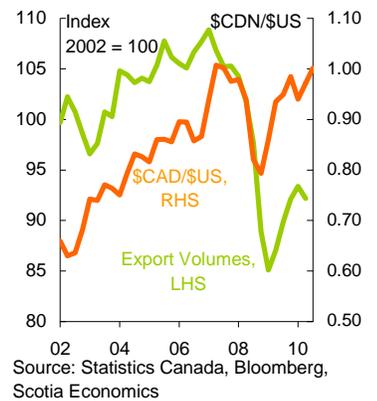
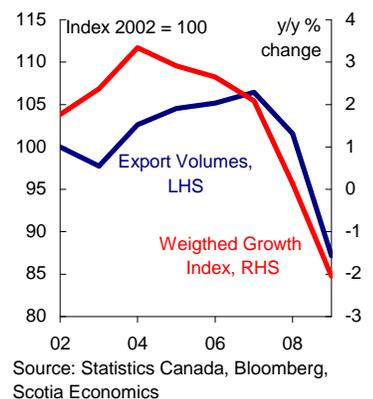


Chart 2 maps out a weighted index of GDP growth — a proxy for foreign growth — for Canada’s top export markets (U.S., EU, China, Japan) against domestic export growth on a volume basis. The trends follow each other closely, suggesting that economic conditions in foreign markets have much more bearing on export fluctuations than the volatility of the dollar. It appears Canadian exports have steadily become more inelastic to currency movements and more heavily weighted towards the demand fundamentals of our trading partners.

Industries producing highly substitutable goods such as textiles, paper, and food tend to struggle most in a high dollar environment. Conversely, capital intensive or more value-added industries actually weather a high dollar rather well, as they are more import intensive — thereby benefitting from the lower input costs that a higher dollar provides — and produce less-substitutable products. Significant restructuring over the past two decades, coupled with shifting supply chains and an increase in multinational linkages, have created a climate in which the current mix of Canada’s industries is such that a strong dollar has limited effects on aggregate export growth.

Business investment has advanced at a faster pace than all other components of GDP over the past year, as industries race to boost productivity in the face of sustained strength in the Canadian dollar. In fact, the inflow of capital goods has been such that on a net trade basis, Canada’s trade deficit will actually widen in 2011. Sustaining this push will be key as Canada will be challenged to further increase the value of its exports in the face of continued dollar strengthening.

Exports & Foreign Demand



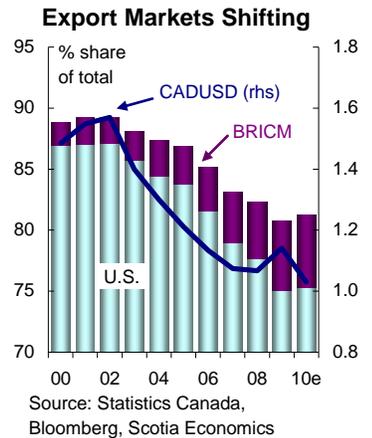
Sarah Howcroft (416) 607-0058
sarah_howcroft@scotiacapital.com

Alex Koustas (416) 866-4212
alex_koustas@scotiacapital.com

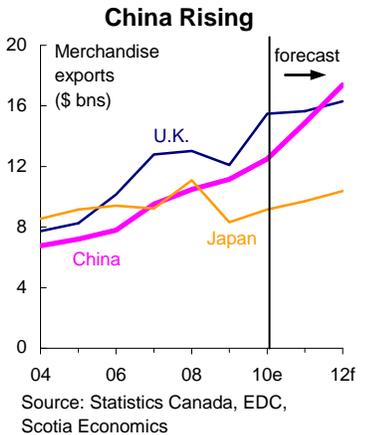
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• **Responding to Canadian Dollar Strength Through Export Diversification**

Accompanying the appreciation of the Canadian dollar over the last several years has been another steady trend — the diversification of Canadian exports away from the United States and other developed trading partners. Chart 3 shows that the share of total Canadian exports destined for the U.S. has fallen by more than 10 percentage points since the early 2000s, while the combined share going to the BRICs (Brazil, Russia, India, China) and Mexico (BRICM) has more than tripled. EDC’s Trade Confidence Index showed that although Canadian exporters were less optimistic about domestic and external conditions overall, confidence in the BRICM nations proved robust, as 23% of respondents now expect these markets to contribute the most to export sales, up from 19% last spring. The movement away from traditional export partners was accelerated by the global recession and the weakening of certain major currencies, and while the U.S. share will likely rebound slightly as the recovery gains momentum, persistent outperformance of the emerging markets globally will ensure that the trade shift continues.



Using 2011-12 forecasts from Export Development Canada and Scotia Economics applied to current merchandise export data from Statistics Canada, it is estimated that China will become the second largest destination for Canadian goods, overtaking the United Kingdom by 2012 (see chart 4). Given the ongoing shift to consumer-driven growth in China, and deep fiscal austerity measures in the U.K., this may be a conservative estimate and the positioning could change even sooner. Another factor favouring increasing Chinese imports is the modest appreciation of the yuan, which is expected to continue into 2011. This timely loosening of government currency control may hasten the yuan adjustment process, with imports picking up accordingly. Of sectors exporting to China, the biggest gains recently have been in forest products — last fall China became the second biggest market for Canadian lumber — and metals and minerals, while future increases are expected in the fertilizer, machinery and equipment and commercial aerospace industries. Brazil also looks set to move up in the export partner rankings on the back of strong performance in the chemicals and plastics, machinery and equipment and resource-based sectors, and may have surpassed India, Norway and France by the end of 2010, or may do so early this year.



While the Canadian export picture looks promising, trends in imports also need to be considered. Given the moderate rate of import growth expected in Canada over the next couple of years, rudimentary calculations show that the trade balance with several key partners should improve — the surplus with the United States will grow, the deficit with Brazil will shrink, and the deficit with China will level off (as will the surplus with the United Kingdom). Scotia Economics forecasts that by 2012, the contribution from net exports to GDP growth will still be negative, but only marginally after a drag of roughly 1% in 2011.

Patricia Mohr (416) 866-4210
patricia_mohr@scotiacapital.com

The Commodity Price 'Super-Cycle' Continues in 2011

- **Only A Slow Resumption of U.S. Gulf 'Deepwater' Drilling Will Lift Oil Prices**

Scotiabank's Commodity Price Index ended 2010 on a strong note, up more than 12% from late 2009. While remaining volatile, commodity prices should strengthen further in 2011, driven primarily by the ongoing strength of 'emerging market' demand (especially in China, India and Southeast Asia) and tightening supplies.

Top 'picks' for investors include hard coking & thermal coal, potash & other fertilizers, copper, uranium and palladium (a 'precious' metal used in auto catalytic converters to control emissions from gasoline-fuelled vehicles). Lumber (Western Spruce-Pine-Fir 2x4s) may also be surprisingly strong, benefitting from rising shipments from B.C. to China amid curtailed supplies.

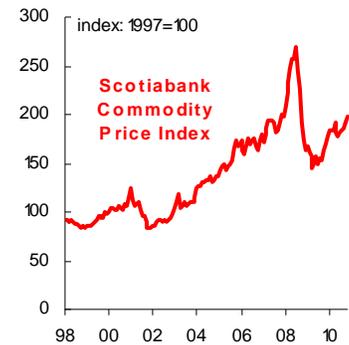
Contract prices in Asia for **Western Canada's premium-grade hard coking coal** could jump to US\$275/300 per tonne (FOB Vancouver) (possibly higher) in 2011:Q2 from US\$225, as China ramps up its steel production in early 2011, after power cutbacks last fall to meet the 20% energy intensity reduction target under China's 11th Five-Year Plan. While the growth of China's steel production will likely slow in 2011, construction of eight Cross-China high-speed rail links and a shift in property development to Tier 3 and 4 cities will underpin demand. Seven large, new steel plants will require high coke strength, benefitting Western Canadian producers. Spot coal prices in China started to climb again last Fall, as steel mills restocked ahead of winter, and have recently jumped alongside higher mining costs in China and severe flooding in Queensland (the source of most of Australia's hard coking coal exports). Australia accounts for 56% of world seaborne shipments of metallurgical coal; mines providing 40% of world coking coal have been affected.

Potash will benefit in 2011 from one of the best global agricultural environments for fertilizer application ever seen. U.S. corn prices (a crop requiring high application of potash as well as other fertilizers) surged to US\$6.31 per bushel on January 12, following the release of U.S. Department of Agriculture estimates indicating that the U.S. corn stocks-to-use ratio will fall to only 5.5 per cent in 2010-11 (the lowest since 1995-96) amid lower yields and rising ethanol production. U.S. corn prices are rapidly closing in on the record US\$7.55 of June 27, 2008 (just prior to the 'credit crisis'). Soybean prices on the CBOT also soared to US\$14.15 on January 12, not far from the record US\$16.49 of early July 2008, with stocks expected to fall to very low levels this crop year. High prices for corn, palm oil and sugar cane (the three crops using the most potash per hectare planted) will incent farmers to apply more fertilizer in 2011. While overseas potash prices will likely move up at a measured pace in the first-half of 2011, with Canpotex and BPC moderating asking prices to prevent derailing the demand recovery, export volumes from Canada are expected to increase substantially (following normalization in 2010).

While not among the Top Five 'picks' for 2011 (as measured by the anticipated percentage price increase through year-end), **WTI oil** prices are expected to strengthen markedly from US\$79 per barrel in 2009 to US\$95 in 2011 and to at least US\$98 in 2012, benefitting the Alberta oil sands and 'tight' oil plays in Western Canada. Alberta oil sands production rose by about 127,000 b/d in 2010 and should climb another 230,000 b/d in 2011 (assuming the current outage at Horizon is limited) to just under 1.7 mb/d.

Stronger oil prices reflect the following developments: 1) World supply/demand conditions were largely balanced in 2010, with the 'call' for OPEC crude oil at 29.4 mb/d actually exceeding OPEC production of about 29.2 mb/d. Global oil demand rose by a robust 2.9% (almost 3%) to about 87.5 mb/d — surpassing the previous peak in 2007, with non-OECD 'emerging market' demand up more than 5% and a partial recovery

Commodity Prices End 2010
on a Strong Note



Source: Scotia Economics

Patricia Mohr (416) 866-4210
patricia_mohr@scotiacapital.com

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in the OECD. In addition to ongoing strength in China's petroleum consumption (up 13.9% yr/yr in November), a number of weather and special events also boosted demand (hot temperatures in the Asia/Pacific region last summer, lifting air conditioner use in Japan, significant restocking of home heating oil in Germany and direct burning of diesel in backup generators in China in the fall (to offset curtailed coal-fired electricity generation to meet China's energy reduction target by late 2010). U.S. temperatures this winter have also been much colder than normal.

