Global Views

Weekly commentary on economic and financial market developments

October 7, 2011

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Weekend European Meetings Could Help Set The Week's Market Tone

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

The week gets off to an early start with potentially market-moving events. The focus on **Europe** could start with Saturday's meeting between IMF Head Christine Lagarde and French President Nicolas Sarkozy for talks on the European debt crisis, and the emphasis will likely be upon coordinating plans to inject capital into banks. The next day German Chancellor Angela Merkel meets with Sarkozy in Berlin toward similar aims, and this one will be followed by a press conference that could impact the Asian market opening. Later in the week EFSF Head Klaus Regling speaks on the future of the Euro on Thursday. The key here is whether sudden momentum is building toward bank recapitalization efforts in order to prepare markets for a Greek default over coming weeks or months. Italy auctions bills and bonds on Tuesday and Thursday, but there are no key peripheral auctions next week. Industrial production readings push into August for France, Italy and the UK. August trade figures for Germany, the UK and Italy are also on tap, as are EC CPI readings.

US markets shouldn't have much of a capacity to swing global market sentiment next week, but with some exceptions. The marquee release will be Friday's retail sales print for September. We know that auto sales were up by about 8% m/m in September so that should help lift the headline, but core sales ex-autos and gas are also expected to come in somewhat higher, with the caveat that we're pushing into the period in which the impact of depressed consumer confidence on sales will be closely watched. Key will be the inflation-adjusted retail sales print which won't arrive until the following week. FOMC meeting minutes (Tuesday) will add further colour to the Fed's debate over the 'twist' as well as possible further easing. The trade deficit for August is expected to widen as global turmoil cools trading activity. We'll be looking for further evidence that the recent modest improvement in initial jobless claims is being sustained in next week's reading (Thursday), while UofM consumer sentiment (Friday) will be watched for whether consumers remain in a dour mood following two bleak prior reports. There are two 10 and 30 yr note reopenings next week that should be favourably received in light of the impact that operation 'twist' had upon flattening the long end of the curve. Fed speeches will be a risk factor as two of the three Fed presidents who drop out of the FOMC voting rotation next year are on the docket (Plosser and Kocherlakota).

Canada starts off slow, with markets closed for Thanksgiving Monday, but picks up later in the week. Two more key glimpses at August GDP growth in **Canada** will be important in terms of determining the pattern of growth for the quarter as a whole, particularly as the readings push further into the period marked by the global confidence shock. The large 2.7% m/m gain in shipments as temporary shocks lifted during July will pose a high base effect off of which it will be difficult to post additional growth in the August report (Friday), while the narrowing of the trade deficit that declined by 55% in July over June will also be difficult to repeat in the August report (Thursday) for the same reason. Thus, we'll be expecting possible disappointment on both indicators. Further, we already know that Canada lost 5,500 jobs that month, but hours worked expanded at a moderate 0.3% following the prior month's large 1.1% gain. Housing starts fell 10% m/m in August, but this was entirely due to lower value-added multiples which will help insulate some of housing's downside to GDP that month. Thus, on balance, we're not terribly up-beat on the sustainability of July's GDP gain into August at this early juncture. If August disappoints by cancelling out much or all of July's 0.3% GDP growth, then the quarter rests entirely upon September for which next Tuesday's housing starts will be insightful. What we do know about September is that despite a mostly artificial gain in jobs, hours worked fell and that would portend a drop in September GDP unless productivity growth suddenly accelerated. Newfoundland and Labrador hold a provincial election on Tuesday, and Canada auctions 5s on Wednesday.

Asian markets will play observer status through much of the week. Both Bank Indonesia and the Bank of Korea are expected to leave rates unchanged in next week's decisions. Australian jobs (Wednesday) will be nervously eyed following two months of job losses that have contributed toward a 10% decline in the A$ against the US$ from July through to the present and thus made it among the worst-performing currencies as commodities have rolled over. Regional trade figures for Japan, China and the Philippines will help fill out the picture of how global trade held up into August and September following the confidence shocks. Chinese CPI (Thursday) and new yuan loans will provide clues to the direction of future monetary policy.

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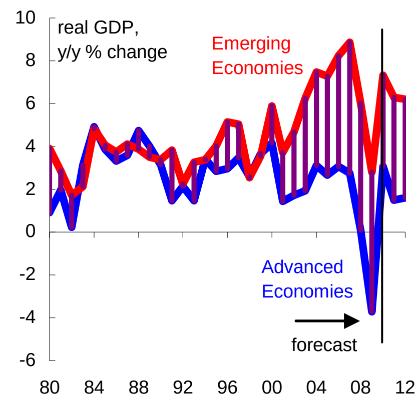
Mind The Gap

Scotia Economics expects that global growth will be sustained by several factors: sharply reduced borrowing costs in the advanced economies that will facilitate accelerated refinancing, cash-rich businesses that will bolster investments, comparatively robust albeit slightly slower growth in the emerging economies, and lower oil prices that will boost spending power. Nonetheless, the pace of economic activity in the advanced nations will be quite slow and uneven over the next few quarters. Intensifying debt-related strains in the euro zone and the United States are roiling financial markets, undermining consumer and business confidence, and restraining spending.

Our forecasts had already assumed slower growth in the more-indebted advanced economies both this year and next. Households in the United States and other countries with distressed housing markets and high jobless rates would continue to deleverage. Credit conditions would be challenged by financial institutions recapitalizing their balance sheets and facing tighter regulatory guidelines. And the pace of fiscal consolidation would gather momentum.

However, the early-year surge in commodity prices and the disruptions in the global manufacturing supply chain triggered by Japan's mid-March catastrophe compounded the slowdown. And more recently, heightened political uncertainty aggravated the slow pace of reforms critical to reducing the significant deficit and debt problems in the euro zone and the United States. At a time when the growth cushion among the advanced nations is very thin, the broad financial market and confidence shake-out around the world, if sustained, is a threat to the durability of the recovery.

The Large Growth Gap Between Emerging and Advanced Economies Should Persist



Source: Scotia Economics, IMF

It is incumbent upon policymakers to resolve the euro zone's severe sovereign debt and banking sector problems, and to forge a credible deficit-reduction strategy in the United States. A quick and effective resolution is critical to prevent further contagion, restore financial market stability, rebuild confidence, and enable the two largest economic regions in the world to regain stronger momentum through the second half of 2012.

Japan's massive rebuilding efforts and the rebound in auto and electronics manufacturing will lift the economy to the top of the advanced nations' growth ladder through the remainder of this year and most of 2012. But once the temporary stimulus wears off, longer-term structural issues — less favourable demographic trends, high debt and currency strength — should leave Japan on a slower growth trajectory. Australia is also expected to remain a relative outperformer because of its close commodity and trade linkages with the still-strong Asia-Pacific region. Nonetheless, the impact of prior rate hikes, a cooling in its hot housing market, and the loss of global economic momentum will temper the country's comparatively strong pace of domestic activity.

The North American economies have slipped to the middle of the advanced nation growth ladder. Mexico's prospects have been reduced by the sharp slowing in U.S. activity, though the country's strong competitive position and more regionally diversified trade will keep industrial activity and domestic spending at a reasonably high level. Canada also faces stiffer headwinds, with the renewed slumps in the United States and Europe dampening non-resource shipments. Some softening in employment conditions and a more subdued housing market will contribute to the lower growth profile, though the buoyancy in resource-producing regions that is being underpinned by continuing large investments will remain an important contributor to growth.

The U.S. economy continues to be weighed down by significant and lingering problems. The housing slump shows no sign of a quick turnaround. The weak job recovery has stumbled again, putting a further squeeze on household incomes and discretionary spending. Exports remain a relative bright spot, with transportation equipment and technology sales leading the way. Even so, the sharp drop in confidence associated with the budgetary deadlock, and the prospect of intensifying fiscal retrenchment, point to weak and uneven growth for a good part of 2012.

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Increasing fiscal retrenchment will dominate European prospects for the foreseeable future. Among the peripheral European nations, intensifying budgetary restraint and increasing unemployment have severely undercut activity. The contagion from the sovereign debt crisis is contributing to a falloff in growth in the larger European economies, most notably in Italy and Spain, but also in Germany and France as increased consumer and business caution sweep the region and regional trade slows. Significant fiscal restraint and the resulting slowdown in domestic demand will keep U.K. growth slightly below 1% this year and next, notwithstanding preparations for the 2012 Summer Olympics.

Output growth in the larger and faster-paced emerging economies is forecast to remain comparatively strong. Even so, the pace of domestic activity has moderated alongside prior tightening initiatives to contain inflationary pressures, and the reduced demand associated with the progressive weakening in the advanced economies since the spring. These countries are benefitting from the continuing strength of domestic-led spending and investment, a reflection of the rebalancing underway to reduce dependency on foreign trade. A number of factors — large private and public savings, massive infrastructure developments, and in some nations renewed interest rate cuts as inflation slows — should reinforce the more moderate but still-strong growth trajectories.

China is expected to remain the global growth leader, though the combination of domestic credit restraint and slowing international demand will trim its output growth to around 9% next year. India’s strong domestically generated expansion will continue to keep the country’s growth rate around 8%. In Brazil, prior policy tightening and a stronger currency — both have reversed somewhat in recent weeks — will contribute to a slower pace of activity, though the country will remain a strong performer because of significant investments in manufacturing and resources. Peru and Chile will continue to post comparatively stronger regional growth on the back of ongoing capital investments in their expanding resource sectors.

The ‘growth gap’ between the emerging and advanced nations has been progressively widening over the past three decades, from essentially no gap in the 1980s to a gap averaging over 5 percentage points near the end of the 2000s as the intensifying problems in the U.S. housing and financial markets spawned a worldwide credit crisis and recession. For much of this time, this gap reflected the much stronger economic performances of the emerging economies. But in recent years, the differential has continued to widen because of the increasing underperformance of the advanced nations.

Going forward, the ‘growth gap’ should remain quite large. Most advanced nations have already embarked upon a multi-year period of household deleveraging and/or fiscal consolidation, and more will follow – developments that will keep output growth in the slow lane. At the same time, emerging nations have the fiscal and financial flexibility to underpin solid economic gains in their home markets, a development that remains supportive over the longer term for international trade and commodity markets.

