

Global Views

Weekly commentary on economic and financial market developments

June 10, 2011

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Karen Cordes Woods (416) 862-3080
karen_woods@scotiacapital.com

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

China The Key Risk, Amid Dovish Global CPI Figures and Bearish Canadian Data

- Please see our full indicator, central bank, auction and event calendars on pp. A4-A10.

Asian markets will be principally focused upon a batch release of Chinese indicators on Monday evening (ET). New yuan loans are 11.3% lower year-to-date compared to the same period last year in an effort to cool the economy through tightened lending quotas and higher reserve ratios. Markets will be attuned to whether this cooling continues in the May print. That said, CPI inflation is expected to accelerate to the 5.5% y/y mark, and this raises the risk of a PBoC rate hike any day including over the weekend (there is no fixed schedule of announcements). Expected strength in retail sales and industrial production would add to the argument in favour of further policy tightening. Of secondary importance will be the Bank of Japan's policy statement on Tuesday, particularly in terms of a rumoured upgrade to growth forecasts while the IMF recently advised the BoJ to add to asset purchases in order to counter deflation risk. Rate decisions are also expected by the Reserve Bank of India for which we expect a 25bps hike, and Bangko Sentral ng Pilipinas.

Only one day matters for **Canada** next week, and that's Wednesday. There could well be solid appetite for a 2s auction that day, as it follows the release of manufacturing sales for the month of April earlier that morning. We're expecting a large drop of 4% m/m, principally owing to the impact of Japan's supply shocks on Canadian industry. As we argued in "Look Through Q1 Canadian GDP to Sharp Downsides Into Q2," *Global Views*, May 27 2011, p.3, the auto sector is at the heart of the shock. We already know that Canadian auto production fell by 25% m/m in April. The 12% weight in total shipments would account for at least a 2-3 percentage point drop in total shipments before even considering other supply shock effects upon other sectors. I'll be at Finance Minister Flaherty's luncheon in NY on June 15 as part of a swing through clients, and the focus will be upon selling last Monday's Federal Budget to U.S. institutional investors with a speech title of "Canada's Strong Performance Through The Economic Crisis and the Way Forward." The speech is well-timed for a likely off-day on Canada data. Good policy and bank stewardship certainly helped the recent out-performance, but our main view is that Canada looked so good through the crisis in large part just because it experienced its own crisis much earlier in the 1990s and cleaned up its act. The pent-up demand from that period was unleashed upon housing and consumer markets in the past decade, and this process has now brought Canada to all-time highs across many household sector variables that probably point to slowing contributions to growth from the household sector. BoC Governor Mark Carney also speaks on Wednesday afternoon and the focus will be upon housing.

In a week with no auctions or significant speeches, **US** markets will be facing elevated data risk. Headline retail sales on Tuesday are expected to soften on sharply lower vehicle sales and gasoline prices, but it is hoped that the core figure will continue expanding. Key will be the St. Louis Fed's real retail sales figures that should follow Wednesday's CPI report. We're expecting a soft m/m inflation print due to commodity price softness. Real retail sales stalled out in April by posting only 0.1% m/m growth, so markets will be sensitive to any further downsides in Q2. Also key will be the start to the next round of regional manufacturing surveys including cautious expectations for small improvements in each of the Philly Fed and Empire gauges following the sharp declines registered in April.

A round of inflation updates for May begins to sweep through **European** economies, including the UK and across the euro zone. The figures should show ebbing inflation pressures on the m/m comparisons due to May's commodity correction, but not on the year-ago figures. Because of high base effects, inflation-adjusted UK retail sales are also likely to soften (see Alan Clarke's piece on the UK consumer in last week's *Global Views*). Speech risk will be high throughout the week with big names on tap like EU Financial Markets Commissioner Michel Barnier, European Commission President Manuel Barroso, French President Nicolas Sarkozy, the likely next ECB President Draghi, and European Council President Herman Van Rompuy. Movement toward a new deal for Greece will be a focus in at least some of them. Peripheral auctions return as a risk with each of Spain, Portugal and Belgium slated to sell bills, while Spain also auctions a 2026 bond.

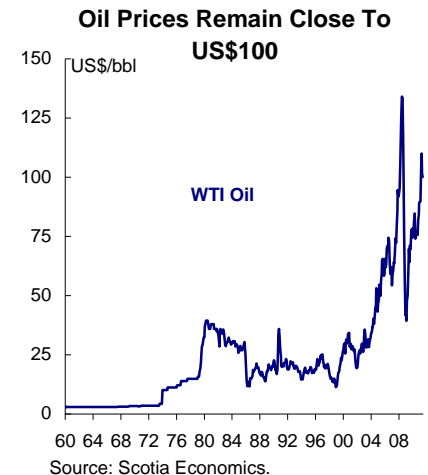
The key development in **Latam** markets will be consensus expectations for 25bps rate hikes in Chile and Colombia.

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

Saudi Arabia Moves Unilaterally to Increase Oil Output, Exerting Its Leadership Within OPEC

- **Drought in China boosts diesel demand for backup generators.**

Brent oil prices — a world benchmark — surged over US\$119 per barrel (WTI over US\$101), in the immediate aftermath of OPEC's meeting on June 8. A proposal by Saudi Arabia to boost OPEC output by 1.5 mb/d — supported by other key Gulf producers Kuwait, the UAE and Qatar — was overruled by 'price hawks' Iran, Venezuela and Algeria, who led opposition by six members. However, Brent prices have edged down today to US\$118 (WTI to US\$99) on news that Saudi Arabia will unilaterally increase output to 9.5-10.0 mb/d in July (if needed) from April's 8.8 mb/d. Aramco is offering additional volumes to refineries in Asia to prevent high oil prices from derailing global growth and to stem a further shift away from oil to other fossil fuels & renewables (though some renewables are heavily subsidized by government and costly).



The failure of OPEC to agree to an output increase (especially via an increase in official quotas from the 24.84 mb/d set in December 2008) comes as no surprise, in view of the political upheaval in some North African and Middle East OPEC members (notably Libya and Bahrain) and resulting tensions among key OPEC producers. In addition, Iran and Venezuela are already operating close to full capability, with the bulk of OPEC's 'spare capacity' held by Saudi Arabia (3.24 mb/d out of a total 4.52 mb/d as of April for the eleven OPEC members subject to quotas).

The lack of a formal accord at the meeting also reflects disagreement over the 'need' for stepped-up production, given differing world supply & demand estimates for the second half of 2011 and the limited success Saudi Arabia had in offsetting disrupted Libyan supplies last March. Saudi Arabia designed several new crude oil blends to offset the loss of about 1.3 mb/d of light, sweet Libyan crude — shipped mostly to refineries in Italy and Spain — but found few buyers for its sourer crude (possibly due to spring refinery maintenance and ample stocks on hand of Libyan crude at refineries). However, the Libyan supply disruption has been prolonged and European inventories are now dwindling, heightening the need for Saudi crude.

Saudi Arabia and the OPEC Secretariat anticipate that the 'call' for OPEC oil will rise to 30.7 mb/d in the second half of 2011, requiring an increase in OPEC production of 1.73 mb/d from 28.97 mb/d in May. This estimate appears slightly optimistic, given the recent slowdown in U.S. petroleum consumption and an uncertain global outlook. Saudi Arabia must take care not to over-supply the market, if it wishes to avoid a price plunge as occurred in late 1998 (when OPEC mistakenly stepped-up output, just as demand was fading).

U.S. petroleum product demand, as measured by 'products supplied', fell by 3.7% yr/yr in the latest four-week period ending in early June, though some of this decline may reflect destocking. Diesel and other products declined substantially (alongside slower industrial activity) and gasoline demand plateaued, after dropping in May. U.S. gasoline consumption started to soften in May, when average retail gasoline prices reached US\$4 per gallon (this time at the US\$110 mark for WTI oil prices). Pump prices are currently US\$3.78.

Retail gasoline prices in Beijing (and India) have recently been higher than in the United States, though gasoline consumption in China continues to increase yr/yr. China's implied petroleum consumption climbed by 9.2% yr/yr in April. Oil demand will be underpinned over the summer as manufacturers burn diesel in backup generators to offset curtailed hydro-power due to drought. Beijing has recently banned diesel exports from China and allowed the electricity rate cap to increase to encourage coal-fired utilities to step up generation.

The net result, Saudi Arabia's planned production increase should be absorbed into the market, without causing an undue price decline. WTI oil prices are expected to average US\$100 in 2011 and a slightly higher US\$103 in 2012.

Carlos Gomes (416) 866-4735
carlos_gomes@scotiacapital.com

Vehicle Production to Rebound Across North America, Boosting Economic Activity

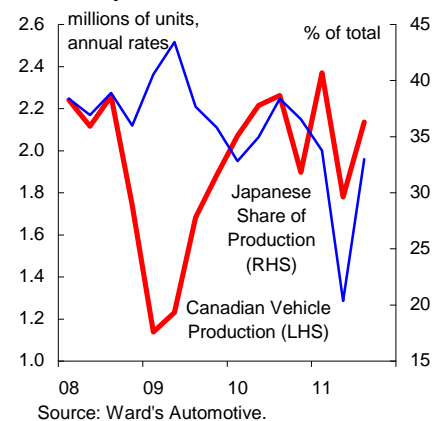
Canada Will Lead the Way

Faced with a shortage of several popular models (especially small cars and crossover utility vehicles), and given the resumption of auto parts production at key suppliers in Japan, automakers are gearing up to boost third-quarter production 18% above a year earlier. This represents a sharp acceleration from a slowdown in the April-June period, when supply chain disruptions in Japan limited North American assemblies to an annual rate of only 12.4 million units, down from 13.3 million in the opening months of 2011. We estimate that third-quarter vehicle output in North America will climb above an annualized 14.0 million units — the highest level since mid-2008, prior to the sharp fall-off in global economic activity later that year.

The recent slowdown in vehicle production, both in North America and across the world, has been a large factor behind the recent moderation in global macroeconomic activity. However, that trend will begin to reverse in July, when automakers boost output across all major vehicle producing nations — a development that will bolster global economic growth in coming months.

In North America, Canadian plants will benefit most from higher output in the July-September period. Vehicle production at Canadian plants is expected to jump 21% year-over-year, compared to only a 3% gain in the first half of 2011. The outperformance reflects that fact that Toyota and Honda, which typically account for 36% of overall Canadian vehicle output, will be ramping up production. The share of Japanese vehicle assemblers is smaller in the United States at about 30%, and in Mexico at only one-quarter. Nevertheless, improving vehicle production will add roughly an annualized percentage point to overall GDP growth throughout the NAFTA region between July and September.

Canadian Assemblies Rebound, As Japanese Raise Production



During the second quarter, production cutbacks at Toyota and Honda slashed their share of Canadian assemblies to just over 20% (see chart). Their share of Canadian output will climb to 33% in the third quarter, as the two companies attempt to recoup as much of the lost production as possible. However, even with overtime at several facilities, their share will remain below the traditional 36%, as parts shortages for the new Honda Civic will keep operating rates at plants assembling the Civic at about 50%. Aside from the Civic, Honda also assembles the Acura CSX, Acura MDX and the Acura ZDX in Alliston, Ontario. Canadian assemblies will also be boosted by the ongoing ramp-up of the new Buick Regal in Oshawa. Production of the new vehicle began in March 2011.

Another positive economic indicator for vehicle production is a 33% year-over-year jump in heavy truck output scheduled for the third quarter across North America. This reflects rising orders as fleet owners rush to upgrade and increase the size of their fleet in an environment of rising freight volumes and freight rates. In particular, freight rates — as measured by revenue per loaded mile — are now advancing at 2.3% year-over-year, the strongest performance in more than four years.

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

Global Real Estate Activity Cools

- **After some encouraging signs of revival last year, residential real estate markets in much of the developed world are losing momentum — or in some cases, even reversing course.**

Increasing nervousness over global economic prospects alongside rising food and fuel prices and persistently high unemployment are keeping potential homebuyers on the sidelines despite highly accommodative monetary policy. A lingering oversupply of housing and/or still tight credit conditions are reinforcing the downward pressure on sales and prices in a number of markets globally.

A marked improvement in housing affordability, particularly in those regions suffering large valuation declines in recent years, will eventually put a firmer floor under prices and underpin a gradual turnaround for the sector. For the time being, however, the process of repairing bloated public and household balance sheets points to a protracted period of subpar economic growth among debt-heavy developed nations that will restrain household borrowing and spending. A generally more cautious lending environment also will hold back the pace of recovery.

While housing demand in **Australia** is supported by strong economic growth and low unemployment, record high home prices alongside a series of interest rate increases by the Reserve Bank of Australia (RBA) are eroding the nation's already strained affordability. Average home prices in Q1 were unchanged from a year earlier, and down 3½% adjusted for inflation. While the RBA has put further rate hikes on hold for now, the eventual resumption of monetary tightening will reinforce the more muted housing outlook.

In the **U.K.**, average inflation-adjusted home prices were down 4% y/y in Q1. Notwithstanding ultra-low borrowing costs, recent tax breaks for home buyers and an easing in lending conditions, aggressive fiscal austerity measures and persistently high unemployment will continue to depress activity in the near-term.

Following steep price declines from 2008-2010, average inflation-adjusted home prices in **Spain** were down more than 8% y/y in Q1. Prices are likely to fall further in the coming year given a massive glut of unsold homes, soaring double-digit unemployment, the elimination of mortgage funding for low income families at the beginning of 2011 and a dearth of foreign vacation property buyers.

In the **U.S.**, average inflation-adjusted home prices were down 5% y/y in Q1. High unemployment and tight credit availability are restraining demand, while a large volume of distressed properties is adding to the downward pressure on prices. Despite gradually improving job markets and near-record housing affordability, the expected addition of at least another 1 million foreclosed properties to the market this year suggests more downside price risk in 2011.

Not all residential property markets are in negative territory, as the housing recovery continues in some of Europe's better performing economies. In **France**, average real prices were up 7% y/y in Q1, though weakening global growth expectations may limit further price gains in the near-term. In **Germany**, for which only annual price data are available, real home prices increased in 2010 for first time in over a decade. **Switzerland** reported steady real price increases averaging 4% y/y through Q1.

Canada also reported positive real price appreciation in the first quarter of 2011, with average inflation-adjusted home prices up 5% y/y in Q1. Sales, while below the record-setting pace seen in at the height of the boom in 2005-2007, are being supported by steady job creation and still attractive borrowing costs. Relatively tight supply is adding to price pressures in several cities. Nonetheless, high home prices, the further tightening in mortgage insurance rules effective mid-March, and the upward drift in longer-term mortgage rates this year appear to have slowed demand somewhat, most notably among first-time buyers. We anticipate relatively flat sales volumes and average prices through the latter half of the year.