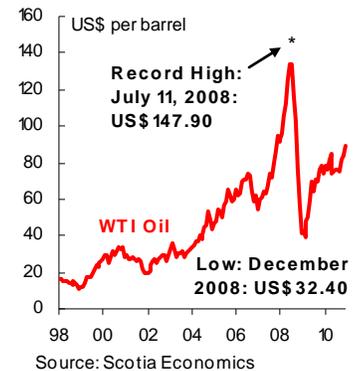
The recent strength in oil prices (WTI at US\$91.86 on January 12 and Dated Brent closing at US\$97.33) reflects expectations that global supply/demand conditions will tighten further in 2011. More specifically, the demand for OPEC crude oil will increase (albeit modestly), with non-OPEC supplies rising by a mere 0.8 mb/d (0.6 mb/d excluding biofuels) — well below expected global demand growth (at least 1.7%, lifting consumption by 1.5 mb/d).

This partly reflects expectations that the resumption of exploration & development drilling activity in the 'deepwater' U.S. Gulf of Mexico will be slow, stalling production. While the ban, implemented in the wake of the Macondo oil spill, was lifted on October 12, as yet no new drilling permits (for development or 'rank wildcat deepwater exploration' in technically more challenging areas of the Gulf) have been issued. In some recognition of the negative impact on the U.S. Gulf Coast economy from the lapse in drilling activity, the U.S. Bureau of Ocean Energy Management, Regulation and Enforcement (BOEM) announced in early January that 13 operators (already holding permits and in the midst of 'completing' development wells at the time of the Macondo incident) will be allowed to resume operations without submitting revised exploration or development plans, though they must comply with new federal regulations. While this drilling may slowly resume in the first half of 2011, new permits for 'rank wildcat exploration' are unlikely to be issued until late 2011 (at the earliest). Though output in the U.S. Gulf may hold near current levels, production will be held well below 'potential' given last year's drop in development drilling and the likelihood that new permits will be slow in coming. Regulatory and operating costs will also climb.

Prior to the oil spill, the Federal Gulf of Mexico accounted for more than one-third of U.S. oil production (1.7 mb/d). The Federal GOM (up 388,000 b/d) together with gains from the Bakken light oil play in North Dakota (up 46,000 b/d) and in the Rocky Mountains helped to boost U.S. oil output in 2009, after annual declines in every year since 2000 (linked to falling output in Alaska, California, Texas and Louisiana). The potential for 'elephant' fields in the relatively unexplored U.S. GOM has been the major hope for growth in U.S. domestic supplies going forward. U.S. oil production appears to have edged up in 2010 alongside further development of the Bakken and a plateauing of output in Texas linked partly to development of the liquids-rich Eagle Ford natural gas shale (actual production from the 'deepwater' Gulf was not halted). However, there is considerable uncertainty over the outlook for U.S. Gulf production in 2011-12, unless significant development activity resumes soon — likely to be pushed by a Republican-dominated Congress. (Shutdown of the Trans Alaska Pipeline for four days due to a small oil leak added to concern over U.S. supplies in early 2011, though pipeline shipments have been partially restored. Alaskan output was 618,000 b/d last fall and 2 mb/d at its peak in the late 1980s.)

Strong demand in China, the rest of 'emerging Asia' and parts of Latin America will also lift oil prices. China is soon expected to begin a second round of 'strategic' stockpiling of petroleum, having completed the construction of new storage facilities; this stockpiling may already have begun.

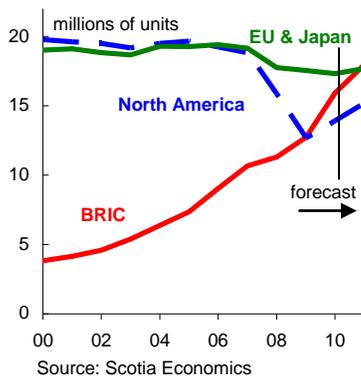
WTI Oil Likely To Climb Higher in 2011-12



Global Auto Sales To Rev Up To Record Highs In 2011

- **Increase Driven by Emerging Markets & Improving Job and Credit Creation**

The cyclical recovery in global auto sales that began in the spring of 2009 accelerated over the past year, and will likely lift volumes to record highs in 2011. The emerging markets of China and India will continue to lead the way, but the U.S. market is also expected to post its second consecutive double-digit increase in the coming year — a development that has not occurred since the early 1980s.

Emerging Nations Drive Global Car Sales to Record Highs

The recovery in global car sales has shifted gears and will increasingly be driven by improving labour markets and rising auto loans. This represents a healthy transition from the massive and synchronized monetary and fiscal stimulus that was required to get the industry, and the global economy, back on a positive growth trajectory. The pace of job creation — and not the level of unemployment — is the key driver of global car sales, and the ongoing improvement should enable the United States and the euro zone to climb out of their deep hole.

Improving global job growth — currently at about 2% year-over-year, the strongest pace since late 2007 — leaves potential new vehicle buyers better equipped to deal with ongoing concerns about the pace of the U.S. economic recovery, as well as with persistent sovereign debt problems emanating from Western Europe. Job creation is being led by growth of 4% year-over-year in the BRIC nations. However, prospects have even improved in Western Europe, with fourth-quarter euro zone employment

likely climbing above a year earlier for the first time since mid-2008.

The auto industry is also getting a helping hand from increased auto lending around the globe — especially in emerging nations, where loan growth is approaching 40% year-over-year. Brazil is leading the way, with loan growth of nearly 50% y/y, followed by China and India at 38% and 21% y/y, respectively. Credit availability is key to increasing car sales in emerging markets, as more than 80% of cars sold in India require credit. In Brazil, more than 70% of all vehicles are purchased on credit.

Highlighting the improvement in credit availability, interest rates on auto loans in Brazil fell to a record low of 23.7% in late 2010, from a peak of 38% at the height of the global credit crisis in 2008. Interestingly, auto loan rates have continued to decline even as the central bank of Brazil has raised short-term interest rates by 2 percentage points over the past year to dampen higher-than-expected inflation. Credit terms have also been extended significantly, and can now be stretched up to 80 months, from about 36 months two years ago. Estimates suggest that these measures now enable about 16% of the Brazilian population to buy a new car, up from only 10% several years ago. Of note, improving economic conditions and the loosening of credit conditions have sharply reduced the number of auto loans in arrears both in Brazil and elsewhere.

Rising incomes and favourable demographic trends — especially in China and India — will also continue to buoy global car sales. China became the world's largest auto market in 2009, surpassing the United States. Purchases soared an additional 30% over the past year, and will continue to lead the global auto recovery in 2011. More than one-quarter of the world's key vehicle-buying age group — 40-49 year olds — reside in China, and are experiencing rapid income gains. This age group has the highest disposable income, and its share of the Chinese population continues to increase, climbing to 17% of China's population by 2015, from less than 14% in 2005.

Longer-term, India will become increasingly important for the auto industry. Half of its 1.2 billion inhabitants are less than 25 years old. In fact, India is home to 20% of the world's population under 25 years of age. These 610 million potential future car buyers represent nearly two-thirds of the current global vehicle fleet.

Canadian Corporate Bonds — Calmer in 2011

This is a partial summary of a document in the Corporate Bond Weekly — January 7, 2011

If you thought that the Canadian corporate bond market was lacking some spark in 2010, then get ready for an even less exciting market in 2011. While the broader economic picture continues to see some shocks and swings, we feel that the performance of the C\$ corporate bond market will be remarkably unspectacular, with overall investment grade spreads likely to end 2011 modestly wider than at the beginning of the year.

A Quick Review — 2010 Results vs Expectations

Last year at this time, we had indicated that we expected to see:

- Corporate index returns in “the low end of the 7-10% range”
- Spreads initially tightening and then widening in 2H10
- Issuance to rise to “the \$60-\$65bn range”
- Net rating changes to be “modestly negative”
- BBB’s outperform “A” rated, and particularly “AA” rated bonds
- Top performance from US banks/brokers, Infrastructure, Communication segments
- Under-performance from Canadian bank deposit notes, air related infrastructure, utilities.

A review of these targets showed that:

- The DEX Universe All Corporate Bond Index returned 7.34% for 2010
- Spreads initially tightened, and then widened in 2H/10
- Issuance rose from \$58.784bn in 2009 to \$87.047bn in 2010
- There were 19 downgrades vs 18 upgrades
- DEX Corporate Index returns: BBB-9.51%, A-8.36%, AA-4.95%
- Top performing sectors included Infrastructure (10.79%), Energy (10.42%), Industrial (10.39%) segments
- Lowest returns in the Securitization (4.47%) and Financial (5.46%) segments

While we were correct in our views of the expected returns, the weakening of performance in 2H/10 vs 1H/10, and the out-performance of the lower rated securities, we materially under-estimated the level of issuance during the year, particularly as it related to bank and ABS issuance. Not surprisingly, the heavier issuance in both these segments was in part responsible for the lower full-year returns reported, although the higher ratings/lower coupons associated with these segments also typically result in lower annual returns.

Expectations for 2011

The macro-economic environment is looking moderately positive for C\$ corporate credit quality in 2011, with Canadian GDP expected to be in the mid-2% range, and with BoC rate hikes not expected until late in 2011. Rate hikes in the US are not expected to occur until even later. While Government of Canada bond yields are anticipated to rise moderately later in the year, the level of economic performance should help to keep interest rates close to historical low levels (although not nearly as low as seen in 2010). The combination of moderate amount of growth and low interest rates is seen as maintaining enough positive momentum to the economy to maintain profitability, and therefore financial performance of most C\$ corporate issuers, with a moderately positive bias. We feel that the expected rise in the C\$ (vs the US\$) during 2011 will act as a moderating influence to overall profit improvement for many Canadian firms, but will not be enough to counteract the modest upside from the growing economic performance. While M&A activity is expected to increase y/y from the very low levels of 2010, we do not yet view levels as impairing broad credit quality.

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In addition to the base economic expectations, we also recognize that there are additional factors that could have a material impact on C\$ corporate spread performance in the coming year. Particularly, we will watch the potential for European sovereign credit concerns, as well as the overall level of issuance in the C\$ market. For this forecast, we will assume that there is not any major sovereign debt restructuring, although this is not assured. Should there be a sovereign restructuring, we would expect a short term widening of all corporate spreads, especially for financial firms with exposure to the European region.