Financial markets can be expected to remain very volatile amid slower global growth and heightened economic and political uncertainty. Interest rates in the advanced nations have declined to historically low levels alongside increased risk aversion and monetary accommodation, though longer-term yields are still vulnerable to the upside later next year as the financial turmoil eases and economic conditions stabilize. Global equity markets have adjusted to lower growth and earnings expectations, though many companies are in good financial shape (i.e. large cash reserves and manageable debt levels) to ride out the current period of instability, even in the most affected countries and regions. Similarly, the ‘greenback’ has soared alongside the profound shift into highly liquid U.S. assets, though progress in resolving the deficit/debt problems in the euro zone and the United States should allow risk assets and most currencies, including the Canadian dollar, to begin the process of retracing some of their recent losses.

(For a perspective on foreign exchange trends, please refer to our October 2011 *Foreign Exchange Outlook* at http://www.scotiacapital.com/English/bns_econ/fxout.pdf.)

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No Major Cracks Yet In Canada's Housing Market

- **Low interest rates are still attracting homebuyers and investors despite increased global economic and financial market turbulence.**

Based on reports from 13 major regional real estate boards that reported this week — representing roughly half of national activity — home sales were up 15% y/y in September, only modestly slower than the 17% y/y major market gain reported for August (see table). Given only partial data and sizeable seasonal adjustments, it is hard to say with certainty how this will translate on an adjusted month-to-month basis once the national figures are released in about a week's time. Overall, however, it would appear to be consistent with the relatively steady sales pace seen in July and August.

Regional activity varies considerably. Toronto remains one of the hottest markets in the country, with strong demand and a shortage of listings. Meanwhile, the Calgary and Edmonton housing markets continue to gradually recover. Conditions remain much softer in Vancouver, with a combination of weak sales and rising listings. Most other markets are fairly steady. Of note, Winnipeg reported its best September sales performance in 108 years last month, perhaps owing to balmy temperatures or excitement over the return of the Jets.

MLS Sales - September 2011	y/y % change
Ottawa	12.2
Toronto	24.8
Hamilton	13.8
London	19.2
Kitchener	-4.7
Winnipeg	6.3
Saskatoon	21.3
Regina	20.8
Edmonton	6.8
Calgary	12.7
Fraser Valley	11.6
Vancouver	1.2
Victoria	15.9
Weighted Average	15.4

Source: Local real estate associations, Scotia Economics

Meanwhile, homebuilders are becoming a bit more cautious. Residential building permits — a leading indicator of housing starts — declined 10% m/m in August, though remained at a high level of 191,000 units. Keep in mind the retrenchment in permit demand in August was primarily in multi-unit projects, largely in Ontario and Quebec. This is a notoriously volatile series given the size and long lags involved in major condominium projects. Multi-unit permit demand fell even more sharply in February and April of this year, only to bounce back strongly the subsequent month.

In any case, we would welcome a somewhat slower pace of housing construction. Housing starts are currently tracking around 195,000 units, below their 10-year average of 205,000 but nonetheless above long-term sustainable levels based on underlying demographic and household formation trends estimated at around 180,000. To date, high levels of construction are being supported by strong new home sales. However, if housing demand cools more sharply in the coming months — a clear risk given waning consumer confidence and a slower pace of private sector hiring — builders could be left with an oversupply of empty units.

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What Do The ISM Indices Say?

- **The ISM goods and services indices show that mid-cycle slowdowns are not uncommon.**

The ISM manufacturing and services indices — generally robust proxies of U.S. GDP growth (chart 1) — suggest that mid-cycle soft patches are not uncommon, and that manufacturing activity may show signs of improvement early next year, should confidence barometers stabilize.

ISM manufacturing and services surveys poll roughly 300 purchasing managers nationwide on a variety of issues, including the general direction of business activity, inventories, exports, prices, hiring and capital expenditure, among others. The headline prints are diffusion indices created from five of the eleven equally-weighted sub-components for manufacturing and four of the twelve for services. These include production, new orders, employment and supplier deliveries, as well as inventories in the case of manufacturing. A reading below 50 indicates contraction. Although the services sector accounts for roughly 80% of the U.S. economy, the ISM services survey only dates back to 1997, making it difficult to carry out longer-term historical analysis.

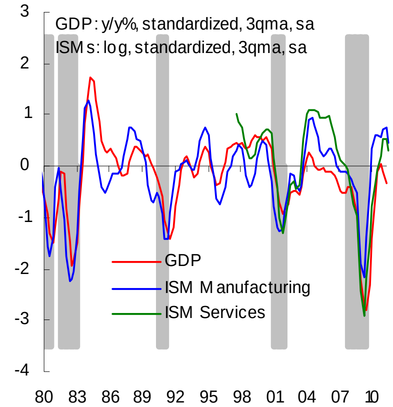
ISM indices are tightly correlated with broader economic activity, leading GDP growth by roughly a quarter (chart 1). While recent data reveal a decelerating trend, headline indices remain above the key 50-point breakeven line. Historical comparisons suggest that mid-cycle slowdowns are normal (chart 2). Currently, the headline ISM manufacturing index sits at 51. Since 1947, the index has moved below this level some 24 times, while there were only 11 actual recessions. It dipped 3 times between the 1981 and 1990 downturns, on 4 occasions after the Savings & Loan Crisis of the early 1990s, and twice after the technology bubble burst in 2001. The steepness of deterioration was comparable in a number of these instances. Plotting long-run average recovery cycles for the production and new-orders component indices — over a period of 40 months following the official end of a recession — confirms that recovery paths tend to be volatile, and that the mid-cycle soft patches tend to 'bottom out' around the 29th to 32nd month, a period equivalent to the first half of 2012 (charts 2, 3).

While most component indices are experiencing some moderation, weakness appears to be concentrated in domestic orders, which have been moving sideways in a narrow range, a touch below the 50-point mark, since July (chart 3). Exports, inventories, employment and capital expenditure remain in growth territory, with business investment actually exhibiting a modest upward trend for the past three months.

Aside from concerns over the global economic outlook, several temporary factors may have played a role in the recent slowdown. Economic activity appears to have 'peaked' in March/April, which coincides with the earthquake in Japan, the peak in oil prices, severe weather conditions (floods, droughts), but also increased political uncertainty in the United States and Europe. The effect of the first three factors is gradually dissipating — visible from the somewhat more moderating pace of deceleration seen since July (charts 2, 3) — but the latter remains a challenge. On the precondition that policy efforts are able to stabilize confidence barometers over the next few months, historical movement in the ISM indices serves as further evidence that a slowdown in the headline index does not necessarily imply an economic downturn.

Chart #1

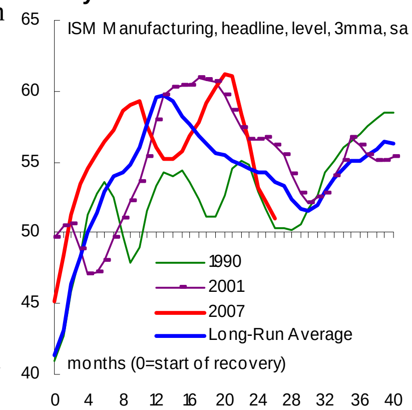
ISM Indices Lead GDP By A Quarter



Source: BEA, ISM, Scotia Economics.

Chart #2

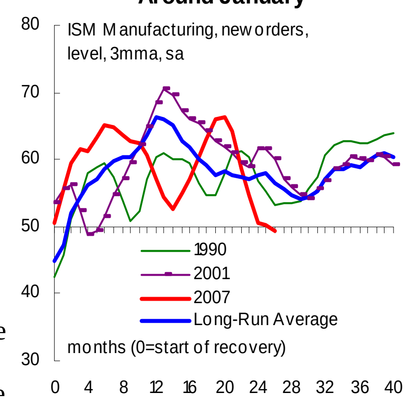
Mid-Cycle Slowdowns Not Uncommon



Source: ISM, Scotia Economics.

Chart #3

History Suggests A Pick Up In Orders Around January



Source: ISM, Scotia Economics.

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After A Bullish September Print, Canadian Jobs Face Downside Risks Into October

- **Distortions fed much of September's gains, and the resulting high base effect could lead to a step backward in October while income growth remains very weak.**

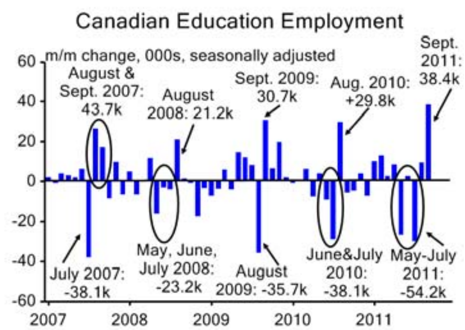
Canada's latest jobs report was far more encouraging on the headline than it was in the details. In fact, after controlling for significant distortions that we don't think will repeat, and upon taking account of mixed leading indicators for future employment growth, the risks may be pointed toward downsides in future job reports. That would mean that CAD's bullish reaction to the latest jobs number for September could possibly leave it vulnerable in the near-term without even getting into the panoply of other risks. In what follows, we are cognizant of the fact that the general tone to Canadian job markets remains much more favourable than stateside, but in calling the direction of forward-looking market risks we'd clearly be remiss not to dig a little deeper into the numbers.

September's Job Report Points To October Risks ...

Canada's latest jobs report was encouraging but by no means as much as CAD's notoriously superficial reaction would have it. Yes, we'll always take an upside over a downside to jobs, but in doing our own job, we can't exactly be over the moon on the headline gain of about 61k jobs.

For one thing, education sector distortions added 38.4k jobs, or nearly two-thirds of the lift, and it's not like there was a sudden rush to hire teachers and related workers. The sector has posed a problem to StatsCan for years. The seasonal adjustment factors have been distorted by contract shifts in the education sector over recent years as we've argued over recent summers. Chart 1 updates the monthly jobs numbers in the education sector over recent years and while the exact month(s) of mythical declines at the beginning of the summer and the exact month(s) of mythical gains at the end of the summer have varied from one year to the next, the volatility in this sector is due to ongoing problems with seasonal adjustment factors that can't control for distortions introduced over the years.

Chart 1



Source: Statistics Canada, Scotia Capital Economics

Secondly, the self-employed category rose by 38.9k jobs and we always treat this category with caution. Many self-employed jobs are vital contributions to a small-business based economy, but the volatility in this component and its tendency to report a pick-up in self-reporting during soft spots in the economy make us doubtful that of such a heavy role in lifting the headline.

