Global Views

Weekly commentary on economic and financial market developments

January 28, 2011

Global Views is available on: www.scotiabank.com, Bloomberg at SCOE and Reuters at SM1C

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European Summit Could Be The Show-Stealer This Week

- ***But every key region of the world economy faces elevated market risk***

Make sure you have your antacid handy going into next week, as data, event, auction and central bank risk will be elevated across all regions of the global economy. Please see pages 19-27for our full calendars of events, indicators, auctions, and central bank meetings. Weekend developments in Egypt carry high event risk on the heels of the recent spike in oil prices and safe haven flows away from equities into Treasuries.

Pending developments in the Middle East, Europe holds the greatest potential to make or break the risk trade next week. In fact, it could well turn out to be among the biggest weeks for European influences upon global markets in the European crisis to date. Its fiscal and credit market challenges will be thrust front and centre onto world markets throughout the week in the lead-up to the key EU Summit on Friday February 4th surrounding which there are high expectations for achieving progress toward a longer-lived and more encompassing solution to Europe's debt challenge. Two days before that, German Chancellor Angela Merkel lays out Germany's terms and conditions and overall summit aims in a background briefing. On that same day (Wednesday), Fitch holds a conference on Europe's credit outlook for 2011. The day between these events (Thursday) puts ECB President Jean Claude Trichet in an awkward position with a rate announcement and ensuing press conference. Lucky (or not...) Portugal holds bill auctions on Wednesday, and Spain holds auctions for 2012 and 2016 bonds the next day. Data risk will also be elevated through purchasing manager indices covering Europe's manufacturing sector that often get material market attention, euro zone retail sales, German jobs, and euro zone CPI.

Canadian markets will start and end the week with material market-moving releases, but will otherwise follow the global tone. The broad tone to the week could well be dovish for the BoC. Monday's November GDP report is expected to continue a mild recovery at a more muted pace than the US recovery. In fact, if we're right on our call, then Q4 is shaping up to post one-handled quarter-over-quarter Canadian annualized growth which would once again disappoint BoC expectations. Wednesday could add to dovish BoC sentiments when BoC Senior Deputy Governor Tiff Macklem speaks on productivity, a key topic to the BoC's view that Canada has lost export competitiveness and will therefore be challenged to leverage up the US recovery especially at elevated CADUSD levels. The week closes with the January jobs report (see our previews on page 21), for which analysts have simply gone around the long-run average for lack of US-style higher frequency and timely labour market indicators. Thus, the tail risk is high on Friday.

US markets will face no auctions, but key data and speeches will be highly market relevant. Both Monday's personal spending and Tuesday's ISM manufacturing prints are always highly relevant to the risk trade and should be positive influences (see our previews). Watch for Fed Chairman Ben Bernanke's address before the National Press Club on Thursday. Two voting FOMC members speak, with Minneapolis Fed President Kocherlakota delivering the same speech he did on January 11th, but Dallas Fed President Richard Fisher delivers fresh remarks on Friday. Fisher remains our odds-on favourite to be the next dissenter.

Asian markets should be relatively subdued in terms of domestic influences drawn from the week-ahead calendars, with the key exception of Monday evening (eastern time) when China releases its purchasing manager index for manufacturing activity followed by the private sector version.

Beyond the ECB, global central bank activity will also bring the RBA into the spotlight with no expectation for a rate movement in light of recent data and concern over the impact of widespread flooding in Queensland. No moves are expected in central bank statements from Russia, Indonesia, Colombia and Iceland.

Latin American markets will be driven overwhelmingly by the tone in global markets, with three modest possible exceptions including fresh CPI data from Peru, Mexico's central bank meeting minutes, and Colombia's rate announcement.

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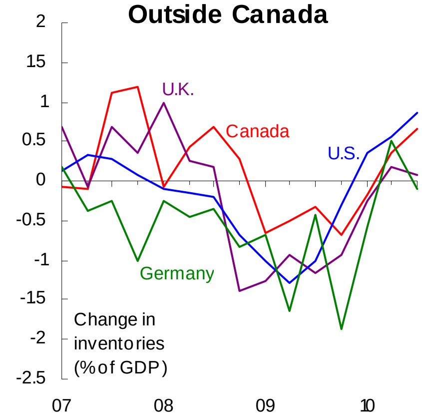
Inventory Mismanagement Another Reason For Canadian Under-Performance

While it may seem like a somewhat arcane topic, few issues matter more to the global economic cycle than how inventories are being managed. In Canada's case, still-high inventories are added to the list of reasons why Canada is likely to underperform other countries on GDP growth this year. That, in turn, is one of the reasons why we expect the BoC to remain on hold for longer than consensus and market pricing currently anticipate. Adrienne Warren explores another reason through her views on Canadian inflation on pages 8-9.

A classic cycle involves coming out of recession with lean inventories after a prolonged period of recession-induced production cuts oriented toward burning off inventories that are costly to finance in a tighter credit environment. Economic growth in recovery is leveraged higher by lean inventories as a pick-up in sales requires faster rates of production and employment growth than would have been required with still-bloated inventory positions. Lean inventories thereby beget a virtuous cycle of production increases, hiring, inventory investment, and multiplier effects throughout the economy. The role of the inventory cycle in driving this round of effects is too often discounted as artificial growth, but in reality it plays a sizeable role in propelling the economy forward.

Chart 1

Potential Inventory Leverage Outside Canada

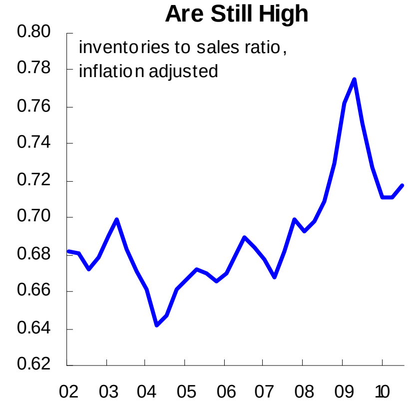


Source: IMF, DataInsight, Scotia Economics

The problem lies in the fact that Canadian business inventories are not lean. Consider chart 1. Inventories were cut more harshly in the US, Germany, and the UK than in Canada. That may well have been because the credit crunch was more significant certainly in economies like the US and UK than in Canada. That made financing inventories more difficult, which further aggravated production cuts in those economies as firms met falling sales largely out of inventories. The fact that Canada escaped the bulk of the credit difficulties that swept through other markets meant that Canadian cuts to production, employment, and inventory positions were not quite as harsh. This is one reason why Canada out-performed other countries through a milder recession. It is, however, also why Canada's recovery may well be more muted over the full cycle forward because there is less of a need for catching up on production and inventory cuts.

Chart 2

CDN Inventories Are Still High



Source: Statistics Canada, Scotia Capital Economics

Also consider charts 2-5. Canadian business inventories are leaner than during the recession, but the inflation-adjusted ratio of inventories to sales remains above its long-run average. Indeed, it currently sits slightly higher than it was going into recession and the ratio was relatively high at that point (chart 2). During 2008, we argued that consensus was giving Canada too much credit for having its own house in order such that it could withstand the impact of a foreign shock to production and exports. Then, as we do now, we believed that businesses had taken their eyes off the ball when it comes to inventory management. Then—in contrast to now—we felt this would be a contributing factor to our recession call, whereas high inventories today likely mean soft growth as the rest of the global economy is gradually on the mend.

On an industry basis, Charts 3-6 show that Canadian business inventories are still high at manufacturers, and to a lesser extent at retailers excluding auto dealers. Still-high manufacturing inventories compound the

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difficulty faced by manufacturers in coping with a strongly valued currency. Canadian auto dealer inventories are low, as are wholesale inventories.

In contrast, US inventories relative to sales sit toward the lowest point ever, and that could help leverage the production gains (chart 7, next page). That said, they remain high in manufacturing and at auto dealers, but are exceptionally lean at other retailers and in the wholesale segment of the value chain (charts 7-11, next page).

Chart 3

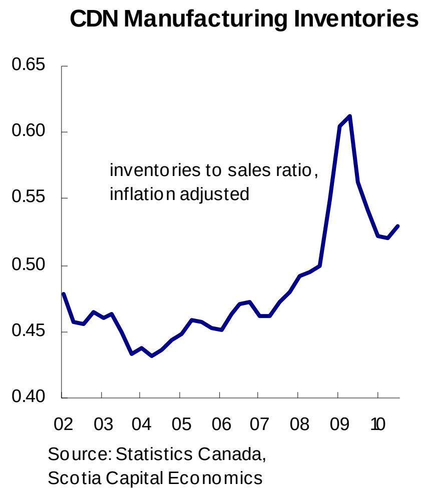
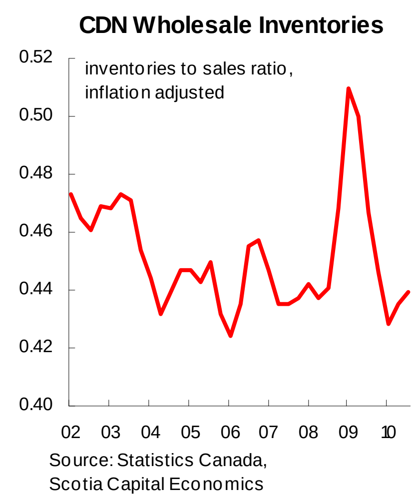


Chart 4

Chart 5

Chart 6



The tie-in to the BoC is that still-high inventory positions will likely constrain the speed by which Canada can close off excess capacity in its economy as represented by the output gap. But the reasons for under-performance on Canadian economic growth over 2011-12 are more varied than just inventories and also include the following.

1. Whereas the US has postponed fiscal contraction until next year — and will likely do so again until 2013 — Canada has not. Canada is allowing fiscal stimulus to drop off the books. This may very well be a long-run positive, but it means a bigger short-run fiscal drag effect north of the border.

2. No pent-up consumer demand in Canada. See last week's *Global Views* for our focus on global pent-up consumer demand.

3. The US may have created the best housing affordability in a long time, and stirred up pent-up housing demand. Canada has not. In fact, Canada is at cycle tops on housing variables like the home ownership rate, house prices, and leverage.

4. Lost export competitiveness. Canada will be more constrained in leveraging the implications of a US recovery this cycle compared to past recoveries because poor productivity growth and CAD's level have impaired the competitiveness of the country's exports.

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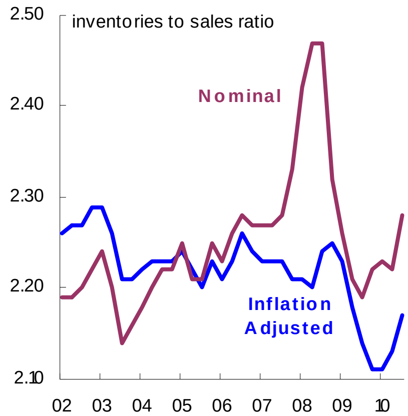
Chart 7

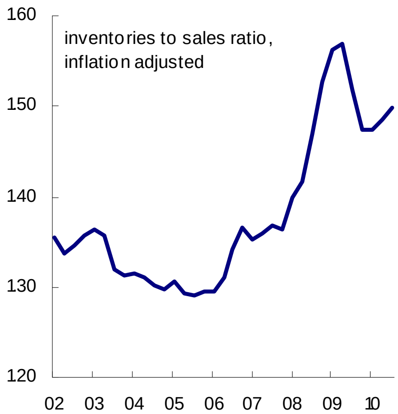
US Inventories Are Lean



Source: BEA, Scotia Capital Economics.

Chart 8

US Manufacturing Inventories



Source: BEA, Scotia Capital Economics.

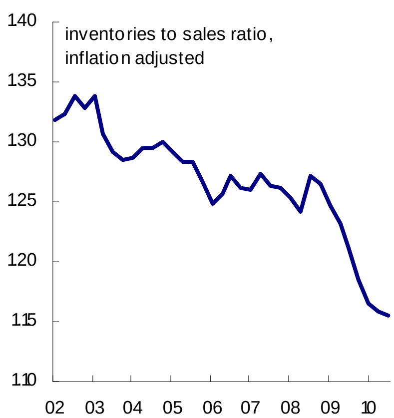
Chart 9

US Auto Dealer Inventories

Source: BEA, Scotia Capital Economics.

Chart 10

US Ex-Auto Retail Inventories



Source: BEA, Scotia Capital Economics.

Chart 11

US Wholesale Inventories

Source: BEA, Scotia Capital Economics.

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CBO Baseline Estimates Add Colour to State of the Union

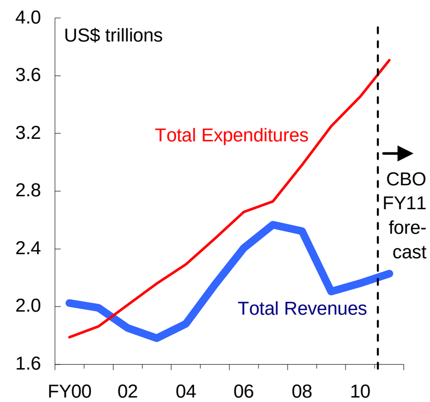
- ***The 2010 Tax Act pushes out fiscal restraint, but estimates of the escalating debt service reinforce, yet again, the cost of indefinitely delaying fiscal repair.***

The release of the Congressional Budget Office's (CBO) *Budget and Economic Outlook* through fiscal 2021 (FY21) illuminates several aspects of the State of the Union address earlier this week. The CBO's forecasts provide some insight into the jobless recovery south of the border. With the historically high share of permanent lay-offs, new jobs for the unemployed are likely to be in a different industry, frequently in a different location and almost certainly requiring new skills. Consequently, the CBO estimates that full employment, even with annual job creation just under 2%, will not be accomplished until 2016. If annual job growth averaged an improbable 2.5%, full employment could be regained by late 2014, but weakening annual job growth by 0.5 percentage points would push this goal out to late 2019.

