

# Global Views

Weekly commentary on economic and financial market developments

July 8, 2011

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

## 2-11 Economics

- 2 • A Quiet Summer? Don't Bank On It For Next Week ..... Karen Cordes Woods & Derek Holt
- 3-4 • Canada's World Trade Position Is Slipping ..... Adrienne Warren
- 5 • What Canadian Inflation Threat? ..... Karen Cordes Woods & Derek Holt
- 6 • High Gasoline Prices Crowding Out Big-Ticket Purchases ..... Gorica Djerić & Alex Koustas
- 7 • Be Skeptical of Canada's Summertime Job Reports ..... Karen Cordes Woods & Derek Holt
- 8 • Thailand's Smooth Electoral Process Reinstates Bullish Financial Market Tone ..... Oscar Sánchez & Sacha Tihanyi
- 9 • Portugal and Ireland Work Hard to Differentiate from Greece ..... Tuuli McCully
- 10 • Promising Currency and Economic Outlook in Colombia ..... Daniela Blancas & Pablo Bréard
- 11 • Emerging Economies' Health Care Opportunities ..... Gaelan MacKenzie & Mary Webb

## 12-15 Equity Strategy

- Global Portfolio Strategy — Summer 2011 Update ..... Vincent Delisle
- Model Portfolios & Sector Strategy — July Update ..... Vincent Delisle

## 16-17 Fixed Income Strategy

- Vital Statistics — UK On Strike ..... Alan Clarke

## A1-A12 Forecasts & Data

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

Karen Cordes Woods (416) 862-3080  
[karen\\_woods@scotiacapital.com](mailto:karen_woods@scotiacapital.com)

Derek Holt (416) 863-7707  
[derek\\_holt@scotiacapital.com](mailto:derek_holt@scotiacapital.com)

### ***A Quiet Summer? Don't Bank On It For Next Week***

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

Ahhhh summer. Nice and quiet, right? Perhaps in some ways, but for financial markets, don't bet on it for next week if you haven't been convinced as yet that quiet summers went away a long time ago. Every major region of the world will be in the spotlight through a mixture of event and fundamentals risk.

**Canadian** markets will digest the last batch of economic updates before the BoC's rate announcement and Monetary Policy Report the following week. Institutional investors will firm up their bets on BoC policy at the 2 year GoC bond auction on Wednesday. They will do so following the release of two fresh BoC surveys that land on Monday. Watch for business expectations for future sales that have been waning ever since the 2009Q3 peak. Also watch for business expectations for future inflation that firmed up in the last quarterly survey but that we dismissed as reflecting adaptive expectations formed in relation to the rise in commodity prices until April such that businesses were simply extrapolating the unsustainable percentage gains of the past. That story has already corrected. Expectations for flat housing starts and another round of weak manufacturing and trade data round out the risks on the week. On balance, we continue to forecast that the BoC is on hold until 2012Q2. Given that Q1 real GDP growth of 3.9% was almost entirely driven by an undesired inventory build following soft demand conditions even before the Japanese shocks, and that Q2 growth built upon such weakness when the shocks arrived, the first half of 2011 was remarkably weak for the Canadian economy. That makes it unlikely that Governor Carney will shift toward a hawkish bias over coming months. Rather, we think the BoC will need a minimum of a couple of quarters of solid economic growth in order to evaluate what kind of traction the economic recovery may have before it pulls the trigger lest it risk hiking and reversing course soon thereafter. Also see our note on Canadian inflation (page 5).

**US** markets will build upon the disappointing nonfarm payrolls print for June by adding heavy global headline risk next week. The midnight oil will be burning at the White House this weekend and into next week. While the divides between the GOP, its Tea Party faction, and the Democrats remain large, the Treasury's stated August 2nd deadline for a deal to be done that raises the US debt ceiling in order to avoid an outright default on US debt payments is motivating a hurried rush toward such an agreement. The rough math on the range of proposals being debated is such that paring between \$250 billion and \$400 billion a year on average out of fiscal deficits through program spending cuts and tax hikes would impose a sharp drag effect on US GDP growth. US nominal GDP stands at about \$15 trillion, so the budget cuts in nominal dollar terms translate to between 1.7% and 2.7% of the economy. With such fiscal retrenchment coming down the pipeline and carrying spill-over effects elsewhere including into Canada where fiscal austerity is already being embraced, it is difficult to envision monetary tightening alongside fiscal and regulatory belt tightening.

US markets will also be focused upon Fed Chairman Ben Bernanke's semi-annual monetary policy testimony to the House of Representatives on Wednesday which is likely to reinforce a dovish bias especially on the heels of nonfarm's disappointment. Key releases will also garner attention, such as an expected soft print for retail sales, and dovish CPI figures on a m/m basis that will eventually begin to drag the y/y inflation comparisons lower and take the wind out of the hawk's sails. Trade, FOMC minutes, industrial production, and Treasury auctions of 3s, 10s and 30s will round out the calendar.

**European** markets will be mostly left hanging on any possible outcome stemming from euro-area finance minister meetings on Monday and Tuesday. It is possible that a technical Greek default proposal is advanced and tested in markets, but we doubt there is enough resolve across the euro zone to do so. We put higher odds on little progress before the next round of funding is required by Greece in September. Also, we expect soft m/m June readings on French, German, Italian, euro zone and UK CPI on Tuesday and Thursday reflecting weaker commodity prices. There is an Italian bond auction on Thursday, and Trichet speaks on Sunday.

**China** also poses large data risk to global markets as it releases most of its key indicators on Saturday and Thursday, including inflation that follows comments by Premier Wen that policy tightening may be coming to an end. Central bank announcements are expected from the BoJ, Bank Indonesia, and the Bank of Chile.

Adrienne Warren (416) 866-4315  
adrienne\_warren@scotiacapital.com

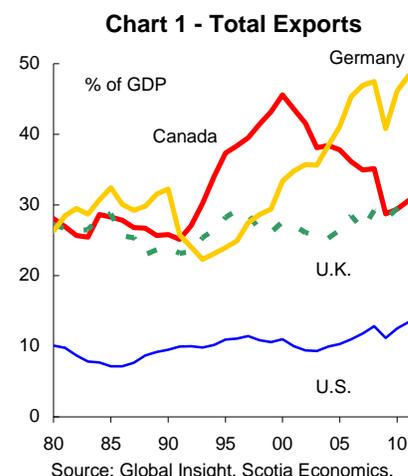
**Canada's World Trade Position Is Slipping**

- **The export orientation of the Canadian economy has declined steadily over the past decade, placing Canada at a disadvantage relative to some of its peers at a time when global trade volumes are rising rapidly and international competitive pressures are on the rise.**

Canada is still a big trading nation, but its overall exposure to foreign markets has declined markedly over the past decade. The country's export orientation — exports of goods and services as a share of nominal GDP — has fallen from a peak of 46% in 2000 to 31% today (chart 1). The decline reverses much of the increase that occurred following the implementation of the FTA (1988) and NAFTA (1994), bringing this overall measure of 'openness' back to 1993 levels.

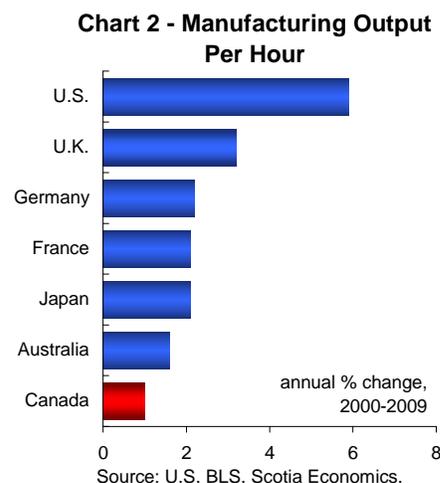
A number of factors have likely contributed to the decline:

- Relatively strong domestic demand compared with our major trading partners, most notably the United States, has tilted growth in favour of domestically-generated sources. Real domestic demand in Canada increased an average of 3.3% annually from 2000-2010, compared with only 1.9% in the United States.
- Exporters have faced several competitive headwinds, including the 60% rise in the Canadian dollar from the low 60 cent(US) range in 2002 to above parity today. Over this period, the U.S. dollar, measured against the currencies of its major trading partners, fell roughly 25%.
- Persistently weak labour productivity has weighed on manufacturing performance. Output per hour in the manufacturing sector averaged just 1.0% from 2000-2009, about one-third the rate recorded over the prior decade. Canadian productivity growth has lagged our major competitors, including the United States, the U.K. and Germany (chart 2).



Canadian firms are also using imports less extensively, despite the sharp rise in the value of the Canadian dollar. The import content of Canadian exports rose through the 1990s, peaking at close to 32% in 1998/1999 (chart 3). It has since fallen to around 27%.

The shift in the composition of exports away from more import-intensive manufactured goods such as autos and electronics toward low import content natural resources accounts for some of the decline, as do shifts in the terms of trade (i.e. rising export prices and lower import costs). Nonetheless, the decline in import intensity has been pervasive across industries. (Data on the import content of exports are available only to 2007. The further strengthening in the Canadian dollar may have more recently boosted import shares.)



There is some urgency to raise our export orientation, particularly with domestic consumer spending, housing activity and government expenditures all expected to moderate over the next few years. Canada's declining export exposure is occurring at a time when worldwide trade is climbing rapidly. Propelled by trade

Adrienne Warren (416) 866-4315  
[adrienne\\_warren@scotiacapital.com](mailto:adrienne_warren@scotiacapital.com)

... continued from previous page

liberalization and expanding global supply chains, global exports as a share of global GDP have increased steadily over the past two decades, from 19% in 1991 to around 30% today (chart 4).

Meanwhile, Canada is losing global export market share among advanced nations. U.S. exports as a share of GDP, while much lower than in Canada at about 10%, have trended higher over the past decade (chart 1). The export orientation of the U.K. economy has also edged up over this period, and now matches Canadian levels. Germany's 'openness' has further accelerated, with exports now accounting for almost half of the nation's output.

We are encouraged by several more recent developments. Policymakers have stepped up efforts to establish new bilateral Free Trade Agreements (FTAs) in recent years. Five new FTAs covering eight countries have been finalized since 2008: Canada-Peru, Canada-Panama, Canada-Colombia, Canada-Jordan and Canada-EFTA. Negotiations are progressing at various stages on several others, including with the EU, India and Honduras.

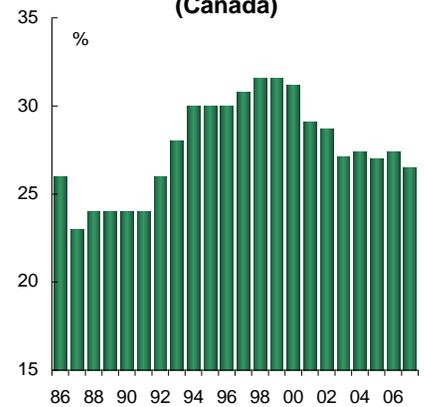
From a productivity standpoint, the elimination of tariffs on imported machinery & equipment and manufacturing inputs for manufacturers is a positive development, as is the extension of the accelerated depreciation allowance on processors' and manufacturers' purchases of machinery & equipment to the end of 2013.

But more needs to be done to diversify Canadian exports. While the United States will remain Canada's dominant export market for the foreseeable future, fast-growing emerging nations in Asia and Latin America provide greater growth potential. These economies are expected to continue to post comparatively stronger growth than advanced nations over the coming decade, supported in part by more favourable demographics.

Greater product diversification is also needed. Canadian resource producers are benefitting from strong demand and rising prices for commodities, which have increased sharply as a share of the nation's total exports. However, we are losing ground in value-added manufactured goods and agricultural products, both of which are also in high demand globally. In fact, in volume terms, global trade in manufactured goods and food products have outpaced demand for energy & mining products over the past decade.

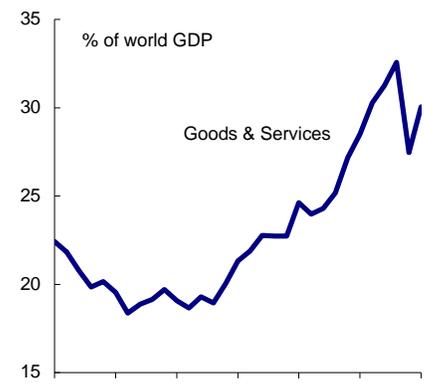
Meanwhile, increasing the use of imported inputs or outsourcing other production would help to lower production costs and support export competitiveness. Rising import shares have historically been associated with rising productivity. Any potential costs savings are especially important in an environment where commodity-linked currencies such as the Canadian dollar are expected to remain relatively strong.

Chart 3 - Import Share of Exports (Canada)



Source: Statistics Canada, Scotia Economics.

Chart 4 - World Exports



Source: WTO, IMF, Scotia Economics.

Karen Cordes Woods (416) 862-3080  
[karen\\_woods@scotiacapital.com](mailto:karen_woods@scotiacapital.com)

Derek Holt (416) 863-7707  
[derek\\_holt@scotiacapital.com](mailto:derek_holt@scotiacapital.com)

**What Canadian Inflation Threat?**

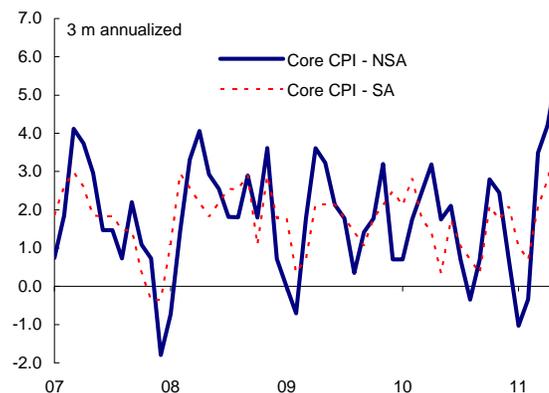
- **Core inflation is tamer than the hawks are arguing.**

Fun with numbers. That about sums up what I think of misleading portrayals of Canadian inflation data. It was bad enough when the latest inflation report was interpreted through a hawkish lens by inappropriately referencing seasonally UNadjusted data. The 0.7% m/m and 0.5% m/m rise in headline and core inflation during May was almost entirely due to seasonal pricing swings. When adjusted for seasonality, headline and core inflation were up only 0.2% m/m in each case. Further, higher gas prices drove headline CPI higher but we know they reversed in June. Higher clothing prices drove core higher, but they had fallen the prior month. There was little if any evidence of a broader fanning out of inflationary pressures in the latest Canadian CPI figures.