The key point here is that because so much of the rise was likely due to distortions, we're of the view that the next jobs report faces downside risk due to the high base effect posed by September's exaggerated gain. What may add to downside risks is the timing of provincial elections. Three provinces held elections in early October — Ontario, Manitoba and PEI. They may have experienced election-related hiring in September but whether that contributed to the 13.7k gain in public administration jobs in September or whether most of the hiring occurred outside of the reference period that goes up to the 15th of the month is unclear. Nevertheless, it's likely that this election-related hiring will have dropped out of the figures in October which may be an added downside risk. Newfoundland and Labrador holds an election next week, and there are also elections in the NWT and Yukon this month and Saskatchewan in November, but the bulk of any hiring and firing election effect would have already been captured by the other three elections.

… And Surveys Provide Mixed Guidance …

In terms of future-oriented job indicators, one is that the seasonally adjusted employment gauge within the September Ivey purchasing managers' index slipped back into contraction territory for the first time since February 2010. The employment gauge slipped from 52.5 in August to 47.2 in September, with a print below 50 signalling that employers are reducing jobs. No, that doesn't cement the return of job losses in the near-term, but

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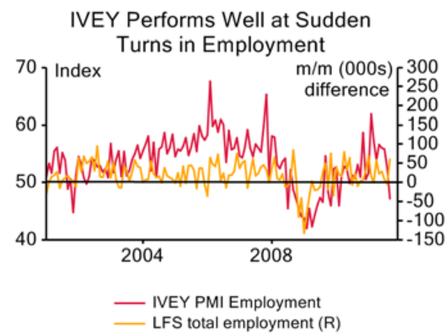
consider charts 2 and 3. When Ivey's employment gauge turns south, it performs reasonably well at predicting turning points in terms of the y/y % change and m/m difference in jobs. Note, however, that Ivey's limited history doesn't lend an enormous degree of confidence here.

Other leading indicators for Canadian jobs are sparse to say the least. Unlike the United States which has fresh, up-to-date weekly jobless claims, Canada's employment insurance claims are monthly and too dated to have predictive value. Canada also does not have the employment components as in regional US surveys. One indicator we can point to comes from Manpower Group which polls employers on their staffing intentions one quarter ahead. The latest survey pointed to a seasonally adjusted net 13% of employers looking to add to their payrolls in Q4 which was down from 16% in Q3 — and thus signals slowing hiring plans — but remained around the most positive readings of the last few years. This survey nevertheless failed to pick up flatness in the Labour Force Survey through much of the third quarter. Like the Ivey employment subcomponent, the Manpower gauge provides soft guidance at best.

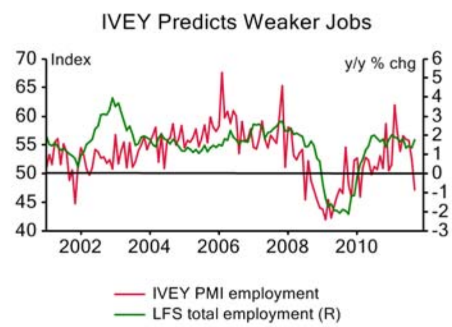
Another measure is the employment component to the Bank of Canada's Business Outlook Survey (BOS). The last survey was conducted in July of this year, and the balance of intentions had employers strongly expecting to add to employment levels over the next year. In fact, the favourable balance of opinion hit a record high. That said, this may be too dated in that it pre-dates most of the period of heightened global turmoil. In addition, its track record in predicting job growth is mixed. The next BOS is scheduled for release on October 17th.

Chart 2



Source: Statistics Canada, IVEY, Scotia Capital Economic

Chart 3



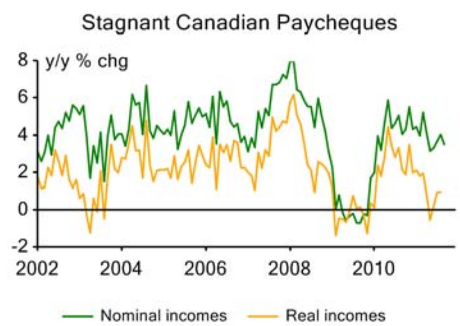
Source: Statistics Canada, IVEY and Scotia Capital Economics

… But Waning Paycheque Growth Is More Important Than The Body Count

What really matters, however, is not the job count and where it's going in the near term but what is happening to Canadian incomes. For a higher-frequency gauge, we multiply hours worked by wages drawn from monthly job reports and then take the yearly growth rate. Chart 4 depicts the results in both unadjusted terms and adjusted for inflation. After accounting for inflation, growth in paycheques remains very slim. What this means is that, while lower commodity prices may help consumers, falling wage growth is offsetting this leaving growth in real incomes very soft which is not a plus for consumer spending. The paycheques of the masses are far more pressured than the modest (compared to the size of the work force) monthly headline job changes would lead you to believe.

This fact was further reinforced in the September figures. Hours worked fell 0.3% m/m in September. That's key since GDP equals hours worked times labour productivity such that a decline in hours worked means September GDP already faces downside risk before we have many of the indicators for the month. To avoid a decline in September GDP there would have to be a sudden pick-up in Canada's thus far moribund productivity growth. On top of the drop in hours worked, wage growth decelerated yet again. Wages are up only 1.5% y/y for all employees and 1.6% y/y for permanent employees.

Chart 4



Source: Statistics Canada, Scotia Capital Economics

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Brazil To Activate Intervention Mechanisms In Response To Global Market Turmoil

- **Healthy currency adjustment eases transition to a decelerated global economic environment.**

The volatile risk repricing episode across emerging markets during the latest financial market turmoil has triggered significant adjustments in the valuation of Brazilian assets, prompting policymakers to increase intervention measures. The Brazilian real (BRL) lost 14% against the US dollar (USD) last month, becoming, at one point, the worst performer among its Latin American currency peers. Additionally, the country's reference equity market index, Bovespa, has dropped 18% since July, compared with a loss of 10.5% in Mexico and a 24% decline in China during the same period. To a large degree, the currency adjustment has been received positively by industrial exporters, who have been suffering from rapid appreciation. Exchange rate stabilization, at a weaker BRL level, will become a net positive factor for the South American giant over the next two years.

The macroeconomic fundamentals in Brazil remain solid, yet growth is expected to slow from the fast pace recorded in 2010. Industrial and agricultural output slowed significantly in the second quarter, while the services sector decreased at a slower rate. Recent economic indicators confirm that this pattern could extend further as the global deceleration continues. The monetary authorities have reacted to a less optimistic outlook, reducing the reference rate by 50 basis points to 12.0% in late August on the back of a significant economic slowdown. In doing so, the central bank is placing less emphasis on the inflation rate, which remains above the bank's official range. We anticipate that the central bank will continue easing monetary conditions through the end of 2012. Once the profit-taking phase subsides, Brazil will regain its attractiveness in global investment portfolios, as it still offers the highest short and long-term interest rates within the G10.

Brazilian Real (USDBRL)

Source: Thomson Reuters.

As a regional leader in monetary policy (with the exception of Mexico, which is closely related to North American policy), Brazil plays an influential role among other major central banks in South America, which are poised to resume a more relaxed monetary policy stance in the near term. In addition, the contagion effect of an economic slowdown in Brazil remains an area of concern for policymakers in the rest of the region. With the exception of the Argentine peso (ARS) which has been strongly supported by massive central bank intervention connected with electoral dynamics (presidential elections will take place on October 23rd), most regional floating currencies (Mexican, Chilean and Colombian pesos) have been strictly correlated with the bearish momentum affecting the BRL and other top-tier emerging-market currencies.

Expectations for looser monetary policy in Brazil (despite higher inflation), as well as the recent financial transaction tax (IOF) increase on foreign capital inflows and currency derivatives, exacerbated the BRL losses in early September, prompting the central bank to sell foreign-exchange swap contracts to avoid further depreciation against the US dollar. We expect the Brazilian exchange rate to close the year at 1.80 vis-à-vis the USD.

Exports will benefit from a weaker BRL; however, external demand could also be negatively affected by deteriorating global conditions, making Brazil reliant on the economic performance of China and the US. We expect Brazilian real GDP to expand by 3.5% y/y this year and by 4.0% y/y in 2012; while inflation is expected to remain high at 6.5% y/y in 2011 and 6.0% in 2012.

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Moody's Downgrades Italy To A2 With Negative Outlook

- **Despite muted market response, the rating cut signals heightened systemic risk in Europe.**

On October 4, 2011 Moody's Investor Service lowered Italy's long-term (foreign and local) government bond rating by three notches to A2 with a negative outlook.

Significance

Italy's rating downgrade marks a new chapter of excess-leverage shocks in Europe. The decision will add to mounting pressure on the Italian government to step up fiscal consolidation and structural economic reform measures, and on the European Central Bank (ECB) to boost sovereign debt purchases through the Securities Market Programme (SMP). The rating revision highlights intensifying risk aversion in the European banking system.

Market Reaction

In the day following the announcement (October 5th), financial markets reacted positively, though the event was likely overshadowed by reports of a Europe-wide bank recapitalization plan. The benchmark Italian equity market index, the FTSE MIB, was up almost 4% on the day in line with most other major European indices. However, the index remains down more than 25% year-to-date, outperforming only the Brazilian Bovespa and Hong Kong's Hang Seng. The yield on 10-year Italian government bonds edged up to 5.51% (still a far cry from the early August peak of 6.19%), while the yield spread between Italian bonds and German bunds initially widened but ended the day slightly narrower (367 basis points versus 376 on October 4th), remaining higher than the equivalent Spanish spread at around 320 basis points. The euro-US dollar exchange rate was largely unaffected by the news.

Analysis and Outlook

Amid growing downside risks to the nation's growth prospects and a heightened susceptibility to financial shocks, this marks the first downgrade of Italian sovereign credit by Moody's since 1993, and brings the nation's rating below that of Spain — which remains at Aa2 with a negative outlook – and in line with S&P's current rating on Italy (cut in September). The decision by Moody's is reflective of the increased risks confronting Italy's outlook on three fronts: political, macroeconomic, and financial.