With this as background, for 2011 we expect;

- *Corporate index returns in the 6-8% range*
- *Spread performance flat to modestly positive in 1H/11, wider in 2H/11*
- *Issuance declines modestly y/y to the \$80-\$85bn range*
- *Rating changes still infrequent – modestly net positive*
- *Lower rated credits to outperform – BBB's return better than A, better than AA*
- *Top performing sectors to include:*
- *Industrial segment – includes a number of BBB issuers*
- *Communication – moderate issuance, spread appeal vs utilities*
- *Insurance – further recovery compared to banks*
- *Under performing sectors to include:*
- *Senior bank debt – heavy issuance expected*
- *Regulated utilities – spreads currently tight*
- *Securitization – low yields, spread tightening has ended*

One broad-market aspect that may take on greater importance over 2011 is the likelihood of an allocation shift from bonds into equities, or at least less sharply into bonds. The lower yields and returns on bonds during 2010, and likely during 2011, may lead to some re-direction of funds from bonds into other asset classes. We expect that this movement, combined with relatively heavy issuance of bonds, will put more pressure on spreads in the second half of 2011 than will be seen earlier in the year.

Summary Views

The performance of corporate Canada, and most of the C\$ issuers in particular, is expected to be incrementally stronger in 2011. We expect that there will continue to be volatility surrounding sovereign credit concerns, and the ongoing regulatory actions surrounding the banking system, but our “most likely” scenario is that these do not have a material impact on the C\$ corporate bond market. Credit rating performance in aggregate is expected to be slightly better y/y, but not have a notable impact on spreads. We continue to focus on the banking segment, particularly as it impacts overall issuance levels, as having a material impact on spread levels. For 2011, we feel that issuance in C\$ will be heavy, but not excessive enough to push spreads sharply wider. However, the impact of relatively heavy issuance, combined with our expectation that fund inflows into the corporate bond market may ease somewhat compared to 2010 (although high yield inflows may remain), should result in moderate spread widening. As such, we expect that 2011 will be a rather non-eventful year for the C\$ corporate bond market, as events impacting banks and sovereign credits are not expected to have a “direct” negative impact on spreads, although the “indirect” impacts may be a periodic negative to C\$ market tone.

Joe Kogan (212) 225-6541
joe.kogan@scotiacapital.com

Emerging Market Themes and Credits for 2011

This article is an introduction to and a summary of a powerpoint presentation distributed on December 29, 2010.

Interest in emerging market investments seems higher than ever. Continual news stories of crises and bailouts in Europe, accompanied by uncertainty regarding the recovery in the United States, have shaken the public's confidence in developed markets. Meanwhile, emerging markets' rapid recovery from the financial crisis, their robust growth rates, and their relatively attractive debt levels, have challenged investors' assumptions about risk and return, changing the way that these investments can be marketed.

For decades, economists had espoused the diversification benefits of emerging markets for US portfolios, to no avail. Now it seems, emerging market proponents can make a much simpler argument based on returns alone. "We believe emerging markets will lead," says one television commercial for mutual funds that plays daily. Responding to such arguments, retail investors have piled into dedicated emerging markets funds as never before (Figure 1). Particularly strong have been retail inflows to local currency EM funds, demonstrating the depth of fears regarding the strength of the dollar.

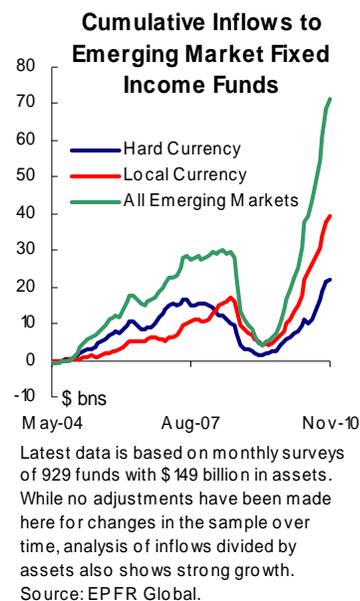
The pace at which interest in EM assets continues to grow has significant implications for which assets are likely to perform well in the year to come. While certainly some investors new to emerging markets may start with most solid and liquid instruments such as USD-denominated bonds issued by Mexico and Brazil, we think spreads of only 150bp over US Treasuries will not keep investors' interest for very long, especially as many existing EM investors have in the past seen total returns of 15% to 20%.

The first place where we think investors will look for higher returns is of course the lower-rated EM sovereigns. Bond prices for these credits have still not fully recovered from the financial crisis. More importantly, the bonds of these countries are pricing far too much default risk. Implied probabilities of default in 10 years are as high as 85%, which is far higher than the 14% to 25% default rate we have seen among lower-rated credits historically (Figure 2). Contrary to public opinion, sovereigns, even poorly-rated sovereigns, do not actually default that often.

We follow two poorly rated sovereigns in particular: Venezuela and Belize. Venezuela is well-known for its counterproductive policies and deteriorating economy. It would be hard to imagine recommending equity investments in that country. Nevertheless, it is oil revenue that keeps the government going, and we believe that even the smallest threat on that revenue stream from sovereign bondholders will ensure that the government continues to pay its debt even as local economic conditions worsen. In Belize, the debt burden is high but not unsustainable. We think the biggest risk stems from large international lawsuits against the government by a local business group; the eventual resolution of such lawsuits could allow spreads to compress further.

A second-place where investors can find additional yield, and this time without significantly greater risk, are quasi-sovereigns. These public companies trade at what to us seems as too high a spread differential over the sovereign once we consider the relative risks of default. These spreads over sovereign have been stable for the past year, and we foresee little potential for negative firm-specific news in the near-term that could cause those spreads to widen. Yet, we caution corporate analysts that the implicit promise of support from the sovereign usually comes at the expense of inefficiencies and poor financials.

Figure 1



Joe Kogan (212) 225-6541
joe_kogan@scotiacapital.com

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The case is clearest for Pemex, Mexico's national oil company, where negative profits and even negative equity result from the government keeping 50% of firm revenues as taxes and royalties. It seems obvious that, in times of financial difficulty, the government would rather lower its royalty rate than allow the firm to fail. The discussion is more complex for ENAP, Chile's public energy company, since ENAP does not generate revenue for the state. Nevertheless, some argue that the firm is needed for national energy security, and the current government wants to strengthen the company in order to attract private investors. Another investment premised on the continuity of government policy is the bonds of Mexican homebuilders focused on affordable housing. The viability of these large private companies is crucial to the government's goal of financing half a million homes for the poor every year.

Finally, investors are turning to bonds denominated in emerging market currencies. Typical to the cycle for EM assets, investors switch to local currency bonds when spreads have compressed sufficiently on the hard currency bonds. This time, that stage of the cycle is bolstered by concerns about the ultimate stability of those "hard" currencies. Two local currency issuers representing the extremes of the spectrum demonstrate the options and tradeoffs available. Peru is an investment grade credit whose stable path of currency appreciation continues to attract foreign investors; in the last six months, non-residents increased their holdings of treasury bonds from 18% of the amount outstanding to 46%. High economic growth, high FDI, and a central bank that constantly intervenes to maintain currency stability, should ensure a slow but steady currency appreciation in the future. On the other extreme is the Dominican Republic, a single B-rated credit, with little foreign participation in the local curve. While the currency depreciates at about 3% per year, local bonds sold in government auctions last year offered yields above 15%, making them far more attractive than the global bonds paying only 6%. Foreign investors are starting to take notice.

These three types of investments—higher-risk global bonds, quasi-sovereigns, and local currency bonds—should all do well this year. Performance will be especially strong if interest in EM continues, and we see no reason why the current enthusiasm about EM assets should abate any time soon.

Figure 2

Agency/ Credit	Historical vs. Implied default probabilities (%)				
	Rating	1-YR	3-YR	5-YR	10-YR
S&P historical	BBB	0	1.6	4	6.1
Brazil implied	BBB-	1.7	6.2	11.9	28.3
Colombia implied	BBB-	1.7	6.2	12.1	27.8
Mexico implied	BBB	1.7	6.2	18.3	26.9
Peru implied	BBB-	1.7	6.7	12.2	25.7
S&P historical	BB	0.7	3.7	6.4	13.6
Venezuela implied	BB-	18.8	51.1	77.4	84.6
S&P historical	B	2.1	6.7	11.7	24.6
Argentina implied	B-	0.9	31.9	48.7	73.8

Historical default rates are from S&P data for 1975-2009. We calculated implied default rates from CDS data as of December 27, 2010, with a recovery assumption of 50%, which is the Moody's historical issuer weighted recovery rate.

Source: S&P, Moody's, Bloomberg.

Vincent Delisle (514) 287-3628
vincent_delisle@scotiacapital.com

Hugo Ste-Marie (514) 287-4992
hugo_ste-marie@scotiacapital.com

2011 Strategy Stance

The Federal Reserve recently launched its QE2 program and stimulative monetary conditions should extend throughout 2011 in the United States. The Canadian dollar is expected to strengthen modestly as the Bank of Canada resumes rate hikes in the second half of 2011. Short-term interest rates should stay low, but mean-reverting inflation expectations could push long-term yields higher. We are positioned for U.S. 10-Year yields rising above 3.5% and we expect Bond total returns to hover between 2% and 4% in 2011. In our opinion, the risk for bond yields is to the upside if U.S. employment visibility improves. We expect shorter maturities and corporate bonds to outperform.

Exhibit 1				
Scotia Capital Financial Forecasts				
	2009	2010 E	2011 E	2012 E
S&P/TSX	11,746	13,443	14,000	
EPS	600	700	860	925
S&P 500	1,115	1,258	1,325	
EPS	57	83	90	95
Mexico Bolsa	32,120	38,550	41,000	
EPS	1,770	2,100	2,400	2,600

Source: Scotia Capital estimates

The 2011 outlook for equities is positive and we expect the S&P 500 to trade in the 1,125-1,325 range this year. However, investor sentiment will remain vulnerable to myriad challenges and a tactical approach should add value again in 2011. Investors have been through bouts of euphoria and despair in recent months and 2010's volatile equity climate could continue in 2011. In our opinion, the catalyst to sustained improvement in equity sentiment; i.e., a

positive reversal in flows that would lift valuations, will materialize when the Fed talks about its exit strategy (rate hikes). In the U.S. mutual fund market, bond flows have reversed and have been negative in the dying weeks of 2010. However, we have yet to witness a positive reversal into U.S. equities.

Our global earnings revisions ratio remains high and we are comfortable with a scenario of sustained profit growth in 2011. A steep U.S. yield curve points to low double-digit profit growth over the next 18 months. Our 2011/2012 earnings estimates stand at \$860/\$925 for the TSX and US\$90/US\$95 for the S&P 500. Our 12-18 month price targets are set at 14,000 for the TSX (15.1x forward P/E) and 1,325 for the S&P 500 (13.9x forward P/E). Based on our revised equity targets, we expect total returns of 10% (TSX +8% in C\$; +12% in US\$, S&P 500 + 8% in C\$; +12% in US\$) in 2011.