But what of the q/q surge? Sure, in seasonally UNadjusted terms, core inflation was up about 5.6% over the past three months at an annualized pace. Adjust for seasonality, however, and that number drops to 3.8% (chart 1). Furthermore, take out the one single bad month of March when core inflation spiked higher following the prior month's small dip, and the three month ago annualized and seasonally unadjusted rate of core CPI inflation drops to 2.8% (chart2) and 1.7% in seasonally adjusted terms (chart 3). Better yet, take it on a full year-to-date basis from December 2010 levels, and the annualized rate of seasonally adjusted core CPI inflation drops to 2.3%; if the one bad month of March is excluded again, then the annualized YTD rise in core inflation is only 1%.

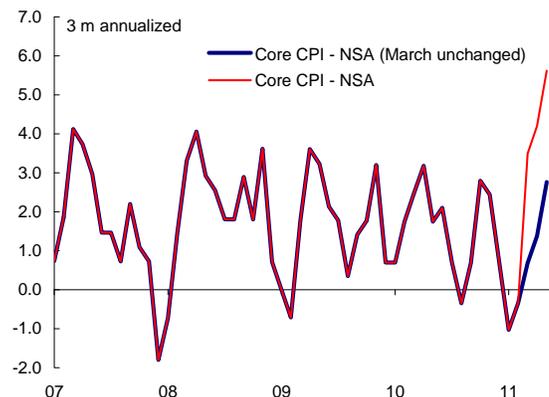
Our point is this: the hawks are misinterpreting the inflation data in some rather curious ways, and also extrapolating the one bad month of March over the full rest of the year when they imply that the BoC is in danger of being confronted by egregiously high core inflation. That one bad month might have just been testing pricing power before such attempts got whacked back, or it might have reflected the end to the pass-through effect of refunded HST tax credits into core prices, and it came off a weak prior month. Besides, the BoC has stated rather clearly to look through near-term inflation, partly because there isn't anything it can do about it anyway but also because (and we agree) it believes many of the pressures will abate into next year.

**Adjusting for Seasonality**



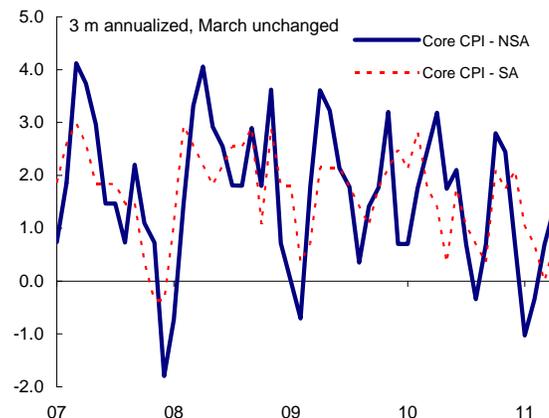
Source: Statistics Canada, Scotia Capital Economics

**March was the Aberration on Trend**



Source: Statistics Canada, Scotia Capital Economics

**A Truer Picture of Trend Inflation**



Source: Statistics Canada, Scotia Capital Economics

Alex Koustas (416) 866-4212  
alex\_koustas@scotiacapital.com

Gorica Djeric (416) 866-4214  
gorica\_djeric@scotiacapital.com

**High Gasoline Prices Crowding Out Big-Ticket Purchases**

- **Although household characteristics have dampened the sensitivity, rising gasoline prices affect public sentiment for discretionary spending in both Canada and the United States.**

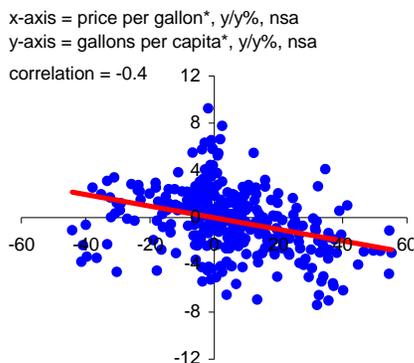
Two episodes of rising commodity prices over the past four years — one of which is ongoing — have pushed retail gasoline prices to near-record levels, adversely affecting broader household spending patterns. Lower income families are disproportionately affected, as essential goods comprise a greater share of their overall budget.

In Canada and the United States, higher prices at the pump result in lower gasoline usage (see charts 1, 2). Sensitivity is less pronounced in the short term — especially in more recent times — as consumers have less flexibility to adjust spending habits. This is in part due to greater commuting distances and lower public transit connectivity — created by sprawling suburbs — decentralized shopping locations and an increase in driving needs of multiple-worker families.

When faced with rising gasoline prices, Canadian and US consumers have historically put big-ticket items (e.g., autos, appliances, furniture) on the back burner (see charts 3, 4) — with a lag of up to two quarters — while smaller discretionary purchases (e.g., eating out, entertainment, apparel) show considerably less evidence of crowding out (see charts 5, 6). Canada displays more sensitivity for both types of discretionary spending, given higher relative gasoline prices, a colder climate and traditionally more financially cautious consumers. In both countries, this relationship broke down from late 2008 to early 2010, given extraordinary circumstances of the recent downturn — which prompted households to cut back on all types of spending — but seems to have since resumed. Given that fuel prices are expected to remain elevated, we would expect a structural shift in discretionary spending to occur, translating into higher demand for more fuel-efficient vehicles and household goods.

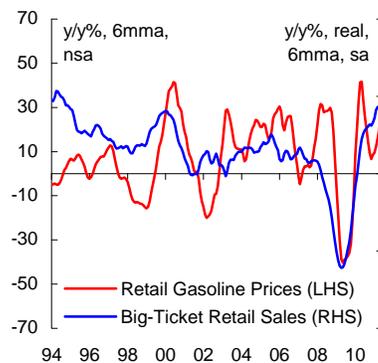
Charts 1, 3, 5

**U.S. - High Pump Prices Curb Gasoline Demand**



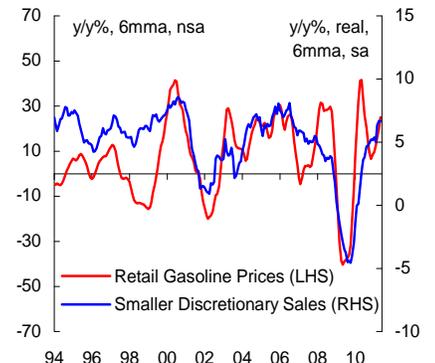
\*Data from January 1983 to May 2011  
Source: EIA, Scotia Economics.

**U.S. - Rising Gasoline Prices Put Big-Ticket Items On Hold**



Source: EIA, U.S. Census Bureau, Scotia Economics.

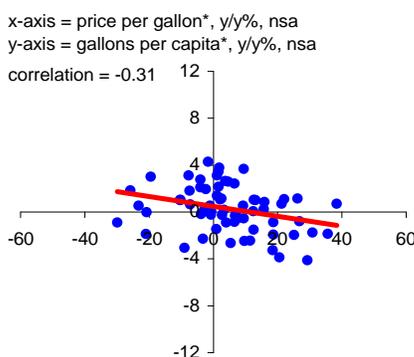
**U.S. - But Smaller Discretionary Purchases Remain Less Sensitive**



Source: EIA, Scotia Economics.

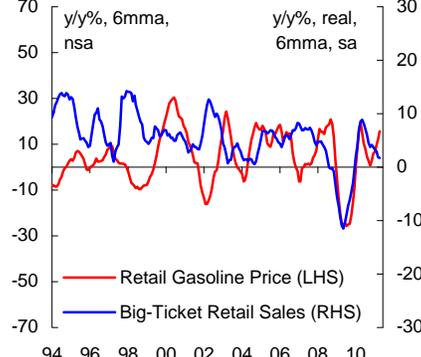
Charts 2, 4, 6

**Canada - High Pump Prices Also Lower Gasoline Demand**



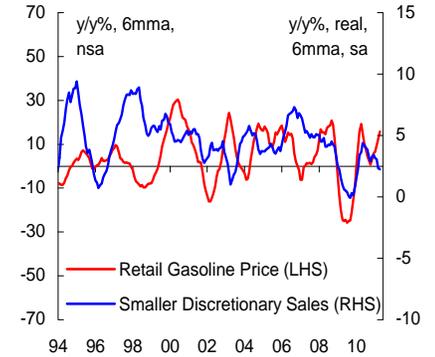
\*Data from January 1994 to December 2009.  
Source: Statistics Canada, Scotia Economics.

**Canada - Big-Ticket Sales Also Take A Hit**



Source: Statistics Canada, Scotia Economics.

**Canada - Smaller Discretionary Purchases Somewhat Less Affected**



Source: Statistics Canada, Scotia Economics.

Karen Cordes Woods (416) 862-3080  
[karen\\_woods@scotiacapital.com](mailto:karen_woods@scotiacapital.com)

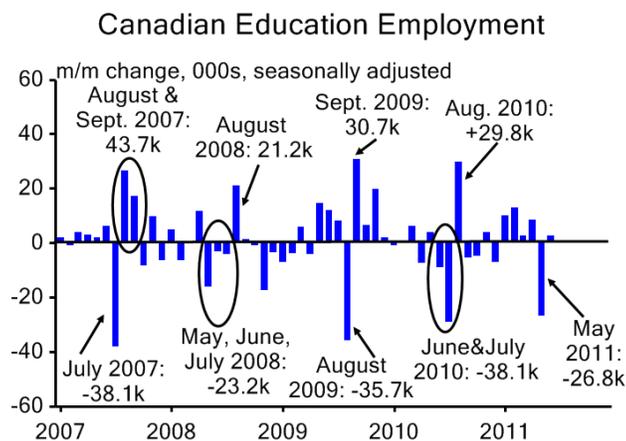
Derek Holt (416) 863-7707  
[derek\\_holt@scotiacapital.com](mailto:derek_holt@scotiacapital.com)

## Be Skeptical of Canada's Summertime Job Reports

- Huge swings in the education sector could distort the headline tally again.

All else being equal, Canada may be poised for a bigger-than-average monthly job loss in the July jobs report due a month from now, followed by a higher-than-average monthly job gain in either August and/or September. Given market tendencies to react to headlines without delving further, there is the risk that the front end of the Canada curve could be accordingly whipsawed around each jobs report.

As the accompanying chart shows, the culprit lies in mythical gyrations in education sector employment that began in 2007. Teacher and related jobs appear to have artificially become as volatile as Wall Street jobs. The data is seasonally adjusted, but since 2007, education sector jobs have been very volatile over the summer months.



Source: Statistics Canada, Scotia Capital Economics

Note that Statistics Canada has revised education sector employment compared to the last time this was an issue last summer in order to lessen some of the effect, but there are still material distortions. Revised figures show that in 2007, a sharp decline of 38,000 education sector jobs in July was followed by a gain of 26.5k in August. There was little effect in 2008 when May witnessed a decline of 16k jobs and was then followed by small declines in June and July, only to be followed by a 21k rise in August. The effect came back in July 2009, however, when August posted a 36k decline that was almost entirely reversed the following month. Lastly, 2010 witnessed 29k jobs lost in the education sector and an offsetting gain the following month. Thus, the exact months in which the hiring and firing distortions occur is unstable from one year to the next but is regularly observed in stand-out fashion over recent summers.

This year witnessed a 27k decline in education sector workers in May and small 3k rise in June, suggesting parallels to 2008 when June and July were non-events but August saw a large gain. That might suggest an earlier effect than in past years, but all of the losses in May of this year were at postsecondary educational institutions and that isn't traditionally where the sampling problems have occurred. Thus, perhaps July of this year will indeed witness a large decline in education sector jobs. But why are such distortions occurring?

The heart of the matter is that education sector contracts have changed materially, and in two ways. One is greater use of temporary contracts that have gained as a share of overall employment in the education sector. Two is a push toward shorter contracts than the past use of twelve-month agreements that get renewed each September. These two factors mean that education sector jobs are wildly distorted especially during the summer school break since, in response to the LFS survey, one technically has to respond that s/he is not presently employed during the period in which no contract is available regardless of prospects for its renewal at the start of each new school year. Perhaps this effect moved into postsecondary educational institutions this year and did so more in keeping with their shorter academic year.

In total fairness to Statistics Canada, it is not simple to control for such distortions. Seasonal adjustment factors have become unstable during this period. Further, a panoply of school boards within the provincial area of jurisdiction over education policy may all be taking somewhat different approaches to contracts which only compounds the problem in adjusting for the distortions. What would help, however, would be greater richness in alternative measures of the health of Canadian job markets that would be more on par with the variety of such indicators in the US regardless of whether the development of such indicators is led by the public or private sector.