Karen Cordes Woods (416) 862-3080
karen_woods@scotiacapital.com

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

Why Abandoning The Euro Wouldn't Help Greece

- **Six reasons why bringing back the drachma wouldn't solve much.**

A popular notion posits that unhitching itself from the euro and bringing back the drachma would solve Greece's woes. There are at least six reasons to be cautious toward such a view, without even getting into the faulty argument that a default automatically begets an exit from the euro. First, the impact of currency devaluation trades off against being unable to get financing in order to feed an export revival. A default that begets a banking crisis — which Greece may very well be facing — may then transform into currency risk that would trade off a devalued currency's effects on exports against the inability to get financing for a possibly very long time. In fact, multiple defaults are not outside of the norm experienced by countries in past defaults. A depreciated exchange rate only helps if the financing is there to capitalize upon it. Studies tend to argue there is a sizeable negative effect of default on access to trade credit in the first two years following default, while the multiple- or delayed-default option would lengthen this impact.¹

Second, it is generally understood that the effects of currency devaluation depend in part upon the nature of a country's labour markets. In order for currency devaluation to improve labour costs and hence trade competitiveness, the resulting higher import prices cannot be offset by higher nominal wage demands or the equivalent of lessened productivity. Real (inflation adjusted) wages must go down and productivity must remain flat or rise if currency devaluation is to work. If we were talking about a fluid labour market like the US, that may well occur. But real wages are stickier in Greece. This is partly owing to the nature of their contractual bargaining exercises.² Briefly, public sector wages are determined according to law set by government. Private sector wages are determined through collective bargaining in the National General Collective Labour Agreement which covers a two-year period and sets minimum wages depending upon years of service and family status. Cartels play a significant role in determining prices and wages in Greece's economy, and wage indexation to inflation is common. The issue of flexible real wages is key in the debate over the power of flexible exchange rates, particularly in Greece's context: "Flexible exchange rates work as shock absorbers in a world of sticky nominal prices and wages, but rigidities in real wages and prices mean that nominal exchange rates do not serve the role of shock absorber in the adjustment of output and the real exchange rate."³ Collective bargaining methods are also likely to attempt to factor in expectations of higher taxes and greater collection enforcement on top of the impact of higher inflation.

Third, the impact of currency devaluation on prices is itself uncertain. Pass-through effects of currency changes into prices is thought to be weaker for the euro zone than for countries such as Canada.

Fourth, at what exchange rate between the euro and a new drachma would Greece be entitled to leave? Negotiating entry rates of exchange was difficult enough for the old currencies that the euro replaced. It's possible that the euro zone members will be motivated by their banking obligations and would not be magnanimous in charitably granting a fire sale rate of exchange to Greece. Indeed, they may well adopt a beggar-thy-neighbour stance to price away benefits to Greece and guard Europe's own banking interests.

Fifth, Greece could well face better long-run prospects restructuring with support from within the euro framework. Reintroducing currencies like the drachma or lira would return some of Europe's economies to their vices of the past. Currency depreciation or competitive devaluations were often relied upon as a shock absorber, over and above pursuing structural and fiscal reforms needed to boost productivity levels and stimulate long-run (taxable) income growth. Greece has a chance at restructuring toward much lower spreads; dropping the euro and reintroducing the drachma would likely eliminate that chance.

Lastly, defaulting and reintroducing the drachma would quite possibly invite contagion risk across the euro zone and a negative feedback effect on Greece. Given market tendencies, the bet would move on to who is next such that treating Greece as a separate, contained experiment is likely unrealistic.

1. Borensztein, Eduardo and Ugo Panizza "The Costs of Sovereign Default," IMF Working Paper # WP/08/238, October 2008.

2. Tikos, Stathis "Greece: Wage Formation," European Industrial Relations Observation On-Line, March 2009.

3. Stournaras, Yiannis "Aggregate Supply and Demand, the Real Exchange Rate and Oil Price Denomination," Bank of Greece, Working Paper # 26, July 2005.

Guillermo Arbe (511) 211-6052
guillermo.arbe@scotiabank.com.pe

Pablo Bréard (416) 862-3876
pablo_breard@scotiacapital.com

Financial Markets Stabilize Following the Completion of Elections in Peru

- **President-elect Ollanta Humala takes office on July 28th.**

The Electoral Cycle: Official results and transition Calendar

On Sunday June 5th, the second round of presidential elections took place in Peru. Mr. Ollanta Humala (*Gana Perú - GP*) received 51.5% of the votes (7.9 million). Ms. Keiko Fujimori (*Fuerza 2011*) received 48.5% of the votes (7.4 million).

Market Reaction — Financial markets, which reacted negatively to the news on Monday, recovered consistently by the end of the week. Despite the election-related volatility, market metrics had been discounting the electoral outcome since mid March 2011.

Foreign Exchange — The exchange rate environment stabilized through the remainder of the week after a mild negative reaction on Monday. The Peruvian sol (PEN) depreciated somewhat from 2.758 per USD (Friday close) to 2.79 (Monday) before recovering partially to close the week at 2.76.

Equity Market — Peruvian stocks, which declined by 12% on Monday prompting the Lima Stock Exchange to temporarily halt trading activity, have recovered most of the lost ground by the end of the week. Peruvian equities have gained 52% (in USD terms) over the past 12 months. Please note that Peru has also been influenced by a bearish trend affecting US and Brazilian stock markets over the past month. Peru decoupled from the regional trend in mid March, but recovered consistently since last Tuesday.

Sovereign Debt and Credit Ratings — The five-year sovereign credit default swap (CDS) for Peru is priced at 142 basis points (bps) today, reflecting an improved perception of risk from Friday's close. This implies, at present, a high degree of comfort by foreign "fixed-income" debt holders. Peru is an "investment-grade rated" country. Credit rating agencies have not issued any official communiqué since the elections. At present, all three major rating agencies hold a "positive" outlook on Peru's sovereign credit ratings.

Policy Environment — It is premature to assess the impact of Ollanta Humala's victory, despite ideological statements made during the campaign period. In initial public statements, President-elect Humala stressed that he will seek to lead a coalition government to deepen integration within Latin America. He also said that he will maintain what is working well and fight corruption by all means. Looking ahead, the make-up of the cabinet when the government is sworn in late July is likely to be a market-sensitive event.

The government transfer team that President-elect Humala has put together is dominated by intellectuals, many of whom participated in some capacity in the government of former President Alejandro Toledo. Prominent among them are Kurt Burneo, who was a Vice-Minister of Treasury under Kuczynski in the Ministry of Finance. Oscar Dancourt and Daniel Schydrowsky were both members of the Board of Directors of the central bank, with Dancourt holding the position of interim president of the Board in 2005-2006. Three other members of the transfer team were cabinet members in previous governments.

The Humala government will inherit Peru's strong macroeconomic fundamentals, and has signaled its intention to protect this legacy and in general terms to stay the pro-market policy course. At the same time, GP has generated immense expectations, which are likely to translate quickly into public demands, some of which may require populist measures to appease, and most of which will put pressure on fiscal resources. The business community is giving GP the benefit of the doubt, but remains in a wait-and-see mode. This suggests that private investment should still grow, although at a slower pace than recently.

Guillermo Arbe (511) 211-6052
guillermo.arbe@scotiabank.com.pe

Pablo Bréard (416) 862-3876
pablo_breard@scotiacapital.com

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Macroeconomic Trends — Real GDP expanded by 8.8% in 2010 (and also by 8.8% y/y in Q1 2011). The government estimates that the Peruvian economy will expand by 6.5% this year. Consumer prices increased by 3.1% y/y in May, a deceleration from 3.4% in April, but a steady increase from the 0.7% rate recorded in April 2010. The central bank policy rate is currently set at 4.25%, representing a 300 bps cumulative hike since April 2010.

The main fiscal concern is the scope of future social programs. It is well known that the new government plans to expand social programs aggressively, as well as broaden the reach of public sector pensions. The Humala government will need to balance its ambitious social agenda with the fiscal resources available. Given the current fiscal surplus and savings, together with the expected growth trend of fiscal resources, the GP government really only needs to adjust the rate of increase in spending on social programs to the accelerated pace of revenue growth ensuring fiscal and overall macro stability.

GP is also contemplating raising taxes. The potential for doing so without affecting long-term GDP and fiscal revenue growth is likely to be tested. The fiscal starting point is strong, however, although somewhat misleading. In July, the public surplus is likely to be 3% of GDP or greater. However, given that the bulk of government revenue occurs in the first half of the year, whereas spending is heaviest in the second semester, this should translate into a slim positive balance for the full year. Nonetheless, it is still a comfortable fiscal position for the new government.

The monetary regime will suffer no major alterations. The new leadership of the Central Bank, to be elected in the second half of the year, will maintain the current inflation-targeting policy. However, GP members are more likely to pursue an exchange rate policy with an eye on stimulating exports and domestic business. The central bank typically uses both the reference rate and reserve requirements as broad instruments of monetary policy, whereas GP members would likely focus more on reference rates.

Mining Sector Outlook — Due to high metal prices, mining has been a major beneficiary of the investment wave that has driven growth over the past six years. Assuming metal prices do not collapse, mining investment over the next five years will hinge on two things: government tax treatment of mining companies, and the way which the State confronts social conflicts.

GP may implement a windfall tax on mines. However, it is not exactly clear what the structure and magnitude of the tax would be. Over time, the proposal has migrated towards something similar to the *regalías* tax in Chile, which is levied on increases in operating margins. Importantly, this tax would require congressional approval. Some sort of tax is likely, although the approval process may limit its magnitude, given that there is clearly an awareness that too high a tax might affect investment.

Social conflicts concerning mining have been frequent in the past decade, and will be an issue that the next government will face almost immediately. GP purportedly has closer ties with some of the movements behind the protests, which could help the government manage better them. On the other hand, with increased social expectations, the risk of disappointment is also high, which could pose a problem. In any event, GP's expertise in managing protests will be tested very quickly.

Institutional Environment — At this point, it seems clear that the new government is very unlikely to affect Peru's democracy and institutional framework. The signals being sent on the economic front have, so far, also been more comforting than not. Following the elections, GP spokespeople have continued to convey the campaign message that they plan to uphold the market economy, promote private investment and honour property rights. Key phrases being stressed include "building bridges", "reconciliation" and "seeking consensus".

Guillermo Arbe (511) 211-6052
guillermo.arbe@scotiabank.com.pe

Pablo Bréard (416) 862-3876
pablo_breard@scotiacapital.com

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The overall make-up of Congress is, however, helpful in preventing radical measures. GP holds 47 seats out of a total of 130 (36%) in Congress. They have an agreement with Perú Posible (Toledo) which would conceivably add 21 votes (16%), allowing them to reach a 52% majority. However, this alliance is only sustainable over time if GP remains moderate. Furthermore, Perú Posible is not likely to vote in block form, given its weak party structure, so this relative majority is far from reliable, even with regards to relatively non-controversial issues.

GP's intention to broaden the role of the State is perhaps its main divergence from the economic policy of the last 20 years in Peru. Specifically, the GP government is likely to seek greater market regulation and supervision and to give greater freedom for State enterprises to participate in economic activities. This does not imply expropriations, nor would it put property rights at risk, but it could affect private enterprises in certain sectors of the economy, including finance and natural resources, through competition for resources and clients or other forms of crowding out, or by affecting revenue streams through pricing.

Humala's moderation appears to be part of a strategy to seek a broader basis of support and, thereby, ensure a viable government and a workable economic policy. In particular, Humala is making a concerted effort to reach out to the business community, in tacit acknowledgement that he needs business to continue investing to ensure growth and a viable government. The fact that Ollanta Humala and Gana Perú have had to adapt their plans to the demands of society suggests how difficult it would be to impose any radical agenda in the near term.

Finally, President-elect Humala has initiated an ambitious South American tour, choosing Brazil as the first country to visit. Brazil will become a key strategic partner in economic, financial and diplomatic terms. Regional (Latin American) integration, the fight against narco-terrorism and corruption (in close cooperation with the US), and an ambitious infrastructure development program (where the energy sector will play a prominent role) lead us to anticipate a period of close relations between Peru and other key South American economies.

Karen Cordes Woods (416) 862-3080
karen_woods@scotiacapital.com

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

“Crowding Out” Evidence Remains Weak

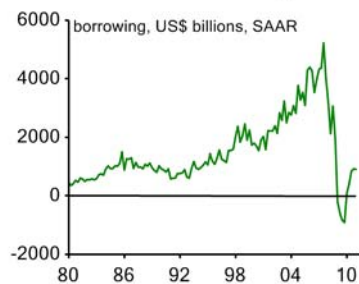
- **Low Treasury yields still supported, but with slightly less conviction.**

While demand and supply dynamics still generally remain supportive of the Treasury market, they are slightly softening as evidenced from within the Fed’s Q1 flow of funds accounts. The near-term market focus is upon a soft spot for US growth, but paying attention to any shifting credit flows is important for a longer-run Treasury view.

We have tended to argue that “crowding in” is the better interpretation of what’s happening in credit markets by way of government issuance filling in the void left by soft private issuance, as opposed to “crowding out” whereby large government issuance puts upward pressure on yields. We remain of that view, but our conviction has softened somewhat. Despite a surge in federal government borrowing coming out of the first stages of the crisis, overall credit balances across the combined public and private sectors have increased only marginally over recent quarters (chart 1). This is what deleveraging is all about, as “crowding IN” has been strongly evident because all-government issuance (chart 2) is filling the void behind soft but firming private sector issuance. Note, however, that government issuance has softened of late and this may help explain recent low yields. Within the private sector, household borrowing flows remain exceptionally weak (chart 3), and this would be weaker yet if not for the fact that the only category of consumer loans that is materially rising is student loans. Also, nonfinancial business borrowing has accelerated but the mixture (chart 4) points to corporate bond issuance as being the only area of strength against ongoing weakness in net equity issuance, commercial paper, and intermediated loans. This reflects corporate debt extension and a capital structure shift at record-low bond yields.

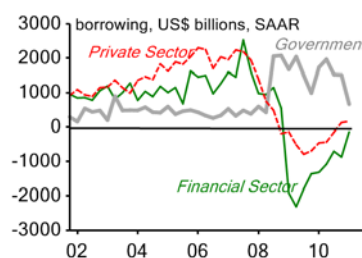
That’s the demand side for loanable funds in the broad US economy. The supply side is important and reflects the willingness of savers to supply capital to the Treasury market. China’s Treasury holdings have diminished slightly since late last year. Also important is that the US household sector has recently reversed its holdings of overall fixed income instruments (chart 5). The overall bottom line is that a still-soft but slowly turning private credit recovery and recently weakened government issuance still support low yields. However, once the debt ceiling impasse lifts such that government issuance picks up, and should private credit turn further upward, Treasuries may well encounter a household sector that is less and less willing to pump savings into credit. We are not there as yet.

Chart 1 Total Net Borrowing



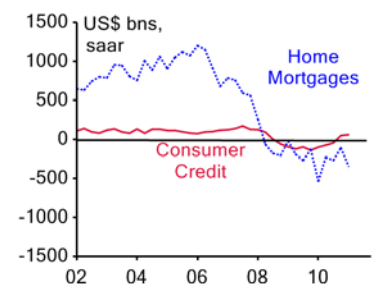
Source: Federal Reserve Flow of Funds Accounts, Scotia Capital Economics

Chart 2 Government Sector Crowding In



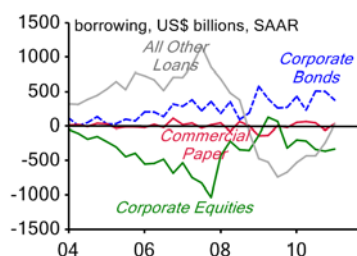
Source: Federal Reserve Flow of Funds Accounts, Scotia Capital Economics

Chart 3 Household Borrowing



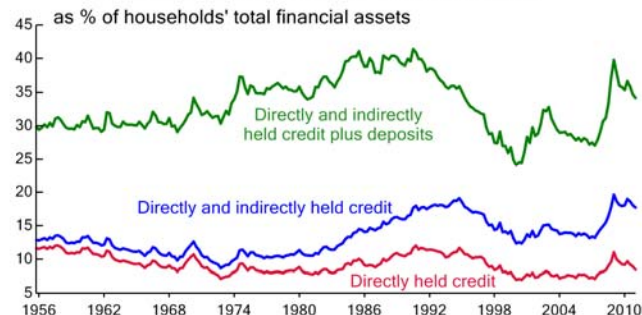
Source: Federal Reserve Flow of Funds Accounts, Scotia Capital Economics

Chart 4 Nonfinancial Business Issuance



Source: Federal Reserve Flow of Funds Accounts, Scotia Capital Economics

Chart 5 Fixed Income Holdings of US Households



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

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

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

Canadian Corporate Tax Reform — A Further Issue

- The final stages of Canada's current corporate tax reforms suggest a further adjustment.

