

# Global Views

Weekly commentary on economic and financial market developments

August 12, 2011

|  |   |  |                                 |                                       |  |  |
|--|---|--|---------------------------------|---------------------------------------|--|--|
| <a href="#">Economics &gt;</a>           | <a href="#">Corporate Bond Research</a>   | <a href="#">Emerging Markets Strategy &gt;</a> | <a href="#">Equity Strategy</a> | <a href="#">Fixed Income Research</a> | <a href="#">Fixed Income Strategy &gt;</a> | <a href="#">Foreign Exchange Strategy &gt;</a> |
| <a href="#">Economic Statistics &gt;</a> | <a href="#">Financial Statistics &gt;</a> | <a href="#">Forecasts &gt;</a>                 | <a href="#">Contact Us &gt;</a> |                                       |  |  |

## 2-9 Economics

- 2 • Markets Will Focus Upon The Freshest Readings ..... Karen Cordes Woods & Derek Holt
- 3 • Why The Fed's Rate Commitment Differs From The BoC's Conditional Promise ..... Karen Cordes Woods & Derek Holt
- 4 • The Fed Could Be Teeing Up A Run At QE3 ..... Karen Cordes Woods & Derek Holt
- 5 • Canadian Consumers Likely To Take Market Turbulence In Stride ..... Adrienne Warren
- 6 • Markets Are Assuming A Low And Long BoC For Too Long ..... Karen Cordes Woods & Derek Holt
- 7 • Should Canada Be Preparing More Fiscal Stimulus? ..... Karen Cordes Woods & Derek Holt
- 8 • U.S. Federal Fiscal Policy Uncertainty Persists ..... Nathan Joshua & Mary Webb
- 9 • U.S. Regional Employment Dynamics ..... Gorica Djeric

## 10-11 Emerging Markets Strategy

- Pricing EM Bonds Without a Risk-Free Rate ..... Joe Kogan

## 12-13 Fixed Income Strategy

- BoE Inflation Report — August ..... Alan Clarke

## 14-15 Foreign Exchange Strategy

- USDCNY Breaks 6.40 During A Tension Filled Week ..... Sacha Tihanyi

## A1-A12 Forecasts & Data

- Key Data Preview ..... A1-A2
- Key Indicators ..... A3-A6
- Global Auctions Calendar ..... A7
- Events Calendar ..... A8
- Global Central Bank Watch ..... A9
- Forecasts ..... A10
- Latest Economic Statistics ..... A11
- Latest Financial Statistics ..... A12

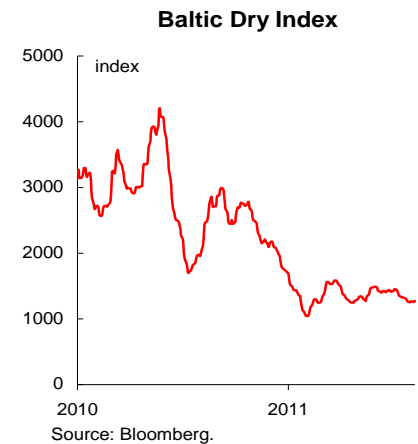
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### Markets Will Focus Upon The Freshest Readings

- Please see our full indicator, central bank, auction and event calendars on pp. A3-A9.

Various indicator readings are now beginning to push into the August time frame during which market turmoil fed in part by political theatrics in the US and Europe began to feed accelerated concerns. That was evident in the weakest University of Michigan consumer sentiment survey since 1980, and it may be more evident in next week's trade and manufacturing indicators. Regional purchasing manager indices for the US — including the Philly Fed (Thursday) and Empire (Monday) gauges — will be closely watched especially in terms of their new order books. We already know that global shipping lanes are reflecting renewed softness. The Baltic Dry Index is a daily average of prices to ship raw materials in global shipping lanes. It has reflected both trade weakness and an emerging supply glut of newly constructed ships that have reduced shipping costs, but its more recent weakness may be one of the first warning signs regarding growth as the Index has fallen 12% since early July after it had begun to regain some momentum in the wake of Japan's shocks. Consensus is all over the map with among the widest ranges of opinions on the Philly Fed that we've seen in a long time.



A planned meeting between French President Nicolas Sarkozy and German Chancellor Angela Merkel on Tuesday will be the other attention stealer as they will discuss proposals to enhance euro zone governance. There are many policy options. One is Jeffrey Sachs' earlier proposal for wider German guarantees as contingent liabilities that may not ultimately cost much. Another moves toward addressing the core problem laid out by Canadian Nobel laureate and intellectual father of the euro zone Robert Mundell which is that Europe lacks a common Treasury-style market. Instead, Europe faces highly fragmented markets that mean political and fiscal divisions in some regions can cause greater grief across the whole euro zone than would otherwise be the case. Greater fiscal oversight is clearly needed this time than the Maastricht Treaty delivered. The euro zone may face a brighter future, but necessary and complementary reforms stalled dead in their tracks after the euro's introduction when growth and the lack of a crisis mentality kept political leaders' feet away from the fire. A wave of European debt auctions in Spain, Belgium, France, Portugal, Switzerland, and Germany will be conducted against this backdrop. Q2 GDP figures for European economies will fan the growth concerns as German growth is expected to abruptly slow. Look past euro zone trade for June, and euro zone CPI for July as the August-September readings will be more critical and likely supportive of a dovish bias at the ECB going forward. Apart from the euro zone, UK markets will be focused upon BoE minutes for additional evidence of a possible QE tilt.

Since markets will be searching for the highest frequency and most timely gauges alongside evidence of political leadership, backward-looking indicators may be discounted more than usual. We'll be expecting soft inflation readings out of the US for the month of July on Thursday, perhaps a rise in home resales given pending sales strength although contract cancellations may be a risk again, and a rise in industrial production but for July such that we stress that it's the forward-looking later releases that will count for more. Fed speak will be back in vogue, with each of Lockhart, Pianalto, and Dudley on tap for speeches on the economy and markets as a follow-up to the divided FOMC statement. Coming speeches and FOMC minutes on August 30th will be closely parsed for the full range of discussion at the last Fed meeting.

Canadian markets will be in the spotlight, principally because we may witness more evidence of falling annual Canadian inflation rates given that the HST that was implemented in Ontario and BC one year ago now starts to drop out of the numbers. Manufacturing sales will help round out Q2 GDP estimates.

Asian markets should generally follow the global tone. RBA minutes will likely reinforce a prolonged pause. Chinese new yuan loan growth typically falls off after the quotas go out earlier in the year, but the numbers may attract attention to Chinese growth. Everyone knows Japanese Q2 GDP will sharply contract, but the trade balance for July is expected to be flat. Each of Hong Kong, Chile, and Colombia make rate announcements.

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### ***Why The Fed's Rate Commitment Differs From The BoC's Conditional Promise***

- **The BoC's commitment used a readily definable metric. The Fed's doesn't, and that could come back to haunt the Fed in future.**

The Fed adopted what too many took as an explicit promise not to raise interest rates for at least two years when it stated that slack in the economy and subdued inflationary pressures "...are likely to warrant exceptionally low levels for the federal funds rate at least through mid-2013." Some said this borrows from a tactic employed by the Bank of Canada in its conditional commitment to keep rates on hold until the end of June 2010. But there are a number of key differences from the BoC's conditional commitment that make the parallels off-base in our judgement.

First, we don't know what the conditionality is to the Fed's loose commitment and that could well prove to be disconcerting. Yes, directionally, it's obviously the requirement that the Fed come closer toward achieving its full employment and price stability mandates. But, operationally, what does that mean in the conduct of monetary policy? The Fed has soft targets for inflation but is not an explicit inflation-targeting central bank like the ECB or BoC, and who knows at what point the Fed believes it is getting close enough toward converging upon full employment in order to justify when to begin raising rates off the emergency floor and cooling unconventional policy. In other words, what's the magic figure for the unemployment rate or inflation in an expectations framework that would trigger tightening? How can markets judge if and when it's close? For now, the point is moot, but this may well come back to one day haunt the Fed's credibility. The BoC's experiment with the conditional commitment that said it would remain on hold until the end of June last year worked because it had an explicit reference point by which to judge such conditionality. When we went against the grain and accurately forecast that the BoC would actually hike just before the end of its conditional commitment, too many took that as a broken promise by the BoC not to raise rates until into the third quarter of last year at the earliest. We never bought that since the commitment was made on the condition that it not risk breaching its inflation target which, at the time, it was.

Second, "exceptionally low" can mean the current 0%-0.25% band, or something higher but still very low, like 0.5% or perhaps even 1%. This means that while it's possible that rate hikes won't occur until after mid-2013, don't interpret the statement's language to mean as such with airtight certainty.

Third, "likely to warrant" leaves the Fed policy flexibility and also connotes the lack of a clear cut promise. "Likely" suggests two tail risks to this and leaves the Fed an out in either direction.

The bottom line is that the Fed may be less successful than the BoC was at successfully managing such a commitment in the eyes of the market. Such a commitment may not work as well for a central bank like the Fed that operates under a dual full employment and price stability mandate with fast and loose policy targets, and considering that the Fed operates under much greater transparency than other central banks by fostering a culture of public dissent. You can bet every single voting member on the FOMC will be grappling with this issue of appropriate and readily observable targets such that the range of debate could be destabilizing to markets. The lack of comfort in dealing with such target vagueness was reflected in the three dissenting voices. While the policy of an extended hold may make sense for the US economy, I might have also dissented in the absence of a more explicit frame of reference.

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### **The Fed Could Be Teeing Up A Run At QE3**

- **The three dissenters won't be obstacles in 2012, but there remains a high bar.**

The FOMC is not yet prepared to pursue QE3 at this juncture, but may well be toward year end and into next year for two reasons.

One reason is that the Fed clearly stated that it is worried about growth and that “inflation will subside to levels at or below those consistent with the Committee’s dual mandate.” Such inflation guidance says they may be willing to take out extra insurance against deflation risk by embracing QE3. That would also fit our bias that the tone of the indicators will worsen over coming months.

The second reason is that none of the three dissenting FOMC voters in the August 9th FOMC statement will matter much should the Fed move toward embracing QE3 by early 2012. That’s because they won’t be voting FOMC members next year. Each of Philly Fed President Charles Plosser, Dallas Fed President Richard Fisher, and Narayana Kocherlakota of the Minneapolis Fed vote this year, but will be neither voting nor alternate members of the FOMC next year. They will cross the country pounding their fists on tables in Hoenig-fashion before audiences of staff ringers, but they won’t be able to stamp their names as dissenters on FOMC statements throughout 2012. The table below summarizes the voting composition of the FOMC positions that rotate each year both for this year and in each of the next two years. In addition to these members are the Governors of the Federal Reserve not listed below. We also give our impressions of the dovish or hawkish attitudes of the individual members that change positions and the overall committee. In short, a somewhat hawkish leaning consensus of rotating FOMC members this year gives way to a dovish balance of voting members next year.

I maintain the belief that QE3 is no panacea — indeed it may well do more harm than good as QE2 may well have done — but the Fed’s signals are pointed in the direction of repeatedly embracing it just as Japan did in futile fashion for much of the past two decades. Bernanke’s Jackson Hole speech on August 26th will therefore face higher odds of teeing up market expectations for a move toward QE3 later in the year or by early 2012. Like last year, the Fed may need several months of very soft inflation readings before it thinks the hurdle on additional stimulus has been exceeded.

#### **Federal Reserve Bank Rotation on the FOMC**

Committee membership changes at the first regularly scheduled meeting of the year.

|                          | <b>2011 (H)</b>                       | <b>2012 (D)</b>                     | <b>2013 (Mixed)</b>                   |
|--------------------------|---------------------------------------|-------------------------------------|---------------------------------------|
| <b>Members</b>           | New York – <b>D</b> (Dudley)          | New York – <b>D</b> (Dudley)        | New York – <b>D</b> (Dudley)          |
|                          | Chicago – <b>D</b> (Evans)            | Cleveland – <b>D</b> (Pianalto)     | Chicago – <b>D</b> (Evans)            |
|                          | Philadelphia – <b>H</b> (Plosser)     | Richmond – <b>H</b> (Lacker)        | Boston – <b>D</b> (Rosengren)         |
|                          | Dallas – <b>H</b> (Fisher)            | Atlanta – <b>D</b> (Lockhart)       | St. Louis – <b>H</b> (Bullard)        |
|                          | Minneapolis – <b>H</b> (Kocherlakota) | San Francisco – <b>D</b> (Williams) | Kansas City – <b>H</b> (TBA*)         |
| <b>Alternate Members</b> | New York – <b>D</b> (Cumming)         | New York – <b>D</b> (Cumming)       | New York – <b>D</b> (Cumming)         |
|                          | Cleveland – <b>D</b> (Pianalto)       | Chicago – <b>D</b> (Evans)          | Cleveland – <b>D</b> (Pianalto)       |
|                          | Richmond – <b>H</b> (Lacker)          | Boston – <b>D</b> (Rosengren)       | Philadelphia – <b>H</b> (Plosser)     |
|                          | Atlanta – <b>D</b> (Lockhart)         | St. Louis – <b>H</b> (Bullard)      | Dallas – <b>H</b> (Fisher)            |
|                          | San Francisco – <b>D</b> (Williams)   | Kansas City – <b>H</b> (TBA*)       | Minneapolis – <b>H</b> (Kocherlakota) |

**D= Dovish      H = Hawkish**

\* **Kansas City Fed President Hoenig to retire on October 1<sup>st</sup>**

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### Consumers Likely To Take Market Turbulence In Stride

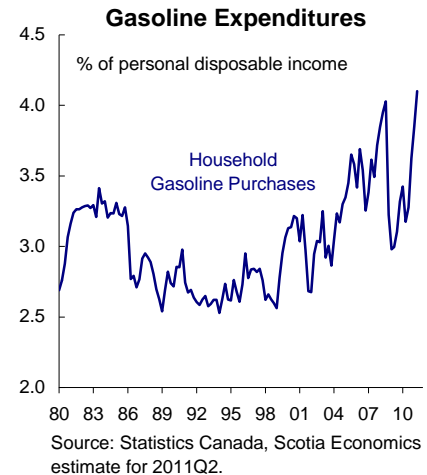
- **The unprecedented volatility in global financial markets and onslaught of negative economic headlines over the past week are likely to dent consumer confidence and spending to some degree relative to our already modest expectations for the latter half of the year. Overall, however, competitive retail pricing and relief at the pump will help insulate household purchasing power and support moderate spending gains.**

Canadian households, facing high debt loads and weak wage gains, were already becoming more reticent consumers. The main risk to the outlook from the latest market gyrations is if heightened economic uncertainty leads to a pullback in hiring. Canadian businesses have been expanding their payrolls steadily this year, with July's 95,000 increase the strongest in a decade. Recent surveys have been pointing to continued strong hiring intentions for the second half of the year.