Before the passage of the *2010 Tax Act* in December (and to a lesser extent the small business legislation in September), fiscal restraint in the U.S. was set to begin to tighten this year, in part through automatic fiscal stabilizers but also reflecting the peaking of the stimulus delivered through the US$821 billion *2009 American Recovery and Reinvestment Act(ARRA).* The CBO estimates the fiscal cost of the ARRA as US$183 billion in FY09, climbing to US$395 billion in FY10, and dropping to US$148 billion in FY11. The *2010 Tax Act*, with the extension of the lower personal income tax rates widely anticipated for all but the upper income brackets, focuses a significant share of its additional stimulus in calendar 2011.

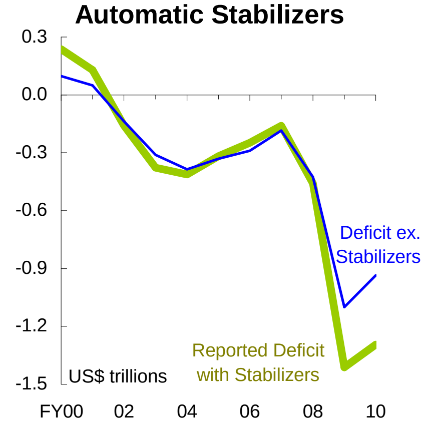
For FY11, the CBO estimates a US$1.48 trillion budget shortfall, US$186 billion wider than FY10, but this is before possible additional expenditure restraint. Political gridlock has prevented the passage of key appropriation bills to date for FY11, and thus Washington is operating under a continuing resolution which largely holds discretionary budget authority at 2010 levels until March 4, though some funding is available from previous appropriations. While debate frequently focuses on defense-related discretionary outlays, estimated at US$712 billion for FY11, and nondefense discretionary spending estimated at US$663 billion, the full scope of the required restructuring in terms of revenue increases and expenditure cuts is better reflected in the Bipartisan Panel's recommendations last fall. The array of major issues requiring resolution, such as changes to the health care reform, presently blur Washington's path. However, the debt service will become the binding constraint. The CBO's deficit projections, even with the very optimistic bias from its required assumption of no policy change, still forecasts that net interest will roughly quadruple from US$197 billion in FY10 to almost US$800 billion by FY21.

The U.S. Federal Budget Gap



Source: U.S. Treasury, CBO.

The Bottom-Line Impact of Automatic Stabilizers



Source: U.S. Treasury, CBO.

Estimated Budget Impact of the *2010 Tax Act*

	FY11	FY12	FY13	FY14-20	Total FY11-20
			US$ billions		
Tax Rates, Credits, and Deductions Initially Enacted in 2001, 2003, and 2009	-98	-147	-65	-16	**-326**
Relief from the Alternative Minimum Tax	-86	-68	17	0	**-137**
Reduction in Employee Payroll Tax Rate in 2011	-84	-28	0	0	**-112**
Increase in First-Year Depreciation	-55	-54	3	87	**-21**
Estate and Gift Taxes	-5	-28	-29	-6	**-68**
Other	-26	-20	-6	-5	**-58**
Subtotal, Revenues	**-354**	**-346**	**-81**	**58**	**-721**
Tax Rates, Credits, and Deductions Initially Enacted in 2001, 2003, and 2009	0	38	39	0	**77**
Extension of Unemployment Benefits	35	22	0	0	**56**
Other	2	1	*	0	**3**
Subtotal, Outlays	**37**	**61**	**39**	**0**	**136**
Total	**-390**	**-407**	**-120**	**58**	**-858**

* Between -US$500 million and +US$500 million. Source: CBO.

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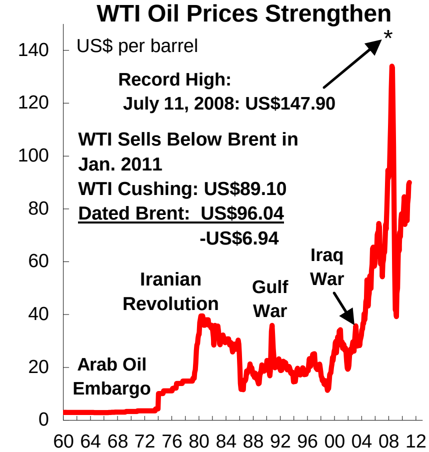
Oil Prices Strengthen, Though WTI Significantly Lags World Prices

- ***Diversifying export markets to Asia would guarantee world prices for Canadian crude***

WTI oil prices have strengthened markedly in recent months, averaging just under US$90 per barrel in January — up from US$78 a year earlier. However, the price of WTI oil – the reference price for North America — has lagged Brent crude oil (a benchmark impacting two-thirds of world oil supplies) since August 17, with the discount widening to US$11 on January 27 (Dated Brent at US$96.64 versus US$85.64 for spot WTI at Cushing, Oklahoma).

Relatively low prices for WTI largely reflect three developments: firstly, inventories at landlocked Cushing, Oklahoma — the pricing point for the NYMEX contract — have once again ballooned near record levels (about 37 million barrels); this reflects limited pipeline takeaway capacity from the Cushing hub to refining centres in the U.S. Gulf; secondly, the relative strength of Brent crude oil given flat-to-down production in the U.K. and Norwegian sectors of the North Sea, abnormally cold winter weather in Northwest Europe this year and a perception of tight supplies after Royal Dutch Shell recently shut four North Sea oil & gas production platforms for repair; and thirdly, a dominant position by a trading company in February Brent and Forties physical cargoes.

WTI Oil Prices Strengthen



WTI oil January 28, 2011: US$86.93.

The wide discount for WTI off Brent highlights the 'commercial risk' for Canada's 'oil patch' of relying mostly on one export market (the United States). This discount is likely to persist for some time, with more Alberta crude soon able to flow to Cushing. The proposed Keystone XL pipeline extension from Cushing to Port Arthur, Texas and Enbridge Pipeline's Monarch project from Cushing to the Houston refining centre should eventually permit (in about two years time) Alberta crude to flow to the United States' largest refining centre, where prices should trade more in line with Brent.

However, building more pipeline capacity to Kitimat, B.C. or using the existing rail link from Alberta to the B.C. Coast for onward shipment to fast-growing Asian markets would 'guarantee' world prices for the Alberta oil sands and other Canadian crudes. China's petroleum consumption rose by a sizzling 12% in 2010 (up 19.1% yr/yr in December). (While Kinder Morgan pipeline facilities near Vancouver have the capability of shipping 100,000 b/d of Alberta crude to Asian markets, the capacity is small relative to potential volumes.)

Canada exports two-thirds of its crude oil production, the vast bulk of which moves to the United States (99% in 2009). Less than world prices for this oil represents a significant opportunity cost for Canada's merchandise trade balance.

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Food Inflation Risk Contained in Canada

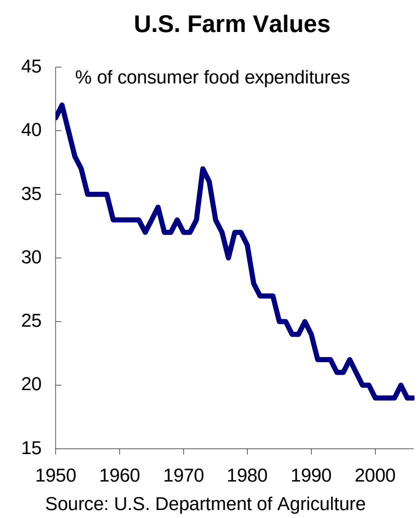
- ***While higher global food costs will inevitably lift Canadian inflation trends this year, a number of mitigating factors will help keep price pressures broadly in check.***

Soaring agricultural commodity prices, alongside rising energy costs, threaten to disrupt Canada's tame inflation environment and erode consumer purchasing power. Wheat and corn prices have jumped more than 60% since last summer, to two-year highs of around US$11.50/bushel and US$6.50/bushel, respectively. The cost of sugar and livestock (hogs and cattle) are also on the rise. This comes on top of gasoline prices that have climbed roughly US$0.10/litre to an average of over $1.10/litre over the same period.

A number of factors have contributed to the latest food price spike, including poor growing conditions in various key producer regions, from excessive rain in the Canadian Prairies, to drought in Russia and Argentina, and floods in Australia. Low stocks and rising global food demand, particularly among fast-growing emerging markets, are also adding to the upward price pressure.

So far, there has been little pass-through to grocery store shelves in Canada. According to the latest CPI data released this week, the average cost of food purchased from stores was up just 1.4% y/y in December. Given the inherent lag (approximately 6 to 12 months) in the transmission of agricultural price increases to retail food prices, we anticipate some acceleration in Canadian food price inflation in the coming months. Yet, even at the intermediate level, costs appear well contained. The industrial product price index (IPPI) for food producers, which measures the price manufacturers receive as products leave the factory gate, was up just 1.4% y/y (through November).

A few mitigating forces can help explain the containment of food prices to date. Importantly, strong price competition amongst suppliers has limited the extent to which food producers and retailers have been able to pass on rising input costs to consumers. These competitive pressures are expected to persist with the expansion of non-traditional grocery retailing formats over the next few years. The rising Canadian dollar also provides some relief to consumers by dampening imported food costs. Many food items consumed in Canada have a high import content, including fresh vegetables and frozen packaged foods.



If sustained, the potential inflationary impact of rising agricultural prices is not insignificant. Grains, for example, are an important component of the food chain, from feedstocks, to bakery and cereal products, and corn-syrup sweetened soft drinks. In recent weeks a number of major food producers, grocery stores and fast food restaurant chains have announced pending price increases. Food (including purchases from restaurant as well as stores) has a weight of 17% in the CPI basket, implying that a 5% average increase in retail food prices would lift the headline inflation rate by 0.8 percentage points.

Nevertheless, fears of a substantial food-related run-up in inflation are premature. For one, farm costs represent a relatively small — and shrinking — share of the final retail price of most food products in developed nations. The U.S. Department of Agriculture estimates that farm values account for about 20% of the U.S. retail price of food, compared with around 30% in 1980 and roughly 40% in 1950 (see chart). Marketing and distribution costs — from processing, packaging, wholesaling and transportation, to advertising and retailing — make up the remaining 80%. Its waning impact reflects in part the development of less energy-intensive farming methods and the increasing use of technology. Meanwhile, a shift in consumer preferences for more convenient but labour-intensive prepared foods has raised later-stage production costs.

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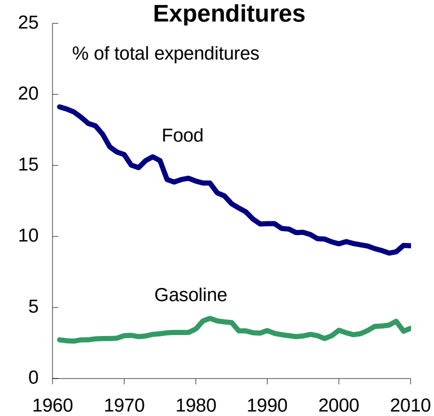
The farm-retail price spread varies considerably across products, decreasing with the degree of processing and other marketing activities. It is highest in foods derived from animal products (typically around 30-45% for beef, chicken and eggs) and lowest in products derived from crops (5-10% for bread and cereals). While detailed statistics on farm-retail price spreads are not readily available for Canada, we expect the distribution chain here is broadly similar to that in the United States. Given the one-fifth share of farm costs in retail prices, this would imply that all else equal, a 10% increase in farm prices should lead to a 2% increase in retail costs.

By comparing Statistics Canada's farm product price index (FPPI) — which measures prices farmers receive for their commodities — to the CPI for food, we find that the observed relationship between farm prices and retail food costs in Canada has likewise weakened over the past several decades. The correlation coefficient between annual changes in the all-items FPPI and the 'food purchased from stores' CPI dropped from around 60% in the 1960s, 1970s and 1980s to a little over 10% over the past decade, and was actually slightly negative in the 1990s. Future analysis could be extended to examine the linkages across different agricultural commodities within the FPPI and CPI baskets, as well as at different stages of production, by incorporating the IPPI.

Canadian Consumer Expenditures



Source: Statistics Canada, Scotia Economics

Higher agricultural prices will no doubt push up food and overall inflation trends in Canada in 2011 as they work their way through the production chain. But the ultimate pass-through to final retail prices reflects many factors, including underlying economic conditions, energy and labour costs, and competitive pressures. For now, we expect excess capacity, moderate wage gains, intense retail competition and a strong Canadian dollar to keep broad price pressures in check.

From a macroeconomic perspective, any substantial rise in food costs would divert purchasing power from other more discretionary purchases, dampening consumer spending and the overall recovery. But its impact is unlikely to be large enough to significantly dent consumer confidence. Food represents a relatively modest share of consumer expenditures for most households in advanced nations. In Canada, spending on food (excluding restaurants) has accounted for a steadily declining share of total household expenditures, to less than 10% in 2010 compared with close to 20% in 1961 (see chart).