Canada's substantial corporate tax reform over the past half decade has extended beyond high profile changes, such as harmonizing a provincial sales tax or reducing general and small business statutory corporate income tax (CIT) rates, to less visible adjustments, including eliminating non-financial corporate capital taxes and more closely matching capital cost allowances to the economic depreciation rate. Persisting through the downturn and subsequent recovery, CIT rate cuts from December 2010 to July 2011 include two Provinces dropping their small business rates and three Provinces plus Ottawa lowering their general rates (*top two charts*). Given corporate capital's documented mobility and CIT rates trending lower around the world, Canada's declining CIT rates are adding to national competitiveness.

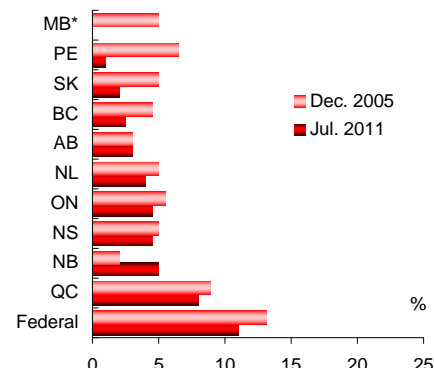
Pacing general CIT rate cuts are drops in small business CIT rates to zero in Manitoba as of December 1, 2010, and to very low levels in PEI, Saskatchewan, British Columbia and Alberta. Yet even though CIT rates have shifted lower, the difference between general and small business CIT rates, federally and across the Provinces, remains substantial (*bottom chart*), hampering a small business's expansion. As of July 2011, this gap will be 10 percentage points or wider in five Provinces and 7-7½ percentage points in another three Provinces. In the recent past, only Quebec has made these two CIT rates equal, and the present spread is almost four percentage points. The result is a steeply rising marginal tax rate for active business income above the designated threshold for the small business deduction. While the small business income threshold has been shifted higher, from \$200,000 across the board in the late 1990s to \$500,000 currently for Ottawa and nine Provinces, this simply pushes out the steep marginal tax adjustment to a higher business income level. The hurdle to small business expansion posed by this CIT rate structure is reinforced by the favourable small business treatment offered in other aspects of the tax system such as the Research and Development Tax Credit and equity tax credits for investors in small businesses.

A partial solution to constrain the CIT challenge for small business expansion is a tiered CIT rate, rising in several steps with active business income. Other remedies could focus on lowering a firm's expansion costs. In this vein, the University of Calgary¹ suggests a capital gains incentive for small businesses going public, a decrease in the lock-in effect of capital gains taxes for small business owners or 100% expensing of annual capital investments to a certain limit. The difficulties facing a smaller business expanding into export markets beyond the U.S. also could be recognized. The costs of these adjustments, possibly covered by eliminating lower priority subsidies and credits, might be quite quickly recouped with a lower barrier to business expansion.

¹ D. Chen and J. Mintz, *Small Business Taxation*, University of Calgary, May, 2011.

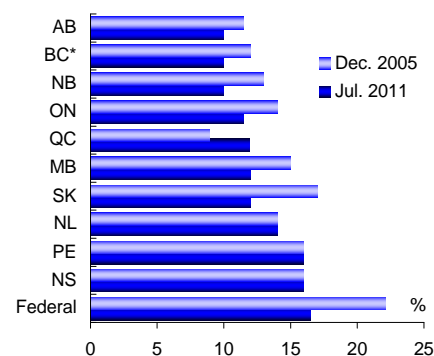
Canadian Corporate Income Tax

Small Business Rates



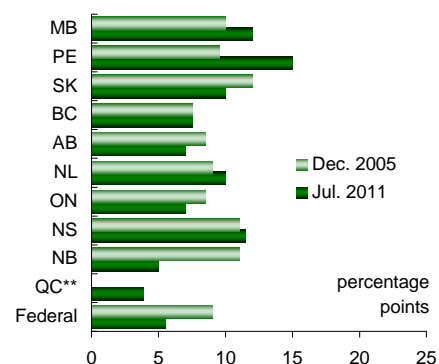
* MB: 0% rate as of Dec. 2010.

General Rates



* If BC retains an HST after its referendum, its general CIT rate will rise to 12% on Jan. 1, 2012, and the slated drop in its small business CIT rate to 0% on Apr. 1, 2012, will be indefinitely deferred.

Difference: General versus Small Business Rates*



* Some narrowing will result from scheduled general rate declines such as Ottawa's 15% general CIT rate as of Jan. 2012. ** QC: zero difference in Dec. 2005.

Source for charts: Budget documents; University of Calgary, The School of Public Policy¹.

Tuuli McCully (416) 863-2859
tuuli_mccully@scotiacapital.com

Poland Enjoys Broadly-Based Economic Recovery; Hungary Supported by Export-Oriented Peers

- The external sector continues to drive the economic recovery in Central and Eastern Europe, with Poland being differentiated from its peers by strong domestic demand.

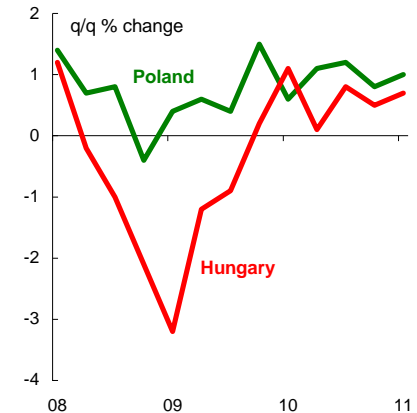
The **Polish** economic outlook is promising. In addition to benefiting from its close ties with Germany, Poland's robust domestic demand conditions are pointing towards broadly-based economic momentum through 2012. Compared with its regional peers, the country is less dependent on its export sector as the engine of growth, making its economy less vulnerable to fluctuations in global demand. Indeed, solid private consumption and investment supported Poland's real GDP growth in the first quarter of 2011, with output advancing by 1.0% q/q (4.4% y/y) compared to a 0.8% q/q (4.5% y/y) rate recorded in the final quarter of 2010. We expect Poland's output to expand by 4¼% in 2011 and 2012.

Polish inflationary pressures are building. Consumer price inflation picked up to 4.5% y/y in April from 4.3% the month before, continuing to exceed the central bank's 2.5% target by a wide margin. While higher global energy prices are partly responsible for the persistent inflationary pressures, prices at the core level are intensifying as well. We expect headline CPI growth to close the year at 3¾%, and to continue to subside to 3% by the end of 2012. In the context of a robust economic outlook, elevated inflation, and significant growth in employment that may raise the risk of intensifying wage pressure, Polish monetary authorities again tightened monetary conditions following the June 7-8th Monetary Policy Council meeting. The reference rate was increased by 25 basis points to 4.50%, marking the third hike since the beginning of the year. We expect that the policymakers will refrain from further tightening in the coming months.

In **Hungary**, economic expansion is supported by strong external demand, while domestic demand remains weak. Consumer spending prospects are limited by high household indebtedness and ongoing balance sheet adjustments. Furthermore, public spending will continue to be constrained by austerity measures as Hungary remains in fiscal consolidation mode. Real GDP expanded by 0.7% q/q (2.5% y/y) in the first quarter of the year, accelerating from the 0.5% q/q (1.9% y/y) pace recorded in the final quarter of 2010. We expect the country's output to grow by 2½% this year and to accelerate to 3% in 2012 as the recovery becomes more broadly-based.

Inflationary pressures are intensifying on the back of elevated commodity prices with the headline inflation rate accelerating to 4.7% y/y in April from 4.5% the month before. Nevertheless, still-weak domestic demand and weak employment conditions (the unemployment rate was 11.4% in April) should alleviate any demand-driven pressure on prices. We expect inflation to close the year at 4.5% y/y, before easing towards the central bank's 3.0% target by the end of 2012. Hungarian monetary authorities will remain on the sidelines in the coming months. Following the May 16th Monetary Council meeting, the benchmark interest rate was left unchanged at 6.0% for the fifth consecutive month.

Poland & Hungary Real GDP Growth



Source: Bloomberg.

Gorica Djerić (416) 866-4214
gorica_djeric@scotiacapital.com

Real Interest Rates and the Economy: It's Different This Time

- The relationship between real interest rates and the economy reveals structural changes in the post-1990s period, and the impact of the liquidity trap in the current environment.

The US economy advanced at a sluggish annualized rate of 1.8% q/q in the first three months of the year. Recent data — including consumption, production and employment — point to the soft patch extending into the second quarter, raising concerns that the recovery that started nearly two years ago may be losing traction. With the QE2 scheduled to end this month, and the US government under pressure to tackle fiscal consolidation, hotly debated topics focus on the relative efficacy and co-ordination of monetary and fiscal policy, the optimal mix of policies for economic stabilization going forward and the existence of a trade-off between unemployment and inflation. The relationship between real interest rates and GDP — particularly in the post-1990 period — may shed further light on the current discussion.

Real interest rates, interest rates adjusted for inflation, reflect the real cost to the borrower, and thus signal the market's expectations for future growth. We measure short-term real interest rates by taking the difference between the three-month Treasury bill yield and the lagged annual rate of inflation. Since we are calculating ex-post rates — for the purposes of this article there is not a significant difference between ex-post and ex-ante rates (see chart 1) — we use the PCE deflator, the Fed's preferred barometer of inflation. By this measure, short-term real interest rates have been in negative territory since late 2009, reflecting accommodative monetary policy (low demand for money) and, recently, rising inflation.

Through a multiplier effect, lower real interest rates increase overall domestic demand, helping an economy recover from a recession. The logic is such that, in times of economic downturns, lower real interest rates would act to stimulate business investment by reducing financing cost, boosting demand for equities and reviving household spending, particularly demand for durable goods. Ideally, the transmission mechanism should be stable, or at least predictable. However, some controversy exists involving the effectiveness of such a policy, the time lag associated with it and the need to determine more optimized co-ordination with unconventional monetary policy tools and fiscal incentives.

GDP growth appears to track real interest rates relatively closely, at least directionally, but there seems to be a structural break beginning in the early 1990s (see chart 2). The correlation between the two series appears to be positive, and notably stronger from 1963 through 1990 than from 1990s onward. In fact, the relationship in the latter period seems to be inverse, with a lag in GDP of up to three quarters, more pronounced during downturns (2001, 2008-2009). It appears that up to the early 1990s, periods of stronger growth on average either coincided with or followed high rather than low real interest rates. The same goes for key macroeconomic variables — including employment, consumer credit, consumption and investment — and applies to both short-term (3-month) and long-term (10-year) interest rates. Some studies have argued that, in the context of the aggregate supply & demand framework, this relationship can be explained through growth in the aggregate demand curve rather than movement along the existing curve in search of re-establishing equilibrium.

Chart 1

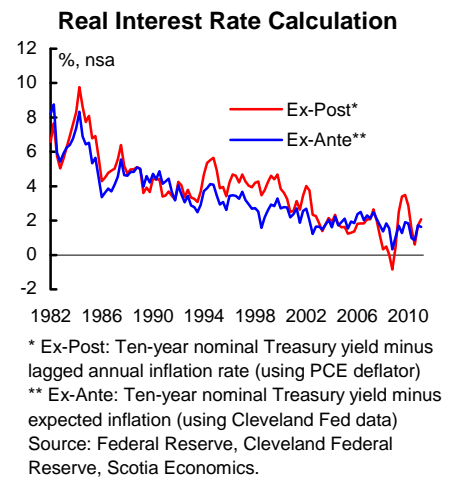
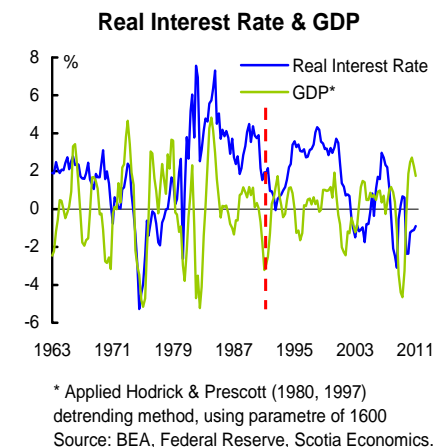


Chart 2



Gorica Djerić (416) 866-4214
gorica_djeric@scotiacapital.com

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In the post-1990s period, while some of the key drivers of growth (private-sector hiring, consumption) continued to move in sync with the real interest rates (see chart 3) — comparable to pre-1990s — headline GDP growth now seemed to follow more of an inverse relationship (see chart 2). A number of factors may have influenced the relationship between real interest rates and the economy, including changes to the monetary policy framework, globalization and innovation.

The United States benefited from an improvement in the monetary policy framework. The Fed moved to a more transparent, credible and accountable approach — in part through the adoption of inflation targeting — to better manage inflation expectations and help reduce the uncertainty over future monetary policy. Stepped-up globalization boosted and diversified exports and capital flows — US exports to Europe have expanded six-fold since the mid-1980s, and now represent nearly 20% of overall exports. In the case of China, that slice has surged from a negligible 0.2% to nearly 10% over the same period. Add to this the multitude of positive technology shocks, which led to the US productivity boom that became pronounced in the second half of the 1990s. Though financial innovation contributed to the credit excesses that triggered the current downturn, it also helped reduce consumption volatility, eradicated the traditional boundaries between commercial banking and capital markets — improving financial intermediation — and lowered the cost of capital.

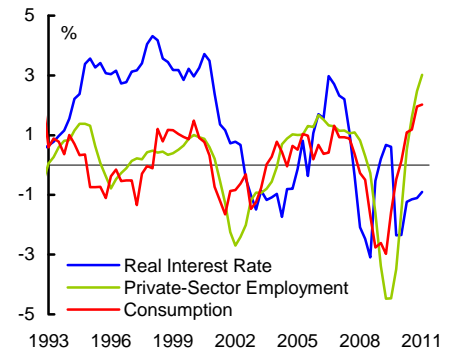
That said, the story is a bit different for the current downturn. While GDP growth and real interest rates have followed an inverse relationship — in line with the post-1990s trend — key macro variables, such as private-sector hiring and consumption have deviated from the historical trend (see chart 3), also adopting more of an inverse relationship. This divergence can be in part explained through the ongoing liquidity trap. If households continue to focus on getting their fiscal house in order, and businesses and financial institutions remain cautious, despite solid profit margins and high cash reserves, the effectiveness of a loose monetary policy is reduced, especially in conventional terms. It is not the high cost of borrowing that is holding the economy back — demand for money needs to improve.

In the past, there have been periods (1970s, 1980s, 2002-2005) where negative real interest rates have persisted for an extended period of time. The longest such period occurred in the 1970s (see chart 2) — during the oil crisis — when real interest rates remained in negative territory over a period of 17 quarters, and the economy started picking up with a two-quarter lag. So far, short-term real interest rates have stayed below the zero mark since late 2009 — for 11 of the last 14 quarters. However, it is important to note that the two recessions are hard to compare. The 1970s oil crisis took place in a structurally different environment (pre-1990s), and its primary cause was a supply shock, rather than demand factors, that led to dramatic increases in commodity prices. That leaves the 2002-2005 period, also very different from the current cycle. Real rates remained negative for 13 quarters, as the then Fed Chairman, Alan Greenspan, tried to limit the damage caused by the bursting of the tech bubble in 2001.