The negative wealth effect from declining stock markets is substantial, with the S&P/TSX off 12% from its April highs. However, stock market wealth is heavily skewed to high-income earners. A potential casualty of the retracement could be luxury goods stores, a retail segment that has outperformed by a wide margin this year as equity markets marched higher. Housing wealth, which is much more widely held, is still intact.

Meanwhile, households will benefit substantially from the sharp decline in oil prices over the past two months. We estimate that gasoline expenditures garnered a record or near record share of total household disposable income in Q2 (chart). By sapping spending dollars from other areas, this was likely a major factor behind the weak retail performance in the quarter. The drop in WTI oil prices from an average of US\$102/bbl in Q2 to \$94/bbl in the current quarter to date translates into aggregate household savings of close to \$1 billion, funds which could be allocated to other spending, used to pay down debt or to build up rainy day savings. If lower transportation costs and/or weaker global growth in turn take some pressure off global food prices, this too will add to household purchasing power.

We also do not anticipate a significant fallout for the Canadian housing market, though some 'move-up' buyers, particularly at the high-end of the market, may now be more inclined to stay on the sidelines for the time being. Importantly, it now appears borrowing costs will remain lower for a longer period of time — good news for both new homeowners and those renewing mortgages. The U.S. Federal Reserve's pledge to keep its funds rate at historically low levels through mid-2013 will likely also keep the Bank of Canada on hold for some time. Meanwhile, low fixed-term mortgage rates could edge even lower in the weeks or months ahead if the sharp drop in bond yields is maintained.



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**Markets Are Assuming A Low And Long BoC For Too Long**

- Debating a near-term cut is a side issue to the bigger issue of long-term pricing.

Consensus and the markets are having the wrong debate by investing too much time and money into whether or not the BoC will cut rates. We think the bigger debate concerns the longer-run outlook for the BoC, and in that regard, the market is being too aggressive in pricing out rate hikes potentially for years to come. Even though we've long had the most dovish voice within consensus, the market has gone excessively dovish in our opinion.

As evidence, three-year Government of Canada bonds are priced on top of the BoC's 1% overnight rate, and 5-year GoC bonds are only about a half point higher. There are many factors that go into determining longer-run borrowing costs, but the market is signaling that it believes the BoC to be on hold for a very long time. Indeed, even longer than the Fed's loose commitment to remain on hold until about the end of 2013Q2.

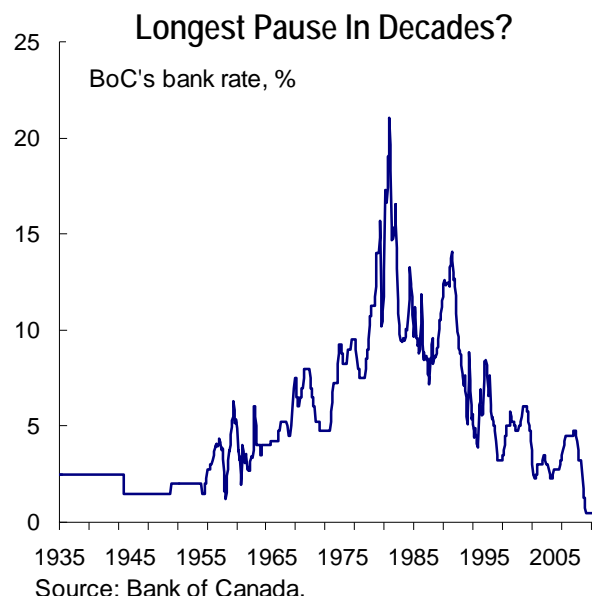


Chart 1 plots the BoC's bank rate over time. While the targeting framework has changed over the years such that the bank rate has altered its meaning over this time period, the bank rate currently sits atop the BoC's targeted band and is 25bps higher than the overnight rate. For a primer, see <http://www.bankofcanada.ca/about/backgrounders/target-overnight-rate/>. What markets are signaling by way of pricing across the whole curve is that the BoC will remain at close to the lowest rate depths for the longest period of time since the period of the 1930s through 1950s.

That makes the prospects for a rate cut in the near term moot by comparison. If you're worried about being wrong on the rate picture, you stand to lose much more in potentially being on the wrong side of longer-run expectations than near-term moves. The table below summarizes the pros and cons facing the BoC in advancing a rate cut near term, and we remain unconvinced that the balance is supportive of potentially returning toward the lower zero bound on rates after the BoC fought so hard to get off of it last year. Stopping short of that would mean a 25bps or 50bps cut that would yield nothing to the economy. We judge the risks to our published consensus-leading forecast for the BoC to recommence rate hikes by 2012Q2 to be significantly later but without parking the BoC on hold for as long as the markets appear to be assuming.

| Pros and Cons Of Renewed Rate Cuts  |   |
|---|---|
| <p><b>Pros:</b></p> <ul style="list-style-type: none"> <li>- just reaffirms market pricing perhaps except further CAD depreciation</li> <li>- Fed's prolonged pause and possible QE3 ties the BoC's hands</li> <li>- much softer commodities ease up on inflation and growth</li> <li>- potentially sharp downsides to growth forthcoming</li> <li>- immediate stimulus to variable rate borrowers</li> <li>- BoC may risk undershooting its 2% inflation forecast</li> <li>- Governor Carney is not against changing his mind if he sees fit</li> <li>- softens other forms of tightening: fiscal, Basel, mortgage rule changes</li> </ul> | <p><b>Cons:</b></p> <ul style="list-style-type: none"> <li>- bond and currency markets have already eased for the BoC</li> <li>- minimal impact upon the economy</li> <li>- negative for banks' spread business, on top of higher interbank funding</li> <li>- policy flip-flop compared to the last statement, rightly or wrongly perceived</li> <li>- BoC would be very reticent to return to the lower zero bound</li> <li>- not a liquidity crisis that requires emergency rates, though Europe is a risk</li> <li>- maybe EMs could lead to reaccelerating commodities into next year</li> <li>- longer-term risks of being too low for too long and setting up future worries</li> <li>- possible negative confidence influence to households/businesses.</li> </ul> <p>Then again, decisive action could be confidence boosting so it's rarely certain where the balance ever sits on this argument.</p> |

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**Should Canada Be Preparing More Fiscal Stimulus?**

- **Probably not. Its starting point on fiscal health is decent, but not immutably so.**

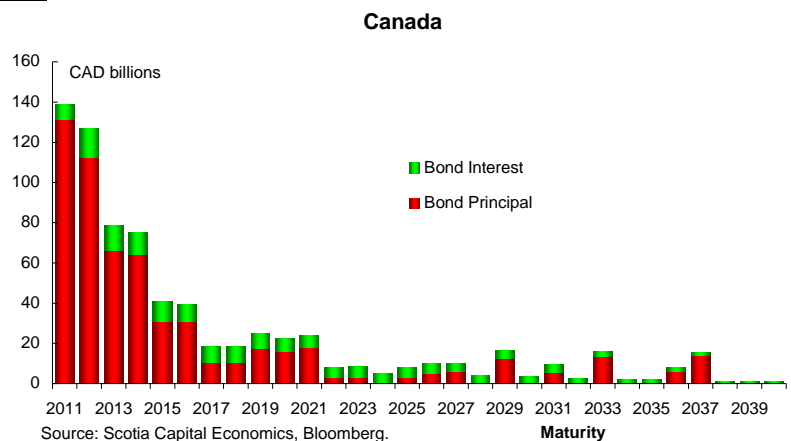
Canada is in an enviable position, but not immutably so. While some advocate federal fiscal stimulus to counter what is likely to be a downdraft on global growth, we're not so sure that's appropriate advice this time around. Stimulus in the early days of the crisis was one thing, but today must be treated with great care.

The country's starting point on government debt is less enviable than one may believe, but what sets it apart from the rest of the pack is a clear exit path. General (all levels) government debt to GDP is over 80% and not terribly outside of the bounds of other debt-challenged economies, while Federal program spending has climbed by over a whopping 40% under the current Federal government's watch partly due to the crisis. The country has plenty of assets to net out to this position and leave behind a net figure that is almost 50 points lower as a share of GDP, but crises can be more skewed toward concerns about the gross than net positions. Added to this is the fact that the country has a significant amount of refinancing ahead using Bloomberg's global debt distribution tables (chart 1). While current markets are hospitable toward refinancing Canadian debt, one must acknowledge the risks going forward and not tempt fate.

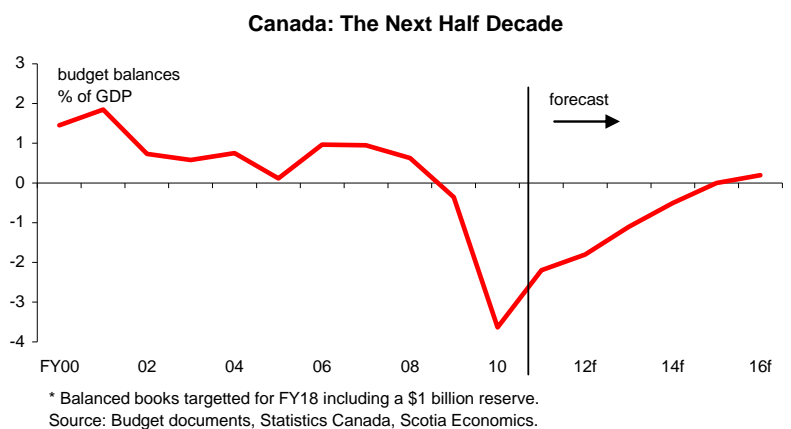
This leads to the point that, from a decent but by no means spectacular starting point, the country would want to ensure that it avoids joining the pack of countries lacking clarity or credibility on their exit paths across Europe and the US. The Federal government's path back to balance within four fiscal years that is hoped to yield largely immaterial deficit to GDP ratios within 1.5-2 years (chart 2) may be more challenged in the

early going through lower revenues via softer commodity prices, weaker growth, and aggressive planned expenditure reviews. To compound such challenges via significant stimulus could cause significant market concern regarding wavering exit paths. Applying more stimulus is something to be regarded with great caution, given: the limited (perhaps understated) global return to the sum total of fiscal stimulus that has been applied against the pressures of the past few years; increased nervousness of bond markets; and more aggressive rating agencies in this sovereign cycle that, for instance, already have Ontario under negative outlook by Fitch. A contingency list of modest targeted quick hits may be prudent while keeping the government's powder dry, but a solid case can be made for broad fiscal parameters remaining intact under a freshly elected majority government. More broadly speaking, it seems the only free market economy out there these days is Canada which has an exit plan, has not imposed short selling bans, is reducing corporate tax rates, and never imposed additional bank levies. Go Canada.

**Chart 1**



**Chart 2**



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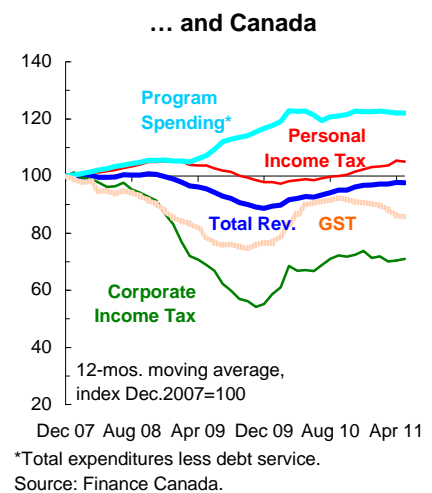
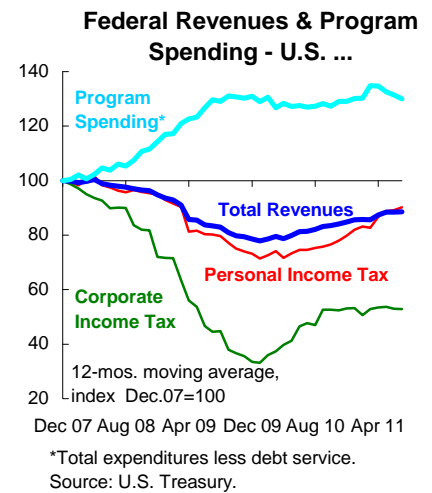
**U.S. Federal Fiscal Policy Uncertainty Persists**

- Washington’s path forward remains clouded by economic events and political positioning.

In a week of unsettling events, one positive note was the U.S. Treasury data for the first ten months of fiscal 2011 (FY11) that affirm an annual deficit in the range of last year’s US\$1.294 trillion shortfall, dramatically narrower than the Administration’s February estimate of red ink totaling US\$1.645 trillion. With the debt ceiling impasse now resolved, expenditures are expected to outstrip revenues for the last two months of FY11, but year-to-date revenues are up 8.0% and spending is only 2.4% higher, in part due to the legislative delays for FY11 appropriations (*top graph*). Yet Washington’s revenues remain roughly 10% below pre-recession levels, dampened by continuing stimulus as well as the weak recovery in employment and personal income that drives the substantial personal income and payroll tax revenue components. Ottawa (*bottom graph*), with a shallower dip and a faster recovery in employment, has witnessed stronger personal income tax receipts, facilitating the unwinding of its two-year stimulus after March 2011, and the completion of its corporate tax reduction strategy.