Oscar Sánchez (416) 862-3174  
[oscar\\_sanchez@scotiacapital.com](mailto:oscar_sanchez@scotiacapital.com)

Sacha Tihanyi (852) 6117-6070  
[sacha\\_tihanyi@scotiacapital.com](mailto:sacha_tihanyi@scotiacapital.com)

### **Thailand's Smooth Electoral Process Reinstates Bullish Financial Market Tone**

- **A sound fundamental backdrop for Thailand's securities markets remains in place.**
- **Manufacturing output gains in June-August will underpin a GDP rebound in 3Q2011.**
- **External flows set to strengthen currency following pre-electoral weakness.**

The victory at the polls for the Pheu Thai (PT) party will assure the formation of a stable government in Thailand. A stronger-than-expected 264 seat win by PT, and the acceptance by the military of the electoral results, sets aside pre-electoral uncertainties paving the way for the country to reap the benefits of a sound economic growth platform. Notwithstanding the strong mandate delivered to PT leader Yingluck Shinawatra, her approach and sensitivity to persistent divisions among the country's main power players will be central in minimizing political uncertainty.

Financial markets reacted positively in the wake of the election. Sovereign credit default swap (CDS) spreads came down to about 130 basis points (bps), from a recent peak at over 150 bps. The Thai stock market SET Index is up 4.5% so far this week, and the Thai baht (THB) has strengthened by 1.6% against the USD. These gains contrast starkly with second quarter underperformance.

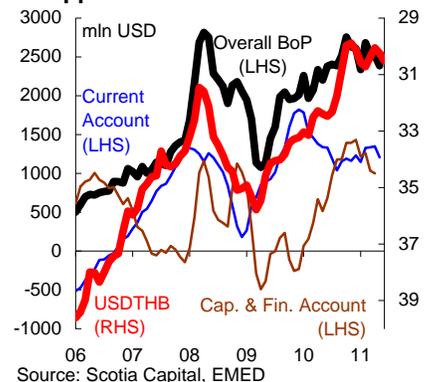
Thailand's economy will continue to be supported by robust local demand and solid foreign sales. Manufacturing output is rebounding as automobile producers were reportedly operating back at 90% capacity in June. With the vehicle industry representing 15% of factory output, and 6% of GDP, auto assemblies are set to reach 467 thousand units in June-August, implying an annualized 5% gain in the country's GDP during the third quarter (the largest contribution worldwide from auto assembly resumption). THB weakness, brought about by the electoral preamble, combined positively with limited labour cost gains, is set to result in an anticipated rebound in industrial output in the second half of 2011. We expect GDP to grow 4.8% y/y in 2011, following an extraordinary 7.9% gain in 2010.

A securities selloff during the second quarter underpinned the outflows in the country's external financial account hindering the THB. While export values remained stable, trade volumes deteriorated on the back of regional supply-chain disruptions. As a result, the sum of current and financial account flows fell into rare deficit territory in May. Looking ahead, as factory output rebounds on a quicker-than-expected resumption in the flow of key inputs, Thailand's current account surplus looks set to turn positive.

The combination of an expected rebound in trade flows, along with a more buoyant financial account on improved investor sentiment, implies that a key THB-supportive balance of payments trend is set to regain momentum (see chart). Combined with a clearer political environment, such fundamentals will instill a strengthening tone in the currency, leading us to continue to expect the THB to close at 29.0 at end-2011, and at 28.0 at end-2012.

While also impacted by elevated food costs, a relatively stable inflationary environment bodes well for financial stability. We expect the Bank of Thailand (BoT) to continue with the process of interest rate normalization. This factor will acquire greater relevance in coming months should fiscal initiatives by the incoming government be put forward in order to validate campaign proposals. BoT vigilance will thus remain a key concern of market participants as they will look to policymakers to negate any risk of a wage-price spiral. Such a proactive monetary policy stance would also do well in supporting our THB outlook.

**USDTHB vs. External Balances:  
Supportive Trends To Resume**



### **Portugal and Ireland Work Hard to Differentiate from Greece**

- **Lack of economic growth threatens the achievement of fiscal targets.**

Portugal and Ireland are facing the difficult tasks of regaining investor confidence and preventing deeper contagion from the persistent turmoil in Greece. The two countries remain decisively on the path to fiscal sustainability, though enormous challenges remain ahead.

Portugal's economic programme – supervised by the European Union (EU) and the International Monetary Fund (IMF) – aims to restore fiscal credibility and stabilize the country's debt level while limiting adverse impacts on economic growth. While Portugal's fiscal situation is not nearly as worrisome as that of Greece, the country's outlook is clouded particularly by subdued economic performance. Real GDP expansion averaged 0.7% over the past ten years and negative growth is expected through the next couple of years, making sustainable progress on the fiscal front challenging. While Portugal has not suffered from a real estate bubble, elevated financial and corporate sector indebtedness, and associated deleveraging efforts, highlight the challenges for the economic recovery. Indeed, Portugal will remain in recession for an extended period of time on the back of front-loaded fiscal consolidation efforts combined with the ongoing repairing of private sector balance sheets. The country's real GDP is expected to contract by around 2% this year (output declined by 0.6% q/q in Q1 2011) and in 2012, following an expansion of 1.4% last year. A rebound from a low base can be expected in 2013.

One of the factors working in favour of Portugal's fiscal efforts is the broad political support of the majority government for decisive actions. Under the EU/IMF's economic program, Portugal is committed to bringing its fiscal deficit to 5.9% of GDP this year from 9.1% in 2010 (and from 7.7% of GDP in Q1 2011), and further to 3% by 2013. Public debt – which stood at 93% of GDP in 2010 and continues to increase – is aimed to be stabilized by 2013. To meet the programme targets ahead of time, the new government, which took office at the end of June, is implementing tougher measures than those initially agreed with the multilateral creditors. The austerity program includes such efforts as privatization of public sector assets, public sector pension cuts and wage freezes, cutbacks in the public sector work force and reductions in government spending, as well as several tax hikes and measures to broaden the income tax base. In addition, structural reforms are planned to improve the economy's productivity and make its labour force more flexible.

Ireland is continuing its rigorous austerity drive in order to differentiate itself from Greece. Like Portugal, Ireland enjoys broad policy consensus regarding the importance of bring public finances back to a sustainable path. The majority government, in office since March 2011, has adopted a comprehensive strategy to reorganize and deleverage the domestic banks – the root of Ireland's fiscal woes. The country's ambitious fiscal restraint plan aims to scale back Ireland's deficit to 2.7% of GDP by 2014 from the shortfall of 32.4% in 2010, which included capital support to the country's troubled banks equivalent to roughly 20% of GDP. According to statements by Irish policymakers, fiscal consolidation is on track, though due to uncertain economic performance the administration is preparing to make larger-than-anticipated adjustments in the 2012 budget in order to meet next year's deficit target of 8.6% of GDP. The public sector debt (96.2% of GDP in 2010) will likely exceed 125% of GDP by 2013 before starting to show signs of stabilization.

Ireland will record a fourth consecutive year of economic contraction in 2011 (which we estimate at -1/2%). The cumulative decline in output in 2008-2011 will be close to 13%, and the economy is unlikely to reach 2007 levels until mid-decade. This punishing downturn follows an extended period of rapid expansion: in the ten years preceding the recession, annual growth averaged 6¼%. High levels of joblessness, a slump in household incomes, and a sharp drop in household wealth resulting from a pronounced real estate collapse point to another year of decline in consumer spending. The retrenchment in business investment may be even deeper, constrained by over-capacity (particularly in the commercial property sector), weak demand and tight credit conditions. Going forward, growth dynamics will be largely dependent on the external sector.

Daniela Blancas (416) 862-3908  
[daniela\\_blancas@scotiacapital.com](mailto:daniela_blancas@scotiacapital.com)

Pablo Bréard (416) 862-3876  
[pablo\\_breard@scotiacapital.com](mailto:pablo_breard@scotiacapital.com)

### **Promising Currency and Economic Outlook in Colombia**

- **Monetary tightening on the horizon.**

The Colombian exchange rate environment is in the process of consolidation after a sustained strengthening phase. The Colombian peso (COP) enjoyed solid gains in the second quarter supported by large foreign capital inflows and positive terms of trade. A steady stream of foreign exchange revenue will allow the government to set up a stabilization fund with excess revenue from bullish commodity markets. The central bank counts on US\$30 billion in international reserves at present. Interest rate differentials, renewed USD weakness, concerns over debt sustainability in the European periphery, global excess liquidity and economic recovery, together with credit ratings upgrade revisions, have helped Colombian assets to revalue.

Colombia's creditworthiness continues to improve: the country's sovereign debt ratings achieved a "full" investment grade status (S&P, Moody's and Fitch) in the second quarter of 2011, supported by an enhanced fiscal and government debt profile. The outlook for the ratings is "stable". Moreover, global investors and bondholders welcomed the extension of a two-year IMF Flexible Credit Line (FCL) of US\$6.2 billion in May 2011, which the authorities intend to treat as a precautionary financing vehicle. The Colombian stock market has been recently subject to profit-taking activity and consolidation trading in line with trends present in top-tier emerging markets like Brazil and China. In addition, a potential review of the equity market integration initiative negotiated with Peru and Chile following the election of President Humala may cause near-term volatility.

The outlook for economic activity remains promising; indeed, recent economic indicators point to a period of sustainable expansion supported by healthy domestic household consumption, extensive access to credit and improved labour market conditions. The economy, which expanded by 5.1% y/y during the first quarter of 2011, may reach trend growth levels during the second half of the year. Despite encouraging indicators on the consumption front, confidence levels, net foreign trade and gross investment trends show a less optimistic view. We expect the Colombian economy to grow at an annualized rate of 5% over the next 18 months. Despite the need of further structural labour market reforms to reduce the unemployment rate to single digits, the restoration of trade relations with Venezuela is a positive growth and employment factor for Colombia.

The external sector remains vibrant. Both exports and imports are growing at annual average rates above 30% on the back of ongoing strong demand for Colombian export goods (such as crude oil, coffee and coal) and improved purchasing power due to favourable employment conditions and steady currency appreciation. Despite positive terms of trade, the external sector will not be a positive contributor to GDP expansion this year. The current account deficit will widen, yet it will remain at a manageable level equivalent to 3% of GDP. Massive foreign direct inflows eyeing the mining-energy sectors will be the main source for funding the external gap. The government continues to show its commitment to fiscal consolidation: new legislation aimed at creating a structural fiscal rule –modeled after Chile– was passed by Congress to address structural issues and reduce the deficit from an estimated 4% of GDP in 2011 to 2.3% in 2014.

An interest rate normalization phase is under way. The central bank has been tightening monetary conditions since the beginning of the year, taking the policy-setting intervention interest rate to 4.25% from 3%. The inflation outlook does not present worrisome signals, yet the *Banco de la República* is acting on a pre-emptive basis to ensure that the headline inflation rate remains well contained within the official 2-4% target range. Commodity and food prices have fed inflationary pressures (3.2% y/y in June). We estimate that further tightening is in store and that the rate of consumer price inflation will close the year near the mid-point of the range.

Gaelan Mackenzie (416) 607-0058  
gaelan\_mackenzie@scotiacapital.com

Mary Webb (416) 866-4202  
mary\_webb@scotiacapital.com

### Emerging Economies' Health Care Opportunities

- From varied starting points, emerging nations face significant health care changes.

In emerging economies<sup>1</sup>, the tremendous scope for future consumer demand includes health services, with the important but complex objective of improving health outcomes. Yet emerging nations, despite their relatively upbeat economic prospects, face challenges as well as opportunities in achieving affordable health care for their entire populations. Offering potentially important lessons will be developed nations' ongoing efforts to attain sustainability in their own health care systems.

Among the nine emerging economies of the G20, the priority placed on health care varies substantially. Total health spending in 2009 ranged from 2.4% of GDP in Indonesia to a high of 9.5% of GDP in Argentina (*top chart*), compared with a 9½% OECD average<sup>2</sup> and a G7 average just above 11%. Access and equity issues are major concerns for emerging economies, with the public-sector share of total health spending averaging roughly 55% among the nine G20 emerging economies relative to the OECD average of almost 71% and the G7 average of nearly 73%. In addition to tax revenues, a common health financing method for emerging nations is social health insurance (SHI), with employers collecting health premiums on behalf of the government, thereby restricting this health coverage to paid workers in the formal economy. While the emerging G20 governments' health financing decisions vary widely, a general trend begins with a very modest package of covered services, often accompanied by co-payments, with services added incrementally as coverage expands under more comprehensive social insurance systems.

With both public-sector health services and private health insurance limited in many emerging nations, and the cost of many health treatments and tests elevated and rising, reliance is heavy on out-of-pocket payments for health care. As a share of total health spending in 2009, out-of-pocket payments averaged only 13% for the G7 and just over 19% across the OECD, but 28½% for the nine G20 emerging economies (*bottom chart*). For many emerging nation households, current health care systems spur precautionary saving, discouraging other consumer spending. A saving option existing in several countries, such as China, requires specific population segments to allocate prepayments for health services to a pooled fund that mitigates individual household risk. Though a process, not a quick fix, these prepayment programs could represent an important step forward in financing expanded health services.

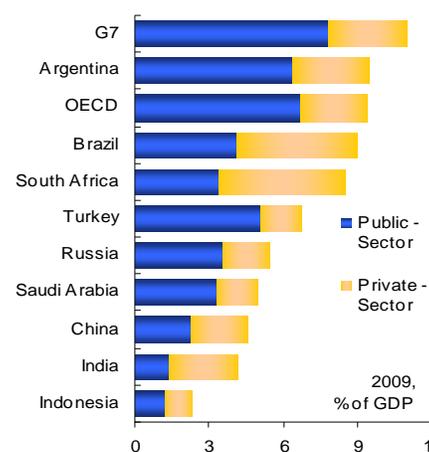
Other health care challenges facing emerging nations' governments include marked urban-rural dichotomies, with rural residents' isolation from urban health services exacerbated by travel difficulties, lower incomes, and rural deficits in other government services. Emerging economies must also deal with the shift in disease patterns from infectious to chronic ailments (i.e., diabetes) that accompanies rising incomes and lengthening life expectancies. Additionally, for emerging nations with population growth expected to outstrip the G7 experience, substantial health capital requirements will be pushed higher. Amongst emerging nations, some will benefit from relatively young populations while others face an expanding elderly cohort with greater health care demands.