The ongoing restructuring of household balance sheets continues to keep money demand and velocity depressed. While we maintain the view that QE3 is unlikely — and that the Fed will keep benchmark rates on hold until at least early next year — should the current soft patch become more entrenched, the White House and the Fed will not stay on the sidelines. One option may be to target the housing market, through the use of the Fed's balance sheet and/or by having the Administration moderate the massive liquidation of foreclosed homes that have accumulated over the course of the downturn at the GSEs, Fannie and Freddie, which is keeping housing prices depressed.

Chart 3

Real Rates & Key Macro Variables



* Applied Hodrick & Prescott (1980, 1997) detrending method, using parameter of 1600
 Source: BEA, Federal Reserve, Scotia Economics.

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

Lessons for Greece from Emerging Markets

The most recent defaults by a developed country were those of Germany and Austria occurring around the start of World War II. As a result, much of what we know today about sovereign defaults comes from the more recent experience of developing countries. We have been following distressed and defaulted bonds of emerging markets for many years, and thought we would share some of the relevant lessons for those trying to understand the situation in Greece.

As European policymakers desperately seek to avoid a default under any circumstances, perhaps the most important lesson from emerging markets is that defaults are actually quite common. S&P records 15 different foreign currency defaults by emerging markets governments since 1999. These defaults do not happen so often as to make investments in emerging market debt unprofitable—it is just the opposite in fact, since emerging market debt tends to price too much default risk premia. Nevertheless, they happen often enough that emerging market investors are accustomed to thinking about default risk. Interestingly, the European debt market used to be similar. One comprehensive academic study notes that, prior to the 20th century, defaults even among developed countries were quite common. Remarkably, Greece spent 51% of the years since 1800 in default.

Based on the more recent history, economists have been able to study the costs of default. The surprising result from much of the academic research is that default in itself is not particularly costly. Usually GDP drops prior to, and perhaps in anticipation of the default, and then recovers afterwards. There is however, evidence of a political cost. Ruling coalitions lost post-default votes in 18 out of 19 cases, providing one reason why politicians often try to delay the default decision and may in effect prolong the crisis. In certain cases, most recently that of Argentina, the devaluation and inflation that accompanied the default caused significant hardship by eroding the value of people's savings, damage that Greece could avoid if it maintains the Euro as its currency. With an economic contraction of 4.8% in the first quarter of 2011, Greece is clearly feeling the pre-default costs already. We wonder whether delaying the default actually increases rather than decreases the economic costs to Greece, especially once we take into account the effect of the fiscal austerity measures.

The impact of default on future market access for Greece is another concern for some. Of course EM countries typically have no market access during a default, but with Greek debt trading at around \$60 on secondary markets, Greece has already effectively lost access to new financing from the private sector. Markets tend to have a short memory, and most studies of the reputational effects of default on the future costs of financing find very small effects. Consider the case of Jamaica, the most recent default we looked at. Jamaica restructured its debt in early 2010 by reducing the coupon on some local debt; it did not decrease the face value of its debt, leaving its debt burden far over 100% of GDP. Nevertheless, Jamaican international bonds are currently trading at low yields of 6% to 8%, probably because it has an IMF program and because many of the internationally-issued bonds are owned by Jamaican financial institutions.

Of course policymakers worry not just about the effects of a default on Greece, but rather the potential spillover to other countries. In recent years, news about problems in Greece has led investors to question the viability of other Eurozone members. The aftermath of the collapse of Lehman Brothers is another widely cited example of how interconnected and interdependent markets are. While the experience of emerging markets here suggests some concern is justified, it is not the case that contagion is inevitable, that markets will always act irrationally, or that market participants are unable to distinguish credit risks.

We saw a large amount of contagion during Russia's default in 1998, but none in the Argentine default or other subsequent defaults. Notably, the Russian default of 1998 led to a significant sell-off in the bonds of most Latin American countries, despite the lack of fundamental links between Russia and Latin America. A commonly cited channel for contagion was that large Russia-related losses posted by emerging market

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investment funds led to customer withdrawals; as a result, the funds were forced to sell their non-Russia investments. An alternate channel may have been that the Russian crisis demonstrated to investors that the multilateral community cannot be relied upon to save the day. Russia defaulted shortly after signing an IMF program, which bears surprising resemblance to the situation in Greece today. In contrast, the Argentine default did not cause a sell-off in other countries, despite the fact that they also received IMF money. Perhaps, there was less of a reaction because the Argentine default was more widely anticipated. In late 2008, Ecuador defaulted on its debt not because it didn't have enough money to pay but because it decided much of its debt was illegitimate and immoral. Bondholders offered little resistance, with 91% agreeing to sell Ecuador back its bonds at 35 cents on the dollar. We worried at the time that Ecuador's success would demonstrate to other renegade debtors how easy it is to take advantage of the lack of sufficient protections in sovereign debt contracts. No country followed suit, however, and bond prices of other countries were unaffected.

The history of emerging market defaults also provides some guidance with regards to how to restructure. Perhaps most surprising is how cooperative creditors can be once they realize that they will not be bailed out. Theory suggests that, in the absence of a formal bankruptcy scheme, sovereign restructurings should be difficult since every creditor has an incentive to become a "hold-out"—if all other creditors agree to a restructuring, the debtor will be financially able to pay the "hold-out" in full. In practice, with the exception of a few investment funds who specialize in the litigation of sovereign debt claims, creditors are generally amenable to restructurings if they are negotiated in good faith. The recent example of Belize's restructuring in 2007 comes to mind. By working closely with over 40 separate creditors in multiple rounds of consultations, they were able to make a credible case about their upcoming repayment difficulties. They also enlisted multilateral and bilateral support, both to back up their claims and provide financing. 97% of creditors voluntarily tendered their bonds into the exchange and no lawsuits were filed against Belize. The Jamaican restructuring also had wide scale acceptance, thanks to appeals to patriotism to local bondholders, accompanied by implicit threats regarding the old bonds. In both of these cases, restructuring was more palatable because no reduction in face value was requested, merely an extension of maturities or a reduction in coupons. To the extent that European officials insist that Greece simply needs more time to pay, EM history suggests that a maturity extension can be easily achieved.

Why are creditors so accommodative? The reason in part is institutional, since organizations whose business necessitates a diversified portfolio of liquid bonds are not set up to hold distressed and illiquid bonds, and to pursue lengthy litigation against the issuers of those bonds. But perhaps more important are the legal reasons. In six years of litigation, hold-out creditors to the Argentine restructuring, upset over Argentina's draconian haircut of 65% despite an ability to pay more, obtained very little relief in a series of lawsuits against Argentina in New York federal court. Since 90% of Greek debt was issued under Greek law—unlike most globally traded emerging market bonds which are issued under NY law—we can only assume that a foreign investor suing the Greek government in a Greek court would have an ever more difficult time than Argentina's creditors. In fact, Greece could change the law governing those bonds in order to make its restructuring even easier.

Thus, our perspective from emerging markets investing with regards to a Greek default, can be summarized as "just get it over with." Critics would of course point to two differences between past emerging markets defaults and the Greek situation today. First, Greece is a member of a currency union which must protect its reputation. Second, the global economy has not yet fully recovered from the financial crisis and cannot handle another disruption. Each of these concerns raises complex questions which are beyond the scope of this article. Nevertheless, we offer the following initial responses. Defaults or potential defaults by individual US municipalities have not threatened the viability of the dollar. We are not sure if the euro would suffer

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

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more from a Greek default or from the repeated use of European government resources to bail out Greece. More importantly, the damage to the currency union, to the value of Greek bonds holding, and to global markets in general has already been done. The discussion today often seems to center not on the economic impacts but on how to more favorably account for those impacts. How can we ensure that a Greek restructuring is not called a “default” seems a frequent question. Perhaps we are biased by the nature of the emerging market bond business with its emphasis on mark-to-market, but we do not think that markets can be fooled so easily. Surely Greece does not think of itself as an emerging market, but judging by the highly inverted yield curve and low bond ratings, it already is one as far as financial markets are concerned, and the same economics should apply.

¹ Carmen Reinhart and Kenneth Rogoff, “This Time is Different: A Panoramic View of Eight Centuries of Financial Crises,” NBER Working paper, April 16, 2008.

² Eduardo Levy-Yeyati and U. Panizza (2007). “The elusive costs of sovereign defaults,” IBD Working Paper No. 581 and CIF Working Paper No. 11/2006.

³ E. Borenzstein and U. Panizza, “The costs of sovereign default,” IMF Working Paper No. 08/238, 2008.

⁴ We provide some graphs on contagion in Joe Kogan and Eduardo Levy-Yeyati, “Contagion from Ecuador – Repricing the cost of default,” Barclays Capital, November 21, 2008.

Alan Clarke (44 207) 826-5986
alan_clarke@scotiacapital.com

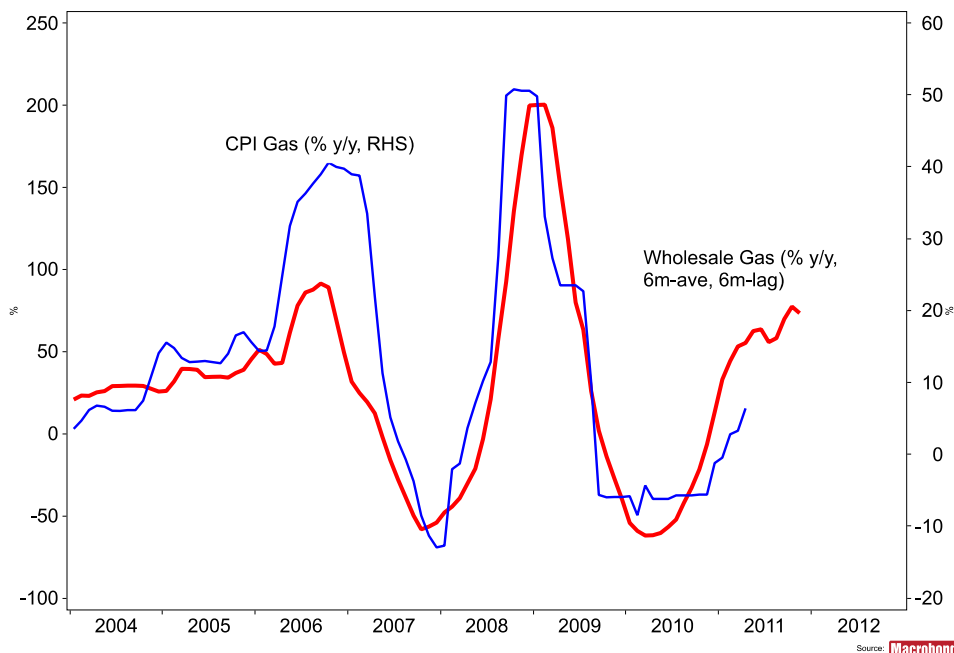
U.K. — Utility Bill Increases

- For some time we have been expecting the major UK utility companies to announce price hikes — passing on the surge in wholesale gas prices. Last week the inevitable was confirmed as the first major supplier announced price hikes. We expect this to be the first of several and it will contribute to inflation accelerating to over 5%/y/y later this year. However, since the BoE had anticipated this news, it should not have any impact on monetary policy.

Confirming the inevitable

We have been expecting utility bill hikes to be announced for some time given the path of wholesale gas prices (Chart 1). This week we had the first company, Scottish Power, bite the bullet and raise its prices. From August, its gas prices will rise by 19% and electricity by 10%.

Chart 1



Although Scottish power is relatively small (9% of the gas market and 13% electricity) past price hiking and cutting cycles have tended to see herding by most of the key utility providers once the first mover has announced a price change.

This latest price hike (which follows a near 10% increase at the end of last year) has been well anticipated. The BoE flagged in the May Inflation Report that it assumed a 15% gas price hike and 10% electricity price hike. Our own inflation profile also assumed a 10-15% price hike, though a little later than August given the typical clustering of past price hikes around the autumn. So this announcement is broadly in line with expectations, if fractionally higher.

Given this, the peak in our inflation forecast or indeed that of the BoE's shouldn't change much, if at all, though timing may be tweaked slightly earlier. This announcement and the presumption that other utility providers will follow suit merely validates what the BoE had already assumed.

We checked with the Office for National Statistics (ONS) with regards to when this increase will enter the CPI and it confirmed that it will be when the price hike becomes effective for customers — i.e. August.

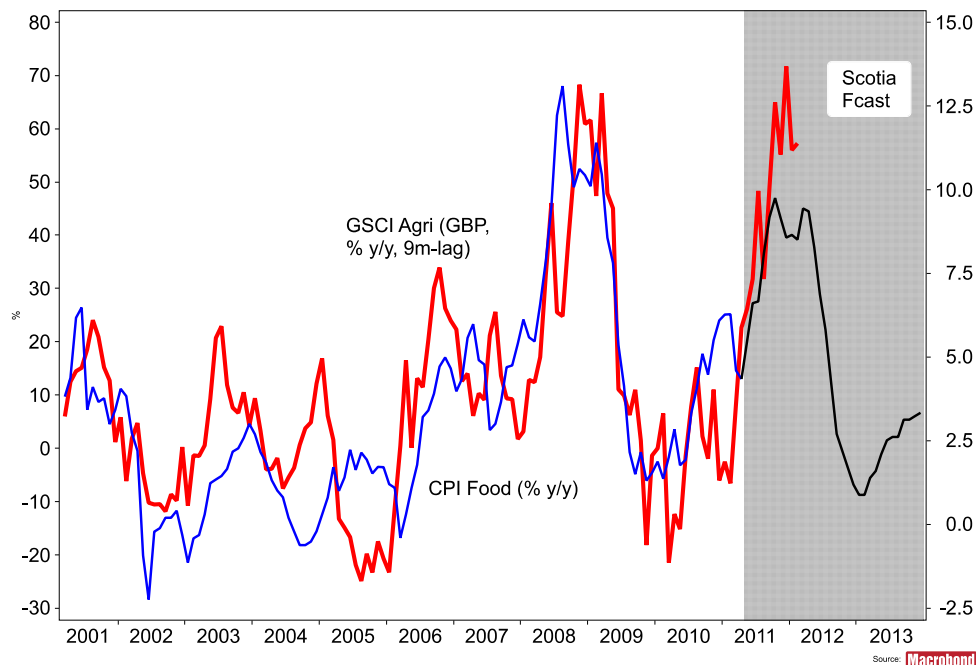
Alan Clarke (44 207) 826-5986
alan_clarke@scotiacapital.com

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We expect that the peak in CPI inflation will be around 5¼ - a little above the BoEs forecast. The main swing factors that could influence that forecast are food and clothing. More specifically, there was a story on the front of the FT this week that talked about the price of wool doubling. Moreover the CPI component for clothing has not fully caught up with the jump in the price of cotton. We have assumed some acceleration from this component but the risk is slightly to the upside.

With regards to food, the last two months have seen surprisingly subdued food price inflation. The attached chart shows that given the surge in agricultural commodity prices over the last year, food price inflation should be expected to at least double from around 4½% now to closer to 10% y/y or even higher (Chart 2). Depending on the extent of the acceleration in food, we could see the peak in CPI inflation as high as to 5.5% y/y.

Chart 2



The Bottom Line

The bottom line is that the inevitable has happened and the first of several utility price hikes has been announced. In so much as the BoE had assumed this would happen, this should not have any implications for monetary policy. The Bank's recent line has been to play down inflation that is caused by components out of its control — rightly or wrongly. In the Bank's defense, the jump in utility bills represents a squeeze on household disposable incomes. That has shown clear evidence of hurting consumer sentiment and in turn consumer spending growth in the last quarter or so. Hiking rates now would merely compound the misery and hurt growth — which has been zero on average over the last 6 months.