Washington now faces softer economic growth than the Administration’s optimistic February estimates, reinforcing the need for a fiscal restraint package in the US\$3.5-4.0 trillion range from FY12 through FY21 to stabilize publicly held debt relative to GDP. The Congressional Budget Office (CBO) estimates that an annual reduction in U.S. real GDP growth of 0.1 percentage points over ten years would deepen the FY21 deficit by US\$68 billion and the cumulative FY12-FY21 budget shortfall by US\$310 billion. In the near term, lower-than-expected interest rates will offer compensating relief. The CBO estimates that avoiding a rise of one percentage point in borrowing costs in FY13 would bolster the bottom line by more than US\$60 billion.

Following the debt ceiling resolution, the President’s immediate focus has shifted back to job creation, prompting a proposal to extend some of the existing stimulus and proceed with new initiatives such as a business tax credit for hiring war veterans and a national infrastructure bank. The possible total, topping US\$150 billion, underlines the Administration’s theme of near-term economic support within a framework of mid-term restraint. Yet Washington’s fiscal resources are now limited and Moody’s has reinforced S&P’s rating cautions. Accommodating additional stimulus will further complicate the FY12 appropriations legislation and/or the bipartisan Congressional Committee’s task this fall of finding new net fiscal restraint totaling US\$1½ trillion. Current spending should be distinguished from long-term investment and additional stimulus outlays should be reviewed in terms of the cost per job created. The suggested one-year extension of the payroll tax reduction, for example, applies to all employees and carries a price tag of over US\$100 billion. A critical hurdle is convincing the business sector to deploy some of its current extensive cash position into domestic job creation and investment. Restoring American household and business confidence in part relies upon a credible fiscal plan. The debate over the past four months has identified some measures with bipartisan support, such as using the chain-linked CPI to avoid overstating inflation indexation, and work could begin on revenue neutral, comprehensive tax reform, as discussed in last week’s *Global Views*.

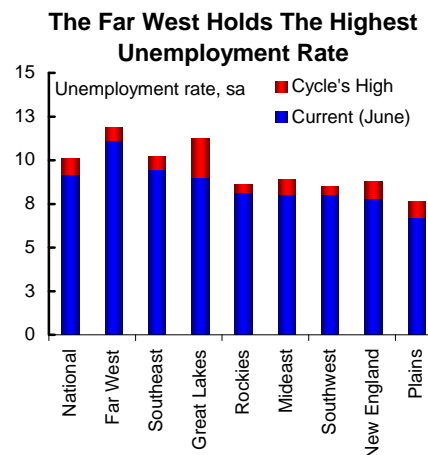


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**U.S. Regional Employment Dynamics**

- Industry mix and the type of economic shock affect regional employment trends.

Of the eight U.S. regions — the Bureau of Economic Analysis divides the country into Far West, Great Lakes, Mideast, New England, Plains, Rockies, Southeast and Southwest — six had unemployment rates below the national average in June, led by the Plains (see chart). Meanwhile, the Great Lakes — the U.S. manufacturing hub — experienced the biggest decline since the rate peaked in late 2009. The Far West and Southeast — the latter accounts for a quarter of overall national employment, its largest slice (see table) — underperformed. Unemployment in all eight regions remains 2-4 percentage points above their respective long-run averages, leaving considerable room for improvement.



Source: BLS, Scotia Economics.

Although wholesale and retail trade account for the biggest chunk of employment across all regions — no surprise given that consumer spending accounts for two-thirds of the economy — the sectoral composition of regional output and the type of economic shock play an important role in explaining regional differences in labour market sensitivity. For example, manufacturing — the most volatile sector — represents varying shares in the industry mix, ranging from a low of 7.8% in the Rockies to a high of 15.1% in the Great Lakes (see table). Construction makes up the biggest part of nonfarm payrolls in the Southwest, while the Mideast, which includes New York State, has the most exposure to finance. These compositional differences help explain why the Great Lakes region experienced a notable improvement in the unemployment rate. With its oversized exposure to the manufacturing sector, recovering global demand for durable goods has given the region a boost. For its part, New England held the second lowest jobless rate in June, benefiting from the cushion provided by education and healthcare, sectors that are relatively immune to economic downturns.

Data back to 1990 allowed us to examine three recessions: the savings & loan crisis of 1990, the burst of the tech bubble of 2001, and the recent financial crisis. We looked at the response of employment to GDP, and compared the sensitivity of regional employment to each recession. This confirmed that the intensity of outcomes varied by the type of economic shock, and that the regions that averaged higher payroll growth, such as the Rockies, Southeast and Southwest, tended to weather downturns better. That said, the sensitivity was most pronounced — across regions — during the latest downturn, led by the Far West and Great Lakes. The former was hit hard by the housing market doldrums — as it contains two of the five states (California, Nevada) which experienced the steepest declines in real estate prices — while slumping global demand for manufactured goods took a toll on the latter. Furthermore, employment trends in certain regions either tend to lead or lag the aggregate economy. The Great Lakes, Plains and Southeast — which dominate manufacturing — stand out as leaders, while the Far West and Mideast are laggards. The latter two hire the most government workers, a sector that tends to trail the economy. This is especially true in the current cycle, as governments at all levels continue to face fiscal constraints. These findings lead us to conclude that the pace of the recovery in the U.S. labour market will be uneven, and that the manufacturing-heavy regions stand to benefit the most, as consumer spending continues to take a backseat to exports and business investment in machinery and equipment.

| Regional Employment Shares By Major Industry |       |                                |               |                                   |                                  |             |                                  |                        |                       |                |            |
|--|-------|--------------------------------|---------------|-----------------------------------|----------------------------------|-------------|----------------------------------|------------------------|-----------------------|----------------|------------|
|  | Total | Mining, Logging & Construction | Manufacturing | Transportation, Trade & Utilities | Finance, Insurance & Real Estate | Information | Professional & Business Services | Education & Healthcare | Leisure & Hospitality | Other Services | Government |
| Total  | 100.0 | 5.1                            | 10.7          | 19.4                              | 6.0                              | 2.4         | 12.7                             | 13.2                   | 9.6                   | 4.1            | 16.5       |
| Southeast                                    | 24.3  | 6.2                            | 10.8          | 20.0                              | 5.4                              | 2.0         | 12.4                             | 12.0                   | 10.0                  | 4.2            | 16.9       |
| Mideast                                      | 16.5  | 4.4                            | 8.1           | 18.5                              | 7.0                              | 2.6         | 13.4                             | 16.7                   | 8.2                   | 4.4            | 16.6       |
| Great Lakes                                  | 16.0  | 4.5                            | 15.1          | 19.5                              | 5.6                              | 1.7         | 12.1                             | 13.4                   | 9.0                   | 4.2            | 14.8       |
| Far West                                     | 15.9  | 5.9                            | 9.8           | 19.0                              | 5.7                              | 3.0         | 13.7                             | 11.1                   | 11.1                  | 3.5            | 17.1       |
| Southwest                                    | 11.0  | 7.7                            | 8.7           | 19.9                              | 6.1                              | 2.2         | 12.3                             | 12.1                   | 9.5                   | 3.7            | 17.9       |
| Plains                                       | 7.5   | 5.0                            | 12.3          | 20.0                              | 6.2                              | 2.4         | 10.4                             | 13.8                   | 9.1                   | 4.1            | 16.8       |
| New England                                  | 5.2   | 4.2                            | 10.7          | 18.4                              | 6.9                              | 2.5         | 12.4                             | 17.9                   | 9.0                   | 3.7            | 14.3       |
| Rockies                                      | 3.5   | 8.1                            | 7.8           | 19.3                              | 6.0                              | 2.9         | 12.7                             | 10.9                   | 10.8                  | 3.6            | 17.9       |

Source: BLS, Scotia Economics.

## Pricing EM Bonds Without a Risk-Free Rate

The following article was published on August 10, 2011.

*Some investors fear that problems in the US Treasury market will make pricing emerging market sovereign bonds more difficult going forwards. We argue that this effect is not a significant problem for the EM market for three reasons: (1) the US is still relatively risk-free; (2) EM bonds don't just trade off of Treasuries; and (3) EM countries can be priced relative to each other.*

Since US Treasuries are used as the key risk-free benchmark to price more risky asset classes, some investors are concerned about the effect of recent troubles in the US Treasury market on those other assets. What would happen to all the financial models if US Treasuries were no longer risk-free? Would the lack of agreement in financial markets around the reference risk-free asset make emerging market (EM) assets more difficult to value, impeding both issuance and secondary market liquidity?

In our opinion, the risks to the US Treasury as a benchmark, at least for the purposes of valuing emerging markets assets, is mitigated by three factors that we explain below. Our focus here is on the technical aspects of EM credit pricing, and we mostly leave the debate regarding EM decoupling for another article.

**1. US still has very little risk.** According to S&P, no sovereign has ever defaulted within fifteen years of having a rating of single-A or higher. The only exception to this may be Greece, whose top rating from S&P was A until 2009. At AA+, the rating agency clearly does not believe that the US has much default risk. Looking at S&P's transition tables based on data between 1975-2009, only 2% of AAA-rated sovereigns have been downgraded from AAA to a level below AA within a fifteen year period. In comparison, implied default rates for even the highest rated emerging market countries are 25% to 50% over the next 15 years. Since expected emerging market default rates are still an order of magnitude greater than those of the U.S., using US Treasuries as a proxy for a risk-free rate should not cause significant distortions.

Some may point to a spread on US 5Y CDS that has increased over the past few months to 56 bp as evidence that default risk in the US is real and much greater than what we are suggesting. In fact, the 1Y CDS spread for the US is currently the same as that of many Latin American countries. We don't believe the CDS market provides a good reflection of risk in the case of the United States. Average daily CDS trading volume in the US of 75mn is one-sixth that of Mexico and one-tenth that of Brazil despite a much larger amount of underlying bonds. The net-notional of US CDS outstanding is \$5.6bn, which is tiny relative to the 11tn of US government bonds outstanding.<sup>1</sup> If the goal of looking at CDS is to understand the market's assessment of US risk, then surely the performance of US Treasury bonds is a more accurate measure; those rallied 20bp on Monday and demonstrated, in a rather perverse reaction to the downgrade, that the U.S. is still considered a safe haven.

**2. EM bonds don't just trade off of Treasuries.** Theoretical models of credit pricing typically assume that investors arrive at bond prices by estimating credit-specific default probabilities and recovery rates, and then adding the corresponding premiums to the risk-free rate. While that type of analysis certainly occurs, it would not, in our opinion, be very helpful in arriving at market clearing prices. The problem is that there is no quantitative model precise enough to estimate a default probability based on some function of a country's economic and political variables. While we can of course distinguish between countries with a 50% probability of default and a 5% probability of default, few analysts could claim with certainty that a default probability is 25% rather 30%. In other words, errors in any quantitative or qualitative model that we use to calculate developing country default probabilities are far greater than errors resulting from an imperfect estimate of the risk-free rate.

One simple demonstration of this idea is the negative correlation between Treasury yields and emerging market spreads. We would expect this correlation to be zero because Treasuries move for a variety of reasons that do not affect our assessment of emerging market default probabilities. Instead, the fact that the response in EM yields to movements in US Treasuries yields is typically less than one-for-one means that other factors play a role in setting EM prices.<sup>2</sup> This "price-stickiness" is just one of many examples of technical factors that play a role in setting EM bond prices that are unrelated to default premiums.

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**3. EM bonds can be priced relative to each other.** Because default risk cannot be precisely quantified, and because various technical factors unrelated to default risk can have large effects on bond prices, EM bonds are more likely to be priced relative to one another than relative to US Treasuries. For example, even if we did not know where US Treasuries were trading today, we could still price a new global USD-denominated bond issued by Brazil by looking at yields on bonds of other high-rated Latin American countries like Peru or Mexico, as well as of course by analyzing yields on other Brazil bonds. In fact, even though new issues are often quoted in terms of spreads over Treasuries, those spreads are always determined by examining spreads over Treasuries on credits with similar risk profiles. Thus, treasuries serve merely as a convenient and commonly accepted unit of measure; we see no reason why they could not serve that same purpose even if the Treasuries were more risky than before.

### Conclusion

The US downgrade may well have effects on emerging markets through traditional channels. For example, on Monday increased global uncertainty led investors to move away from risky assets which included EM bonds and currencies. Some may argue for the opposite effect by suggesting that the faster growing and more fiscally sound emerging market countries can serve as a substitute for US assets. We last saw those arguments back in 2007-2008, where some investors may have hoped that EM countries were immune from concerns about US economic problems, arguments which the financial markets ultimately rejected. Either way, the lack of a risk-free asset seems like the least important driver at this point. While a riskier US Treasury could make certain kinds of derivative transactions and hedging strategies more difficult to value and implement, we don't think that recent events would prevent such transactions or that these transactions are necessary to the basic functioning of the EM market. Thus, the concept of a risk-free rate which is so central to finance theory, is not as essential to the practice of finance and the functioning of certain markets as some may think.

We have assumed throughout this analysis that issuance in dollars by emerging market countries will continue. Barry Eichengreen, an academic cited by S&P, has written that the US dollar has a first-mover advantage that will make it hard to replace as a reserve currency and favored currency for international transactions.<sup>3</sup> Despite the downgrade, few countries can match the US in terms of credit quality, and none can come even close when we also take into account amount of debt outstanding and corresponding liquidity. We have certainly seen a move towards some local currency issuance by emerging markets over the past five years, and at the margin, that trend could pick up if the US creditworthiness comes into question further. Nevertheless, most countries should continue to issue some of their debt in dollars, ensuring that US Treasuries remain one good choice for a benchmark. Libor and swap rates provide another benchmark, one that while not immune, should be less influenced by US government credit risk.