From an asset mix perspective, we reiterate our equity over bond preference for 2011. However, the magnitude of our equity overweight recommendation for 2011 is reduced to 58% (was 65% in 2009 and 68% in 2010). Consequently, our Bond suggested weighting increases to 35% (28% in both 2009 and 2010) and Cash settles in at 7%. Globally, Canada, EM (especially LatAm) and the S&P 500 should be preferred to Japan and Europe. In terms of sector strategy, earnings momentum still favours cyclical sectors over defensives heading into 2011. We would overweight Energy, Industrials, and Technology. Risks of additional tightening in China and euro weakness prompt us to start 2011 with a cautious view on Materials. We are raising Financials to overweight to kick off 2011.

10 Themes for 2011

Following is a list of guidelines (and reminders) that will influence our strategy in the coming months.

1. **The S&P 500 should trade in the 1,125-1,325 range.** The risk-on/risk-off mentality kept investors on edge in 2010 and the S&P 500 traded in the 1,025-1,225 range. Looking at bottom-up forecasts for 2011 and 2012, and using the same P/E range, we expect the S&P 500 to trade within the 1,125 and 1,325 levels. We will continue to focus on tactical indicators such as our risk-on/risk-off barometer in order to alter our cyclical exposure.

Vincent Delisle (514) 287-3628
vincent_delisle@scotiacapital.com

Hugo Ste-Marie (514) 287-4992
hugo_ste-marie@scotiacapital.com

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2. **Stay constructive on equities as long as U.S. employment outlook improves.** This was our number one asset mix guideline in 2010 and we are sticking to it. If weekly claims fall below the 400,000 “sweet spot” in 2011, the pace of monthly employment growth should accelerate. A pickup in employment is positive for equities, negative for yields, and somewhat supportive for the US\$.
3. **Low double-digit earnings growth.** Rebounding U.S. leading indicators, high single-digit GDP growth in Emerging Asia, top line expansion, strong operating leverage, share buybacks, and steep yield curves all point to a favourable profit outlook next year. Our global earnings revisions ratio remains high and we are comfortable with a scenario of sustained profit growth in 2011. Cyclical sectors are still posting superior earnings revisions to defensives at this point, and U.S. small cap revisions are also outpacing large cap revisions.
4. **Limited P/E expansion.** Based on calendar 2011 earnings estimates, the S&P 500 is trading at 13x P/E, two points below its 15x historical average. Sustained bull markets thrive on both EPS and P/E expansion, but until investor sentiment fully recovers from the dreadful secular bear cycle that started in 2000, we see limited contribution coming from valuation expansion for U.S. equities. A reversal in flows would be a catalyst to higher P/Es. In Canada, we could see outright contraction in 2011. The S&P/TSX index is currently trading at a 23% premium to the MSCI AC. There are still many reasons to overweight Canada, but relative valuations are **not** one of them.
5. **Stick with the dividend theme.** In an environment of low (albeit rising) nominal interest rates and thirst for income (aversion to riskier equities), high-yielding stocks should perform well. With cash balances moving higher, important capital allocation decisions await company boards in coming quarters. Although buybacks and M&A are obvious alternatives for cash redeployment, we believe dividends will become an increasingly attractive option. Dividend increases should also get the best reception from investors with equity sentiment at decade lows, flows searching for comfort (government bonds), and income (corporate bonds and dividends). Moreover, dividends have historically represented a large chunk of equity total returns. Since 1980, roughly 60% of the S&P 500 total return comes from dividends.
6. **China policy a bigger risk than U.S. policy.** Chinese monetary policy may stay restrictive for most of 2011 and the PBOC could tighten further in order to contain inflation pressures. With inflation running at 4.4% YOY and the PMI index hovering above the 55 level, challenges to the ongoing commodity enthusiasm may be driven more by China than the United States in the first half of 2011.

Exhibit 2				
Scotia Capital Asset Mix - 2011				
	Asset Mix		Change from	Total Return
	Benchmark	Recommended	Focus 2010	Next 12-M
Equities	50%	58%	-10%	8-10%
Canada (TSX)	10%	13%		
U.S. (S&P500)	15%	17%		
Int'l (Europe, Japan)	15%	15%		
EM-Asia	6%	6%		
EM-LatAm	4%	7%		
Bonds	45%	35%	+7%	3%
Government	35%	23%		2%
Corporate	10%	12%		4%
Cash (91-D Tbills)	5%	7%	+3%	1%

Source: Scotia Capital estimates

Vincent Delisle (514) 287-3628
vincent_delisle@scotiacapital.com

Hugo Ste-Marie (514) 287-4992
hugo_ste-marie@scotiacapital.com

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7. **Transitions in monetary policy.** De-synchronized monetary policy heavily influenced global leadership in 2010 and we expect it will continue in 2011. China, Brazil, India, and Australia are entering 2011 with a tightening bias, the United States is still in easing mode, and Canada is on the sidelines. The early tightening group underperformed in 2010 and this trend could continue in the early part of next year. By the end of 2011, the early tighteners should move to neutral with the Fed hinting at normalizing its policy (rate hikes). This transition could help stabilize the US\$ and benefit U.S. large caps.
8. **NAFTA overweight.** Canada, Mexico, and the S&P 500 all outpaced the MSCI World AC index during the “back-to-school” rally and for 2010 as a whole. If U.S. economic worries moderate in coming months, markets that offer proximity to the U.S. recovery should hold their ground. Our global pair-trades entering 2011 are as follows: S&P 500 over China; Canada over Australia; and Mexico over Brazil.
9. **Catalyst to narrowing small/large cap valuation spread.** Small cap dominance has been ongoing for almost 10 years and the current small cap valuation premium is calling all mean-reversion disciples. Admittedly, the mid-term outlook points to a U.S. large cap resurgence in coming years. In the near term, however, small cap outperformance should last until the Federal Reserve looks to implement its exit strategy. When the Fed starts normalizing interest rates, the 10-year old small cap domination could end.
10. **Everybody loves EM.** EM economies are posting spectacular GDP growth, and flows are exiting G7 markets for exposure to emerging markets. We believe this is very crowded trade that takes its roots from the notion that developed economies will lag and the US\$ will correct forever. GDP growth in China and Brazil is robust, but those markets have been amongst the worst performing indices in 2010 and have lagged the S&P 500. We prefer the LatAm side of EM for 2011.

Exhibit 3

Scotia Capital Sector Allocation – 2011

Sector	Recommendation
Energy	Overweight
Materials	Market Weight
Industrials	Overweight
Discretionary	Market Weight
Staples	Underweight
Health Care	Underweight
Financials	Overweight
Technology	Overweight
Telecom	Underweight
Utilities	Underweight

Source: Scotia Capital

Fixed Income Outlook 2011 (Governments and Swaps)

Note: this is a summary of views and recommendations originally published in the Fixed Income Relative Value Weekly on January 11, 2011.

Our main recommendations for the start of this year are fairly conservative, focused on 1) earning income from high-grade spreads and from positioning on the relatively steep Canada curve; 2) earning capital gains from trading what we think will be fairly choppy ranges in government bonds; and 3) doing relative value trades. This is a big change from last year, when we our recommendations involved bigger bets on direction and curve slope, consistent with our firm's forecast for the Bank of Canada at that time. Although we are starting out cautious, we may look to take a more aggressive stance by the second half of the year, as we get closer to the resumption of central bank tightening.

There are several reasons for the more cautious tone. We think the Bank of Canada will remain on hold until later this year, whereas the market is pricing in rate hikes beginning sooner. In the US, Treasury securities have priced in a moderately better growth outlook after the selloff last quarter. We forecast yields to rise moderately over the year (3.75% 10-years), but not by substantially more than is already reflected in the forward curve. However, the US Treasury market could remain quite volatile, if ultimately broadly range-bound.

We don't think the volatility will be near the extremes of last year, when we had historic rallies and selloffs of more than 100 bps each. However, many of the divergent market opinions that drove last year's Treasury volatility remain relevant, notably concerns about Europe, high US debt, inflation vs disinflation, and whether the Fed is underestimating the US recovery and is perhaps losing control of its policy. My personal view is that some of the more extreme concerns about Treasuries are either overblown or premature (overblown in the case of the Fed, premature in the case of high US debt). The more immediate fiscal problems in 2011 are likely to be the ongoing situation in Europe, and austerity at the US state and municipal level, both of which may tend to keep federal US yields relatively low this year.

Canada Curve: 2s/10s is likely to be largely range-bound through the first half, though we could see a resumption of the big flattening trend in the second half as we get closer to the start of BoC rate hikes. If you want to bet on flattening before then, a better candidate is probably 5y/10y, which tends to flatten earlier than 2y/10y. In contrast, 10s/longs is toward the flatter end of the range, so we think a modest steepener position may perform better during the first part of the year.

Short-term yields and BoC: the recent stronger growth data in Canada and the US raises the probability of rate increases somewhat, but we still think the BoC is on hold until later this year. 2-year yields around 1.75% should prove to be good value from an income standpoint during the first half.

Ten-year yields: the range for US 10-year yields could be fairly broad during the first half, likely 3.0% - 3.75%. The near-term range is 3.27% to 3.57%, the choppy range since December. Canada 10s are likely to be less volatile, with a broad range of 3.0% - 3.50%.

Income: we reiterate our Dec 17 recommendation to buy provincial and Canada Mortgage Bonds for income. We don't expect provincial spreads to tighten substantially this year, but we think they are fair compensation for the expected level of provincial issuance and debt levels. CMB spreads at about 25 bps in the 5-year sector could tighten 5 and perhaps 10 bps this year.

Roll-down: We think the 7 to 10-year part of the Canada curve provides good income and roll-down potential (roll-down refers to the return that would be earned on a bond over time, if the yield curve does not change). See the RV Weekly from Jan 11, 2011 for a chart of this.