The flipside is that if, as highlighted above, inflation gets to 5 1/2 (or dare I say even higher), if that provokes higher wages or inflation expectations then it could provoke a monetary policy response. So far the bank has been pretty relaxed about the inflation expectations numbers and wage inflation has been subdued. This week's inflation expectations survey from the BoE/NOP showed a fall in inflation expectations, which should reassure even the more hawkish members of the committee. It is looking increasingly likely that the bank will continue to look through the peak in inflation and resist calls for higher interest rates.

Alan Clarke (44 207) 826-5986
alan_clarke@scotiacapital.com

ECB Rate Hike in the Pipeline for July

- **The ECB president flagged an interest rate hike at the July governing council meeting — as widely expected. Upward adjustments to the ECB staff projections for GDP and inflation support the case for an imminent interest rate hike. We believe that the ECB's inflation projection for 2011 is still too low in our view and a subsequent upward revision in three months' time will lay the ground for a further interest rate hike — most likely in October.**

As widely expected, the ECB left the refi rate unchanged at 1.25% at the June meeting. However, upward revisions to the ECB staff macroeconomic projections coupled with the traditional code of “strong vigilance” means that a 25bp rate hike is highly likely at the next meeting in July. Other developments at the press conference included that exit from non-standard measures will be postponed with full liquidity allotment for the coming three months.

The tone of the President's statement still suggests that removing accommodative monetary stance remains in the pipeline over the coming months. In addition to raising its inflation projection, the president noted that risks are still seen on the upside — we agree.

The fact that the medium term inflation (2012) forecast is below 2% should be seen as a signal that the pace of rate hikes is unlikely to be accelerated at this stage. Rather, the tempo of three monthly rate hikes appears to be the most likely scenario for now.

Regarding the fiscal situation in Greece; following the push from Germany to orchestrate a seven year extension of maturities, the ECB president stuck to the stance of wanting to avoid any debt restructuring and stuck to the ECB rule on collateral, meaning that Greek bonds will be no longer accepted in case of credit events.

Upward revisions to staff projections

The ECB staff revised up its inflation projection for 2011. It is now seen in the range of 2.5% to 2.7% (mid-point 2.6%) from 2.0% to 2.6% (mid-point 2.3%) previously. The mid-point of the range remained unchanged for 2012 at 1.7%. The upward revision for inflation during 2011 is not a surprise given the upside surprises on inflation seen since March and the ECB's surprisingly low assumption for oil prices 3 months ago.

The midpoint of the ECB's new forecast for inflation is in line with the latest consensus forecast. However, we believe that the risks lie to the upside for this year as the ECB mid-point forecast assumed that inflation passed its peak in April. Indeed, we fear that accelerating food price inflation could push inflation to a fresh high (to above 3%) by the end of the summer. For 2012, the fact that the inflation forecast has been left unchanged at 1.7% means:

1. the ECB still see current elevated level of inflation as temporary. On this point we are also more nervous as we think that there will be pass through from commodity prices into core inflation above and beyond the acceleration that we have already seen (up by around ½% point so far this year to 1.6% y/y in April).
2. it validates the prospect of a gradual removal of monetary accommodation (i.e. 25bp hike every three months). As a guide, during the previous 2005/2007 rate hike cycle, the fact that medium term inflation was seen above 2% was a strong trigger for changing the tempo from a hike every three months to a hike every two months.

Alan Clarke (44 207) 826-5986
alan_clarke@scotiacapital.com

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The ECB staff projection for GDP growth was revised up for this year. The range was nudged higher to 1.5% to 2.3% (mid-point 1.9%) from 1.3% to 2.1% (mid-point 1.7%) in order to take into account the strong Q1 outcome. For 2012, GDP growth was slightly revised down to 0.6% - 2.8% (mid-point 1.7%) from 0.8% to 2.8% (mid-point 1.8%). The risks for growth were still seen as “balanced”. It suggests quarterly growth between 0.3% and 0.5% q/q, meaning close to or slightly above traditional growth potential.

ECB Macroeconomic Projections									
Jun 2011 (latest)							Consensus (end-May)		
	2010	2011		2012		2011 mid	2012 mid	2011	2012
HICP	1.6	2.5	to 2.7	1.1 to 2.3		2.6	1.7	2.6	2.0
GDP	1.7	1.5	to 2.3	0.6 to 2.8		1.9	1.7	1.9	1.65
Mar 2011 (previous)							(based on data available to 19 Nov-10)		
	2010	2011		2012		2011 mid	2012 mid		
HICP	1.6	2.0	to 2.6	1.0 to 2.4		2.3	1.7		
GDP	1.7	1.3	to 2.1	0.8 to 2.8		1.7	1.8		
Revisions Mar-Jun									
	2010	2011		2012		2011 mid	2012 mid		
HICP	0.0	0.5	to 0.1	0.1 to -0.1		0.3	0.0		
GDP	0.0	0.2	to 0.2	-0.2 to 0.0		0.2	-0.1		

Conclusion

The shock factor from the ECB press conference was rather lacking. The smoke signals continue to point to further moderate interest rate hikes of at least a further 50bp between now and October. Although our own forecast for the peak in inflation is above that of the consensus and the ECB, we also expect a sharp decline during 2012. This plus the moderation in global growth prospects could provoke speculation of a pause in the hiking cycle once the refi rate approaches 2%. The flipside is that core inflation is likely to continue to creep higher through next year, maintaining the pressure on the governing council to continue raising rates. Our forecast is that the ECB will err on the hawkish side for now.

Sacha Tihanyi (852) 6117-6070
sacha_tihanyi@scotiacapital.com

Widening the Renminbi Trading Band

- We examine the potential for Chinese policymakers to widen the current USDCNY daily trading band from $\pm 0.5\%$.
- While a wider daily band may create scope for faster CNY appreciation, the pace is actually dependent on inter-day policymaker guidance, rather than intra-day market driven fluctuation.

Over the past few weeks there has been increased chatter in the media regarding the potential for Chinese policymakers to widen the daily exchange rate trading band for USDCNY. News pieces have quoted individuals, including advisors to the People's Bank of China and employees of the State Administration of Foreign Exchange (SAFE), in calling for further monetary tightening and exchange rate reform. The proximity of the May CPI release (June 14th) and the expectation for an increase in the pace of inflation (to 5.5% y/y from 5.3% y/y) is suggestive that the timing of the rhetoric is perhaps intentional, and thus it would not be wholly unexpected to see a policy decision regarding the USDCNY trading band in the near future.

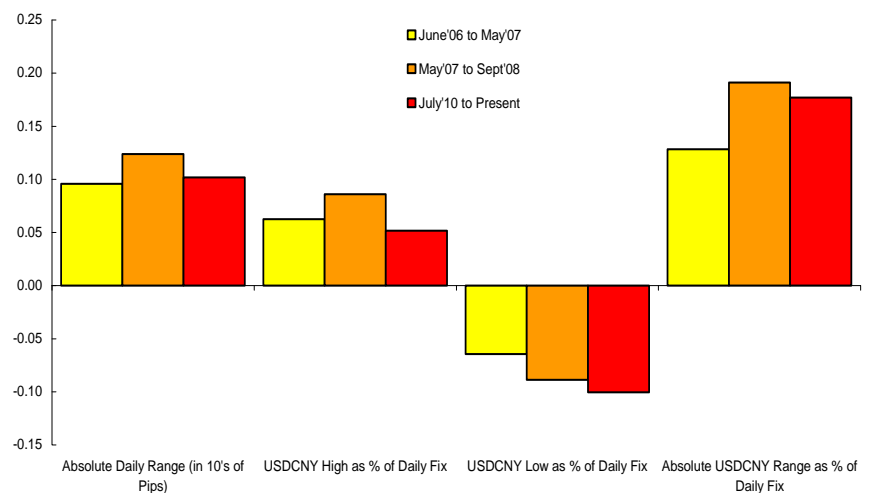
This is an event of high relevance to us and the market. A decision to increase the renminbi's flexibility via a widening of the current permitted $\pm 0.5\%$ daily fluctuation around the central parity fixing for USDCNY would be another incremental step towards the ultimate goal of full renminbi convertibility. However, from the point of view of the pace of CNY appreciation, we believe a widening in the trading band has less relevance.

Not The First Band Shift

This would not be the first time that Chinese policymakers have elected to increase the width of the daily trading band for the renminbi. On May 18, 2007 China widened the width of the trading band through which USDCNY can fluctuate around the central parity fixing to 0.5% on either side of central parity. Before that time, and since CNY was de-pegged from the USD in July of 2005, the trading band was $\pm 0.3\%$. The significance of the decision in May of 2007 was that it directly preceded the May 23 US-China Strategic Economic Dialogue, and was likely a highly politically motivated decision insofar as the timing was concerned. Our goal here is to assess whether the band widening had a direct impact on the subsequent pace of CNY appreciation, so that we may extrapolate to the current day.

Looking at the year that preceded the May 2007 decision, the average daily range in USDCNY was around 96 pips, with the average daily high coming in 0.062% above the central parity, and the average daily low coming in 0.064% below central parity (see Chart 1). This constituted an average absolute daily percentage range around the fix of just under 0.13%. As one can see from Chart 1, USDCNY was on average kept to quite a tight range around its daily parity fixing to both the upside and downside, essentially using only about 20% of the daily variation permitted for movement. Following the

Chart 1: Average Daily CNY and CNY Fix Statistics



Source: Scotia FX Strategy, SAFE, PBoC

Sacha Tihanyi (852) 6117-6070
sacha_tihanyi@scotiacapital.com

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widening of the band to $\pm 0.5\%$, the average daily range increased to 124 pips, with the average daily high in USDCNY 0.086% above central parity fixing and the daily low coming in 0.089% below the central parity fixing. Thus the absolute daily percentage variation around the central fix increased from around 0.13% to 0.19%. Interestingly, after the widening of the band, USDCNY still only (on average) varied within 20% of the possible daily range allowed. This indicates that while flexibility was increased, Chinese policymakers were no more willing to see the limits of their ranges tested relative to the $\pm 0.3\%$ band period.

However, the decision to allow additional daily flexibility in USDCNY seems to have foreshadowed a shift in the pace of CNY appreciation. In the year before the band was widened, USDCNY generally appreciated at a 4.5% y/y rate, whereas after May 18, 2007 the annualized pace of appreciation on an average trend basis was just over 8%, before USDCNY was effectively fixed again in the fall of 2008. In this way, it appears that the widening in the exchange rate band may have been a key factor in providing a more fertile environment for CNY appreciation.

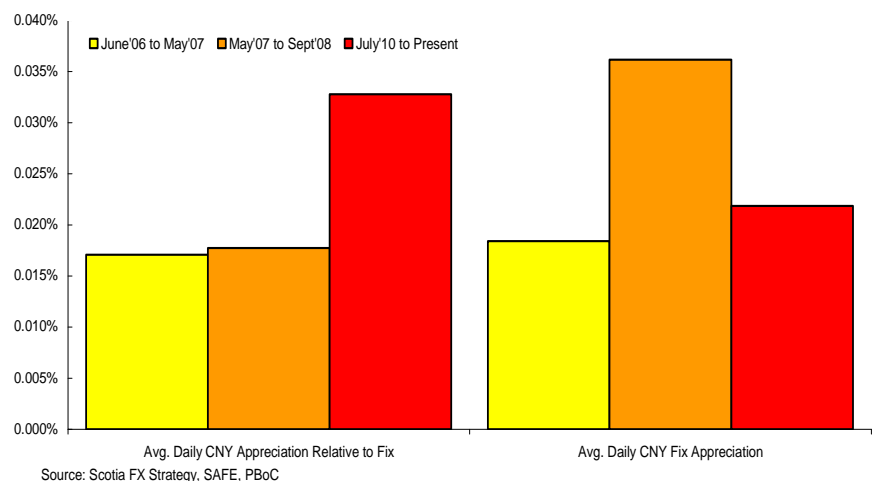
What would this imply as a precedent for today, should we see a move by policymakers to increase the trading band in USDCNY yet again? Let's consider the possibilities for a widening. The previous increment in the band was 0.2 percentage points on each end (from $\pm 0.3\%$ to $\pm 0.5\%$). Given official sources quoted in the media, it appears possible that we could see a band increase of up to 0.5 percentage points on each end, implying an absolute percentage variation around central parity of 2% from the current 1%. In the case that policymakers choose to again widen the band by 0.2 percentage points to $\pm 0.7\%$, and considering that average daily fluctuations have only taken up 20% of the potential daily trading scope, the implied average daily fluctuation in USDCNY would be 0.14% relative to the daily fixing parity to both the topside and the downside. In the case that policymakers act more aggressively and double the daily fluctuation band width to $\pm 1\%$ (a 0.5 percentage point increase), the daily fluctuation in USDCNY about the fix could amount to an average of around 0.20% on each end. This could certainly provide a good deal of scope for a more rapid pace of appreciation in the renminbi.

Does a Widening Trading Band Necessarily Guarantee Faster CNY Appreciation?

In our opinion, a widening in the band does not necessarily guarantee a faster pace of CNY appreciation. What it does present is the possibility of greater daily gains (or losses) for those with structural long CNY positions vs. the USD. We believe that what matters most for the pace of CNY appreciation is not the width of the band, but actual policymaker influence on the daily fix itself. That is to say inter-day fixing volatility matters, not intra-day trading volatility.

It is perhaps natural to assume that if the market is given more scope to pursue renminbi appreciation each day, then CNY should appreciate at a more rapid pace. However, it is highly unlikely that policymakers allow themselves to be influenced by the degree to which the market pressures CNY (higher or lower) on a daily basis relative fixing level; indeed that scenario would be more a case of "the tail wagging the dog". What is much more likely is that any widening of the exchange rate band is

Chart 2: Average Daily CNY Appreciation



Sacha Tihanyi (852) 6117-6070
sacha_tihanyi@scotiacapital.com

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primarily directed at making further steps towards full convertibility of the renminbi, as it prepares market participants for greater intraday CNY volatility.

We do have historical precedent that at least superficially indicates that a widening of exchange rate band can lead to more rapid appreciation, given the faster pace of CNY appreciation post-May 2007. However, appearances can be misleading. Looking back to the post-May 18, 2007 period we can observe a couple of facts that support our assertion that it is not the width of the band that decides pace of appreciation, but the pace at which the fix is adjusted. After May of 2007, the average pace of appreciation in CNY relative to the fix rate remained in line with the average of the preceding year, despite the widening of the exchange rate band to +/- 0.5% from +/- 0.3% (see Chart 2). To put this in perspective, the pace of appreciation over the past year (since July of 2010) by that same measure has been nearly double that of the previous two periods. This indicates greater aggressiveness amongst market participants in pushing CNY appreciation past the fixing rate vis-à-vis the previous periods of a +/- 0.3% band and a +/- 0.5% band. However, the average pace of “officially guided” CNY appreciation, as measured by daily percentage changes in the fix rate, was still much greater in the May 2007 through September 2008 period. This essentially shows that the width of the band wasn’t necessarily the key factor in the pace of CNY appreciation, but rather the decision by policymakers to guide the degree of CNY appreciation via the daily fixing of the central parity level. If the band was the key deciding factor, we should have been observing a more rapid pace of appreciation since July of 2010, on the scale of the May 2007 through September 2008 period (at just over 8% y/y annualized). Even though the market has on average pushed the pace of CNY appreciation past the daily fix to a greater degree in the current period than in the previous two, at an annualized 5.3% y/y the actual pace of CNY appreciation has lagged the May 2007 through September 2008 period.