The recent S&P downgrade begs the question of what would happen if other top-quality sovereign issuers are downgraded or if the US is downgraded further by S&P or the other rating agencies. Eventually, we would imagine that investors would be forced to diversify among a much larger number of credits and currencies than is common practice today. Nevertheless, a convergence in risk profiles between developed and developing questions that would warrant such a change is still very far away.

Endnotes:

<sup>1</sup> Daily volume data is from DTCC based on a survey from December 20, 2010 through March 19, 2011. Net notional data is for July 29, 2011.

<sup>2</sup> Price stickiness in EM bonds has been around for a long time, leading to a negative correlation between US Treasury yields and spreads. While the effect may be small and transitory for the higher-rated EM credits, it can be significant for the lower rated names. See "How Treasuries affect EM in the short-term," *EM Playbook*, February 28, 2008.

<sup>3</sup> See for example, Barry Eichengreen, "The Dollar Dilemma," *Foreign Affairs*, September/October 2009.

**BoE Inflation Report — August**

- **The BoE *Inflation Report* was a little more dovish than we had expected, and much more dovish than most forecasters had assumed. The thrust of the report represented an evolution in the dovish direction, though not enough to provoke further QE in the immediate few months. However, we believe that the Bank is still too optimistic on growth. Disappointing growth is likely to lead to further downgrading of the Bank’s projections and will reinforce the case for QE2 at subsequent *Inflation Reports*.**

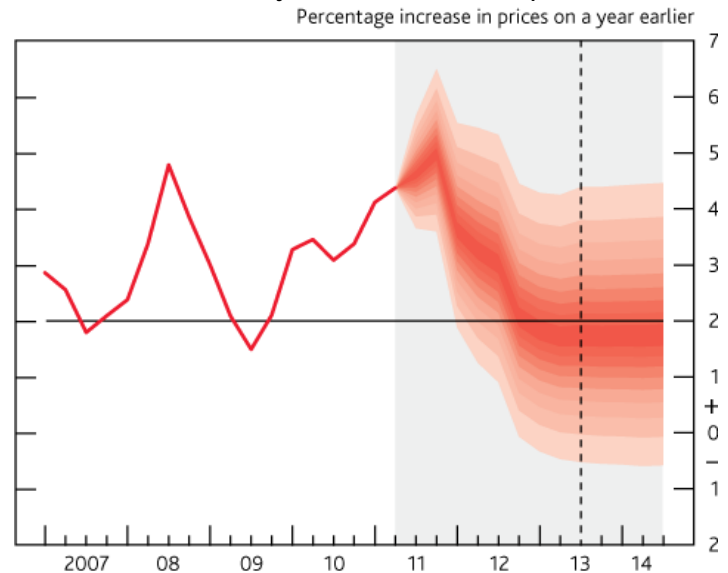
***Inflation projection — revised down by more than expected***

The 2-year ahead inflation projection was revised down to stand at 1.8% y/y 2-years ahead based on market rate expectations and 1.9% y/y based on unchanged interest rates. That was down from 1.9% y/y and 2.34% y/y last time respectively. The majority in the consensus had assumed that the 2012 inflation projection would be unchanged.

Taking on board the risk distribution, the Bank’s ‘Ribbon’ chart showed a slightly greater probability that inflation undershoots target over the medium term horizon.

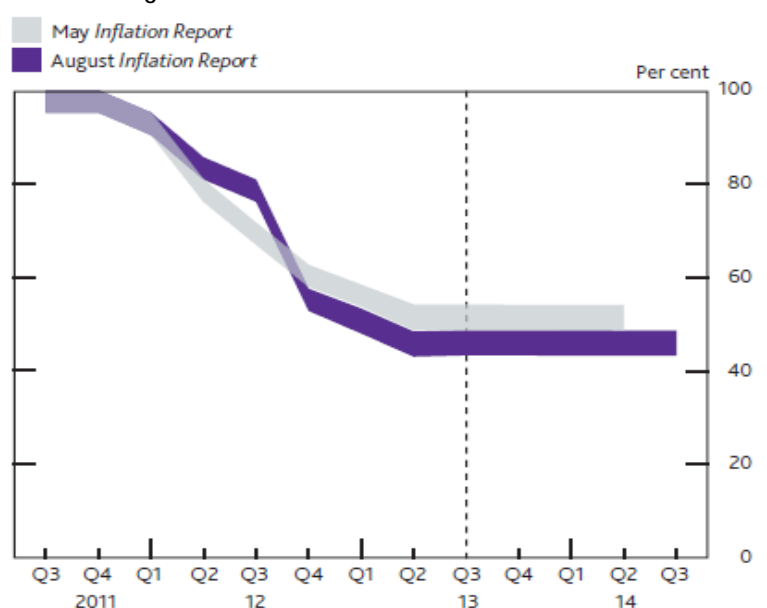
One subtle point that is likely to have been overlooked to some extent is the Governor’s response to a question about tuition fee increases. These will add between 0.2 and 0.4 percentage points to headline inflation from next September onwards. The Governor was asked whether, since these are temporary — like the recent VAT hike, the MPC will look through this effect. The Governor was a little cagey on this. He stated that if the effect is temporary, then the MPC will look through it, if it is permanent it will not. Hence it depends on one’s definition of temporary — 3 years is a long time, but it is essentially a one-off. The point is if the Bank looks through the addition to inflation from tuition fees, then the true forecast 2-years ahead ex-tuition fees could be as low as 1.4% y/y. In practice, we doubt the Bank has taken sufficient notice of the tuition fee hikes. Hence the truth is likely to lie somewhere a little below the published forecast of 1.8% y/y i.e. fractionally more dovish than the raw fan-chart suggests.

Chart 1: BoE Inflation Projection – Market Rate Expectations



Source: Bank of England

Chart 2: BoE Inflation ‘Ribbon Chart’. Probability That Inflation is Above Target.



Source: Bank of England

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### **Growth projection — revised lower, but not enough**

The Bank's forecast for GDP growth was revised down — though not enough in our view. The Bank has positioned itself for a chunky upward revision to GDP over the last year or so.

The official figures will be published in one week. For now, our judgement from the fan chart is that the Bank is assuming GDP growth of 1.6% y/y on average for 2011 and 2.1% y/y for 2012. That is down from 1.8% y/y and 2.5% y/y respectively last time around. Our own forecast is for 1.2% y/y in 2011 and 1.5% y/y next year.

Much will depend on the Bank's assumption of upward revisions to the back-data. The Bank conceded that it has assumed bigger revisions than usual. There is some substance for this. On 5 October, there will be substantial alterations to the UK GDP data as part of the annual 'Blue Book' process. One aspect of this is the deflator will change from RPI basis to CPI basis. There is therefore a risk that if the ONS subtracts CPI inflation (which is lower than RPI inflation) from nominal GDP rather than RPI inflation then real GDP should be higher. Hence there is a risk of some chunky upward revisions around the time of the final estimate of Q2 GDP (end September) onwards.

Upward revisions or not, the BoE has positioned itself for a strong rebound in GDP growth during Q3. We estimate that the Bank expects GDP to bounce by 1% q/q. Our working assumption has been a 0.7% q/q bounce, but were starting to feel altitude sickness — so 1% q/q looks brave.

Overall, the projections and the thrust of the press conference were broadly as we expected — a moderate evolution in the dovish direction, though not yet consistent with more QE.

However, disappointment relative to the Bank's growth expectations in the coming quarter or two is likely to make that a much more plausible outcome. At the very least, the first interest rate hike is likely to be a long way off.

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### **USDCNY Breaks 6.40 During A Tension Filled Week**

- **The break of 6.40 in USDCNY was a notable event, particularly as it came during exceptionally elevated financial market instability. A confluence of events favours a robust near term CNY-appreciatory tone, though more value may be present in the short end of the NDF curve or via spot in the CNH market.**

There has been no shortage of notable events over the past week, but for Asia perhaps none has mattered more than the appreciation in the renminbi. During a global meltdown in equity prices, Chinese policymakers in one sense effectively put their collective foot down to draw a proverbial line in the sand against financial market upset. On Thursday, following a 4.4% drop in the S&P 500, and what looked like an unenthusiastic day in Asian trading, Chinese policymakers guided the USDCNY fix down 176 points to below 6.40 for the first time. This led to the largest daily renminbi appreciation (0.38%) since November 9th, 2010. This move constituted an impressive show of confidence, despite the ongoing concern evident in Europe and North America.

Market reactions to the move have been notable in the offshore renminbi (CNH) market, and in the CNY NDF market. The moves in the longer end of the CNY NDF curve have been particularly violent, and the curve has steepened rather perceptibly. While we maintain a bullish outlook on CNY, targeting 6.25 by the end of this year and 5.88 by the end of next, we wouldn't necessarily say that we have seen a game-changing shift in our expectations due to the events of the past week, and that the scope of the reaction in the NDF market may be attributed to overly bearish CNY positioning since early June. However, a confluence of important near term events and market dynamics does suggest renminbi-bullish positioning in spot or the shorter end of the NDF market should be well rewarded over the next week.

### **Stability in a Storm**

The fixing of CNY to a much stronger level during a period of extreme financial instability to some degree harkens back to China's practice of providing a stabilizing force for the Asian region during periods of uncertainty. During the Asian Financial Crisis, China elected to not devalue its currency. During the most recent financial crisis, China re-pegged CNY to the USD. In doing so it effectively subjected itself to a very large appreciatory nominal effective exchange rate shock during a period of sharp global demand contraction. Its actions this week certainly helped to place a floor under the Asian FX complex vis-à-vis the USD. We note that two of the more volatile Asian currencies, KRW and MYR, had weakened significantly heading into Thursday's fix, but strengthened rapidly following the surprise fix higher in CNY. Regional equities rallied in line with the move, underscoring the importance of what is signified by China's willingness to push strength in CNY in the face of financial market instability. Essentially, it implies that the current financial market volatility was not concerning enough from a fundamental perspective to give pause to Chinese policymakers in their pursuit of the current economic agenda and policy direction. This is certainly something that the region can take heart and confidence from.

### **Global Macro Risks**

The higher than expected July CPI print (6.5% y/y) may initially cause some concern for China watchers. However, due to base effects, unless we see a very sharp near term supply-side price shock, Chinese inflation is likely to trend lower on a y/y basis. This is particularly the case as we move into the September-November period. The trend drop in commodity prices since the beginning of May should help to moderate non-food domestic price pressure. However, a new threat has emerged. The pledge by the Federal Reserve this week to keep rates on hold at least through mid-2013 has caused some consternation amongst Chinese policymakers. The People's Daily, seen as an indirect communication avenue for China's Communist Party, highlighted the concern and perception amongst mainland policymakers that QE3 is becoming more likely. The worry is that further monetary easing would incite the intensification of so-called hot money flows into the mainland. This

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would in turn lead to a build in FX reserves and thus an increase in the supply of yuan in the financial system (one of our key fundamental justifications for requiring a CNY appreciatory stance).

### **Political Dimensions**

The touchy issue of China's persistent trade surplus, and its trade surplus with the United States in particular, was not helped by this week's July trade data. Not only did it show China's trade surplus reaching its highest level on a monthly basis since January of 2009 at \$31.48bn, but it also showed that China's monthly trade surplus with the US had reached a new high at \$20.89bn. This is a dynamic that is typically going to rile US critics of Chinese currency policy at the best of times, but during the current growth-challenged environment, the political knock-on effect could be much more intensive. This is particularly the case considering that the US registered its largest post-recession trade deficit in June, with an acceleration in the pace of deterioration in the deficit well evident. For the time being, the US credit rating downgrade may be stealing the political show, but a very important visit to China will be taking place from August 17th to August 22nd. US Vice President Joe Biden (invited by the hugely influential Vice President Xi Jinping) will be in the country to discuss a number of issues, including regional security concerns. However, those of an economic nature will take particular importance. It is typical Chinese gamesmanship to allow a pick-up in the pace of CNY appreciation moving into a high-level meeting between the two countries. With Vice President Biden's visit just around the corner, some of the near term appreciatory impetus can be logically expected, particularly when placed in the context of the robust July Chinese trade surplus and the large June US trade deficit.

### **Appreciatory Trajectory Intact**

The decision of China to allow a significant appreciation in CNY over the past week has left the renminbi as the top performing non-Japan Asian currency over that same time period. The timing, during a period of remarkable financial market upset, was certainly notable and would have been even more meaningful if not for the upcoming political meetings. The worry amongst policymakers regarding easy US monetary conditions and the potential for any future QE3 to create liquidity producing hot money inflows is an important medium term concern, and argues for faster appreciation and/or greater flexibility (potentially achieved via a widening in the daily trading band).

Ultimately, the timing provided China with an opportunity to once again display regional economic leadership, and contributed towards a stabilization in the FX and equity markets in Asia this week. Greater appreciatory urgency is justified in our view, as China has pursued a relatively tame 4.5% annualized pace of CNY appreciation since the beginning of the year, and around a 4.9% annualized pace of appreciation since de-pegging from the USD last summer. There may be a bit of an overreaction in the longer end of the NDF market, and thus more value for those looking to play CNY appreciation may be present in the shorter end of the NDF curve and spot market (CNH in particular).