In mid-September the Italian parliament approved an emergency austerity budget designed to eliminate the government's budget deficit by 2013, a year earlier than planned as of the June 2011 budget. Despite the augmented fiscal consolidation plans, investor sentiment failed to improve, with Italian bond yields remaining elevated. Much of the concern relates to adjustment-program implementation risk given the highly uncertain future of the coalition government led by Prime Minister Silvio Berlusconi, who faces near-daily calls for his resignation amid an assortment of scandal and legal troubles. There is a growing perception that after a decade of sub-par economic growth, the current government is powerless to enact the labour and product market reforms needed to improve the nation's productivity performance and bring the national debt onto a sustainable downward trajectory. Real GDP growth in Italy is expected to average just less than 1% through 2013 while the gross government debt to GDP ratio is likely to exceed 120% over the same period. There is a significant risk that the outlook for both of these metrics could deteriorate further if the debt crisis continues unabated, spreading elsewhere throughout the currency union. In fact, in the wake of Italy's rating downgrade, Moody's issued an additional warning to other euro zone nations of the sustained high risk of contagion, noting that "all but the strongest [Aaa-rated] euro-area sovereigns are likely to face sustained negative pressure on their ratings".

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On the financial sector side, the rating downgrade illustrates the increased importance of systemically relevant European banking institutions. While down from the September peaks (following the S&P downgrade), credit-default swap (CDS) levels on Italy's major banks are still very high, having increased roughly 300 basis points from their lows six months ago. Access to financing may continue to be impaired given the rating agencies' negative outlook, implying additional downgrade revisions on the horizon. It is not only the Italian banks who may face more adverse market conditions, but those of other euro zone nations, including France and Germany, with significant holdings of Italian debt securities. According to consolidated banking statistics from the Bank for International Settlements (BIS), as of March of this year claims of French banks on Italy were second only to claims on the United States, totaling 12.2% of total foreign exposure. The equivalent figure for Germany was 5.28%, smaller though still significant.

Given the mounting risks related to growth and the banking system in the euro zone, continued near-term financial volatility can be expected. The ECB, IMF and other national and international institutions will most likely join collective forces again to adequately address this renewed phase of financial sector instability, including appropriate financial firewalls to contain the spread of default risk.

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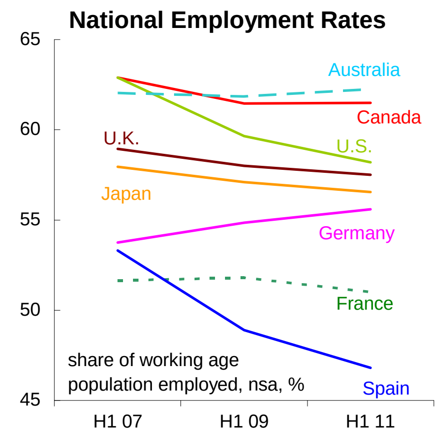
Recovery?... Not in Poverty

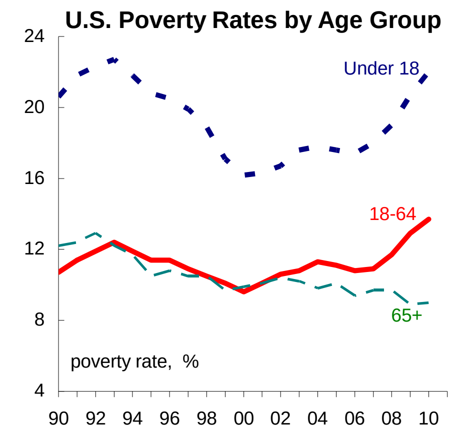
- **U.S. metrics, such as a 2010 poverty rate of 15.1%, underline the challenge for many developed nations in broadening income gains when growth is softening and fiscal constraints are tightening.**

As of July 2011, the OECD reports 44.5 million unemployed among its members, 13.4 million above pre-recession levels. The result is significantly lower employment, relative to working-age population, for many OECD countries *(top chart)*. Labour market marginalization, notably among youth and other higher-risk groups, is not a new problem for developed countries, but it is presently an acute issue, reflecting the accelerated pace of globalization, the breadth and depth of the recent recession and the jobless recovery in many regions. For youth, workers loosely attached to the workforce and the longer-term unemployed, elevated unemployment has raised their reliance on the informal economy and temporary positions that are characterized by low wages, minimal benefits, under-utilization of skills and frequent lay-offs. Among developed nations, the human, economic and social stability benefits of more broadly based employment and income gains are recognized, but accomplishing this objective is now further complicated by softer growth and tighter fiscal constraints.



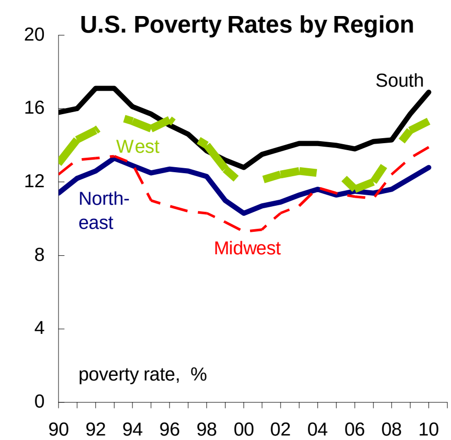
Source: International Labour Office.

Recently released U.S. household income and poverty data for 2010 are telling. Real median household income showed no improvement in 2010, and was 7.1% below the 1999 peak, while the poverty rate[1] rose for the third consecutive year to 15.1% of the population, from 12.5% in 2007. The 46.2 million U.S. residents below the poverty threshold last year was 6.0% higher than in 2009, and almost one in four U.S. residents had incomes less than 150% of their respective poverty thresholds. While the share of seniors below the poverty threshold has decreased, the percentage of adults up to 65 years and children in poverty has climbed sharply *(middle chart)*. In metropolitan areas, the poverty rate in the principal urban agglomeration edged up towards 20% in 2010. Blacks and Hispanics suffered poverty rates averaging 27%. In recent years, the incidence of poverty has climbed in all regions, though only the South in 2010 witnessed a significant jump in both its poverty rate and the number in poverty *(bottom chart)*. For full-time, year-round workers, the 2.6% poverty rate in 2010 contrasted sharply with the 15.0% rate reported for part-time or seasonal workers.



Source: U.S. Census Bureau.

Poverty is typically sensitive to business cycles. Yet the U.S. poverty rate has edged higher during the first calendar year following the past five recessions, contrary to the immediate declines witnessed after the three recessions prior to 1976 *(see chart on next page)*. The U.S. Census Bureau poverty data used in this article are based on money incomes before taxes and tax



Source: U.S. Census Bureau.

[1] The U.S. Census Bureau defines a set of dollar value poverty thresholds, indexed annually and varying by family size and composition, but not by geographic location.

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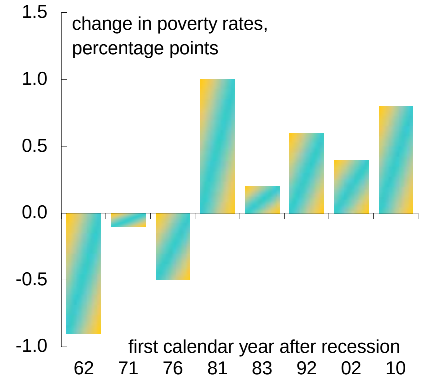
credits, excluding capital gains and noncash benefits such as housing assistance, with no consideration of regional cost-of-living differences and local support programs. A continuing concern are individuals without health insurance, numbering almost 50 million in 2010 or roughly one in six residents.

U.S. Post-Recession Change in Poverty Rates



Source: U.S. Census Bureau.

For federal, state and local governments, the extended period of elevated social support is posing an increasing strain on budgets, with unfortunate consequences. A primary example is Unemployment Insurance (UI). State governments are responsible for up to 26 weeks of regular benefits with Washington covering emergency jobless benefit extensions. Currently, over half of the State administrations have exhausted their UI trust funds, resorting to loans from the federal UI trust fund to cover their share of the benefits. Washington's 2009 stimulus package offered these loans interest-free during 2010, but interest topping US$1 billion was charged during fiscal 2011, and the President's *2012 Budget* proposal, as part of an overall UI solution, to waive interest for another two years has not gained traction. In response, some States are scaling back their UI eligibility and benefits and State and federal UI taxes are rising[2], representing another reason for firms to defer hiring. The vicious circle underlines the intensifying constraints during this recovery and reinforces the escalating premium on strategic policy co-ordination.

[2] If a State does not repay its loan from the federal UI trust fund within two years, legislation requires Washington to recoup the borrowed funds by raising federal UI taxes on employers in the state.

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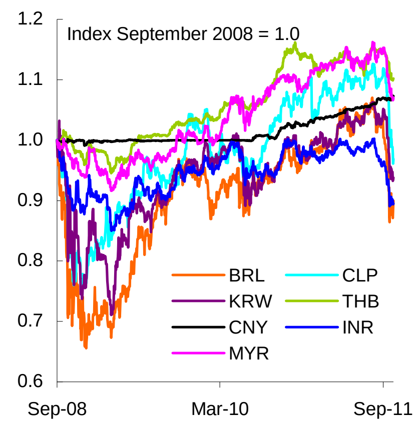
China's Exchange Rate & Fiscal Policy Already Supporting Global Growth

- **Exchange rate stability in China contrasts starkly with currency moves in other emerging markets.**

In the early stages of a renewal period of global slowing, China's exchange rate policy is already playing a stabilizing role. While we expect Chinese yuan (CNY) appreciation to resume sometime in the coming months, the current standstill of the CNY against the USD represents a policy decision to adjust to heightened global financial market volatility.

In the midst of the latest financial storm centered in Europe, developing nation currencies have weakened significantly against the US dollar. That is, with the exception of the CNY, which stayed relatively stable during September, strengthening slightly this week to its current level of 6.36 per USD? Other currencies in Asia have lost value, led by the Korean won with an 11% depreciation. The Indian and Malaysian rupees have weakened over 7%, while the Thai baht has lost a little more than 4%. These are all countries that count China as main trading partner, implying that as long as these adjustments prevail, their products will be less expensive in CNY terms.

Currencies Against the USD



Source: Bloomberg & Scotia Economics.

A similar trend has emerged in South America, from where China sources vast amounts of raw materials. The Chilean peso (CLP) and the Brazilian real (BRL) have lost over 15% against the USD since early September, thereby bolstering Chinese terms of trade.