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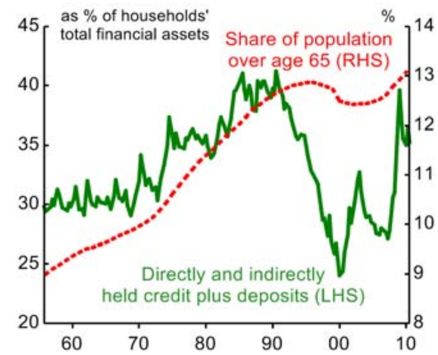
Why Demographics Is Unlikely To Induce A Greater Household Shift Toward Bonds

What remains a popular argument is that an aging population will demand greater fixed income assets as a portion of its portfolios. It is suggested that this could usher in an era of long-lived low or lower yields. We find the evidence to back this hypothesis to be largely nonexistent. But it is important to address in reconciling the competing views of inflation hawks and fans of demographics in that should demographics work in the hypothesized fashion, then any forecast for a sharp longer-run rise in nominal yields driven by inflation worries could be at odds with one's views on demographics.

No Real Historical Connection

As a starting point, consider chart 1. It's an intentionally spurious approach to evaluating correlations that wouldn't stand up in any econometric study, but that's the point. Nothing is so obvious in the debate on the role that demographics plays in shaping market outcomes while holding all else constant. Indeed, note that while there have been large variations in the share of US household financial assets held in fixed income products and deposit substitutes priced off the same markets since the 1950s, there has been little variation by way of the proportion of the population over age 65 in this period. In particular, consider the past two decades. The share of total financial assets held in fixed income products and substitutes plummeted over the 1990s from about 40% to about 25%, before regaining much of that lost share over the past decade and particularly within the past couple of years. This share is currently close to long-run cycle tops set in the late 1980s. What happened to the share of the population over 65 that is supposed to have a fixed income bias? It went from about 12% in 1990 to about 13% in 2010. A one percentage point swing in the share of retirees in the broader population clearly played no role in the massive swings in portfolio allocations over this time period. To put it another way, if you are investing based solely on demographics, you'd better have a back-up plan, as a plethora of other factors dominate market movements over all time periods.

Demographics and Households' Fixed Income Allocation



Source: U.S. Federal Reserve, Scotia Capital Economics.

Intuitive Problems With The Theory

Second, consider a few intuitive arguments. For one, an aging population should theoretically impact both the supply and demand for loanable funds. Don't just shock one part of the picture. In theory, most retirees move toward capital preservation or capital consumption depending upon their circumstances like how much wealth they possess. Therefore, presumably the over-65 cohort will be demanding less credit and simultaneously supplying less new saving at the margin as their earning years are behind them. Thus, backward shifts in both the supply and demand curves for loanable funds could easily cancel out the implications for yields and leave markets smaller on net. But in raw theoretical terms, the impact on yields is indeterminate as it depends to what extent saving and borrowing are impacted relative to one another. That's an empirical question we'll return to.

Another intuitive argument is that a closed economy model that looks only at domestic influences of population shifts doesn't link up with real world realities. An open economy model would not have assets being priced solely by local market considerations such as local demographics. If the U.S. didn't operate in an open economy with minimal capital market frictions, then the Treasury market would have likely surged to far higher yields long ago in the absence of foreign buying such as the long-run rise in China's holdings of US Treasuries.

Also, the theory that demographics will impact markets is too reliant upon a single-period life cycle hypothesis versus the push over time in the academic literature toward embracing multi-generational life cycles that entail not consuming all of one's financial capital within one's own lifetime.

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Broader Problems With Demographic Analysis

But beyond the specific assertions and counter-arguments, there are far more general and useful points of caution to be mindful of in using demographic analysis. A key one is that shifts in behaviour within age cohorts can thoroughly overwhelm the influences of population shifts across the age cohorts. For example, today's 40 year olds borrow and invest in markedly different fashion than 40 year olds in past decades. The US Fed's Survey of Consumer Finances backs this up by pointing toward huge intra-cohort shifts in average inflation-adjusted debt per family or equity holdings as a share of total financial assets over time. These intra-cohort behavioural shifts swamp the impact of simply shifting population age structures across assumed stable behavioural measures at a particular point in time. In other words, figuring out what drives behavioural changes for similarly aged individuals from different generations counts for far more in the push to understand behavioural finance than just evaluating raw demographic change in the age structure of the population.

What may also be a consideration is that much of the loose talk on demographic change assumes something lies ahead in imminent fashion. The truth on shifting age structures is that they operate over much longer periods of time. The boomer generation spanned the era from the mid-1940s through to the mid-1960s and is a twenty-year cohort. The people within this cohort do not act in the same macro sense that demographers assume when lumping them all together, and their influence on anything occurs over extended periods of time over which other developments can thoroughly swamp their effects. Further, one generation begets another, such that as boomers age, their kids born roughly since 1980 and up to the last kids born in recent years will themselves be the second-largest age cohort spanning about a quarter century in time.

But perhaps most damning of all in evaluating the role of demographics on markets is the fact that it is almost impossible to forecast population change to any degree of accuracy. For example, Canadian and US demographers totally missed the baby boom with their post-war forecasts. As a result, StatsCan's 1950 forecast for Canada's population twenty years later was 50% too low. The US Census Bureau also has a terrible track record at forecasting births, a point made by Harvard's N. Gregory Mankiw. Going forward, high and low scenarios for U.S. population forecasts produced by the US Census Bureau over long periods of time produce massive variations. For example, by 2050, the gap between the high and low estimates for US population equals about 60 million, or roughly the current populations in any of Germany, Italy, the UK or France. The gap between high and low estimates for US population in 2100 is large enough to fit the size of present day India's total population. Small compounded errors in forecasts for births, mortality rates and net immigration can yield massive forecast errors over long periods of time.

In concluding, ever since days of the Reverend Thomas Malthus' *An Essay on the Principle of Population* published in 1798 through to Paul Ehrlich's *The Population Bomb* in 1968, and including modern day bestsellers, few areas in the social and hard sciences have been as prone to exaggerated claims as the field of demography. Demographic implications may be more significant at micro market levels for business planning purposes, but even then its influences can be overwhelmed by other factors. Consider prescription eyeglasses for an aging population, versus increasingly popular corrective surgery. But bigger trouble arises through falsely aggregating the microeconomic arguments and translating them into macroeconomic implications.

For further reading, there have been numerous attempts at estimating the impact of changing demographics on financial markets and the economy, but few arrived at more than a loose correlation. One of our favourites is cited below, and was skeptical toward the impact of demographics. The quickest summary is in the author's own words: "These results suggest caution in projecting large future changes in asset values on the basis of projected demographic change."

1. "The Impact of Population Aging on Financial Markets," James M. Poterba, NBER Working Paper # w10851, October 2004.

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Why Treasuries Should Be Concerned About Obama's State Of The Union

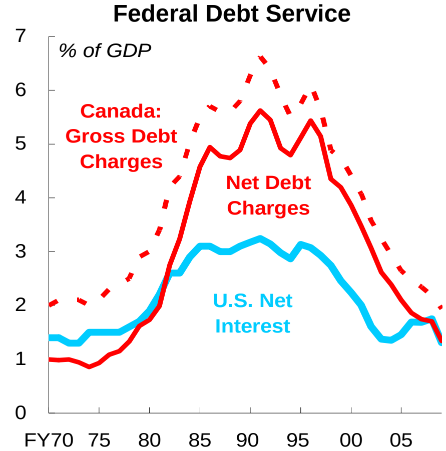
One would think that any bond investor who watched President Obama's State of the Union address would have been disappointed. There was full justification for thinking that the speech set a low bar on deficit reduction targets, and deflected much of the attention away from deficits by going back to the future in attempting to find a common cause against which to rally national economic pride after the dent it has taken in recent years. Onward march, toward flag-waving talk of a new Sputnik era driven by internet access and high-speed trains, more teachers and better health care so that America can better compete with lower-cost jurisdictions like China. One should actually quite like this latter spin as a shot against the China fear-mongers, in that emphasizing how America's innovative strengths offer competition on more than simply cost and price is sounder economic policy than the isolationist and combative policy preferred in some quarters. It is a more constructive approach to addressing the China issue following the successful visit by Chinese President Hu Jintao. Overall, the speech sounded well intended, but it set a defensive start to what will become much more intense debate in the push toward having to raise the legislated debt ceiling before March. Republicans and some Democrats will wish to see far more aggressive deficit reduction plans before rubber-stamping an increase in the ceiling.

On the details, as broadly anticipated, the President prioritized government investment on infrastructure, research and development and education. Major recommendations of the bipartisan deficit reduction panel were cited, including streamlining the federal personal and corporate income tax structures.

A key theme to the speech was expenditure control, but it set a low bargaining point to start the push toward March. Obama only extended a freeze on nonsecurity, discretionary spending by an extra three years to a total of five years, compared to the two-year freeze announced a year ago. This affects 15% of the $3.5 trillion in federal spending, and will save only around $400 billion over the next decade. That helps, but it's a drop in the bucket compared to the more serious debate that is required over long-run fiscal deficits that we think are putting America on the same path that felled Canada by the mid-1990s long after it recognized it had a problem. I'm not sure America is even at this first stage of recognition as yet. The key will be the extent to which deficit reduction plans perpetually fail as the interest bill takes over as the dominant longer-run driver as it did in Canada's case (charts 1 and 2). The interest bill on mounting public debt will hardwire fiscal deficits into the US landscape for decades to come, and crowd out other efforts to contain program spending and raise new tax revenues. That is exactly what made deficit reduction so difficult for Canada and other countries, until markets and rating agencies forced such an outcome. This is a debate that America hasn't even really begun as yet, but eventually it will need to confront deficit largesse and the role played by lofty spending ambitions and social security benefits coupled with the most generous jobless benefit insurance program virtually anywhere, versus having among the world's lowest energy taxes, lowest personal taxes, and no national sales tax. Something must give in this picture, though there is no attention being placed on it as yet.

Chart 1

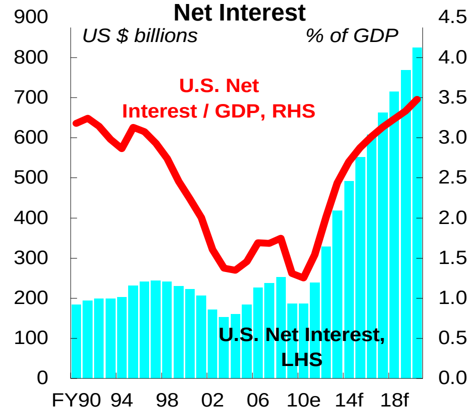
Federal Debt Service



Data to FY09. Source: OMB, Finance Canada.

Chart 2

Forecast Surge in U.S. Federal Net Interest



Source: OMB, Scotia Economics (adjustments for year improvements).

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President Obama reinforced his preference not to make personal tax cut extensions permanent for the upper income brackets, but implicitly supports making them permanent for lower and middle income earners. Pay attention to what he didn't say on this, however, in that he didn't say he would resolutely stand in the way of another temporary stimulus extension for everyone when jobless benefit extensions expire at the end of this year and tax cut extensions expire at the end of 2012. Indeed, we think he will have no choice but to extend jobless benefits and tax cuts yet again as opposed to campaigning in 2012 with a slogan that entails a vote for Democrats means a cut to main street's jobless benefits and higher taxes. Further extensions are likely, and with them growing concern over America's fiscal position. What's likely is that just as Europe makes progress toward addressing its fiscal stresses, the spotlight will turn back upon America's neglected challenges into 2012-13. The benefits will be modest, as Americans will likely pocket most of the stimulus rather than spend it, and bond markets are likely to negate the deficit financed stimulus.

Also, the speech's emphasis upon a simpler tax structure is encouraging, but this is hardly the first time America has had this debate. On corporate tax cuts, Obama supported a reduction in corporate tax rates only if the revenue implications are offset by reductions in loopholes and tax subsidies elsewhere. This sounds like a very laudable goal, but good luck with the well entrenched lobbies. This is not the first President to appeal for simpler taxes and fewer hand-outs, but this is Washington after all.

The coming days will see a growing emphasis upon tallying up the bills to all that was contained in the speech, but much of the effort will be in vain as the debate has only just begun over the near-term debt ceiling and the longer-run fiscal deficit challenge. That debate will have to become more focused on a credible long-run deficit reduction plan with some meat to it, and less focused on pie-in-the-sky ambitions. Mary Webb takes a closer look at the fresh CBO projections that arrived the day after President Obama's speech on page 6, and the Administration's February budget should begin to shed some light on the credibility of the Administration's new deficit reduction proposals.

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Fiscal Austerity is More Effective Than Capital Controls

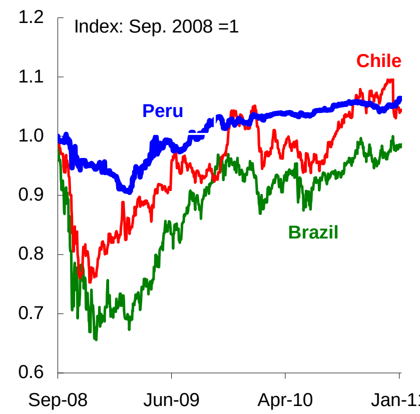
- ***Countries can avert exchange rate pressures via up-trending government savings***
- ***In the face of abundant foreign capital inflows back-to-basics policy is in order***

Emerging markets across the globe will struggle with the question of how to handle currency appreciation at least throughout 2011 as interest rate and growth differentials remain in their favor attracting vast amounts of foreign capital. The issue will become even more pressing as these economies return to pre-crisis capacity utilization levels and home-grown inflation collides with imported pressures as global momentum rewinds.

The question of how to deal effectively with mounting foreign capital inflows falls within the realm of both monetary and fiscal policies. In what follows we bring to the fore evidence on how the current policy mix of some economies is already affecting manufacturing sector performance relative to peers. Although this time around we concentrate on economies within the Latin American region, the issue becomes at least as relevant to emerging markets in Asia where most currencies are already ahead of pre-recession values.