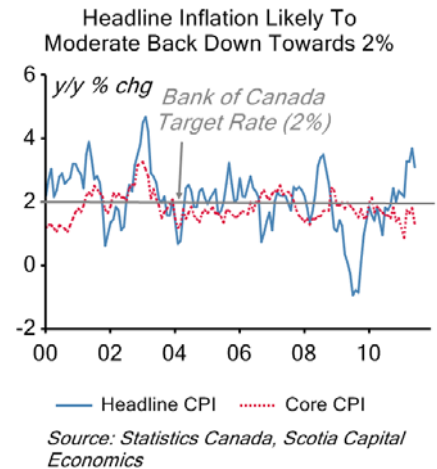
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## Key Data Preview

### CANADA

The Bank of Canada resisted hiking rates over the past few months despite the fact that **Canadian headline inflation** (Friday) remained above its target band of 1-3% (see chart attached), arguing that the recent run-up would prove temporary, with much of the gains in food and gasoline prices and a few distortions from one-off factors such as the introduction of the HST in Ontario and BC and the Olympic Games. While food inflation may continue to climb over the next year amidst the expectation that supply will be tight once again — the USDA just revised down their forecast for U.S. crop production in 2011 — gasoline prices have been trending downwards with a further decline expected in August after the huge plunge in crude oil prices over the last few weeks. This should lead headline inflation back down towards the BoC's 2% target rate by the end of the year. Core CPI should follow suit as auto producers discount further alongside other retailers as wage growth continues to decelerate — especially in inflation-adjusted terms — causing consumption to deteriorate sharply in Q1 with further weakness expected in Q2. Having said that, given the unexpected decline in both headline and core CPI in June and with no obvious seasonal factors affecting the month-over-month numbers, the July report will likely report a modest gain on both fronts. On the year-over-year, however, the increase in the HST last July in BC and Ontario will lead to a deceleration in headline CPI and only a modest gain in core CPI.



**Cdn Manufacturing sales** (Tuesday) declined in April and May on the back of the Japanese tsunami/earthquake which weakened supply chains, especially in the auto sector. Now, with auto production back on stream in Japan and across North America, we should witness a rebound in shipments in June. There is a risk, however, that shipments decline on the month after Canadian exports plunged 1.7% m/m given the relatively strong correlation between the two data series. However, these two series became disjointed in May as the two reports accounted for the Japanese disaster in a slightly different way. Thus, we could see one more month in which exports and shipments diverge with the likelihood that once these temporary factors wane, the two reports will be once again in line with each other.

### UNITED STATES

**US inflation** (Thursday) has faced upward pressure from rising gasoline and grocery prices, pushing headline inflation above 3% in April where it has remained since. This has resulted in several months of real-side weakness in consumption as Americans were forced to pare back discretionary spending amid rising costs for staple goods, culminating in the smallest quarterly gain in consumption in Q2 of this year since Q2 2009 when the US remained in recession. However, since late April, crude oil prices have started to decline, which has put downward pressure on gasoline prices, and we expect to witness further weakness ahead as global demand pulls back following the recent global rout, continued problems in Europe and increased worries over a US recession. This already has several companies providing competitive pricing with an expectation of further discounting in the months ahead to try and get consumers back in the stores. However, continued employment weakness and sluggish wage growth will likely keep consumers on the sidelines. This should therefore lead to a further moderation in core CPI although we will likely witness a few months of upward movement in the year-over-year rate given extremely weak monthly gains last year before core inflation comes back down again.

The US housing market remains in the doldrums and we don't expect much of a shift for a few years still. It is somewhat of a chicken and egg story as home prices continue to decline on a year-over-year basis which keeps prospective homebuyers on the sidelines despite borrowing costs. Prices, on the other hand, will remain low until demand returns. And, the **July existing home sales** (Thursday) report will likely reflect this weakness despite the increase in pending home sales in May and June with further contracts potentially cancelled as consumers remain worried over the US economic outlook. This will have an adverse effect on inventory levels which will lead to further weakness in home construction. Add to this the fact that foreclosures are still rising and we are looking for another decline in both **housing starts and permits** (Tuesday) with **homebuilder sentiment** (Monday via the NAHB Housing Market Index) remaining at extremely low levels.

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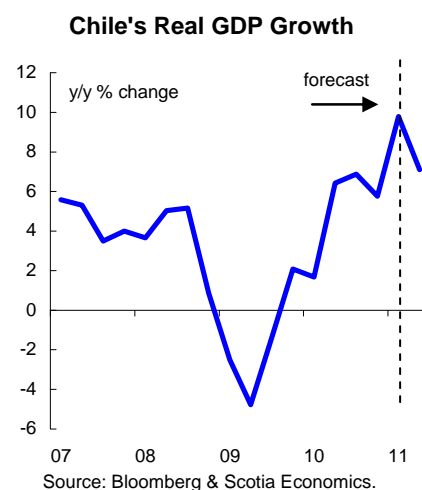
**EUROPE**

Germany’s second-quarter real GDP growth data will be released on August 16<sup>th</sup>. We estimate a significant slowdown from the strong first-quarter pace of 1.5% q/q (non-annualized) to 0.3% q/q. Germany, accounting for 27% of the euro zone economy, will continue to be the engine of growth in the region. While the export sector (which accounts for 50% of GDP) is losing some momentum, net exports will continue to contribute to total output growth through 2012. One of the key factors behind Germany's export sector success is the fact that the country has focused on expanding the share of robustly growing developing economies among its export destinations, with emerging markets such as China and India recently overtaking many historically important trading partners. With domestic employment conditions improving (the unemployment rate, at 7.0%, is at a multi-decade low) and real wages increasing, household spending will continue its gradual recovery through 2012, though concerns regarding the sovereign credit turmoil in the euro zone periphery will be reflected in confidence indicators.



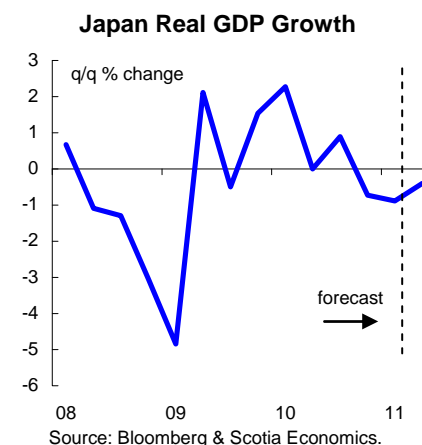
**LATIN AMERICA**

Chile’s second-quarter real GDP growth will be published next week. We expect an advance of 7.1% y/y, to follow the 9.8% y/y gain of the first quarter. The latter number can be attributed to a low base effect, resulting from the impacts of the March 2010 earthquake/tsunami on economic activity in Chile. The Chilean economy remains on an expansionary path on the back of solid domestic demand activity, notwithstanding the central bank’s drive to stabilize inflationary pressures over the past six months. Chile’s close links to the Asian region continue to favour the export sector, while local spending remains supported by household income gains underpinned by rising employment. We expect Chilean GDP to expand at a 6.5% y/y rate in 2011.



**ASIA**

The first estimate for Japan’s second-quarter real GDP will be released on August 14<sup>th</sup>. We anticipate a loss of 0.4%, a smaller contraction than the 0.9% fall of the previous three months. The expedited recovery of Japan’s export sector continues to be a sign of Asia’s persistent industrial momentum, as the region rebounded strongly after the earthquake/tsunami that hit Japan back in March. Our estimate for the quarterly change in output during the second quarter will lead to positive gains during the second half of 2011, consistent with our relatively optimistic forecast of a 0.3% y/y GDP gain for the year.



## Key Indicators for the week of August 15 - 19

| North America |       |       |  |        |      |           |        |  |
|---------------|-------|-------|--|--------|------|-----------|--------|--|
| Country       | Date  | Time  | Event  | Period | BNS  | Consensus | Latest |  |
| US            | 08/15 | 08:30 | Empire Manufacturing Index                   | AUG    | 1.0  | 1.0       | -3.8   |  |
| US            | 08/15 | 09:00 | Net Long-term TIC Flows (USD billions)       | JUN    | --   | --        | 23.6   |  |
| US            | 08/15 | 09:00 | Total Net TIC Flows (USD billions)           | JUN    | --   | --        | -67.5  |  |
| US            | 08/15 | 10:00 | NAHB Housing Market Index                    | AUG    | 15.0 | 15.0      | 15.0   |  |
| CA            | 08/16 | 08:30 | Manufacturing Sales (MoM)                    | JUN    | 0.1  | --        | -0.8   |  |
| US            | 08/16 | 08:30 | Import Price Index (MoM)                     | JUL    | --   | -0.1      | -0.5   |  |
| US            | 08/16 | 08:30 | Housing Starts (000s)                        | JUL    | 600  | 610       | 629    |  |
| US            | 08/16 | 08:30 | Housing Starts (MoM)                         | JUL    | -4.6 | -3.0      | 14.6   |  |
| US            | 08/16 | 08:30 | Building Permits (000s)                      | JUL    | 600  | 606       | 617    |  |
| US            | 08/16 | 08:30 | Building Permits (MOM)                       | JUL    | -0.8 | -1.8      | 1.3    |  |
| US            | 08/16 | 09:15 | Industrial Production (MoM)                  | JUL    | 0.3  | 0.4       | 0.2    |  |
| US            | 08/16 | 09:15 | Capacity Utilization (%)                     | JUL    | 76.8 | 76.9      | 76.7   |  |
| US            | 08/17 | 07:00 | MBA Mortgage Applications (WoW)              | 12-Aug | --   | --        | 21.7   |  |
| CA            | 08/17 | 08:30 | Int'l Securities Transactions (CAD billions) | JUN    | --   | --        | 15.4   |  |
| US            | 08/17 | 08:30 | Producer Price Index (MoM)                   | JUL    | 0.0  | 0.1       | -0.4   |  |
| US            | 08/17 | 08:30 | PPI Ex Food & Energy (MoM)                   | JUL    | 0.1  | 0.2       | 0.3    |  |
| CA            | 08/18 | 08:30 | Leading Indicators (MoM)                     | JUL    | --   | --        | 0.2    |  |
| CA            | 08/18 | 08:30 | Wholesale Sales (MoM)                        | JUN    | --   | --        | 1.9    |  |
| US            | 08/18 | 08:30 | Consumer Price Index (MoM)                   | JUL    | 0.2  | 0.2       | -0.2   |  |
| US            | 08/18 | 08:30 | CPI Ex Food & Energy (MoM)                   | JUL    | 0.1  | 0.2       | 0.3    |  |
| US            | 08/18 | 08:30 | Consumer Price Index (YoY)                   | JUL    | 3.6  | 3.3       | 3.6    |  |
| US            | 08/18 | 08:30 | CPI Ex Food & Energy (YoY)                   | JUL    | 1.6  | 1.6       | 1.6    |  |
| US            | 08/18 | 08:30 | Initial Jobless Claims (000s)                | 12-Aug | 400  | 405       | 395    |  |
| US            | 08/18 | 08:30 | Continuing Claims (000s)                     | 6-Aug  | 3700 | 3725      | 3688   |  |
| US            | 08/18 | 10:00 | Leading Indicators (MoM)                     | JUL    | --   | 0.2       | 0.3    |  |
| US            | 08/18 | 10:00 | Philadelphia Fed Index                       | AUG    | -1.0 | 4.0       | 3.2    |  |
| US            | 08/18 | 10:00 | Existing Home Sales (millions)               | JUL    | 4.8  | 4.9       | 4.8    |  |
| US            | 08/18 | 10:00 | Existing Home Sales (MoM)                    | JUL    | 0.0  | 3.3       | -0.8   |  |
| CA            | 08/19 | 07:00 | Consumer Price Index (MoM)                   | JUL    | 0.2  | --        | -0.7   |  |
| CA            | 08/19 | 07:00 | Consumer Price Index (YoY)                   | JUL    | 2.6  | --        | 3.1    |  |
| CA            | 08/19 | 07:00 | Bank Canada CPI Core (MoM)                   | JUL    | 0.2  | --        | -0.6   |  |
| CA            | 08/19 | 07:00 | Bank Canada CPI Core (YoY)                   | JUL    | 1.5  | --        | 1.3    |  |
| MX            | 08/19 | 09:00 | Global Economic Indicator IGAE (YoY)         | JUN    | --   | --        | 4.6    |  |
| MX            | 08/19 | 09:00 | GDP Constant \$ (YoY)                        | 2Q     | --   | 3.8       | 4.6    |  |