It is important to reiterate that although we are pointing out that there may be no direct deterministic correlation between a wider USDCNY trading band and a faster pace of CNY appreciation, a widening of the exchange rate band would be a very important event nonetheless. Increased flexibility is yet another necessary step along the path of preparing the renminbi for full convertibility and internationalization, and just one in many steps to come over the next few years. With our forecast of 6.25 in USDCNY by the end of this year, and 5.88 by the end of 2012, we are projecting just over a 6% annualized pace of appreciation in CNY versus the USD over the next year and a half.

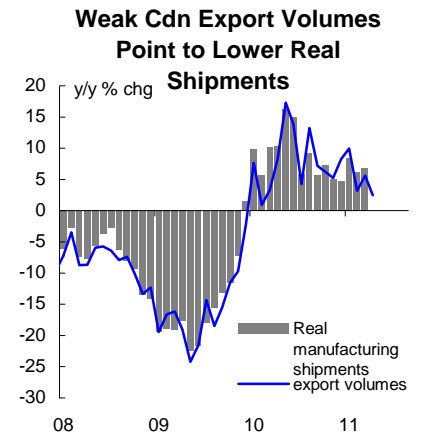
Karen Cordes Woods (416) 862-3080
karen_woods@scotiacapital.com

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

Key Data Preview

CANADA

Manufacturing shipments (Wednesday) is the only major economic data release in Canada next week and will provide us with another clue for April GDP growth. We already have an idea of its direction given that Canadian exports declined 1.9% m/m in April but we think shipments will contract by an even larger amount, with our own estimate of -4.0% m/m making the low end of consensus. For one, auto production plunged 25% in April on the back of supply chain disruptions stemming from Japan's natural disasters and this will have a larger impact on shipments than on exports. Other industries were also hit by the Japanese earthquake, such as electronics and steel, suggesting shipments could be reduced even further. Add to this a 1.9% m/m gain in March implying that there will be a base effect as well and the numbers are not looking very good. While there will likely be a few moderating factors, many of them are focused on higher prices. For example, petroleum and coal prices shot up in April along with food prices with each component accounting for roughly 14% of total shipments.

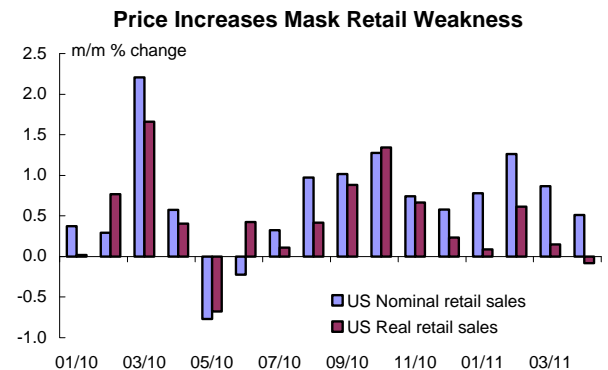


Source: Statistics Canada, Scotia Economics

UNITED STATES

There are several US economic data releases next week but markets will be focused primarily on retail sales (Tuesday), CPI (Wednesday), industrial production (Wednesday), housing starts (Thursday) and the Philadelphia Fed (Thursday) with weakness expected in the beginning of the week, followed by stronger numbers in the latter half.

Headline **retail sales** (Tuesday) will likely decline in May after auto sales plunged on the back of high gas prices and inventory shortages due to Japan's shocks. Excluding autos, however, sales should witness a modest gain although the risks are tilted to the downside as lower retail gasoline prices, terrible weather conditions and weak job and wage growth continue to put downward pressure on consumption growth. Indeed, we are already witnessing the negative impacts that high fuel and food costs are having on consumer spending as real retail sales growth has moderated substantially over the past few months. Indeed, according to the Bureau of Economic Analysis, headline real retail sales turned negative in April while real core sales were roughly unchanged.



Source: US Bureau of Economic Analysis, Scotia Capital Economics

Headline consumer prices (Wednesday) will likely show only a modest monthly gain in May although there is a risk of a negative print as declining energy prices potentially more than offset a further rise in food prices. Core prices will also show only modest gains as consumer demand remains weak, limiting businesses' pricing power. This should provide the Fed with further room to keep rates on hold as economic and employment growth shows signs of weakness.

Housing starts (Thursday) will likely rebound in May after an over 10% m/m decline in April for several reasons. For one, we are starting to see stronger new home sales with gains in both March and April. Second, the NAHB's prospective homebuyers' traffic measure has been trending up, suggesting further improvement in new home sales in the near future. Lastly, months' supply for new homes has been coming down and now sits at 6.5, a huge improvement from the 12.2 registered in January 2009 and very close to the balanced market gauge of 6 months supply. Nonetheless, even with the expected gain in May, home construction remains quite weak and continues to bounce along the bottom first hit in January 2009.

Daniela Blancas (416) 862-3908
daniela_blancas@scotiacapital.com

Alan Clarke (44 207) 826-5986
alan_clarke@scotiacapital.com

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Tuuli McCully (416) 863-2859
tuuli_mccully@scotiacapital.com

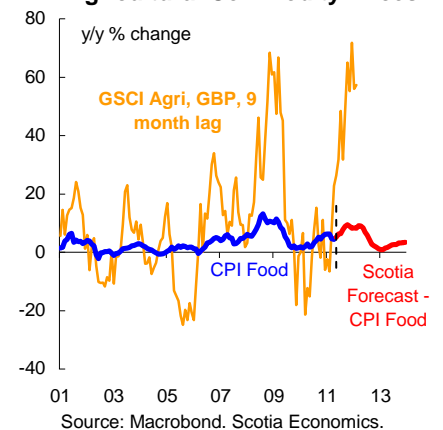
Oscar Sánchez (416) 862-3174
oscar_sanchez@scotiacapital.com

EUROPE

The near-term euro zone inflation outlook is deteriorating, with headline inflation likely to continue to accelerate in the coming months. On June 9th, the European Central Bank (ECB) revised upwards its projections for the region's average inflation rate in 2011 from the earlier 2.0%-2.6% range to 2.5%-2.7%. Nevertheless, the outlook for 2012 was kept unchanged at 1.1%-2.3%. The final print of consumer price inflation in May will be released on June 16th. According to the "flash estimate", headline inflation increased by 2.7% y/y last month, and we do not expect any major revisions to the preliminary data. The inflation rate will likely reach a new high above 3.0% by the end of the summer, reflecting intensifying food price pressures. As it continues to exceed the ECB's target of "below, but close to, 2%" by a wide margin, monetary authorities will remain on a path of gradual policy tightening in order to limit the risk of rising second round inflationary impacts. We expect the next hike in the refinancing rate to take place in July, taking the benchmark interest rate from the current level of 1.25% to 1.50%.

In the United Kingdom, we forecast that both CPI and RPI inflation will remain stable in May at 4.5% y/y and 5.2% y/y respectively. Although the headline is likely to be stable, the underlying breakdown is likely to show more action. In particular, we expect core inflation to slow sharply – partly reversing the prior month's surprise acceleration. A correction lower in airfares is likely to be the main influence on the core. This is likely to be offset by accelerating food price inflation. The RPI will also reflect these influences, though with some additional restraint from the continued deceleration in house price inflation. Beyond May's data, we expect headline inflation to accelerate further over the coming months to reach 5¼% y/y on the CPI measure and 6.2% y/y for RPI. The acceleration in the near term is likely to reflect the ongoing acceleration in food price inflation, coupled with rising utility bills. Inflation is then likely to slow from December onwards, helped by favourable base effects. We expect CPI inflation to trend down to just above 2% y/y in late-2012, and RPI around 4% y/y.

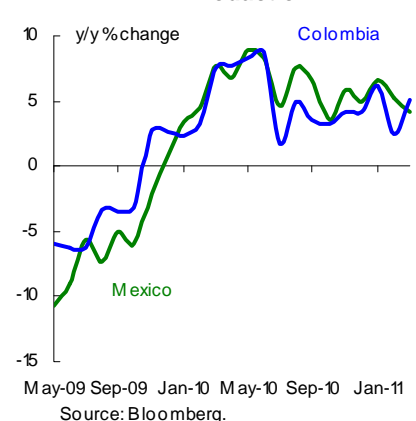
UK CPI Inflation Food vs. Agricultural Commodity Prices



MEXICO & LATIN AMERICA

In both Mexico and Colombia, April industrial production (IP) data will be released next week (June 13th-17th). Recent IP data out of Mexico suggest a slowdown in the pace of growth, despite the strong expansion observed in the first quarter of the year. Industrial output grew by 4.2% y/y in March; however when compared with the previous month, it decreased 0.23%, dampened by declining mining sector output and only a minor increase in the construction sector. On the other hand, electricity, water and gas production increased by 9.5% y/y, maintaining their expansionary bias. In Colombia, IP increased by 5.2% y/y after expanding 7.5% y/y during the same month a year ago. The automotive sector was the main contributor to industrial expansion, while production in iron and steel detracted from the gain.

Mexican and Colombian Industrial Production



Daniela Blancas (416) 862-3908
daniela_blancas@scotiacapital.com

Alan Clarke (44 207) 826-5986
alan_clarke@scotiacapital.com

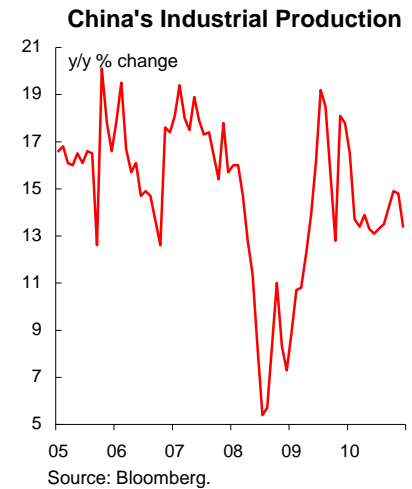
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Tuuli McCully (416) 863-2859
tuuli_mccully@scotiacapital.com

Oscar Sánchez (416) 862-3174
oscar_sanchez@scotiacapital.com

ASIA

Yearly growth in industrial output in China is bound for a rebound in the coming months, and May could be the start of the trend. The first reason is the low base that was carved a year ago, as production went through a soft patch after inventory re-accumulation through the second half of 2009 and the first half of 2010. The second, and most important, justification is the pickup in Chinese imports during May; with imports from Japan accelerating significantly from the lows of the previous month. This evidence points to a possible easing of the earthquake/tsunami related supply-chain disruptions during the month. While there is some risk that these effects will not disappear completely until June, we lean on the latest trade data expecting Chinese industrial production to expand at a 14.3% y/y rate in May.



Key Indicators for the week of June 13 - 17

North America

Country	Date	Time	Event	Period	BNS	Consensus	Latest
MX	JUN 08-15		ANTAD Same-Store Sales (YoY)	MAY	--	--	11.0
MX	06/13	09:00	Industrial Production (YoY)	APR	4.1	3.3	4.2
MX	06/13	09:00	Industrial Production (MoM)	APR	--	--	-0.2
CA	06/14	08:30	Capacity Utilization Rate (%)	1Q	--	77.2	76.4
US	06/14	08:30	Producer Price Index (MoM)	MAY	--	0.0	0.8
US	06/14	08:30	PPI Ex Food & Energy (MoM)	MAY	--	0.2	0.3
US	06/14	08:30	Advance Retail Sales (MoM)	MAY	-0.6	-0.4	0.5
US	06/14	08:30	Retail Sales Less Autos (MoM)	MAY	0.2	0.3	0.6
US	06/14	08:30	Retail Sales Ex Auto & Gas (MoM)	MAY	--	0.3	0.2
US	06/14	10:00	Business Inventories (MoM)	APR	--	1.0	1.1
US	06/15	07:00	MBA Mortgage Applications (WoW)	10-Jun	--	--	-0.4
CA	06/15	08:30	Manufacturing Sales (MoM)	APR	-4.0	-1.6	1.9
US	06/15	08:30	Consumer Price Index (MoM)	MAY	0.1	0.1	0.4
US	06/15	08:30	CPI Ex Food & Energy (MoM)	MAY	0.2	0.2	0.2
US	06/15	08:30	Consumer Price Index (YoY)	MAY	3.2	3.3	3.2
US	06/15	08:30	CPI Ex Food & Energy (YoY)	MAY	1.4	1.4	1.3
US	06/15	08:30	Empire Manufacturing Index	JUN	15.0	13.0	11.9
US	06/15	09:00	Total Net TIC Flows (USD billions)	APR	--	--	116.0
US	06/15	09:00	Net Long-term TIC Flows (USD billions)	APR	--	--	24.0
US	06/15	09:15	Industrial Production (MoM)	MAY	0.2	0.3	0.0
US	06/15	09:15	Capacity Utilization (%)	MAY	77.0	77.0	76.9
US	06/15	10:00	NAHB Housing Market Index	JUN	16.0	16.0	16.0
CA	06/16	08:30	Int'l Securities Transactions (C\$ billions)	APR	--	--	6.3
US	06/16	08:30	Initial Jobless Claims (000s)	10-Jun	430	--	427
US	06/16	08:30	Continuing Claims (000s)	4-Jun	3600	--	3676
US	06/16	08:30	Building Permits (MoM)	MAY	-1.2	-2.3	-1.9
US	06/16	08:30	Housing Starts (000s)	MAY	560.0	540.0	523.0
US	06/16	08:30	Current Account Balance (USD billions)	1Q	--	-126.0	-113.4
US	06/16	10:00	Philadelphia Fed. Index	JUN	8.0	7.0	3.9
CA	06/17	08:30	Wholesale Sales (MoM)	APR	--	-0.5	0.1
US	06/17	09:55	U. of Michigan Confidence	JUN P	--	74.5	74.3
US	06/17	10:00	Leading Indicators (MoM)	MAY	--	0.2	-0.3

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Key Indicators for the week of June 13 - 17