Camilla Sutton (416) 866-5470
camilla_sutton@scotiacapital.com

Sacha Tihanyi (416) 862-3154
sacha_tihanyi@scotiacapital.com

The 2011 Outlook for FX

- **Europe is not the only one facing challenges in 2011; the USD remains poised to weaken**
- **The balance of risk versus reward is more likely to be found in the non USD and non EUR currencies**
- **China, currency wars, monetary policy and sovereign positions are the themes poised to shape 2011.**

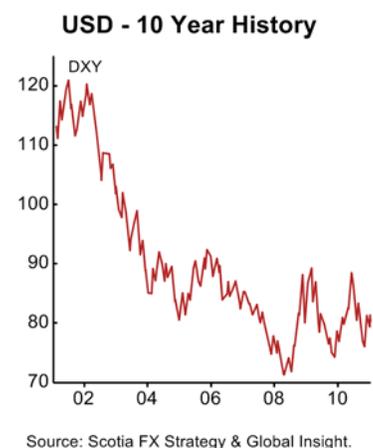
As we enter 2011, the attention of foreign exchange markets is squarely on European sovereign concerns. A similar topic to the spring of 2010, but with a new set of problems and an unproven path to stability. However, looking at the other major economies, Europe is not the only one facing a problematic outlook; trouble is brewing in the UK, Japan and the US. This lays the groundwork for FX markets to shift course several times throughout the year. Through this volatility there will still be key themes that will likely put downward pressure on the USD, help to stabilize EUR and drive CAD and AUD to higher levels. We explore these paths below.

Each of the four major advanced economies are facing hurdles that are arguably as great as any time in history. Europe is struggling with the reality of a monetary union without adherence to a joint fiscal framework. The US faces a new economic reality of high unemployment, low inflation and an increasing debt burden. While the UK's strict fiscal austerity measures are poised to dampen near-term growth, leaving the central bank in an awkward position, facing above target inflation and low growth. Finally, it should become increasingly obvious that Japanese monetary policy will remain much more lax than the rest of the major economies. This fundamental backdrop will lead to challenging markets, forcing FX participants to choose the best of the worst.

As the outlooks below suggest, our core themes in 2011 are 1) Stability in Europe; 2) US, UK, and European sovereign concerns which in turn supports AUD, CAD and CHF; 3) Global investors searching for higher yield drives commodities and associated currencies higher; 3) The desire to find alternatives to the EUR and USD puts upward pressure on the other primary currencies; 4) Flows into Asia remain strong and place appreciatory pressure on Asian currencies; 5) Relative monetary policy (and not necessarily rising US yields) puts downward pressure on the USD; and 6) China continues to be a major influence in FX markets. 2011 is poised to be an interesting year and FX markets will reflect this through relative performance.

THE OUTLOOK FOR THE USD

The problems in Europe are providing a temporary shield of cover for the problems in the US that is unlikely to last. Our core view is that the market will grow increasingly impatient with the lack of fiscal repair in the US and that as we move into the second half of the year the trade off between growth and fiscal austerity will increasingly favour the more conservative European approach. This combined with the Fed's loose and unconventional monetary policy, leave both fiscal and monetary pressures working against the USD. As we move into the second quarter, Europe should begin to stabilize, which is likely to remove a key support for the USD. This in turn should see market participants shift positioning and sentiment against the USD, aggravating bearish pressures. However, in FX markets it is only the relative story that matters. Fundamentals that support a bearish USD do not always equate to a weaker dollar, particularly if there is an absence of a stronger story somewhere else; the first half of 2010 was a good example of this. As the following outlooks detail, we see relative value being found outside the USD.



THE OUTLOOK FOR CAD

We find the fundamental outlook for CAD to be one that is hard to bet against, underscored by a number of supportive factors. The extremely high quality of Canada's sovereign credit profile has enhanced CAD's prestige as a reserve currency alternative to the both the USD and EUR. In addition, the propensity of CAD to

Camilla Sutton (416) 866-5470
camilla_sutton@scotiacapital.com

Sacha Tihanyi (416) 862-3154
sacha_tihanyi@scotiacapital.com

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trade in line with commodities (and counter to the broad USD) favours CAD strength given Scotia's constructive outlook for oil. Indeed, a number large global reserve managers possess domestic currencies that also tend to trade in line with commodities, making a substantial CAD allocation a logical hedge against weakness in USD reserves. As in 2010, the interest rate outlook constitutes another channel of support for CAD. Though Canada has strong economic ties to the US, emerging market growth currents also exert an important influence on domestic economic conditions, primarily via the commodity channel. In light emerging market economic strength, monetary policy in Canada has deviated from that of the US, and stands to do so in 2011. The spread between the policy rates of Canada and US is effectively 75bps, not overly large historically speaking, leaving room to widen further as we expect to be the case over the next 12 months. This provides further upside support for CAD versus the USD as it will become increasingly expensive to fund short CAD positions against the USD. An important caveat however is that too much CAD strength too soon constitutes a constraint to Canadian growth, and thus monetary tightening. In this way, only a slow and measured pace of appreciation is sustainable in 2011.

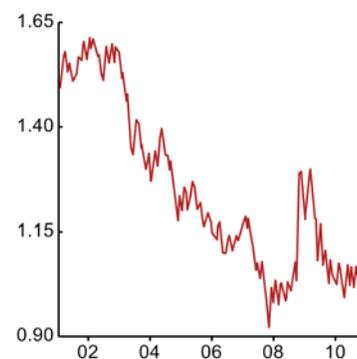
THE OUTLOOK FOR EUR

An escalation in the loss of confidence in the Eurozone is the key risk that underpins the euro in 2011. Quantifying the risk of such a psychological tragedy is virtually impossible. There is a lot to criticize surrounding the reaction of policy makers and markets to date, however the one unwavering strength is the commitment provided to shore up confidence and strengthen the viability of the monetary union. To date, aid packages have been requested by Greece and Ireland (one a solvency issue, the other a liquidity issue) and questions remain as to who might be next in line. Still, the aid package is available and to date the larger economies are not in the line of fire. European fiscal austerity is well on its way, this is likely to dampen growth, but should leave these same nations in a far better position than the US by the end of 2011. Inflationary pressures are building, which will likely force the ECB's hand before the Fed's. Strength in Germany is expected to add a complicating wrinkle to managing monetary policy. The euro story is a difficult one, but as oppose to the US, the solution could well be on the horizon, which in turn will support the stabilization of the EUR in 2011.

THE OUTLOOK FOR JPY

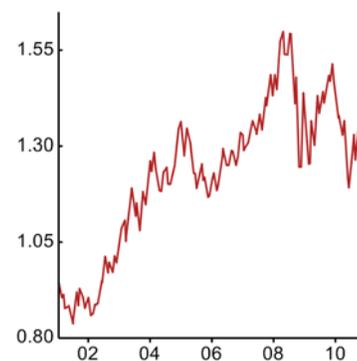
JPY strength against the USD in 2010 was tied to the US monetary policy outlook, with JPY strength tracking closely the strong performance of short term US Treasuries on fears of a double-dip recession and additional monetary easing in the US. This dynamic has shifted somewhat as we begin 2011, arresting JPY's strengthening trend. In 2011, both the monetary and growth outlooks are less favourable for Japan relative to the US. However, we don't expect to see too great an amount of JPY weakness vs. the USD in the near term, as it will take some time before there is a shift in the Fed's monetary policy stance. Nevertheless, we do foresee Fed tightening coming before that of the Bank of Japan, and being of much greater intensity over the next two years. Indeed, it was the last (three year) Fed tightening cycle, initiated in June of 2004 that precipitated a nearly 10% appreciation in the USD against JPY, as lax monetary policy ensured that the yen was the only currency to weaken against the USD over that time period.

USDCAD - 10 Year History



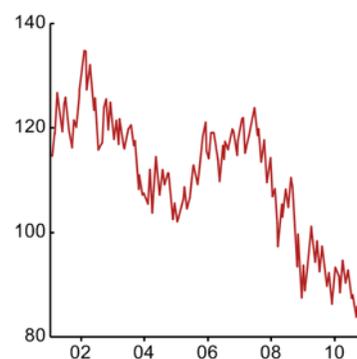
Source: Scotia FX Strategy & Global Insight.

EURUSD - 10 Year History



Source: Scotia FX Strategy & Global Insight.

USDJPY - 10 Year History



Source: Scotia FX Strategy & Global Insight.

Gorica Djerić (416) 862-3080
gorica_djerica@scotiacapital.com

Derek Holt (416) 863-7707
derek_holt@scotiacapital.com

Key Data Preview

CANADA

To date, only three pieces of data have been released that could help us estimate November GDP, due out at the end of January. Sharply higher hours worked and housing starts, alongside a narrowed trade deficit, will help boost the economy. Next week, we get three more reports: **manufacturing shipments** (Wednesday), **wholesale trade** (Thursday) and **retail sales** (Friday). We think they will post headline gains of 0.2%, 0.2% and 0.4%, respectively.

Unlike in the United States, leading indicators for major Canadian releases are limited. Exports — up 0.8% in November — are the only leading indicator of **manufacturing shipments**, but these do not have the ability to capture domestic manufacturing sales and not all exports come from current production. What's more, the relationship is considerably stronger between price-adjusted export and manufacturing volumes than between the nominal series, limiting the predictive power in estimating the headline indicator. As an aside, note that the manufacturing sales report also contains data on inventories and orders, useful gauges of future manufacturing activity. Turning to **retail sales**, the headline print is likely to get a lift from a nearly 6% m/m gain in gasoline prices, the biggest since January of last year, partly offset by weaker vehicle sales, caused by a sharp fall-off at a major automaker.

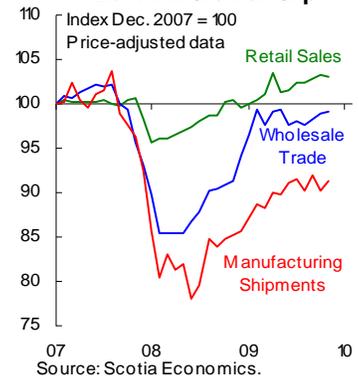
UNITED STATES

Next week will bring a string of key housing releases, including **homebuilders' confidence** (Tuesday), **housing starts & building permits** (Wednesday) and **existing home sales** (Thursday). To track the developments in the housing market, the lead-lag dynamics between key indicators are important. Changes in mortgage rates affect purchase mortgage applications which, in turn, with a processing lag, affect pending home sales — and then only 1-2 months later show up as resales, the time it generally takes for contracts to close (see chart).