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

## Key Indicators for the week of August 15 - 19

| Europe  |       |       |  |        |      |           |         |  |
|---------|-------|-------|--|--------|------|-----------|---------|--|
| Country | Date  | Time  | Event  | Period | BNS  | Consensus | Latest  |  |
| UK      | 08/14 | 19:01 | Rightmove House Prices (MoM)                     | AUG    | --   | --        | -1.6    |  |
| SW      | 08/15 | 03:30 | Industrial Prod. s.a. (MoM)                      | JUN    | --   | -0.9      | 2.6     |  |
| SW      | 08/15 | 03:30 | Industrial Orders s.a. (YoY)                     | JUN    | --   | 10.5      | 13.4    |  |
| GE      | 08/16 | 02:00 | GDP s.a. (QoQ)                                   | 2Q P   | 0.3  | 0.5       | 1.5     |  |
| SP      | 08/16 | 03:00 | GDP (Constant SA) (QoQ)                          | 2Q P   | 0.0  | 0.2       | 0.3     |  |
| UK      | 08/16 | 04:30 | DCLG UK House Prices (YoY)                       | JUN    | --   | --        | -1.7    |  |
| UK      | 08/16 | 04:30 | CPI (MoM)  | JUL    | -0.1 | -0.1      | -0.1    |  |
| UK      | 08/16 | 04:30 | CPI (YoY)  | JUL    | 4.4  | 4.3       | 4.2     |  |
| UK      | 08/16 | 04:30 | Core CPI (YoY)                                   | JUL    | 3.0  | 3.0       | 2.8     |  |
| UK      | 08/16 | 04:30 | RPI (MoM)  | JUL    | -0.1 | -0.2      | 0.0     |  |
| UK      | 08/16 | 04:30 | RPI (YoY)  | JUL    | 5.1  | 5.1       | 5.0     |  |
| EC      | 08/16 | 05:00 | Euro-Zone GDP s.a. (QoQ)                         | 2Q A   | 0.1  | 0.3       | 0.8     |  |
| PO      | 08/16 | 05:00 | GDP (QoQ)  | 2Q P   | --   | -1.1      | -0.6    |  |
| EC      | 08/16 | 05:00 | Euro-Zone Trade Balance sa (euro millions)       | JUN    | --   | 0.0       | -559.5  |  |
| EC      | 08/17 | 04:00 | ECB Euro-Zone Current Account SA (euro billions) | JUN    | --   | --        | -18.3   |  |
| UK      | 08/17 | 04:30 | Bank of England Minutes                          |        |      |           |         |  |
| UK      | 08/17 | 04:30 | Claimant Count Rate (%)                          | JUL    | 4.7  | 4.7       | 4.7     |  |
| UK      | 08/17 | 04:30 | Jobless Claims Change (000s)                     | JUL    | 10.0 | 20.0      | 24.5    |  |
| UK      | 08/17 | 04:30 | Average Weekly Earnings (3M/YoY)                 | JUN    | 2.3  | 2.3       | 2.3     |  |
| UK      | 08/17 | 04:30 | Weekly Earnings exBonus (3M/YoY)                 | JUN    | 2.3  | 2.3       | 2.1     |  |
| UK      | 08/17 | 04:30 | ILO Unemployment Rate (3mths)                    | JUN    | 7.7  | 7.7       | 7.7     |  |
| EC      | 08/17 | 05:00 | Euro-Zone CPI - Core (YoY)                       | JUL    | 1.6  | 1.6       | 1.6     |  |
| EC      | 08/17 | 05:00 | Euro-Zone CPI (MoM)                              | JUL    | -0.6 | -0.6      | 0.0     |  |
| EC      | 08/17 | 05:00 | Euro-Zone CPI (YoY)                              | JUL    | 2.5  | 2.5       | 2.7     |  |
| IT      | 08/17 | 05:00 | Current Account (euro millions)                  | JUN    | --   | --        | -5094.0 |  |
| SP      | 08/17 |       | Trade Balance (euro millions)                    | JUN    | --   | --        | -3409.7 |  |
| UK      | 08/18 | 04:30 | Retail Sales Ex Auto Fuel (MoM)                  | JUL    | 0.3  | 0.4       | 0.8     |  |
| UK      | 08/18 | 04:30 | Retail Sales w/Auto Fuel (MoM)                   | JUL    | 0.4  | 0.3       | 0.7     |  |
| EC      | 08/18 | 05:00 | Construction Output SA (MoM)                     | JUN    | --   | --        | -1.1    |  |
| GE      | 08/19 | 02:00 | Producer Prices (MoM)                            | JUL    | --   | 0.1       | 0.1     |  |
| UK      | 08/19 | 04:30 | Public Finances (PSNCR)                          | JUL    | --   | -8.0      | 21.0    |  |
| UK      | 08/19 | 04:30 | PSNB ex Interventions (GBP billions)             | JUL    | 1.0  | 2.4       | 14.0    |  |
| UK      | 08/19 | 04:30 | Public Sector Net Borrowing (GBP billions)       | JUL    | -1.0 | 0.2       | 12.0    |  |

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

## Key Indicators for the week of August 15 - 19

| Asia Pacific |           |       |  |        |       |           |        |  |
|--------------|-----------|-------|--|--------|-------|-----------|--------|--|
| Country      | Date      | Time  | Event  | Period | BNS   | Consensus | Latest |  |
| CH           | AUG 09-15 |       | Actual FDI (YoY)                                   | JUL    | --    | --        | 2.8    |  |
| CH           | AUG 10-15 |       | New Yuan Loans (CNY billions)                      | JUL    | 600.0 | 550.0     | 633.9  |  |
| JN           | 08/14     | 19:50 | GDP Deflator (YoY)                                 | 2Q P   | -1.5  | -1.7      | -1.9   |  |
| JN           | 08/14     | 19:50 | Nominal GDP (QoQ)                                  | 2Q P   | -1.2  | -1.4      | -1.3   |  |
| JN           | 08/14     | 19:50 | GDP Annualized (QoQ)                               | 2Q P   | -1.6  | -2.5      | -3.5   |  |
| JN           | 08/14     | 19:50 | Gross Domestic Product (QoQ)                       | 2Q P   | -0.4  | -0.6      | -0.9   |  |
| AU           | 08/14     | 21:30 | New Motor Vehicle Sales (MoM)                      | JUL    | --    | --        | 1.3    |  |
| JN           | AUG 14-19 |       | Nationwide Dept. Sales (YoY)                       | JUL    | --    | --        | 0.3    |  |
| JN           | AUG 14-19 |       | Tokyo Dept. Store Sales (YoY)                      | JUL    | --    | --        | 0.4    |  |
| AU           | 08/15     | 21:30 | Reserve Bank's Board August Minutes                |        |       |           |        |  |
| CH           | 08/15     | 22:00 | Conference Board China June Leading Economic Index |        |       |           |        |  |
| JN           | 08/16     |       | Tokyo Condominium Sales (YoY)                      | JUL    | --    | --        | -1.3   |  |
| AU           | 08/16     | 21:30 | Wage Cost Index (QoQ)                              | 2Q     | --    | 1.0       | 0.8    |  |
| MA           | 08/17     | 05:00 | CPI (YoY)  | JUL    | --    | 3.6       | 3.5    |  |
| MA           | 08/17     | 06:00 | GDP (YoY)  | 2Q     | 4.0   | 3.8       | 4.6    |  |
| JN           | 08/17     | 19:50 | Merchandise Trade Balance Total (JPY billions)     | JUL    | --    | 71.0      | 68.6   |  |
| JN           | 08/17     | 19:50 | Adjusted Merchandise Trade Bal (JPY billions)      | JUL    | --    | -152.5    | -191.2 |  |
| JN           | 08/17     | 19:50 | Merchandise Trade Exports (YoY)                    | JUL    | -2.6  | -3.2      | -1.6   |  |
| JN           | 08/17     | 19:50 | Merchandise Trade Imports (YoY)                    | JUL    | 11.9  | 11.7      | 9.8    |  |
| AU           | 08/17     | 21:30 | Average Weekly Wages (QoQ)                         | MAY    | --    | 1.0       | 1.0    |  |
| HK           | AUG 17-18 |       | Composite Interest Rate (%)                        | JUL    | --    | --        | 0.3    |  |
| JN           | AUG 17-23 |       | Supermarket Sales (YoY)                            | JUL    | --    | --        | 0.1    |  |
| JN           | 08/18     | 01:00 | Coincident Index CI                                | JUN F  | --    | --        | 108.6  |  |
| JN           | 08/18     | 01:00 | Leading Index CI                                   | JUN F  | --    | --        | 103.2  |  |
| JN           | 08/19     | 00:30 | All Industry Activity Index (MoM)                  | JUN    | --    | 1.9       | 2.0    |  |
| TA           | 08/19     | 04:00 | Export Orders (YoY)                                | JUL    | --    | --        | 9.2    |  |

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

## Key Indicators for the week of August 15 - 19

| Latin America |           |       |                                       |        |             |             |             |  |
|---------------|-----------|-------|---------------------------------------|--------|-------------|-------------|-------------|--|
| Country       | Date      | Time  | Event                                 | Period | BNS         | Consensus   | Latest      |  |
| BZ            | 08/15     | 07:30 | Central Bank Weekly Economists Survey |        |             |             |             |  |
| BZ            | 08/15     | 10:00 | Trade Balance (FOB) - Weekly          | 14-Aug | --          | --          | 1054.0      |  |
| PE            | 08/15     | 11:30 | Unemployment (%)                      | JUL    | --          | --          | 7.3         |  |
| PE            | 08/15     |       | GDP (YoY) NSA                         | JUN    | --          | --          | 7.1         |  |
| BZ            | AUG 15-22 |       | Tax Collections (BRL billions)        | JUL    | --          | --          | 82726       |  |
| BZ            | AUG 15-19 |       | Economic Activity Indx (MoM) SA       | JUN    | --          | --          | 0.2         |  |
| BZ            | AUG 15-19 |       | Economic Activity Indx (YoY) NSA      | JUN    | --          | --          | 4.3         |  |
| BZ            | AUG 15-22 |       | CAGED Formal Job Creation             | JUL    | --          | --          | 215393      |  |
| BZ            | 08/16     | 07:00 | FGV CPI IPC-S                         | 12-Aug | --          | --          | -0.01       |  |
| BZ            | 08/17     | 04:00 | FIPE CPI - Weekly                     | 15-Aug | --          | 0.33        | 0.33        |  |
| AR            | AUG 17-19 |       | Budget Balance (ARS millions)         | JUL    | --          | --          | 934         |  |
| BZ            | 08/18     | 07:00 | FGV Inflation IGP-10 (MoM)            | AUG    | --          | 0.2         | -0.1        |  |
| CL            | 08/18     | 08:30 | Current Account (USD millions)        | 2Q     | --          | --          | 721.5       |  |
| CL            | 08/18     | 08:30 | Gross Domestic Product (YoY)          | 2Q     | 7.1         | 6.5         | 9.8         |  |
| AR            | 08/18     | 15:00 | Trade Balance (ARS millions)          | JUL    | --          | --          | 1019        |  |
| CL            | 08/18     | 18:00 | <b>Nominal Overnight Rate Target</b>  |        | <b>5.25</b> | <b>5.25</b> | <b>5.25</b> |  |
| BZ            | 08/19     | 08:00 | IBGE CPI IPCA-15 (MoM)                | AUG    | --          | 0.2         | 0.1         |  |
| AR            | 08/19     | 15:00 | Economic Activity Indx (MoM) SA       | JUN    | --          | --          | 1.5         |  |
| AR            | 08/19     | 15:00 | Economic Activity Indx (YoY) NSA      | JUN    | --          | --          | 8.1         |  |
| AR            | 08/19     | 15:00 | Industrial Production (YoY) NSA       | JUL    | --          | --          | 8.2         |  |
| AR            | 08/19     | 15:00 | Industrial Prod. s.a. (MoM)           | JUL    | --          | --          | -0.1        |  |
| CO            | 08/19     | 17:00 | Industrial Production (YoY)           | JUN    | --          | --          | 4.38        |  |
| CO            | 08/19     | 17:00 | Retail Sales (YoY)                    | JUN    | --          | --          | 11.5        |  |
| CO            | 08/19     |       | <b>Overnight Lending Rate</b>         |        | <b>4.50</b> | <b>4.75</b> | <b>4.50</b> |  |

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

## Global Auctions for the week of August 15 - 19

## North America

| <u>Country</u> | <u>Date</u> | <u>Time</u> | <u>Event</u>                       |
|----------------|-------------|-------------|------------------------------------|
| US             | 08/15       | 11:30       | U.S. to Sell 3-Month Bills         |
| US             | 08/15       | 11:30       | U.S. to Sell 6-Month Bills         |
| US             | 08/16       | 11:30       | U.S. to Sell 4-Week Bills          |
| US             | 08/18       | 13:00       | U.S. to Sell 5-Year TIPS Reopening |

## Europe

| <u>Country</u> | <u>Date</u> | <u>Time</u> | <u>Event</u>                             |
|----------------|-------------|-------------|--|
| SP             | 08/16       | 04:30       | Spain to Sell 12M and 18M Bills          |
| SZ             | 08/16       | 05:30       | Switzerland to Sell 3-Month Bills        |
| BE             | 08/16       | 05:30       | Belgium to Sell Bills                    |
| FR             | 08/16       | 09:00       | France to Sell Bills                     |
| GE             | 08/17       | 05:15       | Germany to Sell EU7 Bln 2-Year Notes     |
| PO             | 08/17       | 05:30       | Portugal to Sell 3M and 6M Bills         |
| UK             | 08/18       | 05:30       | U.K. to Sell GBP4.5 Bln 1.75% 2017 Bonds |
| UK             | 08/19       | 06:10       | U.K. to Sell Bills                       |

## Asia Pacific

| <u>Country</u> | <u>Date</u> | <u>Time</u> | <u>Event</u>                |
|----------------|-------------|-------------|-----------------------------|
| JN             | 08/15       | 23:35       | Japan to Sell 1-Year Bills  |
| CH             | 08/16       | 23:00       | China to Sell 10 Year Bond  |
| JN             | 08/16       | 23:35       | Japan to Sell 3-Month Bills |

Source: Bloomberg, Scotia Economics.

## Events for the week of August 15 - 19

## North America

| <u>Country</u> | <u>Date</u> | <u>Time</u> | <u>Event</u>  |
|----------------|-------------|-------------|---|
| US             | 08/15       | 13:25       | Fed's Lockhart Speaks on Economy in Florence, Alabama |
| US             | 08/18       | 08:35       | Fed's Dudley to Speak in Newark, NJ                   |
| US             | 08/19       | 08:30       | Fed's Dudley to Speak in Lyndhurst, NJ                |
| US             | 08/19       | 13:45       | Fed's Pianalto speaks on economy in Columbus, Ohio    |

## Europe

| <u>Country</u> | <u>Date</u> | <u>Time</u> | <u>Event</u>   |
|----------------|-------------|-------------|--|
| GE             | 08/14       | 13:10       | Economy Minister Roesler Gives Interview to ZDF Television |
| GE             | 08/16       | 10:00       | Merkel to Discuss Debt Crisis with Sarkozy in Paris        |
| UK             | 08/17       | 04:30       | Bank of England Releases Monetary Policy Committee Minutes |

## Asia Pacific

| <u>Country</u> | <u>Date</u> | <u>Time</u> | <u>Event</u>  |
|----------------|-------------|-------------|---|
| IN             | 08/13       | 02:30       | RBI Deputy Governor Subir Gokarn at CII event. New Delhi. |
| AU             | 08/15       | 21:30       | Reserve Bank's Board August Minutes                       |

## Latin America

| <u>Country</u> | <u>Date</u> | <u>Time</u> | <u>Event</u>   |
|----------------|-------------|-------------|--|
| AR             | 08/13       | 23:00       | Argentina Political Party Primaries                            |
| AR             | 08/14       | 07:00       | Argentine Parties Hold Primaries for the Presidential Election |
| CL             | 08/18       | 18:00       | <b>Nominal Overnight Rate Target</b>                           |
| CO             | 08/19       |             | <b>Overnight Lending Rate</b>                                  |

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                | September 7, 2011   | 1.00                      | --                         |
| Federal Reserve – Federal Funds Target Rate | 0.25                | September 20, 2011  | 0.25                      | --                         |
| Banco de México – Overnight Rate            | 4.50                | August 26, 2011     | 4.50                      | --                         |

This week's FOMC statement adopted a loose commitment to keep rates on hold until mid-2013, arguing that downside risks to growth remain, along with an increased risk that "inflation will subside to levels at or below those consistent with the Committee's dual mandate." This suggests that there is an increased risk that the BoC will remain on hold next year for longer than our current Q2 2012 estimate.