Europe								
Country	Date	Time	Event	Period	BNS	Consensus	Latest	
IT	06/13	04:00	Industrial Production sa (MoM)	APR	--	0.1	0.4	
UK	06/13	19:01	RICS House Price Balance (%)	MAY	-15.0	-20.0	-21.0	
UK	JUN 13-17		Nationwide Consumer Confidence	MAY	--	45.0	43.0	
FR	06/14	02:45	Current Account (€ billions)	APR	--	--	-4.1	
SP	06/14	03:00	CPI (EU Harmonised) (MoM)	MAY	--	-0.1	0.9	
SP	06/14	03:00	CPI (EU Harmonised) (YoY)	MAY F	3.4	3.4	3.4	
SP	06/14	03:00	CPI (Core Index) (MoM)	MAY	--	0.0	1.3	
SP	06/14	03:00	CPI (Core Index) (YoY)	MAY	--	2.0	2.1	
SW	06/14	03:30	CPI - Headline Rate (MoM)	MAY	--	0.2	0.4	
SW	06/14	03:30	SW CPI - CPIF (MoM)	MAY	--	0.1	0.4	
UK	06/14	04:30	DCLG UK House Prices (YoY)	APR	--	-0.2	0.9	
UK	06/14	04:30	CPI (MoM)	MAY	0.2	0.2	1.0	
UK	06/14	04:30	CPI (YoY)	MAY	4.5	4.5	4.5	
UK	06/14	04:30	Core CPI (YoY)	MAY	3.4	3.5	3.7	
UK	06/14	04:30	RPI (MoM)	MAY	0.4	0.3	0.8	
UK	06/14	04:30	RPI Ex Mort Int.Payments (YoY)	MAY	5.2	5.2	5.3	
FR	06/15	01:30	CPI - EU Harmonised (MoM)	MAY	0.0	0.1	0.4	
FR	06/15	01:30	CPI - EU Harmonised (YoY)	MAY	2.1	2.2	2.2	
FR	06/15	01:30	Consumer Price Index (MoM)	MAY	--	0.1	0.3	
FR	06/15	01:30	Consumer Price Index (YoY)	MAY	--	2.1	2.1	
UK	06/15	04:30	Claimant Count Rate (%)	MAY	4.6	4.6	4.6	
UK	06/15	04:30	Jobless Claims Change (000s)	MAY	10.0	6.5	12.4	
UK	06/15	04:30	Average Weekly Earnings (3M/YoY)	APR	--	2.1	2.3	
UK	06/15	04:30	Weekly Earnings exBonus (3M/YoY)	APR	--	2.1	2.1	
UK	06/15	04:30	ILO Unemployment Rate (3mths, %)	APR	7.7	7.7	7.7	
EC	06/15	05:00	Euro-Zone Ind. Prod. wda (YoY)	APR	--	4.8	5.6	
EC	06/15	05:00	Euro-Zone Ind. Prod. sa (MoM)	APR	--	-0.2	-0.1	
SZ	06/16	03:30	Swiss Libor Target Rate		0.25	0.25	0.25	
IT	06/16	04:00	CPI (NIC incl. tobacco) (MoM)	MAY F	--	0.1	0.1	
IT	06/16	04:00	CPI (NIC incl. tobacco) (YoY)	MAY F	--	2.6	2.6	
IT	06/16	04:00	CPI - EU Harmonized (MoM)	MAY F	0.2	0.2	0.2	
IT	06/16	04:00	CPI - EU Harmonized (YoY)	MAY F	3.0	3.0	3.0	
UK	06/16	04:30	Retail Sales Ex Auto Fuel(MoM)	MAY	--	-0.6	1.2	
UK	06/16	04:30	Retail Sales Ex Auto Fuel(YoY)	MAY	--	1.7	2.7	
UK	06/16	04:30	Retail Sales w/Auto Fuel (MoM)	MAY	1.0	-0.6	1.1	
UK	06/16	04:30	Retail Sales w/Auto Fuel (YoY)	MAY	--	1.5	2.8	
EC	06/16	05:00	Euro-Zone CPI - Core (YoY)	MAY	--	1.6	1.6	
EC	06/16	05:00	Euro-Zone CPI (MoM)	MAY	0.0	0.0	0.6	
EC	06/16	05:00	Euro-Zone CPI (YoY)	MAY	2.7	2.7	2.8	
EC	06/16	05:00	Eurozone Employment (QoQ)	1Q	--	--	0.2	
EC	06/16	05:00	Eurozone Employment (YoY)	1Q	--	--	0.2	
FR	06/17	02:45	Wages (QoQ)	1Q F	--	1.0	1.0	
IT	06/17	04:00	Trade Balance (Total) (€ millions)	APR	--	--	-3942.9	
IT	06/17	04:00	Trade Balance Eu (€ millions)	APR	--	--	-1079.2	
EC	06/17	05:00	Construction Output SA (MoM)	APR	--	--	-0.3	
EC	06/17	05:00	Construction Output WDA (YoY)	APR	--	--	-4.9	
IT	06/17	05:00	Current Account (mlns euro)	APR	--	--	-5507.0	
EC	06/17	05:00	Euro-Zone Trade Balance sa (€ billions)	APR	--	-2.7	-935.4	
EC	06/17	05:00	Euro-Zone Trade Balance (€ billions)	APR	--	-1.9	2800.7	
EC	06/17	10:00	ECB Publishes June Monthly Report					

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Key Indicators for the week of June 13 - 17

Asia Pacific

Country	Date	Time	Event	Period	BNS	Consensus	Latest
CH	JUN 09-15		Actual FDI (YoY)	MAY	--	--	15.2
NZ	JUN 09-11		REINZ Housing Price Index	MAY	--	--	3245.4
NZ	JUN 09-11		REINZ Housing Price Index (MoM)	MAY	--	--	1.1
NZ	JUN 09-11		REINZ House Sales (YoY)	MAY	--	--	-4.2
CH	JUN 10-15		New Yuan Loans (CNY billions)	MAY	680.0	650.0	739.6
CH	JUN 10-15		Money Supply - M0 (YoY)	MAY	--	--	14.7
CH	JUN 10-15		Money Supply - M1 (YoY)	MAY	--	13.7	12.9
CH	JUN 10-15		Money Supply - M2 (YoY)	MAY	15.5	15.5	15.3
JN	06/12	19:50	Machine Orders (MoM)	APR	--	1.7	2.9
JN	06/12	19:50	Machine Orders (YoY)	APR	--	4.9	6.8
HK	06/13	04:30	Industrial Production (YoY)	1Q	--	--	5.7
AU	06/13	20:30	NAB Business Conditions	MAY	--	--	5.0
AU	06/13	21:30	NAB Business Confidence	MAY	--	--	7.0
CH	06/13	22:00	Producer Price Index (YoY)	MAY	--	6.5	6.8
CH	06/13	22:00	Consumer Price Index (YoY)	MAY	5.70	5.5	5.3
CH	06/13	22:00	Retail Sales (YoY)	MAY	18.5	17.0	17.1
CH	06/13	22:00	Retail Sales YTD (YoY)	MAY	--	16.9	16.5
CH	06/13	22:00	Industrial Production (YoY)	MAY	13.0	13.1	13.4
CH	06/13	22:00	Industrial Production YTD (YoY)	MAY	--	14.0	14.2
CH	06/13	22:00	Fixed Assets Inv Excl. Rural YTD (YoY)	MAY	25.5	25.2	25.4
NZ	06/13	23:00	Non Resident Bond Holdings (%)	MAY	--	--	62.7
JN	JUN 13-14		BOJ Target Rate		0.10	0.10	0.10
JN	06/14	00:30	Capacity Utilization (MoM)	APR	--	--	-21.5
JN	06/14	00:30	Industrial Production (MoM)	APR F	--	--	1.0
NZ	06/14	18:45	Retail Sales Ex Inflation(QoQ)	1Q	--	0.9	-0.1
AU	06/14	20:30	Westpac Consumer Confidence s.a. (MoM)	JUN	--	--	-1.3
AU	06/14	20:30	Westpac Consumer Confidence Index	JUN	--	--	103.9
AU	06/14	21:00	Consumer Inflation Expectation (%)	JUN	--	--	3.3
AU	06/14	21:30	Dwelling Starts (QoQ)	1Q	--	-0.8	-5.3
JN	06/15	02:00	Machine Tool Orders (YoY)	MAY F	--	--	34.2
NZ	06/15	18:30	Business NZ PMI	MAY	--	--	51.5
NZ	06/15	18:45	Manufacturing Activity (QoQ)	1Q	--	--	3.1
NZ	06/15	18:45	Manufacturing Activity Volume SA (QoQ)	1Q	--	--	3.3
NZ	06/15	21:00	ANZ Consumer Confidence Index	JUN	--	--	103.3
NZ	06/15	21:00	ANZ Consumer Confidence (MoM)	JUN	--	--	1.9
AU	06/15	21:30	New Motor Vehicle Sales (MoM)	MAY	--	--	-3.5
AU	06/15	21:30	New Motor Vehicle Sales (YoY)	MAY	--	--	-8.4
CH	06/15	22:00	Conference Board China April Leading Economic Index				
JN	06/16	00:00	Tokyo Condominium Sales (YoY)	MAY	--	--	-27.3
IN	06/16	02:30	India REPO Cutoff Yld		7.50	7.50	7.25
IN	06/16	02:30	Cash Reserve Ratio	16-Jun	--	6.00	6.00
IN	06/16	02:30	Reverse Repo Rate	16-Jun	--	6.50	6.25
PH	06/16	04:00	Overnight Borrowing Rate		4.50	4.75	4.50
HK	JUN 16-17		Composite Interest Rate	MAY	--	--	0.25

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Key Indicators for the week of June 13 - 17

Latin America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>	<u>Period</u>	<u>BNS</u>	<u>Consensus</u>	<u>Latest</u>
BZ	06/13	07:30	Central Bank Weekly Economists Survey				
BZ	06/13	10:00	Trade Balance (FOB) - Weekly (USD millions)	12-Jun	--	--	783.0
CO	06/14	17:00	Trade Balance (USD millions)	APR	--	500.0	481.4
CL	06/14	18:00	Nominal Overnight Rate Target		5.25	5.25	5.00
PE	06/15		GDP (YoY) NSA	APR	--	6.9	7.9
BZ	06/16	07:00	FGV CPI IPC-S (WoW)	10-Jun	--	--	0.4
BZ	06/16	07:30	COPOM Monetary Policy Meeting Minutes				
BZ	06/17	04:00	FIPE CPI - Weekly (WoW)	15-Jun	--	--	0.1
BZ	06/17	07:00	FGV Inflation IGP-10 (MoM)	JUN	--	0.2	0.6
CO	06/17	17:00	Industrial Production (YoY)	APR	--	4.2	5.2
CO	06/17	17:00	Retail Sales (YoY)	APR	--	13.3	14.6
PE	06/17		Central Bank Quarterly Inflation Report				
CO	06/17		Overnight Lending Rate		4.25	4.25	4.00

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

Global Auctions for the week of June 13 - 17

North America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
US	06/13	11:30	U.S. to Sell 3-Month Bills
US	06/13	11:30	U.S. to Sell 6-Month Bills
US	06/14	11:30	U.S. to Sell 4-Week Bills
CA	06/15	12:00	Canada to Sell 2-Year Notes

Europe

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
NE	06/14	04:00	Netherlands to Sell Bond
SP	06/14	04:30	Spain to Sell 12M and 18M Bills
IT	06/14	05:00	Italy to Sell 3.75% 2016 Bonds
BE	06/14	05:30	Belgium to Sell Bills
SZ	06/14	05:30	Switzerland to Sell 3-Month Bills
FR	06/14	09:00	France to Sell Bills
SW	06/15	05:10	Sweden to Sell Bonds
GE	06/15	05:15	Germany to Sell Add'l EU6 Bln 2-Year Notes
UK	06/15	05:30	U.K. to Sell GBP2.25 Bln 4.25% 2027 Bonds
PO	06/15	05:30	Portugal to Sell Bills
SP	06/16	04:30	Spain to Sell 5.9% 2026 Bonds
FR	06/16	05:00	France to Sell Bonds/Notes
UK	06/17	06:10	U.K. to Sell Bills

Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
JN	06/12	23:35	Japan to Sell 1-Year Bills
CH	06/14	23:00	China to Sell 10 Year Bond
JN	06/14	23:35	Japan to Sell 3-Month Bills
JN	06/14	23:45	Japan to Sell 20-Year Bond
NZ	06/15	22:30	New Zealand Plans to Sell Government Bonds

Source: Bloomberg, Scotia Economics.

Events for the week of June 13 - 17

North America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
US	06/13	09:30	Fed's Lacker speaks on manufacturing in Roanoke, Virginia
CA	06/15	12:00	Minister of Finance Jim Flaherty Speaks in New York
CA	06/15	15:35	Bank of Canada Governor Carney Speaks in Vancouver

Europe

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
EC	06/13	09:30	ECB Announces Bond Purchases
EC	06/14	05:00	EU's Barroso Speaks at Commodities Conference in Brussels
EC	06/14	05:30	France's Sarkozy Speaks at Commodities Conference in Brussels
EC	06/14	09:00	EU's Barnier Speaks at Commodities Conference in Brussels
EC	06/14	13:00	EU Finance Ministers Meet on Economic Governance, Budgets
PO	06/14	19:00	Portugal to Announce Count of Votes Cast Abroad
EC	06/14		France's Sarkozy, EU's Barnier, EU's Barroso Speak in Brussels
EC	06/14		ECB's Reserve Maintenance Period Ends
EC	06/15	05:25	Italy's Draghi Speaks at Panel Discussion in Brussels
SZ	06/16	03:30	Swiss Libor Target Rate
IT	06/16	07:00	Draghi, Napolitano Speak at Rome University
EC	06/16	11:00	EU's Van Rompuy Speaks at European Policy Centre
EC	06/16	12:30	ECB's Mersch Speaks at Event in Hamburg

Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
JN	JUN 13-14		BOJ Target Rate
AU	06/14	22:00	Stevens Speaks in Brisbane to Economic Society of Australia
NZ	06/15	18:00	Finance Minister English Speaks
IN	06/16	02:30	India REPO Cutoff Yld
PH	06/16	04:00	Overnight Borrowing Rate
JN	06/16	19:50	BOJ to Publish Minutes of May 19-20 Board Meeting
NZ	06/16		Bollard Speaks at Wellington Chamber of Commerce

Latin America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
CL	06/14	18:00	Nominal Overnight Rate Target
CO	06/17		Overnight Lending Rate

Source: Bloomberg, Scotia Economics.

Global Central Bank Watch

North America

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Bank of Canada – Overnight Target Rate	1.00	July 19, 2011	1.00	--
Federal Reserve – Federal Funds Target Rate	0.25	June 22, 2011	0.25	0.25
Banco de México – Overnight Rate	4.50	July 8, 2011	4.50	--

Canadian employment in May came in higher than expected but the details are much softer than the headline print suggests. In fact, if not for self employed, there would have been no job creation. In addition, wage growth decelerated further which is the most important factor to the BoC. While some of the weakness may be reversed in June given the temporary impact of supply chain disruptions on the manufacturing sector, May's employment report provides the BoC with further room to keep rates on hold and indeed adds to the list of reasons to tilt the risk of our current call for a hike in October to later. In the US, April's better than expected trade report released this week provided some optimism for markets but doesn't change our current call for a hike in Q1 2012 - or later.

Europe

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
European Central Bank – Refinancing Rate	1.25	July 7, 2011	1.50	--
Bank of England – Bank Rate	0.50	July 7, 2011	0.50	0.50
Swiss National Bank – Libor Target Rate	0.25	June 16, 2011	0.25	0.25
Central Bank of Russia – Refinancing Rate	8.25	June 24, 2011	8.25	--
Hungarian National Bank – Base Rate	6.00	June 20, 2011	6.00	6.00
Central Bank of the Republic of Turkey – 1 Week Repo Rate	6.25	June 23, 2011	6.25	--

Following the Governing Council meeting on June 9, ECB President Jean-Claude Trichet signalled a forthcoming rate hike in July. He noted that risks to the inflation outlook are on the "upside", and used his code phrase "strong vigilance" in the context of monitoring price developments, which has previously indicated an impending hike.

Asia Pacific

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Bank of Japan – Target Rate	0.10	June 14, 2011	0.10	0.10
Reserve Bank of Australia – Cash Target Rate	4.75	July 5, 2011	4.75	4.75
Reserve Bank of New Zealand – Cash Rate	2.50	July 27, 2011	2.50	--
People's Bank of China – Lending Rate	6.31	TBA	--	--
Reserve Bank of India – Repo Rate	7.25	June 16, 2011	7.50	7.50
Hong Kong Monetary Authority – Base Rate	0.50	TBA	0.50	--
Central Bank of China Taiwan – Discount Rate	1.75	June 30, 2011	1.75	--
Bank Negara Malaysia – Overnight Policy Rate	3.00	July 7, 2011	3.00	--
Bank of Korea – Bank Rate	3.25	July 13, 2011	3.00	--
Bank of Thailand – Repo Rate	3.00	July 13, 2011	3.00	--
Bank Indonesia – Reference Interest Rate	6.75	July 12, 2011	6.75	--
Central Bank of the Philippines – Overnight Policy Rate	4.50	June 16, 2011	4.50	4.75

The Reserve Bank of India will likely lift the benchmark repo interest rate by 25 basis points (bps) next week. While yearly wholesale inflation has been trending down, price pressures remain, particularly as fuel costs are lifted with the withdrawal of government subsidies. This follows a more aggressive 50 bps rise in May. The monetary authority of the Philippines will likely stay put this time around on the back of signs of a slowdown in price pressures from most recent inflationary data.