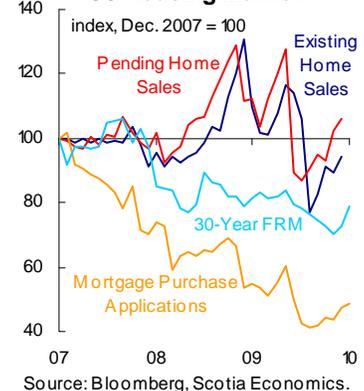
Hobbled by uncertainty, high supply of homes — on and off the market — and fragile employment conditions, the **homebuilders' sentiment index** remains stuck at low levels, with our forecast looking for a modest one-point advance to 17 in January, still well below the breakeven level of 50. Leading indicators (construction employment, building permits, mortgage purchase applications) reaffirm this view. Accordingly, building intentions continue to move sideways along the floor, and have been doing so since early 2009. We expect **building permits** to improve a modest 1.1% m/m to 550k annualized units in December, largely on a base effect, but for **housing starts** to come in flat to slightly lower, continuing to hover around 550k. Data on pending home sales and mortgage purchase applications suggest that **existing home sales** moved higher in December. We estimate a gain of 2.5% m/m to 4.8 million annualized units.

Next week, we also get January updates on **manufacturing activity in New York State** (Tuesday) and **Philadelphia** (Thursday), the first of the regional manufacturing surveys. Manufacturing activity is relatively limited in New York State. Of the top ten industries by employment, the first nine are all in the services sector, with computer & electronic products as the only exception. While manufacturing — formerly the backbone of Philly's economy — accounts for only 5% of overall employment, it still represents a solid cross-section of the national activity. Both surveys were unusually volatile in 2010, sending opposing signals in eight of the past twelve months and visibly disrupting the rule-of-thumb lead-lag relationship. While this has made it challenging to forecast the series, the leading component indices generally point to a further improvement over the next six months.

Cdn Recovery Continues, But At A Slower Clip



Leads & Lags of The US Housing Market



Key Indicators for the week of January 17 - 21

North America							
Country	Date	Time	Event	Period	BNS	Consensus	Latest
CA	1/17/2011	08:30	Int'l C\$ Securities Transactions (C\$ bn)	Nov	--	--	9.5
US	1/17/2011		Fed's Plosser Speaks in Santiago, Chile (07:15)				
CA	1/18/2011	09:00	BoC Interest Rate Announcement (%)		1.00	1.00	1.00
US	1/18/2011	08:30	Empire State Manufacturing Index	Jan	12.0	13.0	10.6
US	1/18/2011	09:00	Foreign Portfolio Flows (\$ bn)	Nov	--	--	27.6
US	1/18/2011	10:00	NAHB Housing Market Index	Jan	17	17	16
CA	1/19/2011	08:30	Manufacturing Shipments (m/m)	Nov	0.2	0.5	1.7
CA	1/19/2011	10:30	Monetary Policy Report				
US	1/19/2011	08:30	Housing Starts (mn a.r.)	Dec	0.55	0.55	0.56
US	1/19/2011	08:30	Building Permits (mn a.r.)	Dec	0.55	0.56	0.54
CA	1/20/2011	08:30	Wholesale Trade (m/m)	Nov	0.2	0.3	0.0
CA	1/20/2011	08:30	Leading Indicators (m/m)	Dec	--	0.4	0.3
US	1/20/2011	08:30	Initial Jobless Claims (000s)	Jan. 15	430	425	445
US	1/20/2011	08:30	Continuing Claims (mn)	Jan. 08	3.90	3.99	3.88
US	1/20/2011	10:00	Existing Home Sales (mn a.r.)	Dec	4.8	4.89	4.68
US	1/20/2011	10:00	Philadelphia Fed Index	Jan	23	21	24
US	1/20/2011	10:00	Leading Indicators (m/m)	Dec	--	0.6	1.1
CA	1/21/2011	08:30	Retail Sales (m/m)	Nov	0.4	0.4	0.8
CA	1/21/2011	08:30	Retail Sales ex. Autos (m/m)	Nov	0.6	0.4	0.9
MX	1/21/2011	09:00	Unemployment Rate (%)	DEC	--	5.08	5.28
MX	1/21/2011	10:00	Overnight Rate (%)	21-Jan	4.50	4.50	4.50

Europe							
Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
UK	1/18/2011	04:30	CPI (m/m)	Dec	--	0.7	0.4
UK	1/18/2011	04:30	DCLG House Prices (y/y)	Nov	--	--	5.5
IT	1/18/2011	05:00	Current Account (EUR mn)	Nov	--	--	-2580
EC	1/18/2011	05:00	ZEW Survey (Economic Sentiment)	Jan	--	--	15.5
GE	1/18/2011	05:00	ZEW Survey (Economic Sentiment)	Jan	--	7.0	4.3
EC	1/19/2011	04:00	Current Account (EUR bn)	Nov	--	--	225.1
UK	1/19/2011	04:30	Jobless Claims Change (000s)	Dec	--	0.0	-1.2
UK	1/19/2011	04:30	Unemployment Rate (%)	Dec	--	7.9	7.9
GE	1/20/2011	02:00	Producer Prices (m/m)	Dec	--	0.5	0.2
FR	1/21/2011	03:00	Services PMI (index)	Jan	--	--	54.9
FR	1/21/2011	03:00	Manufacturing PMI (index)	Jan	--	--	57.2
GE	1/21/2011	04:00	IFO Business Climate Survey	Jan	--	109.9	109.9
UK	1/21/2011	04:30	Retail Sales (m/m)	Dec	--	-0.3	0.3

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Key Indicators for the week of January 17 - 21

Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Indicator</u>	<u>Period</u>	<u>BNS</u>	<u>Consensus</u>	<u>Latest</u>
SG	1/17/2011		Exports (y/y)	Dec	--	11.1	10.0
JN	1/17/2011		Consumer Confidence	Dec	--	41.6	40.6
JN	1/17/2011	23:30	Industrial Production (m/m)	Nov	--	--	1.0
JN	1/17/2011	23:30	Capacity Utilization (m/m)	Nov	--	--	-2.3
CH	1/19/2011	21:00	Retail Sales (y/y)	Dec	--	18.7	18.7
CH	1/19/2011	21:00	PPI (y/y)	Dec	--	5.7	6.1
CH	1/19/2011	21:00	CPI (y/y)	Nov	--	4.6	5.1
CH	1/19/2011	21:00	Industrial Production (y/y)	Dec	--	13.4	13.3
CH	1/19/2011	21:00	Real GDP (y/y)	Q4	--	9.4	9.6

Latin America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Indicator</u>	<u>Period</u>	<u>BNS</u>	<u>Consensus</u>	<u>Latest</u>
BZ	1/17/2011	05:00	FGV CPI IPC-S	16-Jan	--	--	0.9
BZ	1/17/2011	05:00	FGV Inflation IGP-10 (MoM)	JAN	--	0.4	1.3
PE	1/17/2011		GDP YoY NSA	NOV	--	8.6	8.3
PE	1/17/2011		Unemployment	DEC	--	--	7.6
BZ	1/19/2011		SELIC Target - Central Bank	19-Jan	11.25	11.25	10.75
CO	1/20/2011	16:00	Industrial Production (YoY)	NOV	--	2.5	2.7
CO	1/20/2011	16:00	Retail Sales (YoY)	NOV	--	15.2	15.0

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Global Auctions for the week of January 17 - 21

North America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
CA	1/18/2011	10:30	Canada to Sell CAD5.1 Bln 98-Day Bills
CA	1/18/2011	10:30	Canada to Sell CAD1.95 Bln 182-Day Bills
CA	1/18/2011	10:30	Canada to Sell CAD1.95 Bln 364-Day Bills
US	1/18/2011	11:30	U.S. to Sell 3-Month Bills
US	1/18/2011	11:30	U.S. to Sell 6-Month Bills
US	1/19/2011	11:30	U.S. to Sell 4-Week Bills
US	1/20/2011	13:00	U.S. to Sell 10-Year TIPS

Europe

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
NO	1/17/2011	05:00	Norway to Sell NOK3 Bln 3.75% 2021 Bonds
GE	1/17/2011	05:15	Germany to Sell Add'l EU2 Bln 9-Mth Bills (BUBILL-DE000111572)
HU	1/17/2011	05:30	Hungary to Sell 6-Week Bills (HTB)
TU	1/17/2011	05:45	Turkey to Sell 420-Day Zero Coupon Bonds (new)
NE	1/17/2011	06:00	Netherlands to Sell Bills
PD	1/17/2011	06:00	Poland to Sell Up to PLN2 Bln 28-Week T-bills
FR	1/17/2011	09:00	France to Sell Bills (BTF)
SP	1/18/2011	04:30	Spain to Sell 12, 18-Month Bills (SGLT)
SZ	1/18/2011	05:30	Switzerland to Sell 3-Month Bills (CH0036178975)
HU	1/18/2011	05:30	Hungary to Sell 3-Month Bills (HTB)
TU	1/18/2011	05:45	Turkey to Sell 8% 2013 Bonds (tap)
TU	1/18/2011	05:45	Turkey to Sell 2021 CPI-Linked Bonds (new)
BE	1/18/2011	06:00	Belgium to Sell Bills (TC)
HU	1/18/2011	06:00	Hungary's Central Bank to Sell 2-Week Bills
SW	1/19/2011	05:10	Sweden to Sell Bills
GE	1/19/2011	05:15	Germany to Sell Add'l EU6 Bln 2-Year Notes (BKO-DE0001137321)
PO	1/19/2011	05:30	Portugal to Sell Bills (BT)
UK	1/19/2011	05:30	U.K. to Sell 4.25% 2036 Bonds
SP	1/20/2011	04:30	Spain to Sell 4.85% 2020 Bonds
FR	1/20/2011	05:00	France to Sell Bonds/Notes (OAT/BTAN)
HU	1/20/2011	05:30	Hungary to Sell 12-Month Bills
PD	1/20/2011	06:30	Poland to Hold Exchange Offer Auctions
UK	1/21/2011	06:10	U.K. to Sell Bills
IC	1/21/2011	06:45	Iceland to Sell Bonds

Source: Bloomberg, Scotia Economics.

Global Auctions for the week of January 17 - 21

Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
AU	1/17/2011	19:00	Australia Plans to Sell CIB Bonds
TH	1/17/2011	22:00	Bank of Thailand to Sell THB25 Bln 28D Bills
TH	1/17/2011	22:00	Bank of Thailand to Sell THB22 Bln 91D Bills
TH	1/17/2011	22:00	Bank of Thailand to Sell THB15 Bln 182D Bills
HK	1/17/2011	22:30	Hong Kong to Sell HKD25.137 Bln 91-Day Bills
HK	1/17/2011	22:30	Hong Kong to Sell HKD9 Bln 182-Day Bills
JN	1/17/2011	22:45	Japan to Sell 5-Year Bond
PH	1/18/2011		Philippines to Sell PHP9 Bln 20-Yr Govt Bonds
CH	1/18/2011	22:00	China Government Bond to Sell 10 Year Bond
TH	1/18/2011	22:00	Thailand to Sell THB10 Bln Bonds due 2017 (LB17OA)
TH	1/18/2011	22:00	Thailand to Sell THB8 Bln FRN due 2014 (LB14NA)
JN	1/18/2011	22:35	Japan to Sell 3-Month Bills
IN	1/19/2011	06:30	India to Sell INR40Bln 91-Day Bills
IN	1/19/2011	06:30	India to Sell INR15Bln 182-Day Bills
NZ	1/19/2011	20:30	New Zealand Plans to Sell Government Bonds
JN	1/19/2011	22:35	Japan to Sell 2-Month Bills
JN	1/19/2011	22:45	Japan to Sell 20-Year Bond
IN	17-21 JAN		India to sell INR 40-50Bln 5-9Year Bonds
IN	17-21 JAN		India to sell INR 40-50Bln 10-14Year Bonds
IN	17-21 JAN		India to sell INR 20-30Bln 15-19Year Bonds

Source: Bloomberg, Scotia Economics.