<sup>1</sup> Excludes low-income nations. Data for article from the World Health Organization's *National Health Accounts*.

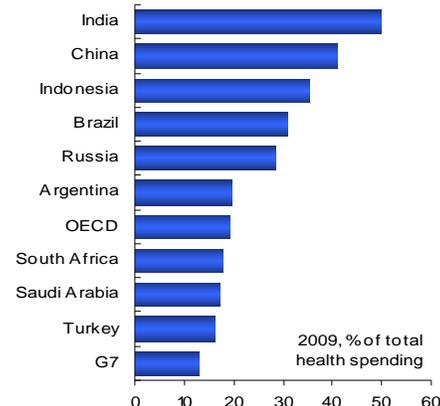
<sup>2</sup> Averages for country groupings are unweighted.

Please see *Fiscal Pulse (July 8)* report for further details.

The G20 Emerging Economies: Total Health Expenditures ...



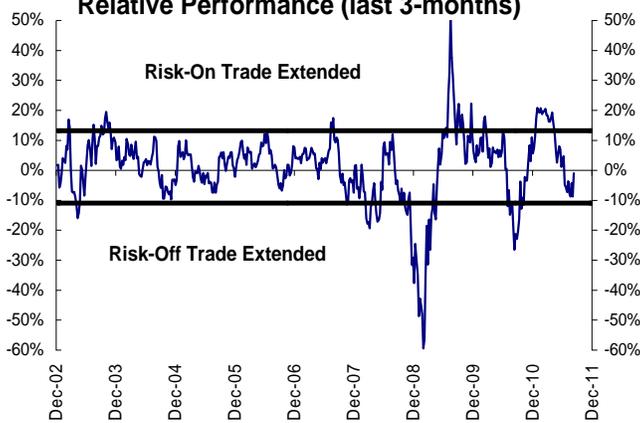
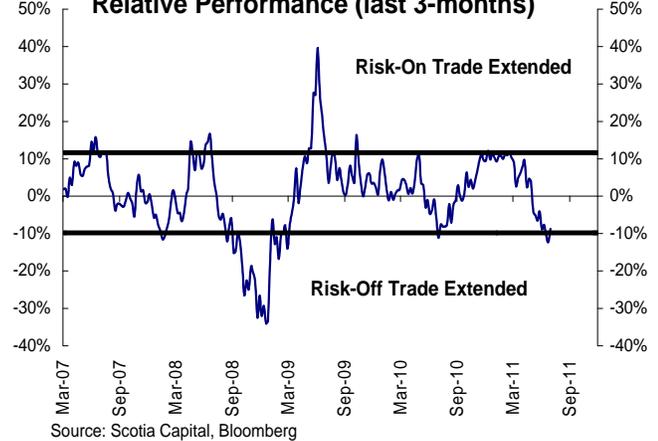
... and Out-of-Pocket Health Spending



Source: World Health Organization.

**Global Portfolio Strategy - Summer 2011 Update****Risk-Reward Has Shifted, Raising Equities & Cyclical**

- Since the start of 2011, we have been cautiously managing risk exposure in our asset mix and equity strategy as prospects of slower economic growth (from recovery to expansion) and tighter monetary policy (especially in developing countries) threatened risk appetite. In addition, equities and cyclicals outperformance appeared overextended after last year's second half rebound. The S&P 500 surged 22.0% from June 2010 to December 2010, while long-term Treasuries (TLT index) declined 7.5%. Consequently, our "risk-on/risk-off" barometers highlighted an extended "risk-on" trade late 2010/early 2011 (see Exhibits 1 and 2).

**Exhibit 1: S&P 500 vs. LT Bonds (TLT) - Relative Performance (last 3-months)****Exhibit 2: TSX vs. LT Canada Bonds (XLB) - Relative Performance (last 3-months)**

- After a strong start to 2011 (MSCI World was up 5.2% YTD as of February 18), mean-reversion pointed to strong odds of an imminent bond and defensive recovery. Japan's negative impact on U.S./global manufacturing, which we believe will be temporary, spiking gasoline costs (currently reversing), and sustained euro debt fears finally triggered Q2's flight-to-quality. Equities (S&P 500 +5.4%/TSX +5.0% in Q1) outperformed long-term bonds (TLT -2.1%/XLB -2.7% in Q1) in the first quarter, but leadership reversed in the second quarter. In the April to June quarter, long-term bonds (TLT +2.1%) edged out equities (S&P 500 -0.4%; TSX -5.8%). With U.S. 10-year bond yields hitting 2.85% levels on June 24 (-90 bp since their peak in February) and the S&P 500 slipping 6.8% from May 10 to June 15, we believe the risk-reward outlook has shifted back in favour of equities and cyclical sectors. We are not at extreme levels, but the "risk-on" opportunity is now looking more compelling than it did six months ago.
- Our objective for 2H/11 will be to position our asset mix and equity strategy for equity/cyclical sector outperformance. We are rolling our forecast period forward to December 2012 and adjusting our S&P 500 target to 1,450 (was 1,400). Our S&P/TSX target remains unchanged at 14,750. We also see U.S. 10-year bond yields increasing towards the 4% level. Based on our 12-to 18-month price forecasts, we expect a 10% total return for equities versus -2% for bonds and 1.5% for cash. We are raising our recommended equity weighting (+4%) and reducing both Bonds (-2%) and Cash (-2%). Our global equity bias remains unchanged, and we are sticking to a developed market (DM) over emerging market (EM) preference. The MSCI EM has lagged the S&P 500 by 4.6% and 3.3% over the last six and 12 months, respectively. LatAm (-3.3% YTD) has underperformed Asia Pacific ex-Japan (-1.0% YTD). We remain more cautious on markets where inflation pressures are fuelling monetary tightening. See Exhibit 3 for our recommended asset mix.

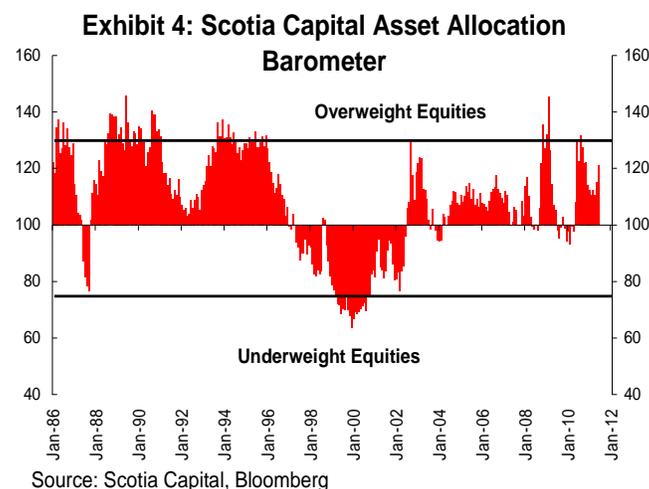
... continued from previous page

	Asset Mix		Last Change (June 2011)	Expected Total Return Next 12-M
	Benchmark*	Recommended		
<b>Equities</b>	<b>60%</b>	<b>68%</b>	<b>4%</b>	<b>10%</b>
Canada (TSX)	5%	6%		
U.S. (S&P 500)	20%	26%	+2%	
Int'l (Europe, Japan)	18%	23%	+2%	
EM-Asia	10%	8%		
EM-LatAm	7%	5%		
<b>Bonds</b>	<b>40%</b>	<b>27%</b>	<b>-2%</b>	<b>-2%</b>
Government	30%	13%	-4%	-3%
Corporate	10%	14%	+2%	2%
<b>Cash (91-D Tbills)</b>	<b>0%</b>	<b>5%</b>	<b>-2%</b>	<b>1.5%</b>

\*Benchmark change on June 30, 2011.  
Source: Scotia Capital estimates

### 3 Reasons for the Equity/Cyclicals Upgrade

- Improved economic visibility in the second half.** U.S. GDP growth has hovered near 2% in the first six months of 2011, and the pace has been slowing down notably in the second quarter. A decline in auto production (-11% since March) and muted consumer spending following the spike in gasoline prices have taken their toll. More damaging to investor confidence, however, has been the extent of negative macro surprises in recent months. Not only has U.S. data been bad in April and May, but the extent of the misses has made it feel worse, in our view. A barometer of U.S. economic surprises has recently collapsed to the lowest level since the 2008 financial crisis. With consensus numbers and investor expectations adjusting lower, odds currently point to this “surprise index” reverting higher in coming months. The ongoing pick-up in Japan industrial production outlook since the post-tsunami paralysis (Japan’s manufacturing PMI has averaged 51 in May/June versus 46.4 in March) should also alleviate U.S. manufacturing fears, and we expect improving ISM visibility in the latter half of the year. Moreover, the recent 15% drop in gasoline prices should take some pressure off consumers. Finally, U.S. Employment Growth, while at sub-par levels, continues to support growth.
- Steep yield curve is equity and earnings friendly.** The slope of the U.S. yield curve (10-year minus 1-year) remains very steep, which is supportive for earnings and S&P 500 performance. In our opinion, 2011 is year three of the global economic/earnings recovery and current conditions (steep-yield curve) continue to point towards growth in profitability. Consensus earnings expectations for calendar 2012 are looking increasingly optimistic, but earnings growth should support higher equity indices heading into next year.
- Valuations & Tacticals pointing towards equities.** Forward P/E's currently range from 10x (Europe, China, Brazil) to 14x (India, Mexico). Canada’s 13.1x P/E multiple is 8% above the S&P 500’s forward P/E (12.1x). Valuations should remain below average in coming months, but we expect modest upside from currently low levels. P/E expansion appears more constrained in regions where real interest rates are moving higher. Our models point to S&P 500 fair value of 1,470 and 4.5% for U.S. 10-year yields. Bottom line: the S&P 500 is 10% undervalued and 10-year bonds are 9% overvalued. This 19 percentage point spread favouring equities is at the highest level since Q3/10.



Vincent Delisle (514) 287-3628  
[vincent\\_delisle@scotiacapital.com](mailto:vincent_delisle@scotiacapital.com)

## **Model Portfolios & Sector Strategy — July Update**

### **Negative quarter for equities in Q2, U.S. and Europe leading YTD**

- Although financial markets ended the last week of June with a furious rally, global equity performance was negative in the 2H/11. The MSCI AC World Index was down 1% in Q2 (in U.S. dollars) with most developed markets (DM) outpacing emerging markets (EM). *The following performance numbers are rounded and translated into U.S. dollars.* Germany (+7%), the United Kingdom (+1%), Japan (+0%), and the United States (+0%) outperformed the MSCI AC World in Q2, while EM (-2%), Latin America (-4%), China (-4%), and Canada (-5%) underperformed. Canadian equities lagged the United States for the first time since Q4/09, and Mexico's performance (-1%) outpaced Brazil's (-5%).
- Since the start of 2011 (June 30 close), the MSCI AC World is up 3% with Europe (+7%) and the United States (+5%) outpacing EM (-1%). Canada's TSX index is up 2% YTD (-1.1% in Canadian dollars), and Mexico (-1%) is outperforming Brazil (-3%) so far in 2011.
- Bond performance was positive in Q2 as risk aversion triggered a decline in yields and pushed commodities prices lower. 10-year yields slipped 31 bp to 3.16% and long-term Treasury bonds total return topped 2%. In Canada, the DEX Universe Bond Index advanced 2.5% (total return, in Canadian dollars) in Q2. Since the start of the year, U.S. equities are outperforming long-term bonds. In Canada, the TSX (-1.1% YTD) is lagging long-term bond performance.

### **Defensive leadership in Q2, negative first half for Materials**

- Defensive sectors took over leadership in the second quarter as global equities were pulling back. Commodity sectors suffered the most, which hurt the TSX relative to the main global benchmarks. In Canada, Telecoms (+8%), Health Care (+3%), and Consumer Staples (+2%) were the top outperformers among the 10 major GICS sectors in Q2. Technology (-31%), Energy (-9%), Materials (-9%) lagged the most in Q2. Diversified Metals and Mining (-1%) outpaced Golds (-8%), while Insurance (-2%) edged out Banks (-5%). Industrials (+1%) were the only cyclical sector to post a gain in the April to June quarter.
- In the United States, all S&P 500 cyclical sectors posted losses in Q2 with the exception of Consumer Discretionary (+3%). Health Care (+7%), Utilities (+5%), and Consumer Staples (+5%) topped sector returns in the April to June period. Financials (-6%), Energy (-5%), and Technology (-2%) were the top underperformers.
- Year-to-date (June 30 close), Canadian sector returns have been led by Health Care (+56%), Telecom (+11%), and Industrials (+10%). Health Care's stunning performance was driven by the sector's only major stock. Technology (-31%), Golds (-13%), and Materials (-10%) have lagged the most so far in 2011 on the TSX. In the United States, the S&P 500's 2011 gain of 5% has been driven by Health Care (+13%), Energy (+10%), and Discretionary (+8%). Financials (-4%), the only S&P 500 sector posting negative returns for the year, along with Technology (+2%) and Materials (+3%), round out the index's most visible lagging performers.

### **Sector Strategy & Model Portfolios - July Update**

- Year-to-date, the Strategic Edge Portfolio (SEP-Canadian large cap) is up 2.2% (total return) and is outperforming the TSX by 200 bp. See Exhibit 1 for historical SEP performance since 2005. Our lower beta, Industrials/Banks/Fertilizers focus, and Materials-Golds underweight bias paid off in 1H11.