In the coming week China's trade data for September will be released. We expect to see a slowing in import growth in value terms as a result the downward adjustment in commodity prices since mid-August. Indeed, the benchmark WTI oil price averaged US$10 dollars less during August-September versus its price in the prior two months. More subdued gains in the cost of agricultural commodities (rice, corn and wheat) also support this trend. Notice, however, that while a fall in the value of the imported content is anticipated, no retraction in volumes is foreseen, if Chinese domestic demand continues to advance at a steady pace. Hence, our forecast is for sequential GDP growth between the second and third quarters to have remained steady at an 8% quarterly annualized rate (consistent with a 9% y/y advance). What underpins this forecast is the persistent expansion within the construction sector, where the majority share of investment outlays is centered. We expect a GDP gain of 9.1% y/y for 2011 as a whole to be followed by an 8.9% advance in 2012.

A policy of a steady CNY appreciation is thus supporting disinflation as import costs retract. Recall that the Chinese authorities became preoccupied with the rise in local costs, particularly food and fuel, during the second half of 2010. These trends have already dented consumer spending (evident in falling retail sales growth). While seasonal factors and one-time events could temporarily disrupt the downtrend in inflation, it would appear that expectations for a stable moderation in price gains could provide room for monetary policy to become more growth-oriented. We do not anticipate any changes until inflation is evidently on a downward track, which could happen in November at the earliest.

Chinese authorities are increasingly in favour of an inwardly generated economic growth foundation, engineering an ambitious social housing development program that took-off during the second quarter. This explains the persistent advance in investment outlays in the midst of a fall in "commodity" (marketable) housing developments. A fiscal impulse within China has thus already been lifted with an eye to the installment of a new generation of leaders in 2012. Chinese policies are likely to become more identifiably pro-growth in the coming quarters.

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The View From Europe: Changing Seasons

- **Changing treatment of seasonal items in the eurozone HICP has continued to cause significant volatility in the y/y inflation rate. While the impact on y/y inflation is likely to be short lived, there is also likely to be a permanent impact on the seasonal pattern of the eurozone HICP. The following is an updated version of a note we first issued two months ago which describes what is happening.**

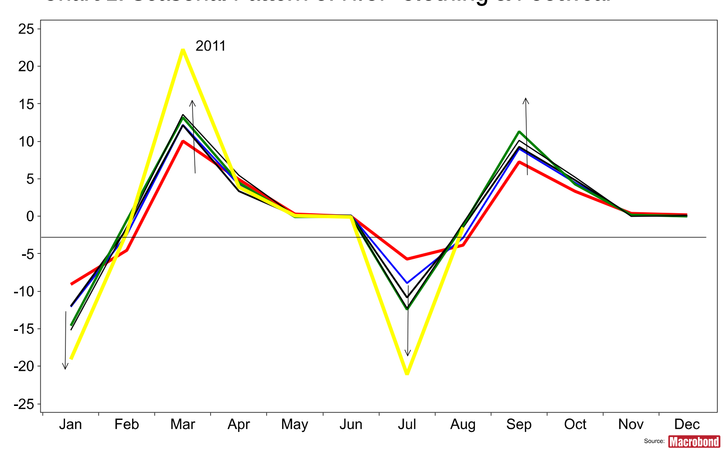
The significant upward surprise in eurozone (and particularly Italian) inflation during September demonstrated that many in the market have still not fully taken account of the adjustment in seasonal patterns in the eurozone inflation data. More specifically, Eurozone HICP inflation surged to 3% y/y in September — far higher than consensus expectations for 2.5% y/y (and even higher than our own 2.8% y/y forecast). Once again, Italy was the primary contributor to the surprise, with its HICP rate surging to 3.5% y/y from 2.3% y/y and far higher than consensus estimates for 2.7% y/y.

As we highlighted some time ago, the upward 'surprise' in September was entirely predictable given that it was payback for extraordinarily deep discounts during July. At that time, Italian HICP inflation surprised significantly to the downside, falling from 3.0% y/y to 2.1% y/y — contrary to consensus expectations for little change. This provoked a downward surprise in Eurozone HICP for the same month.

This situation has come about because of different treatment of seasonal items within the HICP basket by different countries across the Eurozone. Some items within the CPI basket are not available at certain times of the year. This means that the prices of these items need to be estimated or are given a zero weight when calculating the HICP index in certain months. The current gyrations in the inflation indices of some Eurozone economies reflects bringing the calculation methodology into line with the Eurozone harmonized standard.

In practice, this has been most evident in components such as clothing and footwear in Italy and Spain. Chart 1 shows the seasonal pattern of price changes for this component of the Italian HICP basket. Each line represents the % m/m change in that component during each month of a given year. In very simple terms, in July of this year, clothes prices were cut by around 20% m/m — around double the seasonal norm prior to this year. As yet there is no breakdown of the inflation data for September (that will be released on 14 October). However, we suspect that this will show clothes prices rising by close to 20% m/m — double the seasonal norm prior to that.

Chart 1: Seasonal Pattern of HICP Clothing & Footwear



Essentially, months that experience price discounts are now showing much bigger discounts than was previously the case. Similarly, the months that typically experience seasonal price hikes are now registering much bigger price increases than was previously the case.

In the case of the % y/y headline inflation rate, this effect is likely to now be exhausted. The next month on the horizon that typically experiences sharp price movements will be January. However, since this phenomenon has been a one-off shift in the seasonal pattern that started this January, there is unlikely to be a repeat of the significant surprise next January, March, July and September. More specifically, price discounts of circa 20% m/m are the new norm in discount months, so there should not be a major change in the % y/y inflation rate during those months. The reason there was an abrupt swing in the y/y inflation rate this year is because price discounts of 20% m/m this July and January compared to price discounts of around 10% m/m the same month a year ago.

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How much impact?

We suspect that the breakdown of the September data will confirm that the clothing component has been responsible for most of the disruption. This component accounts for around 10% of the weight in the Italian HICP basket and Italy accounts for almost 20% in the eurozone HICP. Given these, we calculate that changes in the seasonal pattern are likely to change the seasonality of the eurozone headline index by as much as 0.4 percentage points in some months.

Implications on Inflation cash and swap market:

Underneath the surface, there will be a more enduring impact from the change in the seasonal patterns. A permanent change in the seasonal patterns is likely to have an impact on short dated inflation linked bonds. The impact on the specific bonds will depend heavily on when the various bonds mature. For example, a bond which has its coupon payments and moreover its redemption payment linked to January and July inflation prints (i.e. when this change in the seasonal pattern bears down on inflation) will be bad news for the price of those bonds. Meanwhile, those inflation linked bonds which have redemption payments linked to March and September (where the seasonal pattern is adding to inflation) should fare better.

Table 2: Maturity & Inflation fixing

	Maturity date	Inflation fixing at Maturity
France OATei/OATi	25 July	25 May
Germany BUNDei	15 April	15 January
Italy BTPei	15 September	15 July
Greece GGBei	25 July	25 May

Source: Scotia

The less favourable seasonal pattern in January and July could therefore weigh on both BUNDei and BTPei papers as, at maturity, their final redemption will be linked to the fixing of inflation measures by the interpolation of January/February data and June/July data respectively. Furthermore, the uncertainty associated with this phenomenon is having a significant impact on liquidity and caution on behalf of market makers — most evident in volatile price action and wide bid-ask spreads.

Conclusion

The sharp upward surprise in eurozone and particularly Italian inflation during September highlights the impact that changing seasonal patterns in some components is still having. Although this is likely to only have a temporary impact on % y/y inflation, the change in the seasonal pattern is likely to be longer lasting, which has significant implications for some inflation linked bonds. In particular, BUNDei and BTPei papers should suffer.

For more colour on the market impact — please contact us for the extended version of this note.

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ECB Focuses On Liquidity But Prefers To Wait For Cutting Rates

- The ECB decided to focus on liquidity, meeting all expectations by reactivating all standard measures.
- In line with most of consensus, the ECB kept the benchmark refinancing rate unchanged at 1.50%. However, Mr. Trichet indicates that the decision to cut rate was a close call.
- The dovish tone from Mr. Trichet in theory keeps open substantial room to manoeuvre for his successor. However, in practice, we fear that the likelihood of seeing the ECB cutting rates in the coming months is significantly reduced.

Addressing the liquidity issue has been the key priority.

There were wide expectations that the ECB would address the current liquidity issue by enhancing its liquidity facilities. Actually, the decisions taken fully met these expectations with the central bank reactivating all the instruments in pace at the peak of the crisis in 2008/2009.

In terms of refinancing operations, three month operations at fixed rate with full allotment will now continue up to the end of H1 2012. In addition, the central bank reintroduced long term operations with a maturity of approximately 12 months in October and the other with a maturity of approximately 13 months in December. As mentioned in the press conference, this allows the possibility to secure full liquidity beyond the turn of 2012/2013.

Furthermore, the ECB launches a new covered bond program. The modalities are very similar to the one seen in the first program introduced in Q2 2009 although the amount is smaller at €40 bn (€60 bn in 2009). Operations will be conducted both on primary and secondary markets and starting in November 2011 up to October 2012 (so 1Y, like the previous one). The first program introduced in 2009 proved at the time to be a strong trigger to reanimate the covered bond market (*"the impact of the Eurosystem's covered bond purchase program on the primary and secondary market"*, ECB occasional paper series, N122, Jan 2011)

Rate cut was likely a close call

The transparency of the comments from Mr. Trichet on the debate between the pros and cons of lowering the rate and the very dovish tone of the statement suggest that today's status quo decision was likely a close call.

Indeed, compared to last's month statement which was already dovish, the comments on growth have been further downgraded with Mr. Trichet recognising that "*GDP growth in the euro area is now expected to be very moderate in the second half of this year*", with no longer any reference to *"ample monetary liquidity"* and pointing to the need for "*thorough analysis of all incoming data and developments over the period ahead is warranted*".

All these elements are in theory dedicated to providing ample room to manoeuvre for his successor in adjusting interest rates lower if needed.

Unchanged rate raises nonetheless question to ECB's future reactivity.

However, we fear that today's status quo raises questions regarding the capacity of the central bank to respond to the deterioration of the macroeconomic environment in the very short term.

Hearing from Mr. Trichet, the fact that interest rates are already low could have been an argument for today's decision. A position which will reflect the position of "keeping its powder dry" for any worsening in the situation.