The exchange rates of some Latin American countries have virtually won back the value lost against the US dollar as a result of the Great Recession. In fact, as illustrated in Chart 1 most currencies are back at or beyond the nominal levels that prevailed just prior to the ignition of the global credit crunch in September 2008. For instance, the Chilean peso and the Peruvian sol are about 5% stronger than where they were two and a half years ago, after having depreciated by 25% and 10%, respectively, during the turn of the year 2008-09. While the Brazilian real is 3% weaker than at that time, it is back from having lost almost 35% of its value against the US dollar towards the end of 2008.

U.S. Dollar Exchange Rates



Nominal. Source: Bloomberg, Scotia Economics.

There is little doubt that exchange rates have come a long way during the past two and a half years, as they played the key role of buffers to the adverse shock impacted upon the economies' export sectors. In fact, the capacity of these countries to allow their currencies to respond in such a way was instrumental in allowing for an agile recovery process. Presently, however, such quick economic rebound is working as a magnet that continues to attract foreign capital further enhancing the outlook for currencies.

Within the described context a relevant issue is how real sector economic performance is being conditioned relative to peer countries suffering from similar currency woes. Chart 2 illustrates the recent behavior of the manufacturing sectors of Chile, Peru and Brazil, with the main message emanating that to our eye there seems to be a distinct contrast between the first two countries and the latter; namely, while manufacturing output has remained on an upward trend during most of 2010 in Peru and Chile, it has practically stagnated in Brazil.

In order to isolate the effect of favorable terms of trade gains (present in all three countries) we focused as much as possible on data that would exclude the commodity sector. Thus, we ended up with different measures for each country. For Chile, non-copper related factory output as measured by the industrial sales index was utilized; for Peru, manufacturing production that excludes mining related activities; finally, for Brazil we focused on the output of intermediate goods as a proxy.

As can be concluded from the chart, after the collapse resulting from the earthquake/tsunami of March 2010, Chilean non-copper related factory output rebounded, remaining on an upward trend through the end of the year. In a similar vein, non-mining related manufacturing output in Peru has yet to show any adverse effect

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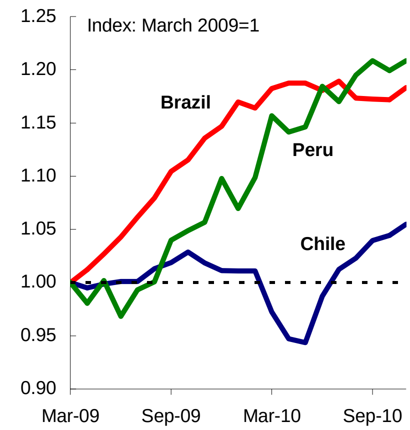
from the strength of the sol. Brazilian febrile production, however, displays a lapse in its uphill climb, having remained practically stagnant as of the first quarter of 2010.

The three countries in question are facing parallel favorable terms of terms of trade gains (as global prices of their main commodity exports remain elevated). Moreover, all of them have been immersed in an expansionary path that continues to attract foreign equity investments, be them in the form of portfolio flows or direct capital injections to productive capacity. Finally, all three jurisdictions have had monetary policy moving already towards normalization as central banks have lifted benchmark interest rates at least a couple of times during the past six months. The question that remains is therefore, why is the Brazilian manufacturing sector the only one stalling?

Manufacturing Output



Seasonally adjusted.
Source: Central Banks, Scotia Economics.

We contend that a differential approach to fiscal policy management is allowing both Peru and Chile to isolate their real sector from deleterious currency appreciation effects. Public sector borrowing requirements (PSBR) were 0.7% of GDP cumulative through the third quarter of 2010, according to the Chilean finance ministry. While the deficit likely went slightly over 1% of GDP for the year as a whole, a contraction is expected for 2011, bringing public finances more in line with the trend observed prior to 2008. In Peru, PSBR were projected at 1.6% of GDP for 2010, with a reduction towards 1% expected for 2011. These figures contrast starkly with Brazilian reports where PSBR has hovered around 3% of GDP through November 2010. Moreover, worth noting is the fact that the national development bank (BNDS) is not included in these calculations, while it is no secret that BNDS continues to support “strategic” Brazilian corporations with loans at below market rates. Given that BNDS funding is backed by the government, the interest spread should be added as a financial cost in the public accounts which would bloat the figures even more.

There is little doubt that the size of the government deficit is provoking demand to expand excessively in Brazil. The upward trend in inflation, which is now running at 5.9% y/y, essentially double the rate in Chile and Peru is one piece of evidence. An expanding negative net-exports balance which has been subtracting from GDP growth with every subsequent quarter is the other. This has already slowed the economy from 7% q/q annualized gains through mid-year, to a 2.1% q/q advance in July-September. In essence, the negative trade gap talks not only of a loss of momentum in manufacturing exports, but also of a pickup in more affordable imports displacing domestic producers. With private consumption growing at very healthy double digit rates as unemployment has reached record low levels, and infrastructure investments in line to continue for several years, there is no absence of growth propellers in the Brazilian economy, making the persistent fiscal impulse not only redundant but now deleterious.

The moral for emerging markets facing excessive inflows of foreign capital seems clear. As government programs are lapsed retiring the support that was essential for the economic recovery but that is no longer needed in view of the rebound in private spending (investment and consumption; the so called “organic growth” so coveted at the start of 2010), excessive demand pressures can be allayed leaving economies on a balanced footing. This translates not only into fewer inflationary concerns, but also onto less strain on the domestic savings pool. The latter effect spans the array of monetary policy options, maneuvering room that disappears if the cost of funds is artificially lifted by excessive government bond issuance. There is a plain message to policymakers: go back to basics, streamline government finances allowing monetary policy to continue to act independently.

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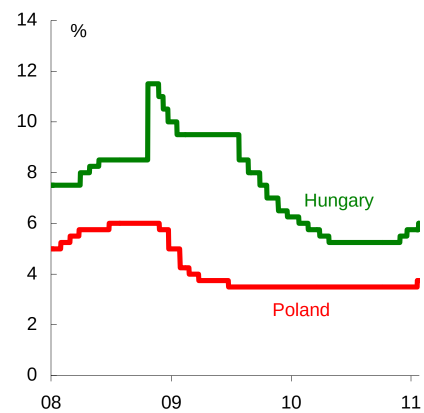
Further Monetary Tightening in View for Poland and Hungary

- ***Both Poland and Hungary have commenced monetary tightening as inflationary pressures intensify***

A monetary tightening cycle is beginning in Poland as the economy continues to recover robustly; following the January 19th Monetary Policy Council meeting, the central bank's reference rate was raised by 25 basis points (bps) to 3.75%. We expect further gradual increases in the coming months. Strong performances in the industrial sector, construction and retail sales together with improving sentiment are pointing towards maintained economic momentum. According to preliminary estimates, output grew by 3.8% in 2010; as domestic demand is increasingly contributing to real GDP activity taking the burden off the external sector, similar output growth rates will likely be maintained over the next two years. As the Polish economy is less export-oriented than many of its regional peers, such as the Czech Republic, the country weathered the global downturn relatively well, being the only country in the European Union to avoid a recession in 2009.

Central Bank Rates

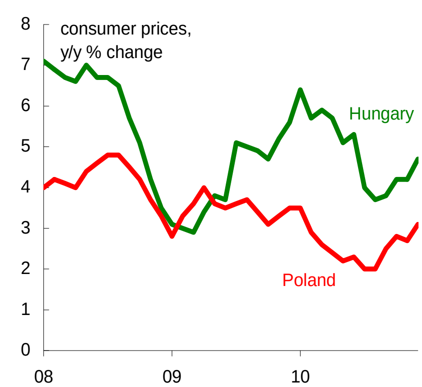


Source: Bloomberg, Scotia Economics.

Inflationary pressures are building in Poland. Consumer prices increased by 3.1% y/y in December, continuing to exceed the central bank's 2.5% inflation target. While higher global energy prices were partly responsible for the acceleration in inflation, pressures at the core level intensified as well. Polish monetary authorities expect heightened inflation expectations to persist while improving labour market conditions will likely fuel wage pressures. Fiscal tightening is important to achieve and maintain macroeconomic stability in order to meet the criteria for adopting the euro, which remains a priority for the Monetary Policy Council. Nevertheless, with parliamentary elections approaching (to be held in the second half of 2011) aggressive fiscal consolidation is not in the cards. We expect that the fiscal deficit will narrow somewhat from the estimated level of 7½% of GDP in 2010 to slightly less than 7% of GDP this year. On January 21st, the International Monetary Fund approved a two-year successor arrangement for Poland under the unconditional Flexible Credit Line. The agreement — that Polish authorities treat as precautionary — will provide a useful insurance against external risks, supporting investor confidence and the Polish zloty.

Hungary is proceeding with further monetary tightening. Following the January 24th meeting, the Monetary Council opted to raise the benchmark interest rate by 25 bps to 6.0%, marking a third consecutive monthly hike. Policymakers remain concerned about upside risks to inflation (consumer prices increased by 4.7% y/y in December, remaining well above the central bank's 3% target) as well as the fact that investor risk aversion towards Hungarian assets remains high, reflecting fiscal sustainability concerns and the unpredictability of the country's economic environment. Hungarian economic growth will likely accelerate to close to 3% in the next couple of years following an estimated 1% expansion in 2010. While the external sector remains the main growth engine, an improvement in labour market conditions together with personal tax rate cuts will support household spending prospects.

Inflation



Source: Bloomberg, Scotia Economics.

Hungary has made significant progress in bringing its fiscal deficit to 3.8% of GDP in 2010 from 9.3% four years earlier. The government aims to narrow the shortfall to 2.9% of GDP this year without further austerity measures. In the context of the administration's reliance on temporary revenue measures combined with an absence of structural spending reforms, concerns regarding Hungary's fiscal sustainability persist.

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Sentiment Shifts

The following article was published on January 24, 2011.

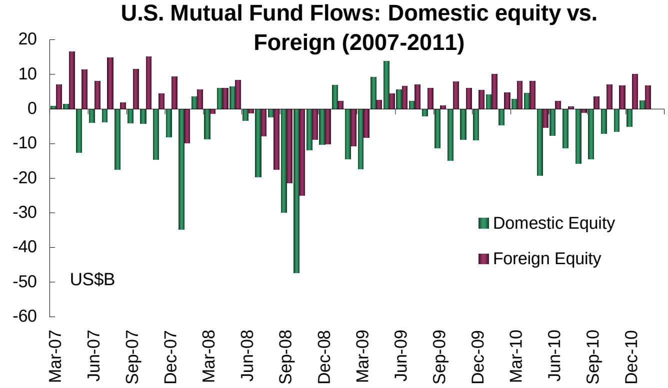
- We have been on the road marketing for the past two weeks (50 meetings in Montreal/Toronto) and can report a notable sentiment shift amongst institutional investors. Retail psyche may also be (slowly) coming back as witnessed by the recent US$3.8B inflow into U.S. domestic equity funds last week. We are now heading west (California and Vancouver) and will stop by New York in early February.
- In contrast to our 2009/2010 tours, we encountered very little pushback to our equity overweight/bond underweight stance. It seems everyone wants to buy the "glass half-full" story now. Although we view this more upbeat equity bias as reasons to worry, we believe portfolios (pension funds and retail) are not aggressively tilted towards cyclical assets yet, i.e. flows have not fully followed sentiment. Moreover, equity valuations (S&P500 forward P/E currently hovering at 13x) are not stretched and earnings growth should continue well into 2012.
- Levels, levels, levels! Lots of questions and discussions on where to turn neutral on equities and what level of bond yields would derail the recovery story. Based on our asset mix model, the S&P500 (fair value of 1,400; 10% undervalued) still has a valuation edge over U.S. 10-Yr Treasuries (fair value of 3.7%; 2% overvalued). In addition, rising profits should push our S&P500 fair value higher while declining jobless claims should lift our bond yield fair value up. We would turn neutral on equities when the S&P500 moves closer/above its fair value. Long term yields hovering near the 4% level would also shut the equity overweight signal. A flattening U.S. yield curve (markets pricing Fed rate hikes) would also be a game changing event and prompt us to trim cyclical exposure.
- Gold stocks are a major part of the equation on the TSX and the recent slip in gold equities (TSX Gold -12.7% YTD; Philadelphia XAU -12.7% YTD) is catching a lot of attention. Our guesstimate is that the average gold weighting in Canadian institutional portfolios hovers near 8% (gold weight in TSX is 11.5%). In our opinion, a positive sentiment shift in the U.S. economic outlook is reducing the fear factor and hurting bullion/gold equities. China's tightening bias is also clouding the commodity trade and hurting base metals.
- The August/December 2010 equity rally caught many investors off guard and the steady trend of improving U.S. macro data is fuelling the current sentiment shift. Most recent releases from key U.S. indicators such as the ISM (57), jobless claims (404k), existing home sales (5.28M), consumer confidence (60.6) and LEI all exceeded expectations and point to robust growth. On a 6-m annualized basis, the LEI is up 6.7% compared to 2% in September, which will make it very difficult to spin a double-dip story in 2011. The latest consumer confidence print beat expectations by a significant margin (60.6 vs. consensus of 54.0), underlining the growing optimism for the U.S. labor market. In our view, Bond and EM sentiment appear at risk of losing their MOJO with U.S. equity sentiment looking to gain.