Events for the week of January 17 - 21

North America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
US	1/17/2011	07:15	Fed's Plosser Speaks in Santiago, Chile
CA	1/18/2011	09:00	Bank of Canada Rate
CA	1/19/2011	10:30	Monetary Policy Report
MX	1/21/2011	10:00	Overnight Rate

Europe

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
EC	1/17/2011	11:00	Euro-Area Finance Ministers Meet in Brussels
PD	1/18/2011	03:00	Polish Central Bank Governor Speech on EU Economy
EC	1/18/2011	03:00	EU-27 Finance Ministers Meet in Brussels
PO	1/20/2011		Portugal Reports December Government Spending, Revenue Data
PD	1/21/2011		Polish Central Bank Governor Speech on Euro Adoption
EC	1/21/2011	18:00	EU's Barnier Speaks in Cannes, France
EC	16-18 JAN		EU Employment Ministers Meet in Budapest
PD	18-19 JAN		Poland's Monetary Policy Council Rate Meeting
AS	18-19 JAN		Euromoney Central & Eastern European Forum in Vienna
PD	15-20 JAN		Poland 2010 Budget Performance

Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
CH	18-21 JAN		President Hu Jintao's State Visit to United States

Latin America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
BZ	01/19/2011		SELIC Target - Central Bank

Source: Bloomberg, Scotia Economics.

Global Central Bank Watch

North America

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Bank of Canada – Overnight Target Rate	1.00	January 18, 2011	1.00	1.00
Federal Reserve – Federal Funds Target Rate	0.25	January 26, 2011	0.25	--
Banco de México – Overnight Rate	4.50	January 21, 2011	4.50	4.50

Comments: We expect the BoC to resume interest rate hikes only by October of this year (see our article in this issue). The Federal Reserve is forecast to commence interest rate hikes only in 2012Q1 along with considerable risk of occurring later than that as it relies upon gradual use of a blend of exit tools. Banco de México is expected to remain on hold next week.

Europe

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
European Central Bank – Refinancing Rate	1.00	February 3, 2011	1.00	--
Bank of England – Bank Rate	0.50	February 10, 2011	0.50	0.50
Swiss National Bank – Libor Target Rate	0.25	March 17, 2011	0.25	--
Central Bank of Russia – Refinancing Rate	7.75	TBA	--	--
Hungarian National Bank – Base Rate	5.75	January 24, 2011	6.00	6.00
Central Bank of the Republic of Turkey – 1 Week Repo Rate	6.50	January 20, 2011	6.50	6.50

Comments: Monetary tightening is expected to continue in Hungary on the back of persistent inflationary pressures and elevated risk aversion towards Hungarian assets.

Asia Pacific

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Bank of Japan – Target Rate	0.10	January 25, 2011	0.10	--
Reserve Bank of Australia – Cash Target Rate	4.75	January 31, 2011	4.75	4.75
Reserve Bank of New Zealand – Cash Rate	3.00	January 26, 2011	3.00	3.00
People's Bank of China – Lending Rate	5.81	TBA	--	--
Reserve Bank of India – Repo Rate	6.25	January 25, 2011	--	6.50
Hong Kong Monetary Authority – Base Rate	0.50	TBA	--	--
Bank Negara Malaysia – Overnight Policy Rate	2.75	January 27, 2011	--	--
Bank of Korea – Bank Rate	2.75	February 10, 2011	--	--
Bank of Thailand – Repo Rate	2.25	March 9, 2011	--	--

Latin America

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Banco Central do Brasil – Selic Rate	10.75	January 19, 2011	11.25	11.25
Banco Central de Chile – Overnight Rate	3.25	February 17, 2011	3.25	--
Banco de la República de Colombia – Lending Rate	3.00	January 28, 2011	3.00	3.00
Banco Central de Reserva del Perú – Reference Rate	3.25	February 10, 2011	3.50	--

Comments: After seven consecutive months of hikes, Chile left unchanged its overnight rate at 3.25%. Latin America's central banks face important goals trying to assess monetary policy as inflation keeps climbing while capital controls or intervention aim to stop currency appreciation.

Africa

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
South African Reserve Bank – Repo Rate	5.50	January 20, 2011	5.50	5.50

Forecasts at time of publication.
Source: Bloomberg, Scotia Economics.

	2000-09	2010e	2011f	2012f	2000-09	2010e	2011f	2012f
Output and Inflation (annual % change)	Real GDP				Consumer Prices²			
World ¹	3.6	4.9	4.2	4.4				
Canada	2.1	2.9	2.4	2.7	2.1	1.8	2.1	2.2
United States	1.8	2.8	2.7	2.9	2.6	1.7	1.5	1.6
Mexico	1.9	5.1	3.5	4.0	4.9	4.5	4.0	3.5
United Kingdom	2.7	1.8	1.6	1.7	2.2	3.1	3.3	2.7
Euro zone	1.2	1.9	1.4	1.6	2.1	2.2	2.3	2.3
Japan	0.7	3.4	1.6	2.7	-0.3	-0.5	0.7	1.0
Australia	3.0	3.0	3.5	3.3	3.2	3.0	2.8	2.5
China	10.2	10.0	9.5	9.7	2.0	3.5	4.5	4.0
India	7.2	8.3	8.5	8.8	5.7	7.0	5.5	5.0
Korea	4.5	5.8	5.0	5.3	3.2	3.0	3.3	3.0
Brazil	2.9	7.5	5.5	5.0	6.6	5.8	5.2	5.0
Chile	3.7	5.0	6.0	5.5	3.4	3.7	3.5	3.0
Peru	5.1	8.5	6.8	7.2	2.5	2.4	3.0	3.0
Central Bank Rates (% end of period)	11Q1f	11Q2f	11Q3f	11Q4f	12Q1f	12Q2f	12Q3f	12Q4f
Bank of Canada	1.00	1.00	1.00	1.50	2.00	2.25	2.25	2.25
Federal Reserve	0.25	0.25	0.25	0.25	0.75	1.25	1.75	2.00
European Central Bank	1.00	1.00	1.00	1.25	1.50	1.75	2.00	2.25
Bank of England	0.50	0.50	0.50	0.75	1.00	1.25	1.50	1.75
Swiss National Bank	0.25	0.25	0.25	0.50	0.50	0.75	0.75	1.00
Bank of Japan	0.10	0.10	0.10	0.10	0.10	0.25	0.25	0.50
Reserve Bank of Australia	5.00	5.00	5.25	5.50	5.75	6.00	6.25	6.50
Exchange Rates (end of period)								
Canadian Dollar (USDCAD)	1.00	0.99	0.98	0.96	0.96	0.95	0.95	0.94
Canadian Dollar (CADUSD)	1.00	1.01	1.02	1.04	1.04	1.05	1.05	1.06
Euro (EURUSD)	1.33	1.33	1.35	1.37	1.39	1.41	1.43	1.45
Sterling (GBPUSD)	1.58	1.60	1.61	1.63	1.65	1.67	1.69	1.70
Yen (USDJPY)	82	83	84	84	86	87	89	90
Australian Dollar (AUDUSD)	1.03	1.05	1.06	1.08	1.07	1.08	1.09	1.10
Chinese Yuan (USDCNY)	6.5	6.3	6.2	6.1	6.0	5.9	5.8	5.8
Mexican Peso (USDMXN)	12.5	12.6	12.7	12.8	12.9	13.0	13.1	13.2
Brazilian Real (USDBRL)	1.66	1.66	1.65	1.65	1.66	1.67	1.69	1.70
Commodities (annual average)	2000-09	2010e	2011f	2012f				
WTI Oil (US\$/bbl)	51	79	95	98				
Nymex Natural Gas (US\$/mmbtu)	5.95	4.40	4.40	4.75				
Copper (US\$/lb)	1.78	3.40	4.50	4.25				
Zinc (US\$/lb)	0.73	0.98	1.03	1.05				
Nickel (US\$/lb)	7.11	9.85	10.00	8.00				
Gold, London PM Fix (US\$/oz)	522	1,225	1,500	1,450				
Pulp (US\$/tonne)	668	960	875	960				
Newsprint (US\$/tonne)	572	607	685	710				
Lumber (US\$/mfbm)	275	252	250	300				

¹ World GDP for 2000-09 are IMF estimates; 2010-12f are Scotia Economics' estimates based on a 2009 PPP-weighted sample of 34 countries.

² CPI for Canada and the United States are annual averages. For other countries, CPI are year-end rates.