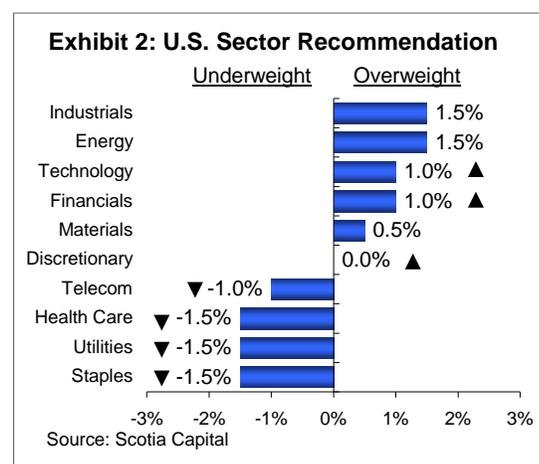
Vincent Delisle (514) 287-3628  
[vincent\\_delisle@scotiacapital.com](mailto:vincent_delisle@scotiacapital.com)

... continued from previous page

Exhibit 1: Strategic Edge Portfolio Performance (Total Return)			
June 30, 2011			
Performance -- Total Return (%)			
Period	SEP	S&P/TSX	Value Added (bp)
June	-2.71%	-3.33%	62
3-M	-5.2%	-5.1%	-4
6-M	2.2%	0.2%	200
YTD	2.2%	0.2%	200
1-Yr	29.1%	20.9%	825
CAGR (%)			
3-Yr	7.0%	0.2%	686
Inception (June-05)	11.2%	7.9%	335
Annual (%)			
2005	13%	15%	-156
2006	16%	17%	-144
2007	11%	10%	156
2008	-28%	-33%	495
2009	42%	35%	704
2010	24%	18%	648

Source: Scotia Capital, Bloomberg

- Since 2009, we have been tactically adjusting our sector strategy to benefit from sporadic risk-on/risk-off leadership cycles. In sync with our asset mix changes, we are now looking to gradually increase cyclical exposure in anticipation of a stronger second half for equities/cyclicals.
- **SEP changes:** reducing Cash (-3.5%), Staples (-1%), Utilities (-1.5%), and Banks (-1.5%); increasing our exposure to Energy (+3%), Base Metals (+2.5%), and Insurance (+2%). Canadian sector focus is in Industrials, Technology, Energy, Fertilizers, and Insurance. We remain underweight the TSX Gold sector. Encana Corporation (ECA) is exiting the portfolio, and Canadian Pacific Railway Limited (CP) joins the Industrials group.
- In-line with our sector changes in the SEP, the U.S. sector model portfolio (Exhibit 2) is also moving towards higher exposure in cyclical sectors. The U.S. portfolio reflects our pure play sector views based on S&P500 sectors.



## Vital Statistics — UK On Strike

### Counting the cost

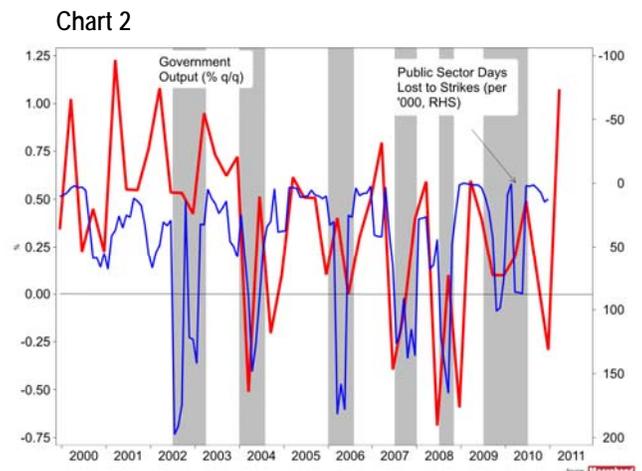
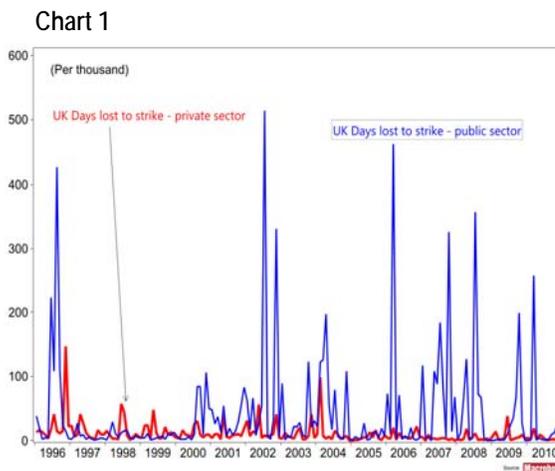
Last Thursday marked the first of potentially several strikes by parts of the UK public sector in protest of changes to pensions. We attempt to quantify what impact this could have on the UK economic data. The bottom line is that GDP could suffer by around 0.1 percentage point.

- Reports suggest that 750k public sector workers were expected to take part in a 24 hour strike. In the context of the UK economic data, public sector strikes tend to have a bigger impact than strikes in the private sector. In particular, the closure or disruption of around 11,000 schools has the potential to have amplified the impact on lost output since for some parents the lack of childcare arrangements may have provoked absence from work. Furthermore, it is hard to substitute away from those services provided by the public sector (such as schools or migration services in the major airports).
- The flipside is that if industrial action is well telegraphed, which in this case it has been, then firms and households are able to make contingency plans to avoid spillover effects into non-striking industries. Perhaps the best example is the ability to work from home. Similarly, although childcare considerations may cause non-striking workers to be absent from work, in some cases this may mean taking a day's holiday which might have been taken anyway – just on a different date later in the year.
- In the most extreme cases, workers have a legal right to take a day of unpaid leave to cope with an emergency involving a dependent. Our emphasis here would be on 'unpaid' especially in an environment where household real disposable incomes are under intense pressure. Faced with a loss of a day's income or going the extra mile to arrange childcare (either with family, friends etc) we suspect most would opt for the latter.
- Nonetheless, we have attempted to quantify how much impact this strike action could have on UK output. Participation in Thursday's strikes was estimated to have included 750k workers, but clearly this could rise at future walkouts. Assuming that on average 1 million workers out of total employment of around 30 million are involved in 5 days of walkouts (given 230 working days in a year) and assuming no spillover effects to non-striking sectors, then **that would knock 0.05 percentage points off of annual GDP** from an output perspective. The most evident corollary to that in terms of GDP by expenditure is likely to be weaker consumption given lost wages for striking workers (especially in an environment of falling real disposable income growth and little in the way of a savings buffer).
- Clearly if the strikes are more prolonged or there are substantial spillovers to non-striking sectors of the economy, then the effect on overall GDP would be amplified. Reports suggest that around 1/3 of schools were closed due to this strike. On the assumption that 1/3 of those employed have a child that would need alternative care arrangements on strike days, and 1/3 of those were absent from work due to lack of childcare, that would imply that close to another 1 million workers could be absent on strike days. **That would therefore take the drag on headline GDP (for the year) up to 0.1 percentage points.** If that is spread over 2 or more quarters it is going to be pretty hard to notice that impact. Clearly there is lots of wiggle room in these estimates – both for greater participation and more strike days, but it is a start.
- If things get ugly, there are other ways that the strike action could impact the economy. The rating agents have afforded the UK government a degree of forbearance. Part of this includes the fact that the general public is broadly in favour of the coalition government's plans to consolidate the budget deficit. However, if the strikes become more widespread and public opinion turns against the government, this could, at the margins, reinforce the threat to the UK's AAA sovereign rating. With public sector workers accounting for 20% of overall jobs, and that sector now undergoing the downgrading to pension plans that the other 80% who work in the private sector have already gone through, it appears doubtful that public support will collapse any time soon.

... continued from previous page

### History Lessons

- We have examined the data on working days lost to strikes to gauge what past experience of strikes might tell us about the likely economic impact. Chart 1 confirms that days lost to strike action (per thousand) are far more significant in the case of the public sector than the private sector.
- When we superimpose the government output component of GDP on the days lost to strikes there appears to be a tentative link between periods of elevated strike action and dips in government output (Chart 2).



- In five of the six episodes of public sector strikes over the last decade, there has been a tangible drag on the government output component of GDP. In the worst cases, government output slipped by around 0.5% q/q. Given a weight of almost 25% in overall GDP, that suggests a drag on overall GDP of around 0.1 percentage point – similar to our estimates above.

### Conclusion

Our best guess is that a spell of public sector strikes will drag around 0.1 percentage point from GDP on the assumption of at least another 4 strike days of the scale of that seen last week. If this is concentrated in Q3, it is likely to come at a time when the GDP data are bouncing back from an artificially depressed Q2. Hence it would mildly hold back the strength in Q3, though not by much. However, much of Q3 is school holidays, hence strike action would be more likely to spill over into Q4. On the one hand spreading the impact over a longer period will mean it is harder to spot in the economic data. That said, growth is likely to be less robust during Q4 meaning a subtraction of 0.1 point is a bigger chunk of overall growth. Much will depend on when and how intense future strike action is.

Karen Cordes Woods (416) 862-3080  
[karen\\_woods@scotiacapital.com](mailto:karen_woods@scotiacapital.com)

Derek Holt (416) 863-7707  
[derek\\_holt@scotiacapital.com](mailto:derek_holt@scotiacapital.com)

## Key Data Preview

### CANADA

Housing is expected to only modestly add to Q2 GDP growth, with business investment as the main driver in Canada. However, recent gains in **housing starts** (Monday) - in part due to demand being brought forward due to the changes in mortgage regulations—suggest that housing may have a stronger impact on Q2 GDP growth than previously expected. In fact, next week's housing starts report for June will likely witness another increase after the number of building permits rose by over 10% m/m in May. While the gains will likely be tilted toward the multi-family segment and thus not provide as much support to economic growth as would be the case if all of the growth stemmed from single-family starts, housing starts should still experience a roughly +2.5% gain in Q2. Having said that, we continue to expect housing to cool going forward as household demand wanes amid cycle top levels for several housing metrics including homeowners affordability.

**Canadian manufacturing shipments** (Friday) declined over 1% m/m in April on the back of a drop in auto production due to supply chain constraints from the Japanese earthquake/tsunami in mid-March. While auto production has now come back on line in Canada, we may witness another decline in shipments in May for three reasons. First, shipments fell less than expected in April given the large decline in auto production, suggesting that perhaps there is a lagged effect on the shipments numbers. Secondly, auto shipments were not the sole sector to witness a deterioration in April with 15 of 21 industries registering a decline in shipments on the month, suggesting that the Japanese effect may only partially explain the weakness in overall shipments. Lastly, crude oil prices dropped over 10% in May which, combined with weak US economic growth and a strong Canadian dollar, suggest that there are several headwinds still facing manufacturing shipments although a weak print in April does offer some support through the base effect. While not all shipments are exported, a good portion of them are, which is why the correlation between shipments and exports is quite tight. As a result, we will also likely witness a further decline in exports in May—especially in the autos sector after US auto sales pulled back by over 10% during the month— leading to a widening in the **international merchandise trade deficit** (Tuesday) once again.

### UNITED STATES

An over 10% m/m decline in crude oil prices will likely provide some support to **US trade** (Tuesday) through lower imports in May, along with a rebound in auto production, weaker US consumer spending, a weak U.S. dollar and continued growth in global demand, especially China. As a result, we are expecting a slight narrowing in the trade deficit.

There are several headwinds facing US consumers right now that will likely continue to put downward pressure on **headline retail sales** (Thursday). First, employment growth remains soft with the recent June nonfarm payrolls report showing an unexpected gain of only 18,000 while the unemployment rate moved up to 9.2%, the highest level since December 2010. Secondly, wage growth was flat in June on a month-over-month basis with inflation-adjusted wages falling even further. Third, hours worked continue to decelerate, suggesting that Americans are worse off than if you just looked at wage growth on its own. As a result, underlying fundamentals on their own point to a weak retail sales report in June. Add to this a decline in retail gas prices which will put downward pressure on gasoline station sales while we already know that auto sales dipped as well during the month. There are some offsetting pressures, however, including a rise in vehicle prices during the month as supply conditions remain tight, while lower crude oil prices should provide some relief to US consumers at the pumps although the magnitude of that relief is likely quite modest. Having said that, uncertainty over the direction of gasoline prices going forward may have kept many consumers on the sidelines. As a result, we are looking for headline retail sales to decline slightly in June, with core sales (excluding autos) unchanged on the month. Nonetheless, while markets will be watching the headline nominal results, the price-adjusted numbers are what matters more to us given its impact on economic growth and we will likely witness a modest gain on this front after two months of declines.

With gasoline prices down almost 6% m/m in June, **headline CPI** (Friday) could decline by a modest 0.1% m/m. Core CPI, on the other hand, will likely post a gain of about 0.1% m/m, in part due to temporary factors such as an increase in vehicle prices due to low inventory levels on the back of the Japanese crises. Overall, however, US inflation still remains well contained with core CPI below 2% and headline CPI likely to come down over the next few months, providing the Fed with further room to keep rates on hold.

Daniela Blancas (416) 862-3908  
[daniela\\_blancas@scotiacapital](mailto:daniela_blancas@scotiacapital)

Alan Clarke (44 207) 826-5986  
[alan\\_clarke@scotiacapital.com](mailto:alan_clarke@scotiacapital.com)

... continued from previous page

Tuuli McCully (416) 863-2859  
[tuuli\\_mccully@scotiacapital.com](mailto:tuuli_mccully@scotiacapital.com)

Oscar Sánchez (416) 862-3174  
[oscar\\_sanchez@scotiacapital.com](mailto:oscar_sanchez@scotiacapital.com)

## EUROPE

Consumer price inflation in the euro zone continues to exceed the European Central Bank's (ECB) target of "below, but close to, 2%" by a wide margin. The final print of consumer price inflation in June will be released on July 14<sup>th</sup>. According to the "flash estimate", the headline CPI increased by 2.7% y/y last month. We do not expect any major revisions to the preliminary data. Inflationary pressures will likely remain elevated, gradually nearing the 3.0% mark in Germany and 2.5% in France in the coming months, before showing signs of easing towards the balance of the year.