Flows Coming Back

- Since markets troughed in March '09, investor scepticism was highly visible and the equity recovery was dubbed as lacking fundamental backing. Equity flows (U.S. and Canada) have also been hurt by the extent of the post-Lehman economic damage and the eradication of the equity culture. Foreign equities (EM) and Bonds have been flow magnets since 2009.
- A look at funds flows into the U.S. mutual fund market sheds a light as to how investors really never bought into the S&P500 recovery story as "domestic equity" redemptions have been a constant fixture in 2009 and 2010 (Exhibit 1). U.S.

Exhibit 1

U.S. Mutual Fund Flows: Domestic equity vs. Foreign (2007-2011)



Source: Scotia Capital, ICI.

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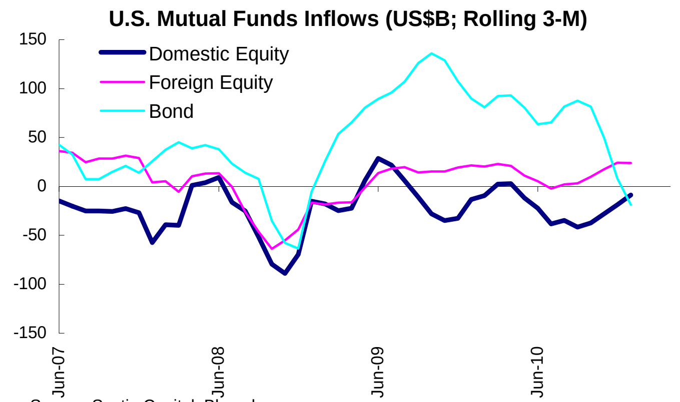
domestic equity funds finally registered positive inflows in the last two weeks. Flows into U.S. domestic equities have been negative in 33 of the last 44 months!

- We welcome this reversal and believe it will be sustained. As highlighted in Exhibit 2, foreign equity flows (positive) and domestic equity flows (negative) have been diverging for months. We expect Bond redemptions to continue and U.S. domestic equity flows to rebound, triggering modest P/E multiple expansion for the S&P500.

Exhibit 2



Source: Scotia Capital, Bloomberg

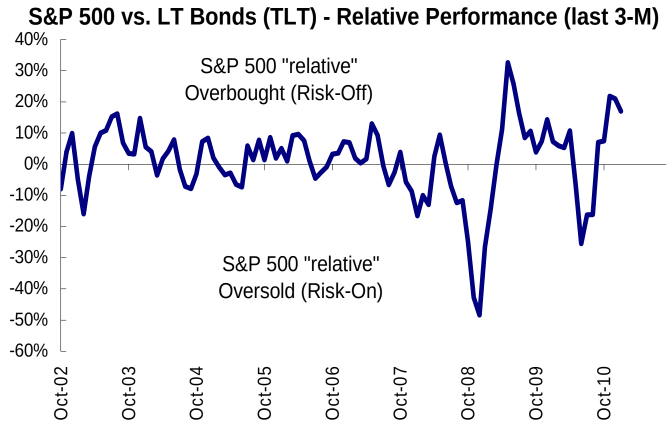
EM Tightening bias hurts

- Accelerating GDP growth in China (Q4/10 GDP > Q3/10) is pointing to further tightening measures in 2011. Investors don't like it (they haven't liked it since Q4/09) and we continue to view China's hawkish bias as one of the main risks for equity/commodity sentiment in the near term. Brazil has also been dealing with rising inflation pressures and the Selic rate was increased to 11.25% last week. Since Q4/09, tightening in Brazil and China has hurt performance for these EM darlings and we believe this theme will extend as long as U.S. policy stays stimulative. S&P500 outperformance, albeit short lived, should also help a nascent U.S. domestic equity sentiment revival.

Choppy January so far

- Equities have been overbought for weeks and we expect a modest pullback in the near term. Why modest? Because we are looking for the U.S. macro to show sustained improvements in 1H/11, corporate earnings should continue to Beat expectations, and equity flows should be supportive. A quick look at our Risk-On/Risk Off (Exhibit 3) and Panic-Euphoria indicators illustrates how overbought equities look in the near term. Tacticals point to some near term caution, but fundamental remain equity positive.

Exhibit 3



Source: Scotia Capital, Bloomberg

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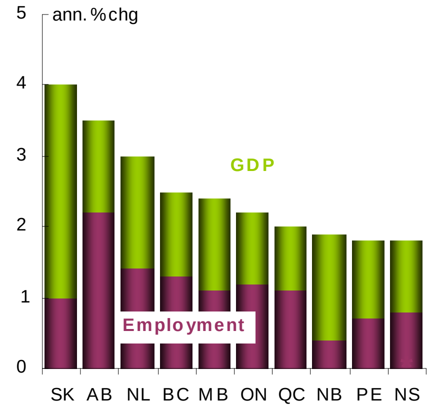
Key Data Preview

CANADA

November GDP is due out on Monday. Solid prints on hours worked, housing starts, wholesale shipments, retail sales and net trade point to a gain, with disappointing manufacturing sales as the offsetting factor. Due to the lack of indicator coverage, the sizeable resource and services sectors remain the wild cards, but overall are expected to provide positive support. We are forecasting a repeat gain of 0.2% m/m. Assuming a flat December print, the fourth quarter is tracking a gain of 1.2% q/q annualized, which would mark the third straight quarter of moderating growth and the weakest pace since mid-2009. To recap, we think that Canada is likely to underperform vis-à-vis the US in 2011 for five reasons, including the lack of pent-up demand in the housing and consumer sectors, high inventories, fiscal tightening and lower export competitiveness. Regionally, Alberta and Saskatchewan are seen as outperformers over that period (see chart).

Regional Economics, 2011F



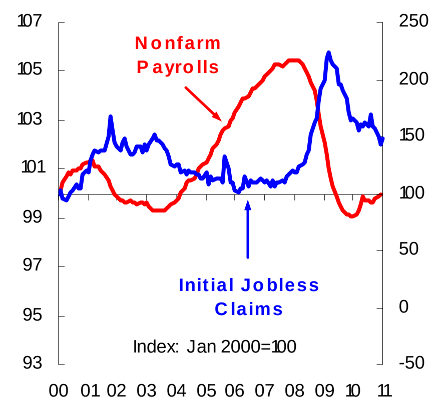
Source: Statistics Canada, Scotia Economics.

We estimate that the **January jobs report** (Friday) will come in 15,000 higher — in line with the long-term average — keeping the unemployment rate at 7.6%. While job growth moderated in the second half of the year, gains are being retained. As we have pointed out before, Canadian leading employment indicators are not only limited, but also have long lags. That leaves us to look at developing trends, base effects and any technical distortions. In the details of the upcoming report, we suggest looking at full-time vs. part-time gains and changes in labour force participation, which may provide more insight on business and consumer sentiment.

UNITED STATES

The **nonfarm payrolls** (Friday) report for January is going to be next week's marquee release. We forecast a gain of 120k and for the unemployment rate to move a touch higher to 9.5%, as more Americans re-enter the labour force. Flat-to-slightly lower jobless claims (see chart), a pickup in regional surveys and solid corporate tax receipts reaffirm our view. Private-sector payrolls are likely to remain the key driver of growth, as state and local governments continue to cut staff.

Nonfarm Payrolls & Jobless Claims



Source: BEA, Department of Labor, Scotia Capital Economics.

Our call is for **personal income** (Monday) to post a gain of 0.4% m/m in December, on higher labour income and dividend payouts. We expect growth of 0.6% m/m in nominal personal consumption expenditure, as headline retail sales — which account for 40% of consumer spending — advanced for the sixth straight month in December, up 0.6% m/m. As a result, the personal savings rate is likely to extend its downward bias started in mid-2010.

Manufacturing and services sectors have been gaining momentum for four successive months. While we do not expect a wide swing in January, regional indices point to a modest slowdown. We anticipate that the **ISM Manufacturing Index** (Tuesday) moved down half a percentage point to 58.0, while the **ISM Services Index** (Thursday) is expected to have held steady at 57.0. The new orders index for services, an indicator of future activity, has been picking up pace since September, an encouraging sign for the sector that accounts for over two-thirds of the economy, a third of exports and over 80% of all private-sector jobs.

While data on the December durable goods orders have already been released — showing a sharp drop of 2.5% on commercial aircraft — next week's report on **factory orders** (Thursday) will shed more light on the non-durable segment, which accounts for over half of all factory orders. Higher prices of industrial commodities, like fuel and chemicals, should have lifted the headline, with our forecast looking for a headline gain of 1.2%.

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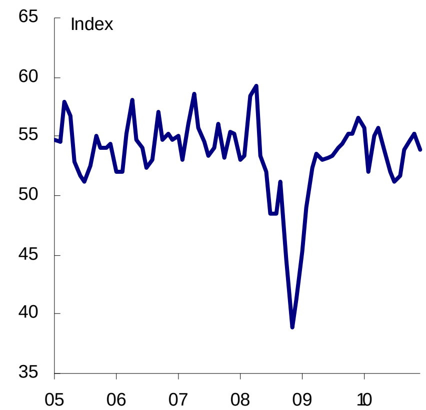
ASIA

Next week's publication of **China's PMI manufacturing index** will reflect persistent strength in the sector as export orders and current production remain well above the expansionary threshold. We expect a rebound to 54.2 from the modest downward correction in December. Sequential robustness in domestic demand underpinned by a reacceleration in domestic credit towards the end of last year is being accompanied by evidence of more solid prospects for external demand. In summary, in coming months manufacturing activity within China is set to remain above mid-2010 lows.

China's PMI Manufacturing



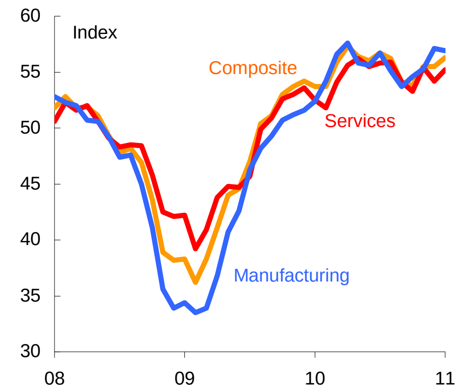
Seasonally adjusted. Source: Bloomberg

EUROPE

The total **euro zone retail sales** in volume terms (to be released on Thursday) have remained subdued in recent months as consumers continue to be cautious, and we expect this trend to continue in the coming months. Following a decline of 0.6% m/m in November, retail sales likely recorded a modest increase of 0.3% m/m in December. However, divergence between economic performances in the euro zone core economies and the periphery will likely continue to be reflected in the retail sales figures. In the euro zone periphery, fiscal consolidation efforts are causing an adverse impact on household spending while improving sentiment should support consumption in Germany and France, for instance. Indeed, increasing domestic demand in the euro zone core economies would be beneficial for the euro zone periphery's recovery prospects.

The underlying momentum of the euro zone economy remains positive despite the ongoing sovereign credit turmoil. The preliminary estimate for the composite **purchasing managers' index** indicated accelerating economic activity in the euro zone in January, supported by stronger performance in the services sector, while the manufacturing sector faced somewhat softer activity though still remained firmly in expansionary territory. We don't expect any significant revisions to the data next week.

Euro Zone PMI

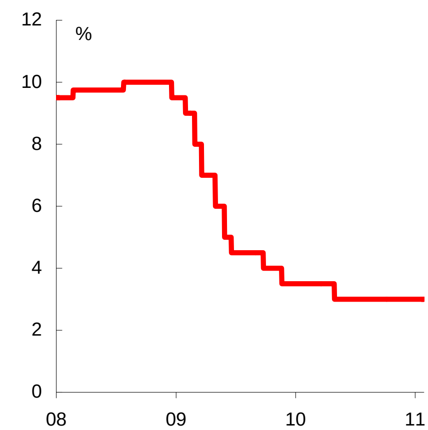


Source: Bloomberg, Scotia Economics.

LATIN AMERICA

The Central Bank of Colombia will publish its monetary policy report on January 31st; we expect the tone to remain similar to the last announcement. Nonetheless, any commentaries on inflation will be closely followed. The central bank maintained an accommodative monetary policy stance throughout 2010, lowering interest rates for the last time in the second quarter of the year as economic activity was still weak. However, Colombia's outlook seems to be changing with internal demand improving economic conditions which, alongside weather conditions, have translated into higher prices. Inflation, currently at a 16-month high of above 3.0% y/y, remains below the central bank's tolerance level of 3.0% +/- 1.0%. However, food prices are accelerating faster than expected worldwide, which could put more pressure on the central bank to follow its peers and hike rates in the first half of the year.

Colombia Intervention Rate



Source: Bloomberg, Scotia Economics.