Canada	2009	10Q2	10Q3	Latest	United States	2009	10Q2	10Q3	Latest
Real GDP (annual rates)	-2.5	2.3	1.0		Real GDP (annual rates)	-2.6	1.7	2.6	
Current Acc. Bal. (C\$B, ar)	-43.5	-51.9	-70.1		Current Acc. Bal. (US\$B, ar)	-378	-493	-509	
Merch. Trade Bal. (C\$B, ar)	-4.6	-9.4	-26.5	-1.0 (Nov)	Merch. Trade Bal. (US\$B, ar)	-507	-678	-685	-614 (Nov)
Industrial Production	-9.4	6.2	7.9	6.2 (Oct)	Industrial Production	-9.3	7.8	6.9	5.7 (Dec)
Housing Starts (000s)	149	199	192	172 (Dec)	Housing Starts (millions)	0.55	0.60	0.59	0.56 (Nov)
Employment	-1.6	1.8	2.1	2.1 (Dec)	Employment	-4.3	-0.5	0.2	0.8 (Dec)
Unemployment Rate (%)	8.3	8.0	8.0	7.6 (Dec)	Unemployment Rate (%)	9.3	9.6	9.6	9.4 (Dec)
Retail Sales	-2.9	4.9	3.5	3.3 (Oct)	Retail Sales	-7.2	7.5	6.1	8.2 (Dec)
Auto Sales (000s)	1459	1518	1608	1601 (Oct)	Auto Sales (millions)	10.4	11.3	11.6	12.5 (Dec)
CPI	0.3	1.4	1.8	2.0 (Nov)	CPI	-0.4	1.8	1.2	1.5 (Dec)
IPPI	-3.5	0.7	1.0	2.1 (Nov)	PPI	-2.6	4.4	3.8	4.0 (Dec)
Pre-tax Corp. Profits	-32.3	26.3	16.0		Pre-tax Corp. Profits	-1.2	46.7	34.8	
Mexico					Brazil				
Real GDP	-6.1	7.6	5.3		Real GDP	-0.6	8.5	5.9	
Current Acc. Bal. (US\$B, ar)	-6.2	-2.5	-7.4		Current Acc. Bal. (US\$B, ar)	-24.3	-46.7	-45.2	
Merch. Trade Bal. (US\$B, ar)	-4.6	-0.2	-9.2	-1.3 (Nov)	Merch. Trade Bal. (US\$B, ar)	25.3	28.0	19.4	64.4 (Dec)
Industrial Production	-7.4	7.9	6.3	5.3 (Nov)	Industrial Production	-7.2	14.2	8.1	4.1 (Nov)
CPI	5.3	4.0	3.7	4.4 (Dec)	CPI	5.2	5.5	5.0	6.6 (Dec)
Argentina					Italy				
Real GDP	0.9	11.8	8.6		Real GDP	-5.1	1.3	1.1	
Current Acc. Bal. (US\$B, ar)	11.0	12.8	3.6		Current Acc. Bal. (US\$B, ar)	-0.07	-0.08	-0.07	-0.04 (Oct)
Merch. Trade Bal. (US\$B, ar)	16.9	21.4	12.0	4.7 (Nov)	Merch. Trade Bal. (US\$B, ar)	-8.0	-32.1	-22.9	-55.5 (Nov)
Industrial Production	0.1	10.1	9.3	12.8 (Nov)	Industrial Production	-18.2	7.7	6.3	4.2 (Nov)
CPI	-26.9	93.3	89.8	11.0 (Nov)	CPI	0.8	1.5	1.6	1.9 (Dec)
Germany					France				
Real GDP	-4.7	3.9	3.9		Real GDP	-2.8	1.8	2.0	
Current Acc. Bal. (US\$B, ar)	168.9	132.0	148.1	197.5 (Nov)	Current Acc. Bal. (US\$B, ar)	-52.2	-58.3	-41.8	-131.0 (Nov)
Merch. Trade Bal. (US\$B, ar)	193.4	179.3	205.9	193.3 (Nov)	Merch. Trade Bal. (US\$B, ar)	-31.4	-42.3	-40.0	-34.0 (Nov)
Industrial Production	-15.5	12.2	10.2	11.1 (Nov)	Industrial Production	-13.5	7.4	5.3	5.1 (Nov)
Unemployment Rate (%)	8.2	7.7	7.6	7.5 (Dec)	Unemployment Rate (%)	9.5	9.8	9.7	9.8 (Nov)
CPI	0.3	1.1	1.2	1.7 (Dec)	CPI	0.1	1.6	1.5	1.8 (Dec)
Euro Zone					United Kingdom				
Real GDP	-4.0	1.9	1.9		Real GDP	-4.9	1.6	2.7	
Current Acc. Bal. (US\$B, ar)	-69.2	-118	-81	-38 (Oct)	Current Acc. Bal. (US\$B, ar)	-37.1	-28.3	-63.9	
Merch. Trade Bal. (US\$B, ar)	54.7	19.8	36.1	111.2 (Oct)	Merch. Trade Bal. (US\$B, ar)	-128.7	-135.3	-159.6	-167.7 (Nov)
Industrial Production	-14.8	9.0	7.1	7.3 (Nov)	Industrial Production	-10.1	1.5	3.2	3.3 (Nov)
Unemployment Rate (%)	9.4	9.9	9.9	10.0 (Nov)	Unemployment Rate (%)	7.6	7.8	7.8	7.9 (Sep)
CPI	0.3	1.5	1.7	2.2 (Dec)	CPI	2.2	3.4	3.1	3.2 (Nov)
Japan					Australia				
Real GDP	-6.3	3.5	5.0		Real GDP	1.3	3.1	2.7	
Current Acc. Bal. (US\$B, ar)	141.8	156.9	227.5	135.0 (Nov)	Current Acc. Bal. (US\$B, ar)	-41.4	-12.3	-33.5	
Merch. Trade Bal. (US\$B, ar)	29.1	59.9	84.6	62.0 (Nov)	Merch. Trade Bal. (US\$B, ar)	-3.2	31.8	27.2	7.1 (Nov)
Industrial Production	-21.8	21.1	12.9	4.2 (Nov)	Industrial Production	-1.6	6.9	5.0	
Unemployment Rate (%)	5.1	5.2	5.1	5.1 (Nov)	Unemployment Rate (%)	5.6	5.2	5.2	5.0 (Dec)
CPI	-1.4	-0.9	-0.8	0.1 (Nov)	CPI	1.8	3.1	2.8	
China					South Korea				
Real GDP	9.1	10.3	9.6		Real GDP	0.2	7.2	4.4	
Current Acc. Bal. (US\$B, ar)	297.1				Current Acc. Bal. (US\$B, ar)	32.8	34.3	37.6	23.2 (Nov)
Merch. Trade Bal. (US\$B, ar)	195.7	164.3	261.4	157.0 (Dec)	Merch. Trade Bal. (US\$B, ar)	40.4	58.0	45.7	44.9 (Dec)
Industrial Production	18.5	13.7	13.3	13.3 (Nov)	Industrial Production	-1.3	19.5	14.1	9.0 (Nov)
CPI	1.6	1.5	1.5	1.9 (Nov)	CPI	2.8	2.6	2.9	3.5 (Dec)

All data expressed as year-over-year % change unless otherwise noted.

Source: Bloomberg, Scotia Economics.

Interest Rates (% end of period)

	10Q3	10Q4	Jan/07	Jan/14*		10Q3	10Q4	Jan/07	Jan/14*
Canada					United States				
BoC Overnight Rate	1.00	1.00	1.00	1.00	Fed Funds Target Rate	0.25	0.25	0.25	0.25
3-mo. T-bill	1.01	1.05	1.04	1.04	3-mo. T-bill	0.15	0.12	0.13	0.14
10-yr Gov't Bond	2.76	3.12	3.19	3.23	10-yr Gov't Bond	2.51	3.29	3.32	3.28
30-yr Gov't Bond	3.36	3.53	3.62	3.65	30-yr Gov't Bond	3.68	4.33	4.48	4.48
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US\$B)	59.4		58.1	(Nov)	FX Reserves (US\$B)	122.1		119.2	(Nov)
Germany					France				
3-mo. Interbank	0.86	0.96	0.94	0.88	3-mo. T-bill	0.51	0.40	0.42	0.41
10-yr Gov't Bond	2.28	2.96	2.87	3.03	10-yr Gov't Bond	2.66	3.36	3.33	3.41
FX Reserves (US\$B)	62.4		61.3	(Nov)	FX Reserves (US\$B)	52.2		52.9	(Nov)
Euro-Zone					United Kingdom				
Refinancing Rate	1.00	1.00	1.00	1.00	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	0.88	0.82	0.38	0.38	3-mo. T-bill	4.85	4.85	4.85	4.85
FX Reserves (US\$B)	300.1		296.1	(Nov)	10-yr Gov't Bond	2.95	3.40	3.51	3.61
Japan					Australia				
Discount Rate	0.30	0.30	0.30	0.30	Cash Rate	4.50	4.50	4.75	4.75
3-mo. Libor	0.15	0.13	0.12	0.13	10-yr Gov't Bond	4.96	5.55	5.62	5.51
10-yr Gov't Bond	0.94	1.13	1.22	1.21	FX Reserves (US\$B)	38.1		38.3	(Nov)
FX Reserves (US\$B)	1077.4		1067.0	(Nov)					

Exchange Rates (end of period)

USDCAD	1.03	1.00	0.99	0.99	¥/US\$	83.53	81.12	83.15	82.89
CADUSD	0.97	1.00	1.01	1.01	US¢/Australian\$	96.71	102.33	99.59	98.85
GBPUSD	1.572	1.561	1.555	1.587	Chinese Yuan/US\$	6.69	6.61	6.63	6.60
EURUSD	1.363	1.338	1.291	1.335	South Korean Won/US\$	1140	1126	1122	1114
JPYEUR	0.88	0.92	0.93	0.90	Mexican Peso/US\$	12.594	12.340	12.232	12.073
USDCHF	0.98	0.94	0.97	0.96	Brazilian Real/US\$	1.687	1.661	1.684	1.683

Equity Markets (index, end of period)

United States (DJIA)	10788	11578	11675	11753	U.K. (FT100)	5549	5900	5984	6004
United States (S&P500)	1141	1258	1272	1287	Germany (Dax)	6229	6914	6948	7073
Canada (S&P/TSX)	12369	13443	13272	13407	France (CAC40)	3715	3805	3866	3986
Mexico (Bolsa)	33330	38551	38601	38048	Japan (Nikkei)	9369	10229	10530	10499
Brazil (Bovespa)	69430	69305	70057	71128	Hong Kong (Hang Seng)	22358	23035	23687	24283
Italy (BCI)	1033	1048	1072	1089	South Korea (Composite)	1873	2051	2086	2108

Commodity Prices (end of period)

Pulp (US\$/tonne)	990	970	970	970	Copper (US\$/lb)	3.65	4.42	4.26	4.35
Newsprint (US\$/tonne)	638	640	640	640	Zinc (US\$/lb)	0.99	1.10	1.09	1.10
Lumber (US\$/mfbm)	236	308	321	309	Gold (US\$/oz)	1307.00	1405.50	1367.00	1367.00
WTI Oil (US\$/bbl)	79.97	91.38	88.03	90.96	Silver (US\$/oz)	22.07	30.63	28.39	28.52
Natural Gas (US\$/mmbtu)	3.87	4.41	4.42	4.39	CRB (index)	286.86	332.80	323.94	331.40

* Latest observation taken at time of writing.
Source: Bloomberg, Scotia Economics.

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Scotia Economics

Scotia Plaza 40 King Street West, 63rd Floor
Toronto, Ontario Canada M5H 1H1
Tel: (416) 866-6253 Fax: (416) 866-2829
Email: scotia_economics@scotiacapital.com

For general and publication-related inquiries, contact us by telephone, email and/or fax.