Furthermore, with Mr. Draghi now taking the lead, we think that he is likely to show his commitment to stick with the ECB's inflation mandate. At a time when inflation data are unlikely to be favourable; it adds to the risk that the ECB could be slow to react. Indeed, we expect inflation to remain around 3% up to November with the first favourable base effect gradually playing in December. So, looking from a pure short term inflation development point of view, the easing trend will only start taking place with the release of the December figure, raising the risk that a rate cut will not come until next year.

The focus will now shift to the December meeting where both growth and inflation forecasts will be readjusted. However, there is already the risk that adjusting interest rates lower in line with the slowdown in activity will come too late, thereby dampening its capacity to restore confidence.

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The View From Europe: BoE QE2: Shock & Awe

Why Wait?

Once again the BoE has made use of its secret weapon — shock and awe. Pretty much everyone expected QE to restart at some point — but it was only a minority view that it would start this soon, or in excess of GBP50bn. In doing so the Bank has achieved the most bang for its buck.

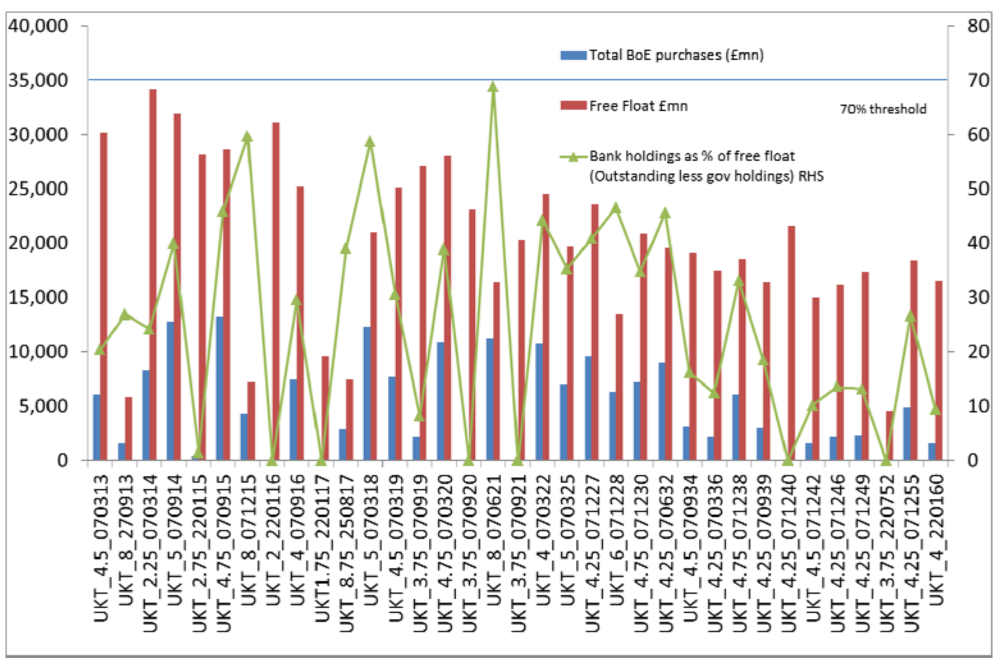
For the record, the BoE re-engaged in QE with an additional GBP75bn — a month earlier than most expected and GBP25bn more than the consensus view of GBP50bn. Although the high frequency monthly data released since the September meeting have on the whole been more upbeat than expected, a number of issues are likely to have provoked the move:

- The revised GDP data showed that GDP growth has been slightly weaker than previously reported over the last year — crushing the Bank's assumption that growth would be revised up sharply;
- This has implied a greater degree of slack in the economy than previously assumed;
- growth has been weaker than expected in the UK's main trading partners; and
- Financial market tensions have not gone away and in some parts have intensified.

The Bank has explicitly stated that it is not concerned that inflation is likely to rise to above 5% y/y in the coming month, because it is likely to fall very sharply through next year. More importantly, the Governor stated that the economy could be experiencing the worst financial crisis ever, hence pre-emptive action was necessary.

It is early days, but there is a good chance that this is not the final instalment of QE. Much will depend on the thrust of the Bank's forecasts in the upcoming November *Inflation Report*. However, we calculate that in the absence of QE, the Bank would have been forecasting inflation of up to ½% below its target 2 years ahead. Based on the Bank's rule of thumb (GBP200bn added ¾% to inflation during QE1) GBP75bn will probably still leave the Bank's projection below the 2% target in November – leaving the door open to more to come at a later stage.

Chart 1: BoE Holdings of Individual Gilts vs Free Float



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What, Where, When, How Much?

The key market considerations are that the purchases are planned to take 4 months to complete (taking us to just ahead of the February MPC meeting). We calculate that taking account of the Christmas break, this implies a pace of purchases of GBP4.5bn to GBP5.0bn per week. That is a little slower than during the early phase of QE1, but faster than towards the end of the programme. The Bank will buy evenly across 3 maturity sectors. The range of eligible securities will be the same as during QE1.

Perhaps most importantly, the BoE will only purchase up to 70% of the free-float (total outstanding minus government holdings) of any individual bond. Chart 1 plots bars representing the current BoE holdings against the free-float of the individual bonds. The line represents the percentage of free-float accounted for by the BoE. The point is that bonds where the BoE ownership is at, or close to the 70% threshold are likely to underperform neighbouring bonds that are a comfortable distance away from that threshold. As an illustration, the UKT 8 21 bond is already at the 70% threshold. However, it is straddled by two bonds (UKT 3T 20 and UKT 3T21) neither of which the BoE currently owns.

Table 1 lists all the individual gilts and the concentration of BoE ownership of each. The table is ordered from the most down to the least concentrated bonds in order to highlight the bonds that are close to the cut-off point and hence at risk of underperforming. The far right hand column shows the amount of each bond (GBP mn) that the BoE would have to purchase in order to hit that threshold.

Table 1: Concentration of BoE Ownership of Individual Gilts

Bond	Bank holdings as % of free float (Outstanding less gov holdings) RHS	Maximum BoE Purchases (£mn) before hitting threshold
UKT_8_070621	68.83	
UKT_8_071215	59.62	
UKT_5_070318	58.71	2,866
UKT_6_071228	46.52	4,210
UKT_4.75_070915	45.89	8,112
UKT_4.25_070632	45.57	6,259
UKT_4_070322	44.17	6,325
UKT_4.25_071227	40.71	8,077
UKT_5_070914	39.90	11,012
UKT_8.75_250817	38.96	3,260
UKT_4.75_070320	38.86	9,777
UKT_5_070325	35.33	8,789
UKT_4.75_071230	34.70	8,566
UKT_4.75_071238	32.99	8,794
UKT_4.5_070319	30.50	10,389
UKT_4_070916	29.44	11,997
UKT_8_270913	26.87	3,614
UKT_4.25_071255	26.56	9,827
UKT_2.25_070314	24.13	15,651
UKT_4.5_070313	20.28	16,797
UKT_4.25_070939	18.44	8,465
UKT_4.5_070934	16.13	10,315
UKT_4.25_071246	13.50	11,393
UKT_4.25_071249	13.11	10,601
UKT_4.25_070336	12.37	13,084
UKT_4.5_071242	10.11	11,451
UKT_4_220160	9.39	10,001
UKT_3.75_070919	8.12	16,761
UKT_2.75_220115	1.47	19,311
UKT_2_220116	-	21,836
UKT_3.75_070920	-	16,217
UKT_3.75_070921	-	14,216
UKT_4.25_071240	-	15,073
UKT1.75_220117	-	6,733
UKT_3.75_220752	-	3,150

Overall

It was a case of 'when', not 'if' for QE2 and the Bank did the sensible thing and pulled the trigger. We all knew it was coming — so why wait? From an inflation standpoint, our own view has been that it is unlikely that inflation will fall much, if at all below the 2% target and that seems all the more likely following today's policy action, which should eventually be supportive for linkers. Clearly our forecast for inflation is at odds with that of the BoE.

On growth, we will have to wait and see if QE is effective. The Bank clearly thinks it will be effective, but we remain sceptical. In light of the revisions to historical GDP data, it is looking likely that GDP growth will remain sub-1% y/y both this year and next. Moreover, given the prospect of a negative GDP print around the turn of the year, we believe it is unlikely that this will be the final instalment of QE. A negative GDP print for Q4 (released in January) would very likely provoke a second instalment at the February MPC meeting.

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Data Review: UK GDP Revisions

Back to the future

- The UK Office for National Statistics has rewritten history. UK GDP data back to 1997 has been revised. At the margins, growth has been revised up. Most importantly, the upward revisions to the recent growth data that the BoE had been banking on failed to materialise — rather there were slight downward revisions! The downward revision to Q2 growth to just 0.1% q/q was disappointing. Given that surveys have weakened since Q2, there is an increasing chance of negative GDP at some point during H2.

It has been a long time coming, but finally the ONS has released the revisions to the National Accounts dating back to 1997. The key points were:

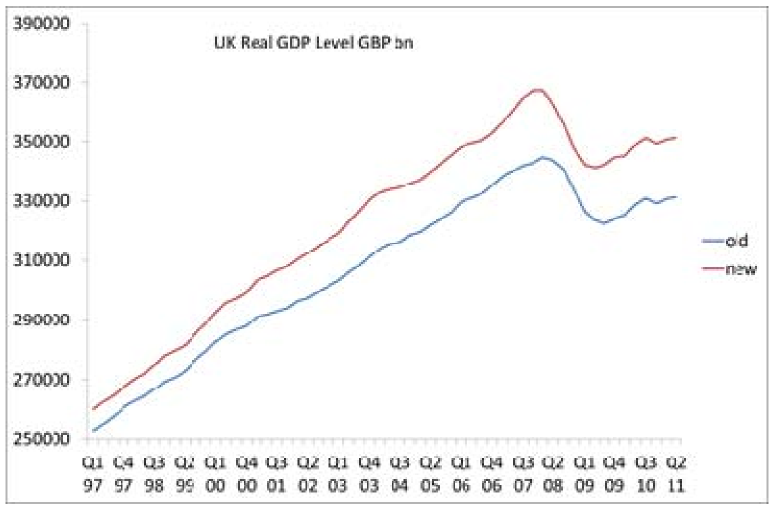
- As expected, the level of real GDP was revised up (Chart 1)
- GDP growth over the last 2 years was revised up by an average of 0.6 percentage points. However, there has been virtually no change to the last year (Chart 2).
- On average over the last 5 years, the average revision to GDP growth has been upwards by 0.08 percentage points.
- The 2008-09 recession is now judged to have been deeper, but shorter.