We forecast that UK CPI inflation will nudge higher in June, rising by 0.1 percentage points to 4.6% y/y – the highest since September 2008. Meanwhile we expect RPI inflation to remain stable at 5.2% y/y. The main influences on price pressures in June are likely to be food, clothing and transport costs. We expect food price inflation to continue to accelerate, reflecting further lagged pass-through of agricultural commodity prices into the CPI. Clothing and footwear saw unusually generous discounting in June 2010 – more than double the seasonal norm. We expect less generous discounts this June, which should add to the y/y inflation rate. The drop in the price of oil over the last month or so is likely to be translated to some extent into lower transport prices. However, surveys of petrol forecourts point to a moderate fall at this stage – down by only 0.6% m/m in June to around 135.9 p/litre. The joker in the pack (as ever) will be airfares as normal service was resumed after the extended Easter break.

## LATIN AMERICA

Retail sales data from April suggested that the Brazilian economy may start showing some signs of a slowdown. New numbers for May will be released on July 12<sup>th</sup>. Despite the fact that retail sales increased by 10% y/y in April, consumption decreased 0.2% from the previous month, the first monthly decline in a year. Consumers seem to be responding to tighter credit conditions. The Brazilian central bank has hiked the SELIC reference rate by 150 basis points since December 2010. Also, inflation and industrial production have shown signs of stabilization, though inflation remains at high levels. All these suggest that the Brazilian economy could start to move towards a more sustainable growth rate, taking some pressure off the monetary authorities in the second half of the year.

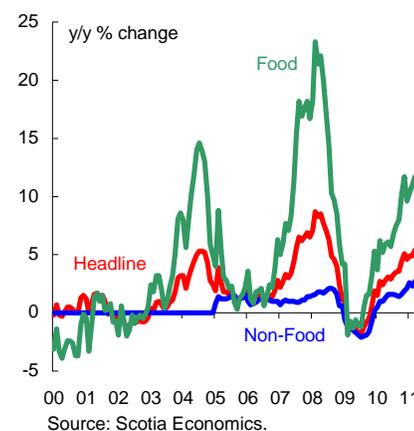
## ASIA

China's inflation is likely to have accelerated to a 6.5% yearly pace in June on the back of sharp pork price increases, which ran contrary to falling price pressures on other food items. Food inflation, the main driver of price gains, will thus show a rebound reverting recent stabilization. Non-food CPI is estimated to have picked up only slightly to 2.9% y/y, with the lack of severe pressures aided by the recent drop in commodity prices. The latter observation is consistent with recent evidence of decelerating producer price gains. Mid-year inflationary peaks in China will give way to more stable conditions as base effects kick in during the second half of 2011. We expect headline CPI inflation to close the year at 5% y/y.

**Brazilian Retail Sales**



**China's Inflation**



## Key Indicators for the week of July 11 - 15

North 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>
CA	07/11	08:15	Housing Starts (000s)	JUN	185.0	185.0	183.6
MX	07/11	09:00	Trade Balance (USD millions)	MAY F	95.0	--	555.3
CA	07/11	10:30	Business Outlook Future Sales Survey	2Q	--	--	13.0
CA	07/11	10:30	BoC Senior Loan Officer Survey	2Q	--	--	-31.7
CA	07/12	08:30	Int'l Merchandise Trade (CAD billions)	MAY	-1.1	-0.9	-0.9
US	07/12	08:30	Trade Balance (USD billions)	MAY	-42.0	-44.0	-43.7
MX	07/12	09:00	Gross Fixed Investment (YoY)	APR	--	6.9	5.8
MX	07/12	09:00	Industrial Production (YoY)	MAY	4.4	4.0	1.5
MX	07/12	09:00	Industrial Production (MoM)	MAY	--	--	-0.1
US	07/12	14:00	Minutes of FOMC Meeting				
US	07/13	07:00	MBA Mortgage Applications (WoW)	8-Jul	--	--	-5.2
US	07/13	08:30	Import Price Index (MoM)	JUN	--	-0.7	0.2
US	07/13	14:00	Monthly Budget Statement (USD billions)	JUN	--	-65.0	-57.6
US	07/14	08:30	Producer Price Index (MoM)	JUN	--	-0.1	0.2
US	07/14	08:30	PPI Ex Food & Energy (MoM)	JUN	--	0.2	0.2
US	07/14	08:30	Advance Retail Sales (MoM)	JUN	-0.1	0.0	-0.2
US	07/14	08:30	Retail Sales Less Autos (MoM)	JUN	0.0	0.1	0.3
US	07/14	08:30	Initial Jobless Claims (000s)	8-Jul	420	410	418
US	07/14	08:30	Continuing Claims (000s)	2-Jul	3690	--	3681
US	07/14	10:00	Business Inventories (MoM)	MAY	--	0.8	0.8
CA	07/15	08:30	Manufacturing Sales (MoM)	MAY	-0.5	-0.2	-1.3
US	07/15	08:30	Consumer Price Index (MoM)	JUN	-0.1	-0.1	0.2
US	07/15	08:30	CPI Ex Food & Energy (YoY)	JUN	1.6	1.6	1.5
US	07/15	08:30	Consumer Price Index (YoY)	JUN	3.6	3.6	3.6
US	07/15	08:30	CPI Ex Food & Energy (MoM)	JUN	0.1	0.2	0.3
US	07/15	08:30	Empire Manufacturing Index	JUL	--	4.2	-7.8
US	07/15	09:15	Capacity Utilization (%)	JUN	77.1	77.0	76.7
US	07/15	09:15	Industrial Production (MoM)	JUN	0.5	0.3	0.1
US	07/15	09:55	U. of Michigan Confidence	JUL P	--	72.5	71.5

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

## Key Indicators for the week of July 11 - 15

Europe								
Country	Date	Time	Event	Period	BNS	Consensus	Latest	
FR	07/11	02:45	Industrial Production (MoM)	MAY	0.6	0.5	-0.3	
FR	07/11	02:45	Manufacturing Production (MoM)	MAY	0.6	0.3	0.2	
UK	07/11	19:01	BRC Sales Like-For-Like (YoY)	JUN	--	-1.4	-2.1	
UK	07/11	19:01	RICS House Price Balance (%)	JUN	--	-24.5	-28.0	
GE	JUL 11-18		Wholesale Price Index (MoM)	JUN	--	-0.2	0.0	
UK	JUL 11-15		Nationwide Consumer Confidence	JUN	--	52.0	55.0	
FR	07/12	01:30	CPI - EU Harmonised (MoM)	JUN	-0.1	0.1	0.1	
FR	07/12	01:30	CPI - EU Harmonised (YoY)	JUN	2.1	2.2	2.2	
FR	07/12	01:30	Consumer Price Index (MoM)	JUN	-0.1	0.1	0.1	
FR	07/12	01:30	Consumer Price Index (YoY)	JUN	1.9	2.1	2.0	
GE	07/12	02:00	Consumer Price Index (MoM)	JUN F	0.1	0.1	0.1	
GE	07/12	02:00	Consumer Price Index (YoY)	JUN F	2.3	2.3	2.3	
GE	07/12	02:00	CPI - EU Harmonised (MoM)	JUN F	0.0	0.0	0.0	
GE	07/12	02:00	CPI - EU Harmonised (YoY)	JUN F	2.4	2.4	2.4	
FR	07/12	02:45	Current Account (EUR billions)	MAY	--	--	-4.8	
UK	07/12	04:30	DCLG UK House Prices (YoY)	MAY	--	--	-0.3	
UK	07/12	04:30	Visible Trade Balance (GBP millions)	MAY	-7400	-7336	-7389	
UK	07/12	04:30	Trade Balance Non EU (GBP millions)	MAY	-4300	-4250	-4339	
UK	07/12	04:30	Total Trade Balance (GBP millions)	MAY	-2750	-2700	-2762	
UK	07/12	04:30	CPI (MoM)	JUN	0.2	0.2	0.2	
UK	07/12	04:30	CPI (YoY)	JUN	4.6	4.5	4.5	
UK	07/12	04:30	Core CPI (YoY)	JUN	--	3.3	3.3	
UK	07/12	04:30	RPI (MoM)	JUN	0.2	0.3	0.3	
UK	07/12	04:30	RPI Ex Mort Int. Payments (YoY)	JUN	5.2	5.3	5.3	
UK	07/13	04:30	Claimant Count Rate (%)	JUN	4.6	4.7	4.6	
UK	07/13	04:30	Jobless Claims Change (000s)	JUN	10.0	15.0	19.6	
UK	07/13	04:30	Average Weekly Earnings (3M/YoY)	MAY	2.3	2.1	1.8	
UK	07/13	04:30	Weekly Earnings exBonus (3M/YoY)	MAY	2.0	2.0	2.0	
UK	07/13	04:30	ILO Unemployment Rate (3mths)	MAY	7.7	7.7	7.7	
EC	07/13	05:00	Euro-Zone Ind. Prod. sa (MoM)	MAY	--	0.4	0.2	
IT	07/14	04:00	CPI (NIC incl. tobacco) (MoM)	JUN F	0.1	0.1	0.1	
IT	07/14	04:00	CPI (NIC incl. tobacco) (YoY)	JUN F	2.7	2.7	2.7	
IT	07/14	04:00	CPI - EU Harmonized (MoM)	JUN F	0.1	0.1	0.1	
IT	07/14	04:00	CPI - EU Harmonized (YoY)	JUN F	3.0	3.0	3.0	
EC	07/14	05:00	Euro-Zone CPI - Core (YoY)	JUN	1.5	1.5	1.5	
EC	07/14	05:00	Euro-Zone CPI (MoM)	JUN	0.0	0.0	0.0	
EC	07/14	05:00	Euro-Zone CPI (YoY)	JUN	2.7	2.7	2.7	
IT	07/15	04:00	Trade Balance (Total) (EUR millions)	MAY	--	--	-3761.4	
IT	07/15	04:00	Trade Balance Eu (EUR millions)	MAY	--	--	-685.7	
EC	07/15	05:00	Euro-Zone Trade Balance (EUR billions) sa	MAY	--	-3.3	-2.9	

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

## Key Indicators for the week of July 11 - 15

## Asia Pacific

Country	Date	Time	Event	Period	BNS	Consensus	Latest
CH	07/09	22:00	Trade Balance (USD billions)	JUN	14.7	14.2	13.1
CH	07/09	22:00	Exports (YoY)	JUN	18.3	18.6	19.4
CH	07/09	22:00	Imports (YoY)	JUN	26	25.3	28.4
CH	JUL 09-15		Actual FDI (YoY)	JUN	--	--	13.4
AU	07/10	21:30	Home Loans (MoM)	MAY	--	4.5	4.8
AU	07/10	21:30	Investment Lending (%)	MAY	--	--	-1.6
AU	07/10	21:30	Owner-Occupied Home Loan Value (MoM)	MAY	--	--	6.3
SK	JUL 10-15		South Korea FDI (YoY)	2Q	--	--	30.1
NZ	JUL 10-14		REINZ Housing Price Index (MoM)	JUN	--	--	-1.8
MA	07/11	00:01	Industrial Production (YoY)	MAY	--	-2.7	-2.2
MA	07/11	00:01	Manufacturing Sales Value (YoY)	MAY	--	--	15.5
JN	07/11	01:00	Consumer Confidence Index	JUN	--	35.5	34.2
JN	07/11	19:50	Domestic CGPI (MoM)	JUN	--	-0.2	-0.1
AU	07/11	20:30	NAB Business Conditions Index	JUN	--	--	1.0
AU	07/11	20:30	NAB Business Confidence Index	JUN	--	--	6.0
PH	07/11	21:00	Total Monthly Exports (USD millions)	MAY	--	--	4302.0
PH	07/11	21:00	Total Exports (YoY)	MAY	--	4.8	19.1
JN	JUL 11-12		<b>BOJ Target Rate</b>		<b>0.10</b>	--	<b>0.10</b>
ID	JUL 11-12		<b>Bank Indonesia Reference Rate</b>		<b>6.75</b>	<b>6.75</b>	<b>6.75</b>
IN	07/12	01:30	Industrial Production (YoY)	MAY	--	8.7	6.3
AU	07/12	20:30	Westpac Consumer Confidence s.a. (MoM)	JUL	--	--	-2.6
AU	07/12	21:00	DEWR Skilled Vacancies (MoM)	JUL	--	--	-2.0
JN	07/13	00:30	Industrial Production (MoM)	MAY F	--	--	5.7
JN	07/13	00:30	Capacity Utilization (MoM)	MAY	--	--	-1.1
TH	07/13	03:30	<b>Benchmark Interest Rate</b>		<b>3.25</b>	<b>3.25</b>	<b>3.00</b>
NZ	07/13	18:30	Business NZ PMI	JUN	--	--	54.7
SK	07/13	21:00	<b>South Korea 7-Day Repo Rate</b>		<b>3.25</b>	<b>3.25</b>	<b>3.25</b>
CH	JUL 13-15		Foreign Exchange Reserves (US\$ billions)	JUN	--	3233.0	3044.7
CH	JUL 13-15		New Yuan Loans (CNY billions)	JUN	--	622.5	551.6
CH	JUL 13-15		Money Supply - M0 (YoY)	JUN	--	--	15.4
CH	JUL 13-15		Money Supply - M1 (YoY)	JUN	--	13.0	12.7
CH	JUL 13-15		Money Supply - M2 (YoY)	JUN	--	15.3	15.1
AU	JUL 13-29		NAB Business Confidence	2Q	--	--	11.0
JN	07/14	00:00	Tokyo Condominium Sales (YoY)	JUN	--	--	3.6
JN	07/14	02:00	Machine Tool Orders (YoY)	JUN F	--	--	34.0
CH	07/14	22:00	Producer Price Index (YoY)	JUN	6.6	6.9	6.8
CH	07/14	22:00	Industrial Production (YoY)	JUN	13.5	13.1	13.3
CH	07/14	22:00	Consumer Price Index (YoY)	JUN	6.4	6.2	5.5
CH	07/14	22:00	Fixed Assets Inv Excl. Rural YTD (YoY)	JUN	26	25.7	25.8
CH	07/14	22:00	Real GDP (QoQ)	2Q	2.2	--	2.1
CH	07/14	22:00	Real GDP (YoY)	2Q	9.5	9.3	9.7
CH	07/14	22:00	Retail Sales (YoY)	JUN	17.0	17.0	16.9