Key Indicators for the week of January 31 - February 4

North America

Country	Date	Time	Event	Period	BNS	Consensus	Latest
CA	01/31	08:30	Gross Domestic Product MoM	NOV	0.20%	0.30%	0.20%
CA	01/31	08:30	Industrial Product Price MoM	DEC	1.00%	0.60%	0.50%
CA	01/31	08:30	Raw Materials Price Index MoM	DEC	6.00%	3.20%	3.50%
US	01/31	08:30	Personal Income	DEC	0.40%	0.40%	0.30%
US	01/31	08:30	Personal Spending	DEC	0.60%	0.50%	0.40%
US	01/31	08:30	PCE Core (MoM)	DEC	0.10%	0.10%	0.10%
US	01/31	08:30	PCE Core (YoY)	DEC	- -	0.80%	0.80%
US	01/31	08:30	PCE Deflator (YoY)	DEC	- -	1.30%	1.00%
US	01/31	09:45	Chicago Purchasing Manager	JAN	- -	65	66.8
US	01/31	10:30	Dallas Fed Manf. Activity	JAN	- -	15	12.8
US	02/01	10:00	Construction Spending MoM	DEC	- -	0.10%	0.40%
US	02/01	10:00	ISM Manufacturing	JAN	58.0	57.9	58.5
US	02/01	10:00	ISM Prices Paid	JAN	- -	73.5	72.5
US	02/01	17:00	Domestic Vehicle Sales	JAN	9.60M	9.60M	9.46M
US	02/01	17:00	Total Vehicle Sales	JAN	12.70M	12.70M	12.53M
US	02/02	07:00	MBA Mortgage Applications	28-Jan	- -	- -	-12.90%
US	02/02	07:30	Challenger Job Cuts YoY	JAN	- -	- -	-29.00%
US	02/02	08:15	ADP Employment Change	JAN	140K	150K	297K
US	02/03		ICSC Chain Store Sales YoY	JAN	- -	- -	3.10%
US	02/03	08:30	Unit Labor Costs	4Q P	0.50%	0.50%	-0.10%
US	02/03	08:30	Nonfarm Productivity	4Q P	1.80%	2.00%	2.30%
US	02/03	08:30	Initial Jobless Claims	29-Jan	420K	420K	454K
US	02/03	08:30	Continuing Claims	22-Jan	3910K	- -	3991K
US	02/03	10:00	ISM Non-Manf. Composite	JAN	57.0	57.0	57.1
US	02/03	10:00	Factory Orders	DEC	1.20%	1.00%	0.70%
CA	02/04	07:00	Unemployment Rate	JAN	7.60%	7.60%	7.60%
CA	02/04	07:00	Net Change in Employment	JAN	15.0K	21.2K	22.0K
US	02/04	08:30	Change in Nonfarm Payrolls	JAN	120K	135K	103K
US	02/04	08:30	Unemployment Rate	JAN	9.50%	9.50%	9.40%
MX	02/04	09:00	Consumer Confidence	JAN	- -	- -	91.2
CA	02/04	10:00	Ivey Purchasing Managers Index	JAN	- -	53.2	50
MX	02/04	13:00	Central Bank Monetary Policy Minutes				

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

Key Indicators for the week of January 31 - February 4

Europe

Country	Date	Time	Event	Period	BNS	Consensus	Latest
GE	01/31	02:00	Retail Sales (MoM)	DEC	- -	2.00%	-2.40%
FR	01/31	02:45	Producer Prices (YoY)	DEC	- -	5.00%	4.50%
SP	01/31	03:00	Total Housing Permits (MoM)	NOV	- -	- -	-19.80%
SP	01/31	03:00	Current Account (Euros)	NOV	- -	- -	-2.7B
SP	01/31	03:00	CPI (EU Harmonised) (YoY)	JAN P	- -	3.30%	2.90%
IT	01/31	04:00	PPI (YoY)	DEC	- -	- -	4.10%
EC	01/31	05:00	Euro-Zone CPI Estimate (YoY)	JAN	- -	2.30%	2.20%
IT	01/31	05:00	Business Confidence	JAN	- -	103.8	103
RU	**01/31**		**Russia Refinancing Rate**	**31-Jan**	**7.75%**	**7.75%**	**7.75%**
RU	01/31		Russia Annual GDP Real YoY	31-Dec	- -	3.80%	-7.90%
RU	02/01		Russian Manufacturing PMI for January				
UK	02/01	02:00	Nat'wide House prices nsa(YoY)	JAN	- -	-1.00%	0.40%
SP	02/01	03:15	Spain January Manufacturing PMI				
IT	02/01	03:45	PMI Manufacturing	JAN	- -	54.6	54.7
FR	02/01	03:50	PMI Manufacturing	JAN F	- -	54.3	- -
GE	02/01	03:55	Unemployment Change (000's)	JAN	- -	-10K	3K
GE	02/01	03:55	Unemployment Rate (s.a)	JAN	- -	7.50%	7.50%
GE	02/01	03:55	PMI Manufacturing	JAN F	- -	60.2	60.2
IT	02/01	04:00	Unemployment Rate (SA)	DEC P	- -	8.70%	8.70%
EC	02/01	04:00	PMI Manufacturing	JAN F	56.9	56.9	- -
UK	02/01	04:30	PMI Manufacturing	JAN	- -	57.9	58.3
UK	02/01	04:30	Net Consumer Credit	DEC	- -	0.0B	-0.1B
UK	02/01	04:30	Mortgage Approvals	DEC	- -	47.0K	48.0K
EC	02/01	05:00	Euro-Zone Unemployment Rate	DEC	- -	10.10%	10.10%
RU	02/01		Reserve Fund	JAN	- -	- -	$25.4B
RU	02/01		Wellbeing Fund	JAN	- -	- -	$88.4B
IT	02/01	12:00	New Car Registrations (YoY)	JAN	- -	- -	-21.70%
IT	02/01	13:00	Budget Balance	JAN	- -	- -	9.1B
SP	02/02	03:00	Unemployment MoM Net ('000s)	JAN	- -	83.8	-10.2
IC	**02/02**	**04:00**	**Sedlabanki Interest Rate**	**2-Feb**	**4.00%**	**- -**	**4.50%**
SP	02/02	04:00	Spain Consumer Confidence	JAN	- -	- -	64.6
UK	02/02	04:30	PMI Construction	JAN	- -	49.6	49.1
EC	02/02	05:00	Euro-Zone PPI (YoY)	DEC	- -	5.20%	4.50%
RU	02/03		Russian Services PMI for January				
SP	02/03	03:15	Spain January Services PMI				
IT	02/03	03:45	PMI Services	JAN	- -	50.8	50.2
FR	02/03	03:50	PMI Services	JAN F	- -	57.1	- -
GE	02/03	03:55	PMI Services	JAN F	- -	60	60
EC	02/03	04:00	PMI Composite	JAN F	56.3	56.3	56.3
EC	02/03	04:00	PMI Services	JAN F	55.2	55.2	- -
UK	02/03	04:30	PMI Services	JAN	- -	51	49.7
UK	02/03	04:30	Official Reserves (Changes)	JAN	- -	- -	$976M
EC	02/03	05:00	Euro-Zone Retail Sales (MoM)	DEC	0.30%	0.50%	-0.60%
RU	02/03		Gold & Forex Reserve USD	28-Jan	- -	- -	482.0B
EC	**02/03**	**07:45**	**ECB Announces Interest Rates**	**3-Feb**	**1.00%**	**1.00%**	**1.00%**
SP	02/04	03:00	Industrial Output WDA (YoY)	DEC	- -	1.80%	2.30%
IT	02/04	05:00	CPI - EU Harmonized (MoM)	JAN P	-1.00%	- -	0.40%
IT	02/04	05:00	CPI - EU Harmonized (YoY)	JAN P	2.60%	2.30%	2.10%
UK	02/04		New Car Registrations (YoY)	JAN	- -	- -	-18.00%

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

Key Indicators for the week of January 31 - February 4

Asia Pacific

Country	Date	Time	Event	Period	BNS	Consensus	Latest
JN	01/31		Housing Starts (YoY)	DEC	- -	4.60%	6.80%
JN	01/31		Construction Orders (YoY)	DEC	- -	1.10%	-5.30%
TH	01/31	02:30	Total Exports YOY%	DEC	- -	- -	28.70%
TH	01/31	02:30	Total Imports YOY%	DEC	- -	- -	35.00%
TH	01/31	02:30	Total Trade Balance	DEC	- -	- -	$490M
TH	01/31	02:30	Current Account Balance (USD)	DEC	- -	$2075M	$1019M
TH	01/31	02:30	Business Sentiment Index	DEC	- -	- -	52.5
NZ	01/31	16:45	Average Hourly Earnings QoQ	4Q	- -	0.60%	1.00%
SK	01/31	18:00	Consumer Price Index (MoM)	JAN	0.40%	0.70%	0.60%
SK	01/31	18:00	Consumer Price Index (YoY)	JAN	3.60%	3.80%	3.50%
SK	01/31	18:00	Core Consumer Price Index(YoY)	JAN	- -	- -	2.00%
SK	01/31	19:00	HSBC Manufacturing PMI	JAN	- -	- -	53.9
AU	01/31	19:30	House Price Index QoQ	4Q	- -	-0.20%	0.10%
CH	01/31	20:00	PMI Manufacturing	JAN	- -	53.5	53.9
SK	01/31	20:00	Ext Trade - Export (YoY)	JAN	- -	39.20%	23.10%
SK	01/31	20:00	Ext Trade - Imports (YoY)	JAN	- -	26.60%	23.30%
SK	01/31	20:00	Ext Trade - Balance in US$ Mln	JAN	- -	2520	3743
CH	01/31	21:30	HSBC Manufacturing PMI	JAN	- -	- -	54.4
AU	**01/31**	**22:30**	**RBA CASH TARGET**	**1-Feb**	**4.75%**	**4.75%**	**4.75%**
ID	01/31	23:00	Total Trade Balance	DEC	- -	$1949M	$2267M
ID	01/31	23:00	Exports (YoY)	DEC	- -	16.60%	42.30%
ID	01/31	23:00	Total Imports (YoY)	DEC	- -	28.00%	- -
ID	01/31	23:00	Inflation (YoY)	JAN	- -	6.85%	6.96%
ID	01/31	23:00	Core Inflation (YoY)	JAN	- -	4.30%	4.28%
JN	02/01		Vehicle Sales (YoY)	JAN	- -	- -	-28.30%
IN	02/01	00:30	Exports YoY%	DEC	- -	- -	26.50%
IN	02/01	00:30	Imports YoY%	DEC	- -	- -	11.20%
TH	02/01	02:00	Consumer Price Index (YoY)	JAN	- -	3.00%	3.00%
TH	02/01	02:00	Core CPI (YoY)	JAN	- -	1.40%	1.40%
HK	02/01	03:30	Retail Sales - Value (YoY)	DEC	- -	15.40%	17.90%
HK	02/01	03:30	Retail Sales - Volume (YoY)	DEC	- -	12.80%	15.20%
AU	02/01	19:00	HIA New Home Sales (MoM)	DEC	- -	- -	-0.20%
NZ	02/02	16:45	Unemployment Rate	4Q	- -	6.50%	6.40%
NZ	02/02	16:45	Employment Change (QoQ)	4Q	- -	0.20%	1.00%
AU	02/02	19:30	Building Approvals (MoM)	DEC	- -	1.30%	-4.20%
AU	02/02	19:30	Trade Balance	DEC	- -	1600M	1925M
CH	02/02	20:00	China Non-manufacturing PMI	JAN	- -	- -	56.5
HK	02/02	21:30	Purchasing Managers Index	JAN	- -	- -	55
PH	02/03	20:00	Consumer Price Index (YoY)	JAN	- -	3.30%	3.00%
ID	**02/04**		**Bank Indonesia Reference Rate**	**4-Feb**	**6.50%**	**6.50%**	**6.50%**

Latin America

Country	Date	Time	Event	Period	BNS	Consensus	Latest
CO	**01/31**		**Overnight Lending Rate**	**31-Jan**	**3.00%**	**3.00%**	**3.00%**
CL	01/31	07:00	Unemployment Rate	DEC		7.00%	7.10%
CO	01/31	11:00	Urban Unemployment Rate	DEC		11.00%	10.60%
BZ	02/01		Trade Balance (FOB) - Monthly	JAN	- -	- -	$5368M
PE	02/01		Consumer Price Index (MoM)	JAN	- -	- -	0.18%
PE	02/01		Consumer Price Index (YoY)	JAN	- -	- -	2.08%
BZ	02/01	07:00	PMI Manufacturing	JAN	- -	- -	52.4
BZ	02/02	06:00	Industrial Production sa (MoM)	DEC	- -	0.60%	-0.10%
BZ	02/02	06:00	Industrial Production YoY	DEC	- -	- -	5.30%
BZ	02/04		Vehicle Sales (Anfavea)	JAN	- -	- -	381552
BZ	02/04		Vehicle Production (Anfavea)	JAN	- -	- -	283873
BZ	02/04		Vehicle Exports (Anfavea)	JAN	- -	- -	49370

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

Global Auctions for the week of January 31 - February 4

North America

Country	Date	Time	Event
US	01/31	11:00	U.S. Fed to Purchase USD6-8 Bln Notes/Bonds
US	01/31	11:30	U.S. to Sell USD32 Bln 3-Month Bills
US	01/31	11:30	U.S. to Sell USD30 Bln 6-Month Bills
CA	02/01	10:30	Canada to Sell CAD5.9 Bln 98-Day Bills
CA	02/01	10:30	Canada to Sell CAD2.3 Bln 168-Day Bills
CA	02/01	10:30	Canada to Sell CAD2.3 Bln 350-Day Bills
US	02/01	11:00	U.S. Fed to Purchase USD1-2 Bln TIPS
US	02/01	11:30	U.S. to Sell 4-Week Bills
US	02/02	11:00	U.S. Fed to Purchase USD1.5-2.5 Bln Notes/Bonds
CA	02/02	12:00	Canada to Sell CAD3.0 Bln 10-Year Notes
US	02/03	11:00	U.S. Fed to Purchase USD7-9 Bln Notes/Bonds
US	02/04	11:00	U.S. Fed to Purchase USD6-8 Bln Notes/Bonds