Latin America

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Banco Central do Brasil – Selic Rate	12.25	July 20, 2011	12.25	--
Banco Central de Chile – Overnight Rate	5.00	June 14, 2011	5.25	5.25
Banco de la República de Colombia – Lending Rate	4.00	June 17, 2011	4.25	4.25
Banco Central de Reserva del Perú – Reference Rate	4.25	July 7, 2011	4.25	--

We expect the central bank of Colombia to raise the reference rate by 25 basis points (bps) to 4.25%. Consumer prices increased by 2.93% y/y in May, compared with 2.84% in April; therefore, the central bank is expected to maintain its "prudence to retrieve monetary stimulus". In Chile, the CPI rate accelerated in May to 3.3% y/y, but has still remained close to the 3.0% expected target range; thus we anticipate an increase of only 25 bps in the reference rate to 5.25%, after a 50 bps hike last month.

Africa

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
South African Reserve Bank – Repo Rate	5.50	July 18, 2011	5.50	--

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

	2000-09	2010	2011f	2012f	2000-09	2010	2011f	2012f
Output and Inflation (annual % change)	Real GDP				Consumer Prices²			
World ¹	3.6	5.1	4.2	4.5				
Canada	2.1	3.2	2.8	2.6	2.1	1.8	3.0	2.4
United States	1.8	2.9	2.6	2.8	2.6	1.6	2.9	2.1
Mexico	1.9	5.5	4.4	3.8	4.9	4.4	3.9	4.0
United Kingdom	1.7	1.3	1.4	1.7	1.9	3.7	3.7	2.9
Euro zone	1.0	1.6	1.8	1.7	2.1	2.2	2.5	2.3
Japan	0.6	4.0	0.3	3.5	-0.3	0.0	0.8	1.3
Australia	3.1	2.7	3.4	3.0	3.2	2.7	2.8	2.5
China	9.4	10.4	9.3	9.5	2.0	4.6	5.0	4.5
India	7.4	9.0	8.3	8.5	6.2	9.5	7.5	6.0
Korea	4.4	6.2	5.4	5.3	3.1	3.5	3.5	3.0
Brazil	2.9	7.5	4.0	4.5	6.6	5.9	6.5	5.5
Chile	3.6	5.2	6.0	5.5	3.7	3.0	4.5	3.5
Peru	5.1	8.8	7.0	7.2	2.5	2.1	3.5	3.0
Central Bank Rates (% end of period)	11Q1	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	1.25	1.50	1.75	2.00	2.25	2.50	2.50
Bank of England	0.50	0.50	0.75	1.00	1.25	1.50	1.75	2.00
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	4.75	4.75	5.00	5.25	5.50	5.75	6.00	6.25
Exchange Rates (end of period)								
Canadian Dollar (USDCAD)	0.97	0.95	0.94	0.93	0.94	0.94	0.93	0.92
Canadian Dollar (CADUSD)	1.03	1.05	1.06	1.08	1.06	1.06	1.08	1.09
Euro (EURUSD)	1.42	1.47	1.49	1.50	1.48	1.48	1.50	1.50
Sterling (GBPUSD)	1.60	1.64	1.64	1.65	1.65	1.67	1.69	1.70
Yen (USDJPY)	83	79	82	84	86	87	89	90
Australian Dollar (AUDUSD)	1.03	1.07	1.08	1.09	1.09	1.10	1.10	1.11
Chinese Yuan (USDCNY)	6.5	6.4	6.3	6.3	6.2	6.1	6.0	5.9
Mexican Peso (USDMXN)	11.9	11.6	11.8	12.0	12.1	12.0	12.1	12.3
Brazilian Real (USDBRL)	1.63	1.58	1.59	1.60	1.62	1.65	1.67	1.70
Commodities (annual average)	2000-09	2010	2011f	2012f				
WTI Oil (US\$/bbl)	51	79	100	103				
Brent Oil (US\$/bbl)	50	80	112	115				
Nymex Natural Gas (US\$/mmbtu)	5.95	4.40	4.40	4.75				
Copper (US\$/lb)	1.78	3.42	4.25	4.15				
Zinc (US\$/lb)	0.73	0.98	1.03	1.05				
Nickel (US\$/lb)	7.11	9.89	11.25	8.90				
Gold, London PM Fix (US\$/oz)	522	1,225	1,530	1,600				
Pulp (US\$/tonne)	668	960	1,020	1,050				
Newsprint (US\$/tonne)	572	607	660	715				
Lumber (US\$/mfbm)	275	254	270	285				

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	2010	10Q3	10Q4	Latest	United States	2010	10Q3	10Q4	Latest
Real GDP (annual rates)	3.2	2.5	3.1		Real GDP (annual rates)	2.9	2.6	3.1	1.8 (Q1-A)
Current Acc. Bal. (C\$B, ar)	-50.0	-71.5	-41.1		Current Acc. Bal. (US\$B, ar)	-470	-502	-453	
Merch. Trade Bal. (C\$B, ar)	-9.0	-26.9	1.5	-11.1 (Apr)	Merch. Trade Bal. (US\$B, ar)	-646	-671	-637	-697 (Apr)
Industrial Production	4.6	7.7	6.0	5.2 (Mar)	Industrial Production	5.3	6.7	6.2	4.9 (Apr)
Housing Starts (000s)	192	192	179	184 (May)	Housing Starts (millions)	0.58	0.58	0.54	0.52 (Apr)
Employment	1.4	1.8	1.7	2.1 (May)	Employment	-0.8	-0.1	0.5	0.2 (May)
Unemployment Rate (%)	8.0	8.0	7.7	7.4 (May)	Unemployment Rate (%)	9.6	9.6	9.6	9.1 (May)
Retail Sales	5.5	4.0	5.3	0.9 (Mar)	Retail Sales	6.8	5.8	8.1	7.9 (Apr)
Auto Sales (000s)	1560	1609	1554	1627 (Mar)	Auto Sales (millions)	11.5	11.6	12.3	11.8 (May)
CPI	1.8	1.8	2.3	3.3 (Apr)	CPI	1.6	1.2	1.3	3.2 (Apr)
IPPI	1.0	1.0	2.6	-5.0 (Apr)	PPI	4.2	3.8	3.8	6.8 (Apr)
Pre-tax Corp. Profits	21.2	19.0	19.1		Pre-tax Corp. Profits	36.8	34.8	16.1	
Mexico					Brazil				
Real GDP	5.4	5.1	4.4		Real GDP	6.7	5.9	4.2	
Current Acc. Bal. (US\$B, ar)	-5.7	-7.5	-14.0		Current Acc. Bal. (US\$B, ar)	-47.4	-46.1	-48.0	
Merch. Trade Bal. (US\$B, ar)	-3.1	-9.0	-4.2	9.2 (Apr)	Merch. Trade Bal. (US\$B, ar)	20.2	19.3	30.0	42.3 (May)
Industrial Production	6.0	6.2	4.8	4.2 (Mar)	Industrial Production	10.5	8.0	3.6	-0.1 (Apr)
CPI	4.2	3.7	4.2	7.1 (May)	CPI	5.1	5.0	6.1	12.2 (May)
Chile					Italy				
Real GDP	5.2	6.9	5.8		Real GDP	1.2	1.4	1.5	
Current Acc. Bal. (US\$B, ar)	3.6	-0.2	4.9		Current Acc. Bal. (US\$B, ar)	-0.07	-0.06	-0.07	-0.09 (Mar)
Merch. Trade Bal. (US\$B, ar)	11.6	14.7	17.7	21.5 (May)	Merch. Trade Bal. (US\$B, ar)	-39.1	-28.2	-46.3	-66.2 (Mar)
Industrial Production	0.6	4.4	2.7	8.5 (Apr)	Industrial Production	6.5	7.5	5.1	3.2 (Mar)
CPI	1.4	2.2	2.5	3.3 (May)	CPI	1.6	1.6	1.8	2.6 (Apr)
Germany					France				
Real GDP	3.5	3.9	3.8		Real GDP	1.4	1.7	1.4	
Current Acc. Bal. (US\$B, ar)	187.9	165.7	250.8	171.5 (Apr)	Current Acc. Bal. (US\$B, ar)	-54.3	-41.8	-94.9	-46.1 (Mar)
Merch. Trade Bal. (US\$B, ar)	201.5	207.6	219.8	207.6 (Apr)	Merch. Trade Bal. (US\$B, ar)	-38.9	-42.7	-39.1	-59.4 (Apr)
Industrial Production	10.1	10.2	11.8	9.6 (Apr)	Industrial Production	5.1	4.3	4.6	2.6 (Apr)
Unemployment Rate (%)	7.7	7.6	7.4	7.0 (May)	Unemployment Rate (%)	9.8	9.8	9.6	9.4 (Apr)
CPI	1.1	1.2	1.5	3.2 (May)	CPI	1.5	1.5	1.6	2.1 (Apr)
Euro Zone					United Kingdom				
Real GDP	1.7	2.0	1.9		Real GDP	1.3	2.5	1.5	
Current Acc. Bal. (US\$B, ar)	-77	-43	-41	-64 (Mar)	Current Acc. Bal. (US\$B, ar)	-56.1	-56.0	-62.2	
Merch. Trade Bal. (US\$B, ar)	0.0	43.0	53.2	39.6 (Mar)	Merch. Trade Bal. (US\$B, ar)	-153.0	-161.1	-171.9	-144.9 (Apr)
Industrial Production	7.4	7.3	8.0	5.7 (Mar)	Industrial Production	2.1	3.2	3.3	-1.1 (Apr)
Unemployment Rate (%)	10.0	10.0	10.0	9.8 (Apr)	Unemployment Rate (%)	7.9	7.8	7.9	7.7 (Feb)
CPI	1.6	1.7	2.0	2.8 (Apr)	CPI	3.3	3.1	3.4	4.5 (Apr)
Japan					Australia				
Real GDP	4.0	4.8	2.4		Real GDP	2.7	2.5	2.7	
Current Acc. Bal. (US\$B, ar)	195.9	227.5	176.8	58.4 (Apr)	Current Acc. Bal. (US\$B, ar)	-31.8	-27.6	-37.4	
Merch. Trade Bal. (US\$B, ar)	74.7	75.1	58.4	-71.5 (Apr)	Merch. Trade Bal. (US\$B, ar)	19.2	27.8	25.8	32.5 (Apr)
Industrial Production	16.6	13.3	6.8	-12.8 (Apr)	Industrial Production	4.3	4.3	0.0	
Unemployment Rate (%)	5.1	5.0	5.0	4.7 (Apr)	Unemployment Rate (%)	5.2	5.2	5.2	4.9 (May)
CPI	-0.7	-0.8	0.1	0.3 (Apr)	CPI	2.8	2.8	2.7	
China					South Korea				
Real GDP	10.3	9.6	9.8		Real GDP	6.2	4.4	4.7	
Current Acc. Bal. (US\$B, ar)	30.5				Current Acc. Bal. (US\$B, ar)	28.2	39.7	36.6	22.5 (Apr)
Merch. Trade Bal. (US\$B, ar)	181.8	259.6	247.6	156.6 (May)	Merch. Trade Bal. (US\$B, ar)	41.2	42.5	52.1	33.0 (May)
Industrial Production	13.5	13.3	13.5	13.4 (Apr)	Industrial Production	16.6	12.9	9.9	7.1 (Apr)
CPI	4.6	3.6	4.6	5.3 (Apr)	CPI	3.0	2.9	3.6	6.9 (May)

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

Source: Bloomberg, Scotia Economics.

Interest Rates (% , end of period)

Canada	10Q4	11Q1	Jun/03	Jun/10*	United States	10Q4	11Q1	Jun/03	Jun/10*
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	1.05	0.96	0.97	0.91	3-mo. T-bill	0.12	0.09	0.03	0.04
10-yr Gov't Bond	3.12	3.35	2.99	3.00	10-yr Gov't Bond	3.29	3.47	2.99	2.95
30-yr Gov't Bond	3.53	3.76	3.48	3.49	30-yr Gov't Bond	4.33	4.51	4.22	4.17
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US\$B)	57.0	60.4	62.9	(Apr)	FX Reserves (US\$B)	121.4	128.3	131.9	(Apr)
Germany					France				
3-mo. Interbank	0.96	1.26	1.28	1.44	3-mo. T-bill	0.40	0.80	1.00	1.08
10-yr Gov't Bond	2.96	3.35	3.06	2.97	10-yr Gov't Bond	3.36	3.71	3.36	3.34
FX Reserves (US\$B)	62.3	64.8	66.4	(Apr)	FX Reserves (US\$B)	55.8	61.0	57.5	(Apr)
Euro-Zone					United Kingdom				
Refinancing Rate	1.00	1.00	1.25	1.25	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	0.82	0.90	0.88	1.30	3-mo. T-bill	4.85	4.85	4.85	4.85
FX Reserves (US\$B)	300.2	319.9	316.7	(Apr)	10-yr Gov't Bond	3.40	3.69	3.29	3.22
Japan					FX Reserves (US\$B)	68.3	75.3	79.2	(Apr)
Discount Rate	0.30	0.30	0.30	0.30	Australia				
3-mo. Libor	0.13	0.14	0.13	0.13	Cash Rate	4.75	4.75	4.75	4.75
10-yr Gov't Bond	1.13	1.26	1.14	1.14	10-yr Gov't Bond	5.55	5.49	5.23	5.18
FX Reserves (US\$B)	1061.5	1080.6	1097.8	(Apr)	FX Reserves (US\$B)	38.7	33.3	37.9	(Apr)

Exchange Rates (end of period)

USDCAD	1.00	0.97	0.98	0.98	¥/US\$	81.12	83.13	80.34	80.20
CADUSD	1.00	1.03	1.02	1.02	US\$/Australian\$	102.33	103.29	107.16	105.60
GBPUSD	1.561	1.603	1.643	1.624	Chinese Yuan/US\$	6.61	6.55	6.48	6.48
EURUSD	1.338	1.416	1.464	1.437	South Korean Won/US\$	1126	1097	1080	1083
JPYEUR	0.92	0.85	0.85	0.87	Mexican Peso/US\$	12.340	11.905	11.664	11.870
USDCHF	0.94	0.92	0.83	0.84	Brazilian Real/US\$	1.661	1.632	1.576	1.598

Equity Markets (index, end of period)

United States (DJIA)	11578	12320	12151	11992	U.K. (FT100)	5900	5909	5855	5765
United States (S&P500)	1258	1326	1300	1274	Germany (Dax)	6914	7041	7109	7061
Canada (S&P/TSX)	13443	14116	13518	13120	France (CAC40)	3805	3989	3891	3805
Mexico (Bolsa)	38551	37441	35124	34925	Japan (Nikkei)	10229	9755	9492	9514
Brazil (Bovespa)	69305	68587	64341	62686	Hong Kong (Hang Seng)	23035	23528	23254	22420
Italy (BCI)	1048	1120	1080	1054	South Korea (Composite)	2051	2107	2114	2047

Commodity Prices (end of period)

Pulp (US\$/tonne)	968	970	1020	1020	Copper (US\$/lb)	4.42	4.26	4.09	4.08
Newsprint (US\$/tonne)	640	640	640	640	Zinc (US\$/lb)	1.10	1.05	1.01	1.02
Lumber (US\$/mfbm)	268	297	230	230	Gold (US\$/oz)	1405.50	1439.00	1540.00	1529.25
WTI Oil (US\$/bbl)	91.38	106.72	100.22	99.16	Silver (US\$/oz)	30.63	37.87	35.19	37.38
Natural Gas (US\$/mmbtu)	4.41	4.39	4.71	4.73	CRB (index)	332.80	359.43	348.61	347.10

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

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Scotia Economics

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

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