So what?

A key reason for the upward revision was the adjustment in the deflator applied to real GDP from an RPI based index to CPI. In simple terms, if the ONS subtracts less inflation from nominal GDP, then the level of real GDP ends up higher. Given that this is happening because of an adjustment in the inflation index makes it feel rather artificial. Had there not been the transition from the RPI to CPI (for a variety of purposes) these revisions would probably never have happened. The point is that has the productive capacity of the economy or the availability of underutilised labour or capital equipment changed at all? We don't think so.

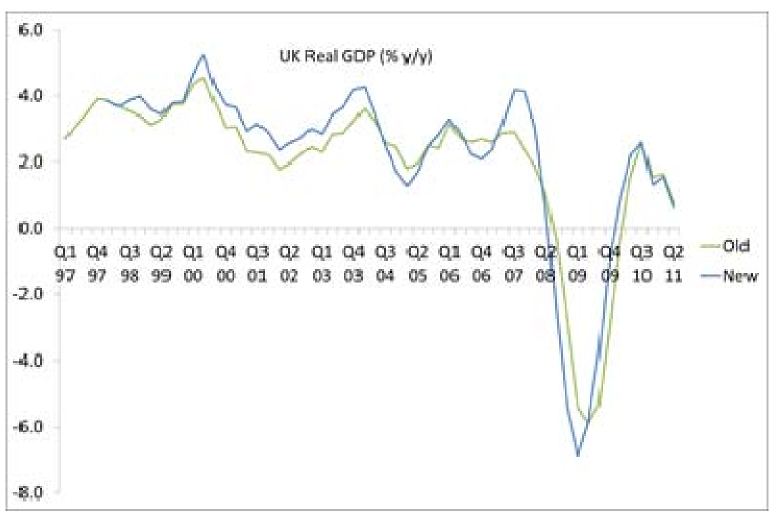
Furthermore, the bulk of the revisions are backward looking. What we believe is of more significance, not least for monetary policy, is where GDP growth has been over the last year and where it is going from here. The BoE had banked on some chunky upward revisions to the last year or so

Chart 1: Level of GDP – Before and After Revisions



Source: ONS

Chart 2: Real GDP Growth – Before and After Revisions



Source: ONS

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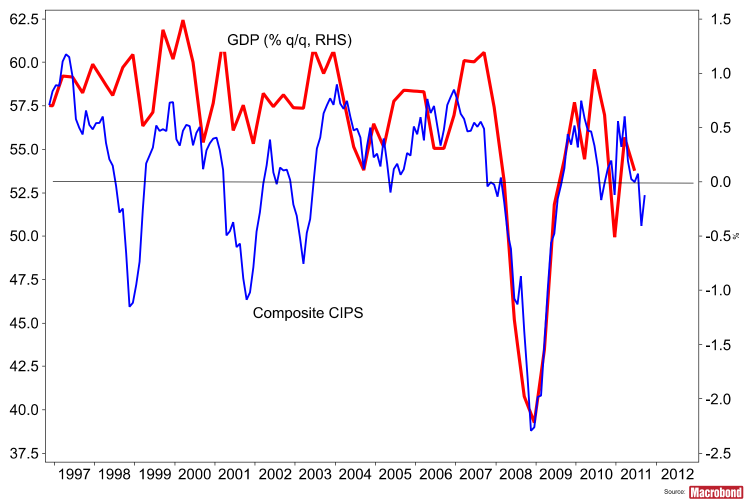
and what we have got is the opposite — downward revisions! This is a big blow to the Bank's growth projection and points to significant downward adjustments at the November *Inflation Report*.

Sub-1% Growth Likely

Chart 3: UK GDP vs Composite CIPS



On the back of these revisions, it is going to be very hard for UK GDP growth to exceed 1% y/y on average for this year. That compares to the latest BoE projection of around 1½% y/y. Admittedly, the monthly services sector output data for July were better than expected and make it less likely that growth contracted during Q3. Nonetheless, the current level of the PMI surveys and our view that these fall further highlights the significant risk of a negative reading during Q4 (Chart 3).

Even assuming a reasonable pace of recovery next year (especially during Q3 as a result of the London Olympics), it is looking likely that full year GDP growth for 2012 will also be below 1% y/y.

Conclusion

The long awaited revisions to GDP failed to show the upward revisions that the BoE had projected. Now that the uncertainty of these revisions is out of the way we would expect to see more and more forecasts for UK GDP growth below 1% y/y for this year and next. We suspect that this was a major factor behind the earlier and bigger than expected injection of asset purchases at this week's MPC meeting.

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Diverging Views Four Months After Peru's Election

The following article was published on October 6, 2011.

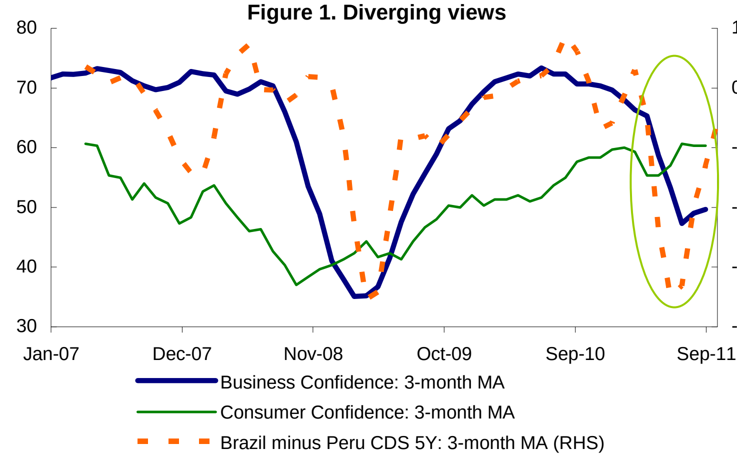
Uncertainty created by last spring's elections caused drops in business confidence, consumer confidence, and fixed income markets. Half-a-year later, business confidence remains subdued, even as consumers are increasingly optimistic and fixed income assets have recovered most of their earlier losses. We discuss different explanations for these diverging views, which have important implications for markets and for medium-term economic forecasts.

Economic indicators conflict

An interesting macroeconomic development that has emerged in Peru since political uncertainty increased in the spring is the divergence in the views of three stakeholders in Peru's economic future: those of consumers, of financial markets, and of local businesspeople. While consumers and fixed income markets have largely accepted the moderation of President Humala's views on economic policy, businesspeople remain sceptical. As a result, even as consumer spending in areas such as department store sales and vehicles grows at rates exceeding 20%, fuelled in part by the increase in consumer credit, businesspeople have been reluctant to acquire inventories, purchase intermediate goods, or to hire new employees at the heightened pace we saw earlier. That divergence adds significant uncertainty around the economic outlook, as one of these groups must be wrong. In this article, we explore the differing views in more detail, starting with the quantitative evidence.

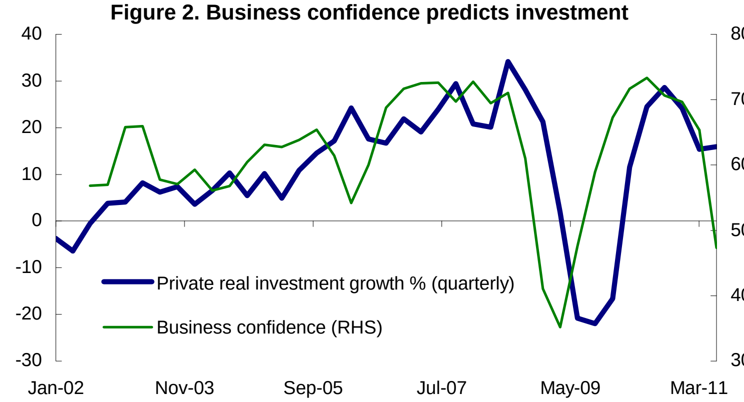
As shown in Figure 1, business and consumer confidence followed each other closely in recent years, both falling together at the end of 2008 and recovering afterwards. They even fell together as Humala's lead increased at the start of 2011 but have diverged significantly since then; consumer confidence has continued on its upwards trend while business confidence has stagnated. That latter variable has historically been quite a good predictor of private investment (Figure 2), which we imagine is one reason that the central bank and many other economists expect the growth rate of private investment to moderate, and as a result, are also forecasting a lower growth rate for GDP overall.

Figure 1. Diverging views



Source: Peru Central Bank, Ipsos Apoyo, Bloomberg.

Figure 2. Business confidence predicts investment



Source: Peru Central Bank.

The economic data shows no change in investment so far as second quarter private investment growth was 16% as opposed to 15% in the first quarter. Nevertheless, the Central Bank is expecting private investment growth to slow to 11% this year and 8% the following year. With private investment previously accounting for 21% of GDP, that slowdown is enough to reduce investment's contribution to growth from 4% to about 2%. Luckily, consumption growth remains stable at around 6%, and as such can contribute nearly 4% to GDP

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growth. Developments in those two key components are consistent with most economists' economic growth forecasts of 5% to 6%. (Our own bank economists in Lima are projecting 5.5% growth for next year).

Financial markets have mostly forgotten the political uncertainty that was responsible for much volatility earlier this year. Peru CDS has recovered to levels consistent with the country's Latin American peers. By the end of the summer, the currency had reached its strongest level in recent years and yields on soberanos compressed to what we last saw a year ago. True, it is possible that with US Treasuries where they are now, yields could be even lower and the currency's appreciation trend even stronger, were it not for political uncertainty. Nevertheless, it does seem that financial markets are giving President Humala the benefit of the doubt.

Movements in these variables prompt an interesting question: what accounts for the sharp divergence in views between consumers and financial markets on one side and businesspeople on the other side?