Europe

Country	Date	Time	Event
NO	01/31	05:00	Norway to Sell NOK3 Bln 322-Day Bills
BE	01/31	05:30	Belgium Cancels Bond Auction of Jan. 31
FR	01/31	09:00	France to Sell EUR1.5 Bln 343-Day Bills
FR	01/31	09:00	France to Sell EUR2 Bln 160-Day Bills
FR	01/31	09:00	France to Sell EUR4 Bln 84-Day Bills
AS	02/01	05:00	Austria to Sell 4.15% Bonds Due 2037 (AT0000A04967)
AS	02/01	05:00	Austria to Sell 3.2% Bonds Due 2017 (AT0000A0GLY4)
AS	02/01	05:01	Austria to Sell 3.2% Bonds Due 2017 (AT0000A0GLY4)
SZ	02/01	05:30	Switzerland to Sell 3-Month Bills (CH0036178991)
UK	02/01	05:30	U.K. to Sell GBP3750 Mln 2% 2016 Bonds
HU	02/01	05:30	Hungary to Sell 3-Month Bills (HTB)
BE	02/01	06:00	Belgium to Sell Bills (TC)
HU	02/01	06:00	Hungary's Central Bank to Sell 2-Week Bills
SW	02/02	05:10	Sweden to Sell SEK10 Bln 103-Day Bills
PO	02/02	05:30	Portugal's IGCP Holds Auction of Aug. 2011, Jan. 2012 Bills
PO	02/02	05:30	Portugal to Sell 350-Day Bills
PO	02/02	05:30	Portugal to Sell 196-Day Bills
HU	02/02	05:30	Hungary to Hold Exchange Offer Auction
RU	02/02	06:00	Russia to Sell Up to RUB30 Bln OFZ Bonds; series 26204
PD	02/02	06:30	Poland to Hold Exchange Offer Auctions
SP	02/03	04:30	Spain to Sell 2.5% 2013 Bonds
SP	02/03	04:30	Spain to Sell 3.15% 2016 Bonds
FR	02/03	05:00	France to Sell 4.25% 2023 Bonds
EC	02/03	05:00	France to Sell 3.75% 2021 Bonds
EC	02/03	05:00	France to Sell 2.5% 2020 Bonds
EC	02/03	05:00	France to Sell 3.25% 2016 Bonds
SW	02/03	05:10	Sweden to Sell I/L Bonds
UK	02/03	05:30	U.K. to Sell GBP2000 Mln 4.25% 2040 Bonds
HU	02/03	05:30	Hungary to Sell 12-Month Bills
HU	02/03	05:30	Hungary to Sell Bonds (HGB)
UK	02/04	06:10	U.K. to Sell GBP500 Mln 28-Day Bills
UK	02/04	06:10	U.K. to Sell GBP1 Bln 91-Day Bills
UK	02/04	06:10	U.K. to Sell GBP1.5 Bln 182-Day Bills

Source: Bloomberg, Scotia Economics.

Global Auctions for the week of January 31 - February 4

Asia Pacific

Country	Date	Time	Event
IN	01/31		India to sell INR 30-40Bln 5-9Year Bonds
IN	01/31		India to sell INR 40-50Bln 10-14Year Bonds
IN	01/31		India to sell INR 20-30Bln 20 & above Year Bonds
SK	01/31		Korea Central Bank to Sell KRW1 Tln 91-Day Bonds
HK	01/31	22:30	Hong Kong to Sell HKD26.810 Bln 91-Day Bills; Q1105
HK	01/31	22:30	Hong Kong to Sell HKD9 Bln 182-Day Bills; H1158
HK	01/31	22:30	Hong Kong to Sell HKD1.3 Bln 364-Day Bills; Y1186
JN	01/31	22:45	Japan to Sell 10-Year Bond
PH	02/01		Philippines to Sell PHP 9 Bln 7-Yr Govt Bonds
AU	02/01	19:00	Australia Plans to Sell A$500 Mln 4.50% Bonds Due 2020
TH	02/01	22:00	Thailand to Sell THB6 Bln Bonds due 2031 (LB316A)
JN	02/01	22:35	Japan to Sell 3-Month Bills
IN	02/02	06:30	India to Sell INR 50Bln 91-Day Bills
IN	02/02	06:30	India to Sell INR 15Bln 182-Day Bills
AU	02/02	18:30	Australia Plans to Sell A$1000 Mln 2-Month Bills
AU	02/02	18:30	Australia Plans to Sell A$1000 Mln 3-Month Bills
AU	02/02	18:30	Australia Plans to Sell A$1000 Mln 4-Month Bills
NZ	02/02	20:30	New Zealand Plans to Sell Government Bonds
JN	02/03	03:00	Japan Auction for Enhanced-Liquidity
AU	02/03	19:00	Australia Plans to Sell A$700 Mln 4.75% Bonds Due 2012

Source: Bloomberg, Scotia Economics.

Events for the week of January 31 - February 4

North America

Country	Date	Time	Event
US	01/31	12:00	Fed's Lockhart Speaks in Miami, Florida
CA	02/01	14:15	Bank of Canada's Macklem Speaks in Edmonton, Alberta
CA	02/02	14:15	Bank of Canada's Macklem Speaks in Calgary, Alberta
US	02/02	17:30	Fed's Duke Speaks in North Carolina
US	02/03	13:00	Bernanke Speaks at National Press Club
US	02/03	20:00	Fed's Kocherlakota Speaks in St. Paul, Minnesota
US	02/04	13:00	Fed's Fisher Speaks in Texas on U.S. Economy

Europe

Country	Date	Time	Event
EC	01/31	04:00	EU General Affairs Ministers Hold Meeting
EC	01/31	05:00	EU's Oettinger Briefs Press on Financing Renewable Energy
EC	01/31	05:00	Barroso, Orban, Tusk, Kubilius Speak at EU Regional Conference
IR	01/31	06:00	Irish Central Bank Releases Quarterly Report
PO	01/31	07:00	Former Brazilian Central Bank President Speaks in Lisbon
EC	01/31	08:30	EU's Barroso, Poland's Tusk Brief Press in Brussels
EC	01/31	09:00	EU Foreign Ministers Meet in Brussels
UK	01/31	12:00	Bank of England's Andrew Haldane speaks in Munich
RU	01/31		Russia Refinancing Rate
EC	02/01		EU's Rehn Gives Speech in Helsinki
EC	02/01		EU's Rehn Gives Speech in Oulu, Finland
EC	02/01	09:00	EU's Fule, Hungary's Martonyi, Ukraine's Gryshchenko Speak
EC	02/01	10:00	ECB's Trichet Speaks in Milan, Italy
GE	02/02	03:45	German Deputy Finance Minister Asmussen Speaks in Frankfurt
IT	02/02	04:00	Fitch Holds Presentation on European Credit Outlook for 2011
IC	02/02	04:00	Sedlabanki Interest Rate
GE	02/02	06:30	German Government Briefing on EU Summit Aims
EC	02/02	09:00	EU Parliament Debates Upcoming EU Summit
EC	02/02	11:30	EU's Fule, Turkey's Yildiz, OMV Chief Speak in Brussels
EC	02/03	07:45	ECB Announces Interest Rates
GE	02/03	09:15	Merkel Meets With Spanish Prime Minister Zapatero in Madrid
GE	02/03	15:15	UN Secretary General Ban Ki-Moon Meets German President
EC	02/04	03:30	ECB's Gonzalez-Paramo Speaks in Malaga
EC	02/04	04:00	EU Leaders Hold Summit on Energy, Innovation
GE	02/04	11:30	Merkel Attends EU Summit in Brussels

Asia Pacific

Country	Date	Time	Event
AU	01/31	22:30	RBA CASH TARGET

Latin America

Country	Date	Time	Event
PO	01/31	07:00	Former Brazilian Central Bank President Speaks in Lisbon

Source: Bloomberg, Scotia Economics.

Global Central Bank Watch

North America

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Bank of Canada – Overnight Target Rate	1.00	March 1, 2011	1.00	--
Federal Reserve – Federal Funds Target Rate	0.25	March 15, 2011	0.25	--
Banco de México – Overnight Rate	4.50	March 4, 2011	4.50	--

Comments: The U.S. Federal Reserve stayed the course in its recent rate statement, and that supports our view that the Fed is on hold until at least 2012Q1. By retaining "extended period" and "exceptionally low" language, there was no change in rate guidance. The Fed did, however, secure greater flexibility in implementing its Treasury purchase program by dropping reference to a fixed target for the average monthly pace of purchases. We continue to forecast the BoC to remain on hold until October.

Europe

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
European Central Bank – Refinancing Rate	1.00	February 3, 2011	1.00	1.00
Bank of England – Bank Rate	0.50	February 10, 2011	0.50	0.50
Swiss National Bank – Libor Target Rate	0.25	March 17, 2011	0.25	--
Central Bank of Russia – Refinancing Rate	7.75	January 31, 2011	7.75	7.75
Hungarian National Bank – Base Rate	6.00	February 21, 2011	6.25	--
Central Bank of the Republic of Turkey – 1 Week Repo Rate	6.25	February 15, 2011	6.25	--

Comments: Despite intensifying price pressures in the UK, we maintain our view that the Bank of England will remain on hold for an extended period of time as the economic outlook will be challenged by fiscal consolidation efforts.

Asia Pacific

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Bank of Japan – Target Rate	0.10	February 15, 2011	--	--
Reserve Bank of Australia – Cash Target Rate	4.75	January 31, 2011	4.75	4.75
Reserve Bank of New Zealand – Cash Rate	3.00	March 9, 2011	--	--
People's Bank of China – Lending Rate	5.81	TBA	--	--
Reserve Bank of India – Repo Rate	6.50	TBA	--	--
Hong Kong Monetary Authority – Base Rate	0.50	TBA	--	--
Bank Negara Malaysia – Overnight Policy Rate	2.75	March 11, 2011	--	--
Bank of Korea – Bank Rate	2.75	February 10, 2011	--	--
Bank of Thailand – Repo Rate	2.25	March 9, 2011	--	--
Bank Indonesia – Reference Interest Rate	6.50	February 4, 2011	6.50	6.50

Comments:The Reserve Bank of Australia is set to remain on the sidelines next week. While inflation went down to 2.7% y/y in the final quarter of 2010, it is likely to revert the fall during the current quarter given crop damage in Queensland as food costs have been leading price pressures. Bank Indonesia will not move as well, as core inflation still displays muted transmission of food price pressures.

Latin America

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Banco Central do Brasil – Selic Rate	11.25	March 2, 2011	11.75	--
Banco Central de Chile – Overnight Rate	3.25	February 17, 2011	3.25	--
Banco de la República de Colombia – Lending Rate	3.00	January 31, 2011	3.00	3.00
Banco Central de Reserva del Perú – Reference Rate	3.25	February 10, 2011	3.50	--

Comments: We expect the Central Bank of Colombia to maintain its interest rate unchanged at 3.0%, as it has done since it last cut in April 2010. Inflation has been climbing in recent months, reaching an annual rate of 3.17% in December; however, it remains well below the central bank's tolerance level.

Africa

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
South African Reserve Bank – Repo Rate	5.50	March 24, 2011	5.50	--

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

	2000-09	2010e	2011f	2012f	2000-09	2010e	2011f	2012f
Output and Inflation (annual % change)		Real GDP				Consumer Prices[2]		
World[1]	3.6	4.9	4.2	4.4				
Canada	2.1	2.9	2.4	2.7	2.1	1.8	2.1	2.2
United States	1.8	2.8	2.7	2.9	2.6	1.7	1.5	1.6
Mexico	1.9	5.1	3.5	4.0	4.9	4.5	4.0	3.5
United Kingdom	2.7	1.8	1.6	1.7	2.2	3.1	3.3	2.7
Euro zone	1.2	1.9	1.4	1.6	2.1	2.2	2.3	2.3
Japan	0.7	3.4	1.6	2.7	-0.3	-0.5	0.7	1.0
Australia	3.0	3.0	3.5	3.3	3.2	3.0	2.8	2.5
China	10.2	10.0	9.5	9.7	2.0	3.5	4.5	4.0
India	7.2	8.3	8.5	8.8	5.7	7.0	5.5	5.0
Korea	4.5	5.8	5.0	5.3	3.2	3.0	3.3	3.0
Brazil	2.9	7.5	5.5	5.0	6.6	5.8	5.2	5.0
Chile	3.7	5.0	6.0	5.5	3.4	3.7	3.5	3.0
Peru	5.1	8.5	6.8	7.2	2.5	2.4	3.0	3.0
Central Bank Rates (%, end of period)	**11Q1f**	**11Q2f**	**11Q3f**	**11Q4f**	**12Q1f**	**12Q2f**	**12Q3f**	**12Q4f**
Bank of Canada	1.00	1.00	1.00	1.50	2.00	2.25	2.25	2.25
Federal Reserve	0.25	0.25	0.25	0.25	0.75	1.25	1.75	2.00
European Central Bank	1.00	1.00	1.00	1.25	1.50	1.75	2.00	2.25
Bank of England	0.50	0.50	0.50	0.75	1.00	1.25	1.50	1.75
Swiss National Bank	0.25	0.25	0.25	0.50	0.50	0.75	0.75	1.00
Bank of Japan	0.10	0.10	0.10	0.10	0.10	0.25	0.25	0.50
Reserve Bank of Australia	5.00	5.00	5.25	5.50	5.75	6.00	6.25	6.50
Exchange Rates (end of period)								
Canadian Dollar (USDCAD)	1.00	0.99	0.98	0.96	0.96	0.95	0.95	0.94
Canadian Dollar (CADUSD)	1.00	1.01	1.02	1.04	1.04	1.05	1.05	1.06
Euro (EURUSD)	1.33	1.33	1.35	1.37	1.39	1.41	1.43	1.45
Sterling (GBPUSD)	1.58	1.60	1.61	1.63	1.65	1.67	1.69	1.70
Yen (USDJPY)	82	83	84	84	86	87	89	90
Australian Dollar (AUDUSD)	1.03	1.05	1.06	1.08	1.07	1.08	1.09	1.10
Chinese Yuan (USDCNY)	6.5	6.3	6.2	6.1	6.0	5.9	5.8	5.8
Mexican Peso (USDMXN)	12.5	12.6	12.7	12.8	12.9	13.0	13.1	13.2
Brazilian Real (USDBRL)	1.66	1.66	1.65	1.65	1.66	1.67	1.69	1.70

Commodities (annual average)	**2000-09**	**2010e**	**2011f**	**2012f**
WTI Oil (US$/bbl)	51	80	95	98
Nymex Natural Gas (US$/mmbtu)	5.95	4.40	4.40	4.75
Copper (US$/lb)	1.78	3.40	4.50	4.25
Zinc (US$/lb)	0.73	0.98	1.03	1.05
Nickel (US$/lb)	7.11	9.85	10.00	8.00
Gold, London PM Fix (US$/oz)	522	1,225	1,485	1,400
Pulp (US$/tonne)	668	960	875	960
Newsprint (US$/tonne)	572	607	685	710
Lumber (US$/mfbm)	275	254	265	300

[1] World GDP for 2000-09 are IMF estimates; 2010-12f are Scotia Economics' estimates based on a 2009 PPP-weighted sample of 34 countries.
[2] CPI for Canada and the United States are annual averages. For other countries, CPI are year-end rates.