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

## Key Indicators for the week of July 11 - 15

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	07/11	07:30	Central Bank Weekly Economists Survey					
BZ	07/12	04:00	FIPE CPI - (WoW)	7-Jul	--	0.1	-0.1	
BZ	07/12	08:00	Retail Sales (MoM)	MAY	--	0.7	-0.2	
BZ	07/12	08:00	Retail Sales (YoY)	MAY	--	8.0	10.0	
CL	07/12	08:30	Central Bank Economist Survey					
PE	07/12		Trade Balance (PEN millions)	MAY	--	--	347.7	
CO	07/14	17:00	Trade Balance (USD millions)	MAY	--	--	696.6	
CL	07/14	18:00	<b>Nominal Overnight Rate Target</b>		<b>5.50</b>	<b>5.25</b>	<b>5.25</b>	
PE	07/15		GDP (YoY) NSA	MAY	--	6.9	7.4	

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

## Global Auctions for the week of July 11 - 15

## North America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
US	07/11	11:00	U.S. Fed to Purchase USD2.5-3.5 Bln Notes/Bonds
US	07/11	11:30	U.S. to Sell 3-Month Bills
US	07/11	11:30	U.S. to Sell 6-Month Bills
US	07/12	11:30	U.S. to Sell 4-Week Bills
US	07/12	13:00	U.S. to Sell 3-Year Notes
CA	07/13	12:00	Canada to Sell 2-Year Notes
US	07/13	13:00	U.S. to Sell 10-Year Notes Reopening
US	07/14	13:00	U.S. to Sell 30-Year Bonds Reopening

## Europe

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
GE	07/11	05:15	Germany to Sell EU4 Bln 6-Mth Bills
FR	07/11	09:00	France to Sell Bills
IT	07/12	05:00	Italy to Sell Bills
SZ	07/12	05:30	Switzerland to Sell 12-Month Bills
GE	07/13	05:15	Germany to Sell Add'l EU4 Bln 10-Year Notes
SZ	07/13	05:30	Switzerland to Sell Bonds
IC	07/13	06:45	Iceland to Sell Bills
IT	07/14	05:00	Italy to Sell Bonds/Floating Rate Notes
UK	07/14	05:30	U.K. to Sell GBP2 Bln 4.25% 2040 Bonds
UK	07/15	06:10	U.K. to Sell Bills

## Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
CH	07/10	23:00	China Muni Bond to Sell CNY 25.4 Bln 5-Year Bonds
CH	07/10	23:00	China Muni Bond to Sell CNY 25 Bln 3- Year Bonds
JN	07/11	04:00	Japan Auction for Enhanced-Liquidity
CH	07/12	23:00	China to Sell 1 Year Bond
JN	07/12	23:35	Japan to Sell 3-Month Bills
JN	07/13	23:35	Japan to Sell 1-Year Bills
JN	07/13	23:45	Japan to Sell 5-Year Bond

Source: Bloomberg, Scotia Economics.

## Events for the week of July 11 - 15

## North America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
CA	07/11	10:30	Bank of Canada Business Outlook and Loan Officers Surveys
US	07/12	14:00	Fed Releases Minutes from June 21-22 FOMC Meeting
US	07/13	10:00	Bernanke Delivers Semi-Annual Monetary Policy Report to House

## Europe

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
EC	07/10	06:00	ECB's Trichet Speaks in Aix-en-Provence, France
GE	07/11	07:15	Merkel Hosts Icelandic Prime Minister Sigurdardottir in Berlin
EC	07/11	11:00	Euro-Area Finance Ministers Meet in Brussels
IT	07/11	11:00	ECB's Bini Smaghi, OECD's Padoan Speak at Conference in Milan
PO	07/11		Bank of Portugal Releases Data on Banks
EC	07/12	02:30	EU's Lewandowski Speaks at Brussels Think Tank
EC	07/12	03:00	EU Finance Ministers Meet in Brussels
EC	07/13	06:00	European Commission Issues Quarterly Report on Euro Area

## Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
JN	JUL 11-12		BOJ Target Rate
ID	JUL 11-12		Bank Indonesia Reference Rate
TH	07/13	03:30	Benchmark Interest Rate
SK	07/13	21:00	South Korea 7-Day Repo Rate

## Latin America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
BZ	07/11	11:30	Central Bank President Tombini speaks at the Harvard Club, NY
CL	07/14	18:00	Nominal Overnight Rate Target

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	August 9, 2011	0.25	--
Banco de México – Overnight Rate	4.50	August 26, 2011	4.50	--

Weaker than expected US data releases this week, including Friday's nonfarm payrolls report and the continued elevation of initial jobless claims, support our view that the Federal Reserve will remain on hold until at least Q3 2012. Canadian employment, on the other hand, came in stronger than expected in June although the details suggest that much of the gain in employment is questionable for six reasons, further supporting our view that the Bank of Canada will remain on hold until at least Q2 2012. First, we're skeptical of the role played by public sector job volatility over the past two reports. Second, most of the growth was in part-time employment. Third, services accounted for the majority of the gains which softens perspectives on the breadth of the gain. Fourth, gains were narrowly focused by region. Fifth, wage growth decelerated once again to the slowest pace since December of last year. Lastly, total hours worked rose at the slowest pace since March 2010.

## Europe

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
European Central Bank – Refinancing Rate	1.50	August 4, 2011	1.50	--
Bank of England – Bank Rate	0.50	August 4, 2011	0.50	0.50
Swiss National Bank – Libor Target Rate	0.25	September 15, 2011	0.25	--
Central Bank of Russia – Refinancing Rate	8.25	August 1, 2011	8.25	--
Hungarian National Bank – Base Rate	6.00	July 26, 2011	6.00	6.00
Central Bank of the Republic of Turkey – 1 Week Repo Rate	6.25	July 21, 2011	6.25	--

Following the Governing Council meeting on July 7, the ECB refinancing rate was increased by 25 basis points to 1.50%. ECB President Jean-Claude Trichet noted that the adjustment of the current accommodative monetary policy stance is warranted, signalling further monetary policy tightening ahead. Accordingly, we maintain that the quarterly rate hike path remains valid, with the ECB likely to increase the policy rate again in October.

## 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	July 12, 2011	0.10	--
Reserve Bank of Australia – Cash Target Rate	4.75	August 2, 2011	4.75	--
Reserve Bank of New Zealand – Cash Rate	2.50	July 27, 2011	2.50	2.50
People's Bank of China – Lending Rate	6.56	TBA	--	--
Reserve Bank of India – Repo Rate	7.50	July 26, 2011	7.50	--
Hong Kong Monetary Authority – Base Rate	0.50	TBA	0.50	--
Central Bank of China Taiwan – Discount Rate	1.88	September 30, 2011	--	--
Bank Negara Malaysia – Overnight Policy Rate	3.00	September 8, 2011	3.00	--
Bank of Korea – Bank Rate	3.25	July 13, 2011	3.25	3.25
Bank of Thailand – Repo Rate	3.00	July 13, 2011	3.25	3.25
Bank Indonesia – Reference Interest Rate	6.75	July 12, 2011	6.75	6.75
Central Bank of the Philippines – Overnight Policy Rate	4.50	July 28, 2011	4.50	--

The Bank of Korea will pause this time around. Notwithstanding the persistent uptrend in core inflation, central bank authorities will be wary of recent currency gains and their monetary tightening effects following the interest rate rise decreed last month. The Bank of Japan will stay put as well. We expect the Bank of Thailand, however, to increase the benchmark interest rate as core inflation continues to rise while the baht remains relatively weak as a result of the uncertainty brought about by the recent electoral process.

## 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	12.50	--
Banco Central de Chile – Overnight Rate	5.25	July 14, 2011	5.50	5.25
Banco de la República de Colombia – Lending Rate	4.25	July 29, 2011	4.50	--
Banco Central de Reserva del Perú – Reference Rate	4.25	August 11, 2011	4.25	--

We expect the central bank of Chile to continue tightening its monetary policy hiking the reference rate by 25 basis points (bps) to 5.50%. After three consecutive hikes of 50 bps between March and May, the central bank slowed down its tightening stance in June and raised the reference rate by only 25 bps. Inflation expectations for the coming 12 months have decreased from 4.0% to 3.7%; nevertheless, consumer price inflation (3.3% y/y in May) is accelerating but yet remains within the central bank's target range.

## 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 21, 2011	5.50	--

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

	2000-09	2010	2011f	2012f	2000-09	2010	2011f	2012f
<b>Output and Inflation (annual % change)</b>	<b>Real GDP</b>				<b>Consumer Prices<sup>2</sup></b>			
World <sup>1</sup>	3.6	5.1	4.2	4.5				
Canada	2.1	3.2	2.7	2.5	2.1	1.8	2.9	2.1
United States	1.8	2.9	2.5	2.7	2.6	1.6	2.8	2.0
Mexico	1.9	5.5	4.4	3.8	4.9	4.4	3.6	3.8
United Kingdom	1.7	1.4	1.2	1.5	1.9	3.7	4.7	2.0
Euro zone	0.9	1.6	1.8	1.7	2.1	2.2	2.8	2.1
Japan	0.6	4.0	0.3	3.5	-0.3	0.0	0.8	1.3
Australia	3.1	2.7	3.4	3.0	3.2	2.7	2.8	2.5
China	9.4	10.4	9.3	9.5	2.0	4.6	5.0	4.5
India	7.4	9.0	8.3	8.5	6.2	9.5	7.5	6.0
Korea	4.4	6.2	5.4	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	6.0	5.8	2.5	2.1	4.0	3.7
<b>Central Bank Rates (% end of period)</b>	<b>11Q1</b>	<b>11Q2f</b>	<b>11Q3f</b>	<b>11Q4f</b>	<b>12Q1f</b>	<b>12Q2f</b>	<b>12Q3f</b>	<b>12Q4f</b>
Bank of Canada	1.00	1.00	1.00	1.00	1.00	1.50	2.00	2.25
Federal Reserve	0.25	0.25	0.25	0.25	0.25	0.25	0.75	1.25
European Central Bank	1.00	1.25	1.50	1.75	2.00	2.25	2.50	2.50
Bank of England	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25
Swiss National Bank	0.25	0.25	0.25	0.50	0.50	0.75	0.75	1.00
Bank of Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Reserve Bank of Australia	4.75	4.75	5.00	5.25	5.50	5.75	6.00	6.25
<b>Exchange Rates (end of period)</b>								
Canadian Dollar (USDCAD)	0.97	0.95	0.96	0.96	0.95	0.95	0.94	0.94
Canadian Dollar (CADUSD)	1.03	1.06	1.04	1.04	1.05	1.05	1.06	1.06
Euro (EURUSD)	1.42	1.47	1.45	1.50	1.48	1.46	1.43	1.40
Sterling (GBPUSD)	1.60	1.64	1.61	1.63	1.65	1.67	1.69	1.70
Yen (USDJPY)	83	79	79	80	82	83	84	85
Australian Dollar (AUDUSD)	1.03	1.07	1.08	1.09	1.09	1.10	1.10	1.11
Chinese Yuan (USDCNY)	6.5	6.5	6.4	6.3	6.2	6.1	6.0	5.9
Mexican Peso (USDMXN)	11.9	11.6	11.9	12.0	12.1	12.1	12.2	12.3
Brazilian Real (USDBRL)	1.63	1.57	1.59	1.60	1.62	1.65	1.67	1.70
<b>Commodities (annual average)</b>	<b>2000-09</b>	<b>2010</b>	<b>2011f</b>	<b>2012f</b>				
WTI Oil (US\$/bbl)	51	79	97	100				
Brent Oil (US\$/bbl)	50	80	110	114				
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	1,000	1,055				
Newsprint (US\$/tonne)	572	607	655	715				
Lumber (US\$/mfbm)	275	254	265	270				