## 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                  | 1.50                | September 8, 2011   | 1.50                      | --                         |
| Bank of England – Bank Rate                               | 0.50                | September 8, 2011   | 0.50                      | 0.50                       |
| Swiss National Bank – Libor Target Rate                   | 0.00                | September 15, 2011  | 0.00                      | --                         |
| Central Bank of Russia – Refinancing Rate                 | 8.25                | September 1, 2011   | 8.25                      | --                         |
| Hungarian National Bank – Base Rate                       | 6.00                | August 23, 2011     | 6.00                      | 6.00                       |
| Central Bank of the Republic of Turkey – 1 Week Repo Rate | 5.75                | August 23, 2011     | 5.75                      | --                         |

Following an unanticipated rate cut by the Turkish central bank on August 4th, and given persistent concerns related to the nation's substantial current account deficit, no further move is expected at the next meeting of the Monetary Policy Committee on August 23rd. As focus shifts from inflation to the impacts of the ongoing European debt crisis on economic activity and monetary policy in Hungary, minutes from last month's Monetary Council meeting show that Hungarian policymakers intend to keep the base rate unchanged at 6% for an "extended period".

## 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                | September 7, 2011   | 0.10                      | --                         |
| Reserve Bank of Australia – Cash Target Rate            | 4.75                | September 6, 2011   | 5.00                      | 4.75                       |
| Reserve Bank of New Zealand – Cash Rate                 | 2.50                | September 14, 2011  | 2.50                      | --                         |
| People's Bank of China – Lending Rate                   | 6.56                | TBA                 | --                        | --                         |
| Reserve Bank of India – Repo Rate                       | 8.00                | TBA                 | 7.75                      | --                         |
| Hong Kong Monetary Authority – Base Rate                | 0.50                | TBA                 | 0.50                      | --                         |
| Central Bank of China Taiwan – Discount Rate            | 1.88                | September 30, 2011  | --                        | --                         |
| Bank Negara Malaysia – Overnight Policy Rate            | 3.00                | September 8, 2011   | 3.00                      | --                         |
| Bank of Korea – Bank Rate                               | 3.25                | September 7, 2011   | 3.25                      | --                         |
| Bank of Thailand – Repo Rate                            | 3.25                | August 24, 2011     | 3.25                      | --                         |
| Bank Indonesia – Reference Interest Rate                | 6.75                | September 8, 2011   | 6.75                      | --                         |
| Central Bank of the Philippines – Overnight Policy Rate | 4.50                | September 8, 2011   | 4.50                      | --                         |

## 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               | 12.50               | August 31, 2011     | 12.50                     | --                         |
| Banco Central de Chile – Overnight Rate            | 5.25                | August 18, 2011     | 5.25                      | 5.25                       |
| Banco de la República de Colombia – Lending Rate   | 4.50                | August 19, 2011     | 4.50                      | 4.75                       |
| Banco Central de Reserva del Perú – Reference Rate | 4.25                | September 8, 2011   | 4.25                      | --                         |

The monetary boards of Chile and Colombia will meet next week. We expect both central banks to remain on the sidelines on the back of relatively favourable inflationary trends as of late and given the current global uncertainty. While price pressures have yet to capitulate, recent trends display stabilization particularly in core inflation in Chile and non-food inflation in Colombia.

## 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                | September 22, 2011  | 5.50                      | --                         |

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

|   | 2000-09        | 2010            | 2011f        | 2012f        | 2000-09                            | 2010         | 2011f        | 2012f        |
|---|----------------|-----------------|--------------|--------------|------------------------------------|--------------|--------------|--------------|
| <b>Output and Inflation (annual % change)</b> |                |                 |              |              |                                    |              |              |              |
|   |                | <b>Real GDP</b> |              |              | <b>Consumer Prices<sup>2</sup></b> |              |              |              |
| World <sup>1</sup>                            | 3.6            | 5.1             | 4.0          | 4.3          |                                    |              |              |              |
| Canada  | 2.1            | 3.2             | 2.6          | 2.4          | 2.1                                | 1.8          | 2.9          | 2.1          |
| United States                                 | 1.7            | 3.0             | 1.8          | 2.5          | 2.6                                | 1.6          | 2.8          | 2.0          |
| Mexico  | 1.7            | 5.4             | 3.9          | 3.5          | 4.9                                | 4.4          | 3.6          | 3.8          |
| United Kingdom                                | 1.7            | 1.4             | 1.2          | 1.5          | 1.9                                | 3.7          | 4.4          | 2.1          |
| Euro zone                                     | 1.1            | 1.7             | 1.7          | 1.5          | 2.0                                | 2.2          | 2.5          | 2.1          |
| Japan   | 0.6            | 4.0             | 0.3          | 3.5          | -0.3                               | 0.0          | 0.8          | 1.3          |
| Australia                                     | 3.1            | 2.7             | 3.4          | 3.0          | 3.2                                | 2.7          | 2.8          | 2.5          |
| China   | 9.4            | 10.4            | 9.3          | 9.5          | 2.0                                | 4.6          | 5.0          | 4.5          |
| India   | 7.4            | 9.0             | 8.3          | 8.5          | 6.2                                | 9.5          | 7.5          | 6.0          |
| Korea   | 4.4            | 6.2             | 5.0          | 5.3          | 3.1                                | 3.5          | 3.7          | 3.3          |
| Brazil  | 3.3            | 7.5             | 4.0          | 4.5          | 6.7                                | 5.9          | 6.5          | 5.5          |
| Chile   | 3.6            | 5.8             | 6.5          | 5.5          | 3.5                                | 1.4          | 4.0          | 3.5          |
| Peru  | 5.2            | 8.8             | 6.0          | 5.8          | 2.5                                | 2.1          | 4.0          | 3.7          |
| <b>Central Bank Rates (% end of period)</b>   | <b>11Q1</b>    | <b>11Q2</b>     | <b>11Q3f</b> | <b>11Q4f</b> | <b>12Q1f</b>                       | <b>12Q2f</b> | <b>12Q3f</b> | <b>12Q4f</b> |
| Bank of Canada                                | 1.00           | 1.00            | 1.00         | 1.00         | 1.00                               | 1.50         | 2.00         | 2.25         |
| Federal Reserve                               | 0.25           | 0.25            | 0.25         | 0.25         | 0.25                               | 0.25         | 0.75         | 1.25         |
| European Central Bank                         | 1.00           | 1.25            | 1.50         | 1.75         | 2.00                               | 2.00         | 2.00         | 2.00         |
| Bank of England                               | 0.50           | 0.50            | 0.50         | 0.50         | 0.50                               | 0.75         | 1.00         | 1.25         |
| Swiss National Bank                           | 0.25           | 0.25            | 0.00         | 0.00         | 0.00                               | 0.00         | 0.25         | 0.25         |
| Bank of Japan                                 | 0.10           | 0.10            | 0.10         | 0.10         | 0.10                               | 0.10         | 0.10         | 0.10         |
| Reserve Bank of Australia                     | 4.75           | 4.75            | 5.00         | 5.25         | 5.50                               | 5.75         | 6.00         | 6.25         |
| <b>Exchange Rates (end of period)</b>         |                |                 |              |              |                                    |              |              |              |
| Canadian Dollar (USDCAD)                      | 0.97           | 0.96            | 0.96         | 0.96         | 0.95                               | 0.95         | 0.94         | 0.94         |
| Canadian Dollar (CADUSD)                      | 1.03           | 1.04            | 1.04         | 1.04         | 1.05                               | 1.05         | 1.06         | 1.06         |
| Euro (EURUSD)                                 | 1.42           | 1.45            | 1.45         | 1.50         | 1.48                               | 1.46         | 1.43         | 1.40         |
| Sterling (GBPUSD)                             | 1.60           | 1.61            | 1.61         | 1.63         | 1.65                               | 1.67         | 1.69         | 1.70         |
| Yen (USDJPY)                                  | 83             | 81              | 79           | 80           | 82                                 | 83           | 84           | 85           |
| Australian Dollar (AUDUSD)                    | 1.03           | 1.07            | 1.08         | 1.09         | 1.09                               | 1.10         | 1.10         | 1.11         |
| Chinese Yuan (USDCNY)                         | 6.5            | 6.5             | 6.4          | 6.3          | 6.2                                | 6.1          | 6.0          | 5.9          |
| Mexican Peso (USDMXN)                         | 11.9           | 11.7            | 12.0         | 12.0         | 12.1                               | 12.1         | 12.2         | 12.4         |
| Brazilian Real (USDBRL)                       | 1.63           | 1.56            | 1.57         | 1.60         | 1.61                               | 1.62         | 1.64         | 1.65         |
| <b>Commodities (annual average)</b>           | <b>2000-09</b> | <b>2010</b>     | <b>2011f</b> | <b>2012f</b> |                                    |              |              |              |
| WTI Oil (US\$/bbl)                            | 51             | 79              | 97           | 100          |                                    |              |              |              |
| Brent Oil (US\$/bbl)                          | 50             | 80              | 111          | 114          |                                    |              |              |              |
| Nymex Natural Gas (US\$/mmbtu)                | 5.95           | 4.40            | 4.40         | 4.75         |                                    |              |              |              |
| Copper (US\$/lb)                              | 1.78           | 3.42            | 4.35         | 4.30         |                                    |              |              |              |
| Zinc (US\$/lb)                                | 0.73           | 0.98            | 1.05         | 1.06         |                                    |              |              |              |
| Nickel (US\$/lb)                              | 7.11           | 9.89            | 11.25        | 9.35         |                                    |              |              |              |
| Gold, London PM Fix (US\$/oz)                 | 522            | 1,225           | 1,540        | 1,650        |                                    |              |              |              |
| Pulp (US\$/tonne)                             | 668            | 960             | 984          | 1,045        |                                    |              |              |              |
| Newsprint (US\$/tonne)                        | 572            | 607             | 650          | 715          |                                    |              |              |              |
| Lumber (US\$/mfbm)                            | 275            | 254             | 265          | 270          |                                    |              |              |              |