Canada	2009	10Q2	10Q3	Latest	
Real GDP (annual rates)	-2.5	2.3	1.0		
Current Acc. Bal. (C$B, ar)	-43.5	-51.9	-70.1		
Merch. Trade Bal. (C$B, ar)	-4.6	-9.4	-26.5	-1.0	(Nov)
Industrial Production	-9.4	6.2	7.9	6.2	(Oct)
Housing Starts (000s)	149	198	192	168	(Dec)
Employment	-1.6	1.5	1.8	1.8	(Dec)
Unemployment Rate (%)	8.3	8.0	8.0	7.6	(Dec)
Retail Sales	-2.9	4.9	3.6	5.3	(Nov)
Auto Sales (000s)	1459	1518	1609	1561	(Nov)
CPI	0.3	1.4	1.8	2.4	(Dec)
IPPI	-3.5	0.7	1.0	2.1	(Nov)
Pre-tax Corp. Profits	-32.3	26.3	16.0		

United States	2009	10Q2	10Q3	Latest	
Real GDP (annual rates)	-2.6	1.7	2.6		
Current Acc. Bal. (US$B, ar)	-378	-493	-509		
Merch. Trade Bal. (US$B, ar)	-507	-678	-685	-614	(Nov)
Industrial Production	-9.3	7.8	6.9	5.7	(Dec)
Housing Starts (millions)	0.55	0.60	0.59	0.53	(Dec)
Employment	-4.3	-0.5	0.2	0.8	(Dec)
Unemployment Rate (%)	9.3	9.6	9.6	9.4	(Dec)
Retail Sales	-7.2	7.5	6.1	8.2	(Dec)
Auto Sales (millions)	10.4	11.3	11.6	12.5	(Dec)
CPI	-0.4	1.8	1.2	1.5	(Dec)
PPI	-2.6	4.4	3.8	4.0	(Dec)
Pre-tax Corp. Profits	-1.2	46.7	34.8		

Mexico	2009	10Q2	10Q3	Latest	
Real GDP	-6.1	7.6	5.3		
Current Acc. Bal. (US$B, ar)	-6.2	-2.5	-7.4		
Merch. Trade Bal. (US$B, ar)	-4.6	-0.2	-9.2	-2.6	(Dec)
Industrial Production	-7.4	7.9	6.3	5.3	(Nov)
CPI	5.3	4.0	3.7	4.4	(Dec)

Brazil	2009	10Q2	10Q3	Latest	
Real GDP	-0.6	8.5	5.9		
Current Acc. Bal. (US$B, ar)	-24.3	-47.6	-45.6		
Merch. Trade Bal. (US$B, ar)	25.3	28.0	19.4	64.4	(Dec)
Industrial Production	-7.2	14.2	8.1	4.1	(Nov)
CPI	5.2	5.5	5.0	6.6	(Dec)

Argentina	2009	10Q2	10Q3	Latest	
Real GDP	0.9	11.8	8.6		
Current Acc. Bal. (US$B, ar)	11.0	12.8	3.6		
Merch. Trade Bal. (US$B, ar)	16.9	21.4	12.0	2.9	(Dec)
Industrial Production	0.1	10.1	9.3	10.6	(Dec)
CPI	-26.9	93.3	89.8	10.9	(Dec)

Italy	2009	10Q2	10Q3	Latest	
Real GDP	-5.1	1.3	1.1		
Current Acc. Bal. (US$B, ar)	-0.04	-0.06	-0.05	-0.08	(Nov)
Merch. Trade Bal. (US$B, ar)	-8.0	-32.1	-22.9	-55.5	(Nov)
Industrial Production	-18.2	7.7	6.3	4.2	(Nov)
CPI	0.8	1.5	1.6	1.9	(Dec)

Germany	2009	10Q2	10Q3	Latest	
Real GDP	-4.7	3.9	3.9		
Current Acc. Bal. (US$B, ar)	168.9	132.0	148.1	197.5	(Nov)
Merch. Trade Bal. (US$B, ar)	193.4	179.3	205.9	193.3	(Nov)
Industrial Production	-15.5	12.2	10.2	11.1	(Nov)
Unemployment Rate (%)	8.2	7.7	7.6	7.5	(Dec)
CPI	0.3	1.1	1.2	1.7	(Dec)

France	2009	10Q2	10Q3	Latest	
Real GDP	-2.8	1.8	2.0		
Current Acc. Bal. (US$B, ar)	-52.2	-58.3	-41.8	-131.0	(Nov)
Merch. Trade Bal. (US$B, ar)	-31.4	-42.3	-40.0	-34.0	(Nov)
Industrial Production	-13.5	7.4	5.3	5.1	(Nov)
Unemployment Rate (%)	9.5	9.8	9.7	9.8	(Nov)
CPI	0.1	1.6	1.5	1.8	(Dec)

Euro Zone	2009	10Q2	10Q3	Latest	
Real GDP	-4.0	1.9	1.9		
Current Acc. Bal. (US$B, ar)	-69.2	-104	-43	-99	(Nov)
Merch. Trade Bal. (US$B, ar)	54.7	17.1	43.0	15.9	(Nov)
Industrial Production	-14.8	9.0	7.1	7.5	(Nov)
Unemployment Rate (%)	9.4	9.9	9.9	10.0	(Nov)
CPI	0.3	1.5	1.7	2.2	(Dec)

United Kingdom	2009	10Q2	10Q3	Latest	
Real GDP	-4.9	1.6	2.7		
Current Acc. Bal. (US$B, ar)	-37.1	-28.3	-63.9		
Merch. Trade Bal. (US$B, ar)	-128.7	-135.3	-159.6	-167.7	(Nov)
Industrial Production	-10.1	1.5	3.2	3.3	(Nov)
Unemployment Rate (%)	7.6	7.8	7.8	7.9	(Oct)
CPI	2.2	3.4	3.1	3.7	(Dec)

Japan	2009	10Q2	10Q3	Latest	
Real GDP	-6.3	3.5	5.0		
Current Acc. Bal. (US$B, ar)	141.8	156.9	227.5	135.0	(Nov)
Merch. Trade Bal. (US$B, ar)	29.6	55.6	91.5	101.7	(Dec)
Industrial Production	-21.8	21.1	12.9	4.2	(Nov)
Unemployment Rate (%)	5.1	5.2	5.1	4.9	(Dec)
CPI	-1.4	-0.9	-0.8	0.0	(Dec)

Australia	2009	10Q2	10Q3	Latest	
Real GDP	1.3	3.1	2.7		
Current Acc. Bal. (US$B, ar)	-41.4	-12.3	-33.5		
Merch. Trade Bal. (US$B, ar)	-3.2	31.9	27.3	7.1	(Nov)
Industrial Production	-1.6	6.9	5.0		
Unemployment Rate (%)	5.6	5.2	5.2	5.0	(Dec)
CPI	1.8	3.1	2.8		

China	2009	10Q2	10Q3	Latest	
Real GDP	9.1	10.3	9.6		
Current Acc. Bal. (US$B, ar)	297.1				
Merch. Trade Bal. (US$B, ar)	195.7	164.2	261.0	157.0	(Dec)
Industrial Production	18.5	13.7	13.3	13.5	(Dec)
CPI	1.9	2.9	3.6	4.6	(Dec)

South Korea	2009	10Q2	10Q3	Latest	
Real GDP	0.2	7.2	4.4		
Current Acc. Bal. (US$B, ar)	32.8	35.4	39.7	25.4	(Dec)
Merch. Trade Bal. (US$B, ar)	40.4	58.0	45.7	44.9	(Dec)
Industrial Production	-1.3	19.5	14.1	9.0	(Nov)
CPI	2.8	2.6	2.9	3.5	(Dec)

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

Source: Bloomberg, Scotia Economics.

Interest Rates (%, end of period)

Canada	10Q3	10Q4	Jan/21	Jan/28*	United States	10Q3	10Q4	Jan/21	Jan/28*
BoC Overnight Rate	1.00	1.00	1.00	1.00	Fed Funds Target Rate	0.25	0.25	0.25	0.25
3-mo. T-bill	1.01	1.05	1.04	1.03	3-mo. T-bill	0.15	0.12	0.15	0.14
10-yr Gov't Bond	2.76	3.12	3.33	3.25	10-yr Gov't Bond	2.51	3.29	3.40	3.34
30-yr Gov't Bond	3.36	3.53	3.75	3.72	30-yr Gov't Bond	3.68	4.33	4.57	4.53
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US$B)	59.4		58.1	(Nov)	FX Reserves (US$B)	122.1		119.2	(Nov)
Germany					**France**				
3-mo. Interbank	0.86	0.96	0.96	1.00	3-mo. T-bill	0.51	0.40	0.53	0.65
10-yr Gov't Bond	2.28	2.96	3.18	3.16	10-yr Gov't Bond	2.66	3.36	3.49	3.54
FX Reserves (US$B)	62.4		61.3	(Nov)	FX Reserves (US$B)	52.2		52.9	(Nov)
Euro-Zone					**United Kingdom**				
Refinancing Rate	1.00	1.00	1.00	1.00	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	0.88	0.82	0.71	1.06	3-mo. T-bill	4.85	4.85	4.85	4.85
FX Reserves (US$B)	300.1		296.1	(Nov)	10-yr Gov't Bond	2.95	3.40	3.70	3.66
					FX Reserves (US$B)	67.2		65.1	(Nov)
Japan					**Australia**				
Discount Rate	0.30	0.30	0.30	0.30	Cash Rate	4.50	4.50	4.75	4.75
3-mo. Libor	0.15	0.13	0.13	0.13	10-yr Gov't Bond	4.96	5.55	5.56	5.50
10-yr Gov't Bond	0.94	1.13	1.22	1.22	FX Reserves (US$B)	38.1		38.3	(Nov)
FX Reserves (US$B)	1077.4		1067.0	(Nov)					

Exchange Rates (end of period)

USDCAD	1.03	1.00	0.99	1.00	¥/US$	83.53	81.12	82.57	82.15
CADUSD	0.97	1.00	1.01	1.00	US¢/Australian$	96.71	102.33	98.98	99.37
GBPUSD	1.572	1.561	1.600	1.584	Chinese Yuan/US$	6.69	6.61	6.59	6.59
EURUSD	1.363	1.338	1.362	1.363	South Korean Won/US$	1140	1126	1124	1114
JPYEUR	0.88	0.92	0.89	0.89	Mexican Peso/US$	12.594	12.340	12.064	12.144
USDCHF	0.98	0.94	0.96	0.94	Brazilian Real/US$	1.687	1.661	1.678	1.684

Equity Markets (index, end of period)

United States (DJIA)	10788	11578	11872	11877	U.K. (FT100)	5549	5900	5896	5889
United States (S&P500)	1141	1258	1283	1284	Germany (Dax)	6229	6914	7062	7118
Canada (S&P/TSX)	12369	13443	13259	13442	France (CAC40)	3715	3805	4017	4016
Mexico (Bolsa)	33330	38551	37321	37067	Japan (Nikkei)	9369	10229	10275	10360
Brazil (Bovespa)	69430	69305	69562	66685	Hong Kong (Hang Seng)	22358	23035	23877	23617
Italy (BCI)	1033	1048	1107	1126	South Korea (Composite)	1873	2051	2070	2108

Commodity Prices (end of period)

Pulp (US$/tonne)	990	960	960	960	Copper (US$/lb)	3.65	4.42	4.30	4.35
Newsprint (US$/tonne)	638	640	640	640	Zinc (US$/lb)	0.99	1.10	1.06	1.04
Lumber (US$/mfbm)	236	308	299	300	Gold (US$/oz)	1307.00	1405.50	1343.50	1319.00
WTI Oil (US$/bbl)	79.97	91.38	89.11	88.08	Silver (US$/oz)	22.07	30.63	27.14	26.68
Natural Gas (US$/mmbtu)	3.87	4.41	4.74	4.32	CRB (index)	286.86	332.80	333.99	334.64

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

Scotia Economics

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