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

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

<b>Canada</b>	<b>2010</b>	<b>10Q4</b>	<b>11Q1</b>	<b>Latest</b>	<b>United States</b>	<b>2010</b>	<b>10Q4</b>	<b>11Q1</b>	<b>Latest</b>
Real GDP (annual rates)	3.2	3.1	3.9		Real GDP (annual rates)	2.9	3.1	1.9	
Current Acc. Bal. (C\$B, ar)	-50.9	-41.1	-35.7		Current Acc. Bal. (US\$B, ar)	-471	-449	-477	
Merch. Trade Bal. (C\$B, ar)	-9.0	1.5	5.5	-11.1 (Apr)	Merch. Trade Bal. (US\$B, ar)	-646	-637	-730	-697 (Apr)
Industrial Production	4.6	6.0	5.6	5.0 (Apr)	Industrial Production	5.3	6.2	5.2	8.2 (May)
Housing Starts (000s)	192	179	178	184 (May)	Housing Starts (millions)	0.58	0.54	0.58	0.56 (Jun)
Employment	1.4	1.7	1.9	1.3 (Jun)	Employment	-0.8	0.5	0.9	0.9 (Jun)
Unemployment Rate (%)	8.0	7.7	7.8	7.4 (Jun)	Unemployment Rate (%)	9.6	9.6	8.9	9.2 (Jun)
Retail Sales	5.5	5.3	2.5	3.6 (Apr)	Retail Sales	6.8	8.1	8.6	14.3 (May)
Auto Sales (000s)	1561	1554	1577	1656 (Apr)	Auto Sales (millions)	11.5	12.3	13.0	11.4 (Jun)
CPI	1.8	2.3	2.6	4.8 (May)	CPI	1.6	1.3	2.1	4.8 (May)
IPPI	1.0	2.6	4.0	-5.7 (May)	PPI	4.2	3.8	5.0	10.7 (May)
Pre-tax Corp. Profits	21.2	19.1	13.4		Pre-tax Corp. Profits	36.8	16.1	9.3	
<b>Mexico</b>					<b>Brazil</b>				
Real GDP	5.4	4.4	4.6		Real GDP	6.7	4.2	3.8	
Current Acc. Bal. (US\$B, ar)	-5.6	-14.0	-5.5		Current Acc. Bal. (US\$B, ar)	-47.4	-48.0	-58.3	
Merch. Trade Bal. (US\$B, ar)	-3.0	-4.2	7.6	6.7 (May)	Merch. Trade Bal. (US\$B, ar)	20.3	30.1	12.7	53.2 (Jun)
Industrial Production	6.0	4.8	5.3	1.4 (Apr)	Industrial Production	10.5	3.8	2.4	14.7 (May)
CPI	4.2	4.2	3.5	3.3 (Jun)	CPI	5.1	6.1	6.8	6.4 (Jun)
<b>Chile</b>					<b>Italy</b>				
Real GDP	5.2	5.8	9.8		Real GDP	1.2	1.5	1.0	
Current Acc. Bal. (US\$B, ar)	3.1	4.9	2.9		Current Acc. Bal. (US\$B, ar)	-0.07	-0.07	-0.11	-0.10 (Apr)
Merch. Trade Bal. (US\$B, ar)	11.6	17.7	17.4	7.1 (Jun)	Merch. Trade Bal. (US\$B, ar)	-39.1	-46.3	-77.2	-65.2 (Apr)
Industrial Production	0.6	2.7	11.5	12.6 (May)	Industrial Production	6.5	5.3	2.3	11.0 (May)
CPI	1.4	2.5	2.9	3.4 (Jun)	CPI	1.6	1.8	2.3	4.0 (May)
<b>Germany</b>					<b>France</b>				
Real GDP	3.5	3.8	4.8		Real GDP	1.4	1.4	2.2	
Current Acc. Bal. (US\$B, ar)	188.0	250.8	195.2	118.8 (May)	Current Acc. Bal. (US\$B, ar)	-44.5	-86.6	-57.4	-54.3 (Apr)
Merch. Trade Bal. (US\$B, ar)	201.5	219.8	209.3	220.5 (May)	Merch. Trade Bal. (US\$B, ar)	-39.0	-39.4	-55.0	-62.1 (Apr)
Industrial Production	10.1	11.8	13.0	19.4 (May)	Industrial Production	5.1	4.6	4.8	2.6 (Apr)
Unemployment Rate (%)	7.7	7.4	7.3	7.0 (Jun)	Unemployment Rate (%)	9.8	9.7	9.7	9.5 (May)
CPI	1.1	1.5	2.1	2.3 (Jun)	CPI	1.5	1.6	1.8	3.6 (May)
<b>Euro Zone</b>					<b>United Kingdom</b>				
Real GDP	1.7	1.9	2.4		Real GDP	1.4	1.5	1.6	
Current Acc. Bal. (US\$B, ar)	-77	-41	-173	-113 (Apr)	Current Acc. Bal. (US\$B, ar)	-71.6	-72.2	-74.0	
Merch. Trade Bal. (US\$B, ar)	32.0	53.2	-61.7	-61.7 (Apr)	Merch. Trade Bal. (US\$B, ar)	-153.0	-171.9	-142.4	-144.9 (Apr)
Industrial Production	7.4	8.1	6.6	5.3 (Apr)	Industrial Production	2.1	3.3	2.0	1.0 (May)
Unemployment Rate (%)	10.1	10.0	9.9	9.8 (May)	Unemployment Rate (%)	7.9	7.9	7.7	7.7 (Mar)
CPI	1.6	2.0	2.5	4.3 (May)	CPI	3.3	3.4	4.1	7.7 (May)
<b>Japan</b>					<b>Australia</b>				
Real GDP	4.0	2.4	-0.7		Real GDP	2.7	2.7	1.0	
Current Acc. Bal. (US\$B, ar)	195.9	176.8	193.9	87.3 (May)	Current Acc. Bal. (US\$B, ar)	-31.8	-37.4	-37.9	
Merch. Trade Bal. (US\$B, ar)	74.8	60.4	29.1	-70.1 (May)	Merch. Trade Bal. (US\$B, ar)	19.3	26.1	21.8	48.7 (May)
Industrial Production	16.6	6.8	-2.5	9.6 (May)	Industrial Production	4.3	0.0	-5.4	
Unemployment Rate (%)	5.1	5.0	4.7	4.5 (May)	Unemployment Rate (%)	5.2	5.2	5.0	4.9 (Jun)
CPI	-0.7	0.1	0.0	-0.4 (May)	CPI	2.8	2.7	3.3	
<b>China</b>					<b>South Korea</b>				
Real GDP	10.3	9.8	9.7		Real GDP	6.2	4.7	4.2	
Current Acc. Bal. (US\$B, ar)	305.4				Current Acc. Bal. (US\$B, ar)	28.2	36.6	10.4	27.1 (May)
Merch. Trade Bal. (US\$B, ar)	181.6	247.0	-5.9	156.6 (May)	Merch. Trade Bal. (US\$B, ar)	41.2	52.1	29.6	39.0 (Jun)
Industrial Production	13.5	13.5	14.8	13.3 (May)	Industrial Production	16.6	9.9	11.2	22.8 (May)
CPI	4.6	4.6	5.4	5.5 (May)	CPI	3.0	3.6	4.5	4.4 (Jun)

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

Source: Bloomberg, Scotia Economics.

## Interest Rates (% , end of period)

	11Q1	11Q2	Jul/01	Jul/08*		11Q1	11Q2	Jul/01	Jul/08*
<b>Canada</b>					<b>United States</b>				
BoC Overnight Rate	1.00	1.00	1.00	1.00	Fed Funds Target Rate	0.25	0.25	0.25	0.25
3-mo. T-bill	0.95	0.90	0.90	0.94	3-mo. T-bill	0.09	0.01	0.02	0.02
10-yr Gov't Bond	3.35	3.11	3.11	2.96	10-yr Gov't Bond	3.47	3.16	3.18	3.01
30-yr Gov't Bond	3.76	3.55	3.55	3.42	30-yr Gov't Bond	4.51	4.37	4.39	4.29
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US\$B)	60.4		63.8	(May)	FX Reserves (US\$B)	128.3		135.9	(May)
<b>Germany</b>					<b>France</b>				
3-mo. Interbank	1.26	1.51	1.52	1.51	3-mo. T-bill	0.80	1.18	1.18	1.12
10-yr Gov't Bond	3.35	3.03	3.03	2.83	10-yr Gov't Bond	3.71	3.41	3.41	3.41
FX Reserves (US\$B)	64.8		66.2	(May)	FX Reserves (US\$B)	61.0		61.7	(May)
<b>Euro-Zone</b>					<b>United Kingdom</b>				
Refinancing Rate	1.00	1.25	1.25	1.50	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	0.90	1.72	1.72	0.60	3-mo. T-bill	4.85	4.85	4.85	4.85
FX Reserves (US\$B)	319.9		319.5	(May)	10-yr Gov't Bond	3.69	3.38	3.39	3.19
					FX Reserves (US\$B)	75.3		77.8	(May)
<b>Japan</b>					<b>Australia</b>				
Discount Rate	0.30	0.30	0.30	0.30	Cash Rate	4.75	4.75	4.75	4.75
3-mo. Libor	0.14	0.13	0.13	0.13	10-yr Gov't Bond	5.49	5.21	5.28	5.23
10-yr Gov't Bond	1.26	1.14	1.14	1.18	FX Reserves (US\$B)	33.3		39.3	(May)
FX Reserves (US\$B)	1080.6		1101.7	(May)					

## Exchange Rates (end of period)

USDCAD	0.97	0.96	0.96	0.96	¥/US\$	83.13	80.56	80.83	80.67
CADUSD	1.03	1.04	1.04	1.04	US¢/Australian\$	103.29	107.22	107.70	107.17
GBPUSD	1.603	1.605	1.608	1.602	Chinese Yuan/US\$	6.55	6.46	6.46	6.46
EURUSD	1.416	1.450	1.453	1.423	South Korean Won/US\$	1100	1068	1065	1057
JPYEUR	0.85	0.86	0.85	0.87	Mexican Peso/US\$	11.906	11.713	11.607	11.645
USDCHF	0.92	0.84	0.85	0.84	Brazilian Real/US\$	1.632	1.563	1.558	1.566

## Equity Markets (index, end of period)

United States (DJIA)	12320	12414	12414	12581	U.K. (FT100)	5909	5946	5990	5989
United States (S&P500)	1326	1321	1321	1335	Germany (Dax)	7041	7376	7419	7405
Canada (S&P/TSX)	14116	13301	13301	13343	France (CAC40)	3989	3982	4007	3919
Mexico (Bolsa)	37441	36558	36801	36275	Japan (Nikkei)	9755	9816	9868	10138
Brazil (Bovespa)	68587	62404	63394	61426	Hong Kong (Hang Seng)	23528	22398	22398	22726
Italy (BCI)	1120	1039	1039	1034	South Korea (Composite)	2107	2101	2126	2180

## Commodity Prices (end of period)

Pulp (US\$/tonne)	990	1020	1020	1020	Copper (US\$/lb)	4.26	4.22	4.27	4.41
Newsprint (US\$/tonne)	640	640	640	640	Zinc (US\$/lb)	1.05	1.05	1.06	1.08
Lumber (US\$/mfbm)	290	237	247	251	Gold (US\$/oz)	1439.00	1505.50	1483.00	1541.50
WTI Oil (US\$/bbl)	106.72	95.42	95.42	95.90	Silver (US\$/oz)	37.87	35.02	33.85	36.28
Natural Gas (US\$/mmbtu)	4.39	4.37	4.37	4.18	CRB (index)	359.43	338.05	336.71	343.79

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

This report has been prepared on behalf of Scotia Capital and is not for the use of private individuals. The Scotia Capital trademark is used in association with the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and some of its subsidiaries, including Scotia Capital Inc., Scotia Capital (USA) Inc., Scotiabank Europe plc; Scotia Capital (Europe) Limited; Scotiabank (Ireland) Limited – all members of the Scotiabank Group and authorized users of the mark. The Bank of Nova Scotia, a Canadian chartered bank, is incorporated in Canada with limited liability. The Bank of Nova Scotia, Scotiabank Europe plc, Scotia Capital (Europe) Limited and Scotia Capital Inc. are each authorized and regulated by the Financial Services Authority (FSA) in the U.K.

Opinions, estimates and projections contained herein are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither the Bank of Nova Scotia, its affiliates, employees or agents accepts any liability whatsoever for any loss arising from the use of this report or its contents. The Bank of Nova Scotia, its affiliates, employees or agents may hold a position in the products contained herein. This report is not a direct offer financial promotion, and is not to be construed as, an offer to sell or solicitation of an offer to buy any products whatsoever.

This market commentary is regarded as a marketing communication. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This report has been prepared by SCOTIA CAPITAL INC. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Scotia Capital Inc., nor its affiliates accept liability whatsoever for any loss arising from any use of this report or its contents. This report is not, and is not to be construed as, an offer to sell or solicitation of an offer to buy any securities and/or commodity futures contracts. Scotia Capital Inc., its affiliates and/or their respective officers, directors or employees may from time to time acquire, hold or sell securities and/or commodities and/or commodity futures contracts mentioned herein as principal or agent. This report may not be reproduced in whole or in part, or referred to in any manner whatsoever, nor may the information, opinions, and conclusions contained in it be referred to without in each case the prior express consent of Scotia Capital. SCI is authorized and regulated by The Financial Services Authority. U.S. residents: Scotia Capital (USA) Inc., a wholly owned subsidiary of Scotia Capital Inc., accepts responsibility for the contents herein, subject to the terms and limitations set out above. Any U.S. person wishing further information or to effect transactions in any security discussed herein should contact Scotia Capital (USA) Inc. at 212-225-6500.

Each research analyst named in this report or any subsection of this report certifies that (1) the views expressed in this report in connection with securities or issuers that he or she analyzes accurately reflect his or her personal views; and (2) no part of his or her compensation was, is, or will be directly or indirectly, related to the specific recommendations or views expressed by him or her in this report.

The Research Analyst's compensation is based on various performance and market criteria and is charged as an expense to certain departments of Scotia Capital Inc., including investment banking.

Scotia Capital Inc. and/or its affiliates: expects to receive or intends to seek compensation for investment banking services from issuers covered in this report within the next three months; and has or seeks a business relationship with the issuers referred to herein which involves providing services, other than securities underwriting or advisory services, for which compensation is or may be received. These may include services relating to lending, cash management, foreign exchange, securities trading, derivatives, structured finance or precious metals.

For Scotia Capital Research Analyst standards and disclosure policies, please visit [www.scotiacapital.com/disclosures](http://www.scotiacapital.com/disclosures)

---

### 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](mailto:scotia_economics@scotiacapital.com)

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