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

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

| <b>Canada</b>                 | <b>2010</b> | <b>10Q4</b> | <b>11Q1</b> | <b>Latest</b> | <b>United States</b>          | <b>2010</b> | <b>10Q4</b> | <b>11Q1</b> | <b>Latest</b> |
|-------------------------------|-------------|-------------|-------------|---------------|-------------------------------|-------------|-------------|-------------|---------------|
| Real GDP (annual rates)       | 3.2         | 3.1         | 3.9         |               | Real GDP (annual rates)       | 3.0         | 2.3         | 0.4         | 1.3 (Q2-A)    |
| Current Acc. Bal. (C\$B, ar)  | -50.9       | -41.1       | -35.7       |               | Current Acc. Bal. (US\$B, ar) | -471        | -449        | -477        |               |
| Merch. Trade Bal. (C\$B, ar)  | -9.0        | 1.5         | 7.4         | -18.7 (Jun)   | Merch. Trade Bal. (US\$B, ar) | -646        | -637        | -730        | -811 (Jun)    |
| Industrial Production         | 4.6         | 6.0         | 5.3         | 8.0 (May)     | Industrial Production         | 5.3         | 6.2         | 5.3         | 3.4 (Jun)     |
| Housing Starts (000s)         | 192         | 179         | 178         | 205 (Jul)     | Housing Starts (millions)     | 0.58        | 0.54        | 0.58        | 0.63 (Jun)    |
| Employment                    | 1.4         | 1.7         | 1.9         | 1.5 (Jul)     | Employment                    | -0.8        | 0.5         | 0.9         | 1.0 (Jul)     |
| Unemployment Rate (%)         | 8.0         | 7.7         | 7.8         | 7.2 (Jul)     | Unemployment Rate (%)         | 9.6         | 9.6         | 8.9         | 9.1 (Jul)     |
| Retail Sales                  | 5.5         | 5.3         | 2.5         | 8.2 (May)     | Retail Sales                  | 6.8         | 8.1         | 8.6         | 8.9 (Jul)     |
| Auto Sales (000s)             | 1561        | 1554        | 1572        | 1656 (Apr)    | Auto Sales (millions)         | 11.6        | 12.3        | 13.0        | 12.2 (Jul)    |
| CPI                           | 1.8         | 2.3         | 2.6         | 3.1 (Jun)     | CPI                           | 1.6         | 1.3         | 2.1         | 3.6 (Jun)     |
| IPPI                          | 1.0         | 2.6         | 4.0         | -5.2 (Jun)    | PPI                           | 4.2         | 3.8         | 4.9         | 7.0 (Jun)     |
| Pre-tax Corp. Profits         | 21.2        | 19.1        | 13.4        |               | Pre-tax Corp. Profits         | 25.0        | 1.1         | 2.8         |               |
| <b>Mexico</b>                 |             |             |             |               | <b>Brazil</b>                 |             |             |             |               |
| Real GDP                      | 5.4         | 4.4         | 4.6         |               | Real GDP                      | 6.7         | 4.2         | 3.8         |               |
| Current Acc. Bal. (US\$B, ar) | -5.6        | -14.0       | -5.5        |               | Current Acc. Bal. (US\$B, ar) | -47.4       | -48.0       | -58.3       |               |
| Merch. Trade Bal. (US\$B, ar) | -3.0        | -4.2        | 7.6         | 1.3 (Jun)     | Merch. Trade Bal. (US\$B, ar) | 20.2        | 29.9        | 12.6        | 37.6 (Jul)    |
| Industrial Production         | 6.0         | 4.8         | 5.2         | 3.7 (Jun)     | Industrial Production         | 10.5        | 3.6         | 2.5         | 0.7 (Jun)     |
| CPI                           | 4.2         | 4.2         | 3.5         | 3.5 (Jul)     | CPI                           | 5.1         | 6.1         | 6.8         | 6.8 (Jul)     |
| <b>Chile</b>                  |             |             |             |               | <b>Italy</b>                  |             |             |             |               |
| Real GDP                      | 5.2         | 5.8         | 9.8         |               | Real GDP                      | 1.2         | 1.5         | 1.0         |               |
| Current Acc. Bal. (US\$B, ar) | 3.1         | 4.9         | 2.9         |               | Current Acc. Bal. (US\$B, ar) | -0.07       | -0.07       | -0.12       | -0.09 (May)   |
| Merch. Trade Bal. (US\$B, ar) | 11.6        | 17.7        | 17.4        | 14.6 (Jul)    | Merch. Trade Bal. (US\$B, ar) | -39.1       | -46.3       | -77.2       | -31.6 (Jun)   |
| Industrial Production         | 0.5         | 2.7         | 11.7        | 4.0 (Jun)     | Industrial Production         | 6.5         | 5.3         | 2.3         | 0.3 (Jun)     |
| CPI                           | 1.4         | 2.5         | 2.9         | 2.9 (Jul)     | CPI                           | 1.6         | 1.8         | 2.3         | 2.7 (Jul)     |
| <b>Germany</b>                |             |             |             |               | <b>France</b>                 |             |             |             |               |
| Real GDP                      | 3.5         | 3.8         | 4.8         |               | Real GDP                      | 1.4         | 1.4         | 2.1         |               |
| Current Acc. Bal. (US\$B, ar) | 188.0       | 251.7       | 194.8       | 205.8 (Jun)   | Current Acc. Bal. (US\$B, ar) | -44.5       | -86.6       | -59.7       | -97.3 (Jun)   |
| Merch. Trade Bal. (US\$B, ar) | 201.5       | 219.8       | 209.3       | 198.2 (Jun)   | Merch. Trade Bal. (US\$B, ar) | -39.5       | -39.7       | -54.5       | -46.7 (Jun)   |
| Industrial Production         | 10.1        | 11.7        | 12.8        | 6.6 (Jun)     | Industrial Production         | 5.1         | 4.7         | 4.8         | 2.3 (Jun)     |
| Unemployment Rate (%)         | 7.7         | 7.4         | 7.3         | 7.0 (Jul)     | Unemployment Rate (%)         | 9.8         | 9.7         | 9.7         | 9.7 (Jun)     |
| CPI                           | 1.1         | 1.5         | 2.1         | 2.4 (Jul)     | CPI                           | 1.5         | 1.6         | 1.8         | 1.9 (Jul)     |
| <b>Euro Zone</b>              |             |             |             |               | <b>United Kingdom</b>         |             |             |             |               |
| Real GDP                      | 1.7         | 1.9         | 2.4         |               | Real GDP                      | 1.4         | 1.5         | 1.6         |               |
| Current Acc. Bal. (US\$B, ar) | -77         | -41         | -169        | -315 (May)    | Current Acc. Bal. (US\$B, ar) | -71.6       | -72.2       | -74.0       |               |
| Merch. Trade Bal. (US\$B, ar) | 32.0        | 53.2        | -68.5       | 26.4 (May)    | Merch. Trade Bal. (US\$B, ar) | -153.0      | -171.9      | -142.4      | -172.6 (Jun)  |
| Industrial Production         | 7.4         | 8.1         | 6.5         | 3.0 (Jun)     | Industrial Production         | 2.1         | 3.3         | 2.0         | -0.3 (Jun)    |
| Unemployment Rate (%)         | 10.1        | 10.0        | 9.9         | 9.9 (Jun)     | Unemployment Rate (%)         | 7.9         | 7.9         | 7.7         | 7.7 (Apr)     |
| CPI                           | 1.6         | 2.0         | 2.5         | 2.7 (Jun)     | CPI                           | 3.3         | 3.4         | 4.1         | 4.2 (Jun)     |
| <b>Japan</b>                  |             |             |             |               | <b>Australia</b>              |             |             |             |               |
| Real GDP                      | 4.0         | 2.4         | -0.7        |               | Real GDP                      | 2.7         | 2.7         | 1.0         |               |
| Current Acc. Bal. (US\$B, ar) | 195.9       | 176.8       | 193.9       | 78.5 (Jun)    | Current Acc. Bal. (US\$B, ar) | -31.8       | -37.4       | -37.9       |               |
| Merch. Trade Bal. (US\$B, ar) | 74.7        | 60.5        | 31.8        | -28.5 (Jun)   | Merch. Trade Bal. (US\$B, ar) | 19.3        | 26.1        | 21.9        | 39.4 (Jun)    |
| Industrial Production         | 16.6        | 6.8         | -2.5        | -1.8 (Jun)    | Industrial Production         | 4.3         | 0.0         | -5.4        |               |
| Unemployment Rate (%)         | 5.1         | 5.0         | 4.7         | 4.6 (Jun)     | Unemployment Rate (%)         | 5.2         | 5.2         | 5.0         | 5.1 (Jul)     |
| CPI                           | -0.7        | 0.1         | 0.0         | 0.2 (Jun)     | CPI                           | 2.8         | 2.7         | 3.3         |               |
| <b>China</b>                  |             |             |             |               | <b>South Korea</b>            |             |             |             |               |
| Real GDP                      | 10.3        | 9.8         | 9.7         |               | Real GDP                      | 6.2         | 4.7         | 4.2         |               |
| Current Acc. Bal. (US\$B, ar) | 305.4       |             |             |               | Current Acc. Bal. (US\$B, ar) | 28.2        | 36.6        | 10.4        | 35.9 (Jun)    |
| Merch. Trade Bal. (US\$B, ar) | 181.5       | 246.8       | -6.8        | 377.8 (Jul)   | Merch. Trade Bal. (US\$B, ar) | 41.2        | 52.1        | 29.5        | 86.7 (Jul)    |
| Industrial Production         | 13.5        | 13.5        | 14.8        | 14.0 (Jul)    | Industrial Production         | 16.6        | 9.9         | 11.2        | 6.1 (Jun)     |
| CPI                           | 4.6         | 4.6         | 5.4         | 6.4 (Jun)     | CPI                           | 3.0         | 3.6         | 4.5         | 4.7 (Jul)     |

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

Source: Bloomberg, Scotia Economics.

## Interest Rates (% , end of period)

|                     | 11Q1   | 11Q2   | Aug/05 | Aug/12* |                       | 11Q1  | 11Q2  | Aug/05 | Aug/12* |
|---------------------|--------|--------|--------|---------|-----------------------|-------|-------|--------|---------|
| <b>Canada</b>       |        |        |        |         | <b>United States</b>  |       |       |        |         |
| 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        | 0.95   | 0.90   | 0.88   | 0.77    | 3-mo. T-bill          | 0.09  | 0.01  | 0.01   | 0.01    |
| 10-yr Gov't Bond    | 3.35   | 3.11   | 2.64   | 2.45    | 10-yr Gov't Bond      | 3.47  | 3.16  | 2.56   | 2.24    |
| 30-yr Gov't Bond    | 3.76   | 3.55   | 3.22   | 3.08    | 30-yr Gov't Bond      | 4.51  | 4.37  | 3.85   | 3.72    |
| Prime               | 3.00   | 3.00   | 3.00   | 3.00    | Prime                 | 3.25  | 3.25  | 3.25   | 3.25    |
| FX Reserves (US\$B) | 60.4   | 62.3   | 62.3   | (Jun)   | FX Reserves (US\$B)   | 128.3 | 136.6 | 136.6  | (Jun)   |
| <b>Germany</b>      |        |        |        |         | <b>France</b>         |       |       |        |         |
| 3-mo. Interbank     | 1.26   | 1.51   | 1.51   | 1.49    | 3-mo. T-bill          | 0.80  | 1.18  | 0.81   | 0.72    |
| 10-yr Gov't Bond    | 3.35   | 3.03   | 2.35   | 2.33    | 10-yr Gov't Bond      | 3.71  | 3.41  | 3.15   | 2.98    |
| FX Reserves (US\$B) | 64.8   | 66.0   | 66.0   | (Jun)   | FX Reserves (US\$B)   | 61.0  | 60.3  | 60.3   | (Jun)   |
| <b>Euro-Zone</b>    |        |        |        |         | <b>United Kingdom</b> |       |       |        |         |
| Refinancing Rate    | 1.00   | 1.25   | 1.50   | 1.50    | Repo Rate             | 0.50  | 0.50  | 0.50   | 0.50    |
| Overnight Rate      | 0.90   | 1.72   | 0.85   | 0.90    | 3-mo. T-bill          | 4.85  | 4.85  | 4.85   | 4.85    |
| FX Reserves (US\$B) | 319.9  | 317.2  | 317.2  | (Jun)   | 10-yr Gov't Bond      | 3.69  | 3.38  | 2.69   | 2.53    |
| <b>Japan</b>        |        |        |        |         | <b>Australia</b>      |       |       |        |         |
| Discount Rate       | 0.30   | 0.30   | 0.30   | 0.30    | Cash Rate             | 4.75  | 4.75  | 4.75   | 4.75    |
| 3-mo. Libor         | 0.14   | 0.13   | 0.13   | 0.13    | 10-yr Gov't Bond      | 5.49  | 5.21  | 4.48   | 4.43    |
| 10-yr Gov't Bond    | 1.26   | 1.14   | 1.01   | 1.05    | FX Reserves (US\$B)   | 33.3  | 40.3  | 40.3   | (Jun)   |
| FX Reserves (US\$B) | 1080.6 | 1100.8 | 1100.8 | (Jun)   |                       |       |       |        |         |

## Exchange Rates (end of period)

|        |       |       |       |       |                       |        |        |        |        |
|--------|-------|-------|-------|-------|-----------------------|--------|--------|--------|--------|
| USDCAD | 0.97  | 0.96  | 0.98  | 0.99  | ¥/US\$                | 83.13  | 80.56  | 78.43  | 76.73  |
| CADUSD | 1.03  | 1.04  | 1.02  | 1.01  | US¢/Australian\$      | 103.29 | 107.22 | 104.43 | 103.22 |
| GBPUSD | 1.603 | 1.605 | 1.639 | 1.628 | Chinese Yuan/US\$     | 6.55   | 6.46   | 6.44   | 6.39   |
| EURUSD | 1.416 | 1.450 | 1.428 | 1.424 | South Korean Won/US\$ | 1100   | 1068   | 1058   | 1080   |
| JPYEUR | 0.85  | 0.86  | 0.89  | 0.92  | Mexican Peso/US\$     | 11.906 | 11.713 | 11.990 | 12.305 |
| USDCHF | 0.92  | 0.84  | 0.77  | 0.77  | Brazilian Real/US\$   | 1.632  | 1.563  | 1.576  | 1.617  |

## Equity Markets (index, end of period)

|                        |       |       |       |       |                         |       |       |       |       |
|------------------------|-------|-------|-------|-------|-------------------------|-------|-------|-------|-------|
| United States (DJIA)   | 12320 | 12414 | 11445 | 11246 | U.K. (FT100)            | 5909  | 5946  | 5247  | 5295  |
| United States (S&P500) | 1326  | 1321  | 1199  | 1178  | Germany (Dax)           | 7041  | 7376  | 6236  | 5985  |
| Canada (S&P/TSX)       | 14116 | 13301 | 12162 | 12537 | France (CAC40)          | 3989  | 3982  | 3279  | 3199  |
| Mexico (Bolsa)         | 37441 | 36558 | 33698 | 33682 | Japan (Nikkei)          | 9755  | 9816  | 9300  | 8964  |
| Brazil (Bovespa)       | 68587 | 62404 | 52949 | 53284 | Hong Kong (Hang Seng)   | 23528 | 22398 | 20946 | 19620 |
| Italy (BCI)            | 1120  | 1039  | 885   | 795   | South Korea (Composite) | 2107  | 2101  | 1944  | 1793  |

## Commodity Prices (end of period)

|                          |        |       |       |       |                  |         |         |         |         |
|--------------------------|--------|-------|-------|-------|------------------|---------|---------|---------|---------|
| Pulp (US\$/tonne)        | 990    | 1035  | 1035  | 1035  | Copper (US\$/lb) | 4.26    | 4.22    | 4.17    | 4.01    |
| Newsprint (US\$/tonne)   | 640    | 640   | 640   | 640   | Zinc (US\$/lb)   | 1.05    | 1.05    | 1.03    | 0.98    |
| Lumber (US\$/mfbm)       | 290    | 237   | 242   | 230   | Gold (US\$/oz)   | 1439.00 | 1505.50 | 1658.75 | 1736.00 |
| WTI Oil (US\$/bbl)       | 106.72 | 95.42 | 86.88 | 85.91 | Silver (US\$/oz) | 37.87   | 35.02   | 39.24   | 38.29   |
| Natural Gas (US\$/mmbtu) | 4.39   | 4.37  | 3.94  | 4.09  | CRB (index)      | 359.43  | 338.05  | 326.80  | 327.30  |

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

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