Recent legislation

Part of the explanation may lie in recent legislation, some already approved and some merely in preliminary stages, which to those suspicious of the President's agenda gives cause for alarm. Three such measures are:

1) **Mining taxes** — A crucial portion of Humala's campaign platform that was ultimately adopted by other candidates was an increase in mining taxes. It was inevitable that Humala would pursue this bill, especially as few in Congress would stand up for the rights of mining companies in the face of such popular support for a tax increase. Ultimately, the increase in taxes was small, with average tax rates rising by about 5% of profits; the new tax scheme further minimized the impact of new taxes on marginal projects by making new taxes dependent on profits. Mining companies that had tax stability agreements in place accepted the increased taxes anyway, perhaps because the increase was small and they wanted access to future projects. So far, we are not aware of any pending mining investments that have been cancelled due to higher taxes, but of course it is possible that such decisions could take time and would not be announced as readily as decisions to invest. One provision in the legislation that was ultimately deleted would have given the executive branch the ability to raise taxes further without congressional approval. President Humala promised after legislation was approved that there would be no further tax increases.

2) **Community consultation law** — This law would give local communities the right to object to legislation and business projects that affect them. While the interpretation of this law must still be worked out, it seems likely that the government will be able to override the concerns of community groups when necessary to ensure that important projects can continue.

3) **General labor law** — A committee with representatives from both business and labor is working on developing a labor code, as previously there was no separate code to cover labor issues. One provision under discussion would eliminate part-time contracts for agricultural workers, prompting concern that a more rigid labor law is coming that would ultimately impede new hiring.

Explaining the divergence

These are just a few of the examples of legislation that may have raised concerns in the business community and prompted expectations of lower investment. Under this explanation, the government will continue to maintain and probably strengthen the safety net with measures such as higher pensions or additional support for the marginal classes, which explains why consumers are feeling so confident. In contrast, new taxes or new labor regulations threaten to make serving that rising customer demand less profitable, diminishing the incentives for investment. So far, the government is showing itself to be pro-market, but not necessarily as pro-business as previous administrations.

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Yet, there are also some problems with this explanation. First, recent legislation does not really tell us what the Humala administration wants to do. Instead, it tells us that many congressional representatives of Humala's party are more radical than he is, which we already knew. Even if all 47 representatives were more radical, it would still not be enough to have a majority in the 130 seat Congress. So far, the legislation that has been approved has successfully balanced different extremes in order to produce a moderate outcome. In addition, the Peruvian executive has an implicit veto in its ability to send back to Congress for further consideration legislation that it does not like.

Second, the survey responses do not seem internally consistent. We could have easily attributed the differing views to differences in time horizon, arguing that consumers and hedge fund managers have shorter horizons than businesses; however, the business confidence survey asked for expectations just three months into the future rather than several years. It is unlikely that legislation is bad enough in such a short-period of time to affect business conditions. Another item in the Central Bank survey asked businesses their expectations of product demand in three months; the survey found that expectations had fallen from 67 in March to the mid 50s by the summer. Thus, it seems that either the positive trend in consumption, including increasing credit for consumption, must soon reverse, or the business sector will notice that their worst case scenarios are not materializing, and be forced to revise their expectations.

While we do not have a comprehensive explanation, we can think of a number of additional factors that are relevant to understanding the situation. Remember that Humala was deeply unpopular among the upper income class even after moderating his views, with Ipsos Apoyo polls before the election showing him getting one-fourth the votes of Fujimori. In this sense, it is not surprising that the businessmen surveyed were pessimistic about the economic situation in the months following the election. Those views may be changing, however, as some of the fears about Humala have not materialized. Consider for example some of the conservative appointments he has made since his election — Castilla for Finance Minister, Velarde at the Central Bank, and directors of the Central Bank appointed earlier this week — which should have reassured investors. September's Ipsos Apoyo survey found a surprising 62% approval rating for the President among the upper class.

Meanwhile, the deterioration in the global environment may have offset any gains in political certainty. We would expect business leaders to be more attuned to changes in the global environment, and to anticipate the effects on the local economy long before local consumers take notice. Similarly, fixed income markets may have moved away from pricing idiosyncratic political risk and may now be pricing global economic risk in line with that faced by other Latin American countries. The administration's actions so far suggest that attention should continue to shift away from politics in the near-term; nevertheless, weak global growth could affect politics in the long-term.

We think that consumer, business, and foreign investor confidence should eventually converge. For example, September survey data released earlier this week showed a 2 point increase in business confidence even as consumer confidence remained unchanged. Consumer confidence remains near historical highs, however, even as business confidence is below historical averages. Whether the differing views ultimately reconcile at higher or lower levels of confidence will have important implications for medium-term growth. Yesterday, Julio Velarde commented that Peru's GDP growth this year could exceed the Central Bank's forecast of 6.3%; that is consistent with some early indicators of third quarter GDP growth such as high electricity demand. Since Peru's growth rates of 8% to 10% have earned it significant attention, even among other fast-growing Latin American peers, and the variables critical to forecasting growth are volatile, we think these issues are important to track going forwards.

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Asian FX Forecast Update: The Trend Remains The Same

- **We have revised our Asian FX forecasts weaker over our forecast horizon, however the structural appreciatory trend remains intact.**

- **We Our CNY forecast remains unchanged, as we expect the renminbi to maintain a modest appreciatory trend.**

We have recently revised our Asian FX forecasts in order to reflect the downshift in the global growth outlook, and the impact that sustained financial market volatility has had on the monetary policy outlook for the Asian region. In broad terms, we have essentially adjusted the appreciatory profile for many Asian currencies versus the USD, incorporating weaker overall levels though the forecast horizon. However, we have maintained a structurally bearish USD profile that implies the eventual resumption in Asian FX appreciation.

The greater weight of our forecast changes are front end loaded into the end of year 2011 targets, recognizing that heightened and sustained financial market volatility has driven short term flows out of the countries in question. Whereas past periods of high risk aversion, once completed, could be expected to give way to a resumption of portfolio and other investment flows back into risk assets, we believe that there will be somewhat more restraint this time. This is in consideration of the broad deceleration in global growth indicators, perhaps best summarized by the rapid fall-off in PMI indicators over the past few months. The IMF, in its September World Economic Outlook, downgraded world output by a cumulative 0.8% over 2011 and 2012, while advanced economies received a 1.3% cumulative downgrade, and developing Asia received a 0.6% cumulative downgrade. While EM Asia is still relatively well positioned, the shift in growth momentum will likely serve to restrain investment flow to some degree vis-à-vis the outlook a few months ago, despite the incremental monetary easing still seen in some advanced economies.

	Forecast			
	End of 2011		End of 2012	
	old	new	old	new
USDCNY	6.25	6.25	5.88	5.88
USDHKD	7.75	7.75	7.75	7.75
USDINR	44.8	47.5	43.5	46.0
USDIDR	8540	8750	8400	8500
USDMYR	2.92	3.10	2.87	3.00
USDPHP	42.00	43.50	41.00	41.50
USDSGD	1.19	1.26	1.17	1.22
USDKRW	1030	1130	1000	1070
USDTHB	29.10	30.50	28.50	28.60
USDTWD	28.50	30.00	27.80	29.00

We have however, not changed our outlook for the Chinese renminbi, as the government continues to pursue gradual currency appreciation, at a trend pace of around 5% annualized since the renminbi was once again allowed to appreciate in June of 2010. With no apparent shift in policy stance being signaled thus far by policymakers, we remain confident in additional gradual appreciation, in line with the economic goals of the Chinese leadership. Indeed it would have been quite a shock, and against the historical precedent of both the Asian financial crisis and the most recent global financial crisis/recession, to have seen any kind of significant FX weakness allowed by the Chinese authorities, considering the stabilizing force that the renminbi represents in the region. Nevertheless, the dynamic for the rest of the Asian FX space has been quite different. We had in previous research noted that the Asian currency space had not reacted as immediately to the initial spike in financial market volatility (late July / early August) as has been the case during past periods of high financial market volatility (see chart below).

To recap our view in the context of what is currently taking place, we reprint what we wrote on Monday, August 22nd in a publication entitled Asian FX Comment: No Safe Haven: “The longer such volatility persists, the higher the risk that it impacts the already strained growth outlook. Indeed, regional policymakers have repeatedly pointed to the European situation as a risk to their own outlooks. Should Asian central banks perceive that extended financial market volatility risks presenting a serious drag on growth, they may once again decide to step back from the market and accommodate some degree of weakness in their currencies as a

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buffer. A quick look at past periods of similar spikes in risk asset volatility suggests that should the current period persist for around a month, essentially to around September 5th, we may begin to see Asian FX weakness come into play. We note that this would not constitute a game-changer, so far as our structurally bullish Asian FX view versus the USD is concerned, but we would certainly be forced to acknowledge that less central bank hawkishness via FX could imply less monetary tightening going forward and weigh on currency performance."

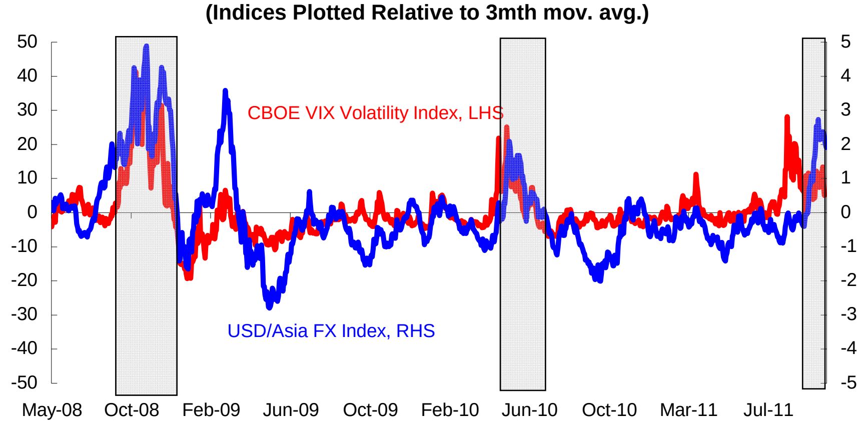
We suspected that Asian central banks were taking more of a "wait and see" approach in deciding whether to accommodate the downside pressures on their currencies versus the USD, as inflation concerns for many were still the dominant risk in the economic outlook. The outlook and the balance of risks shifted perceptibly however, as the absolute degree and persistence of financial market volatility heightened the downside risk to the real economic outlook, and lessened the upside risk to the outlook for inflation. Indeed, the fall in commodity prices in recent months helped to soften the inflation outlook, as did the fact that inflation pressures in a number of countries, including China, looked to be on their way to already peaking. However, this was not the case across the board as in other countries, including India, Korea and Thailand, core inflation pressures were still persistent.

As it became obvious that the balance of risk had shifted, the violent reaction in Asian FX ensued. Though the reaction was very much delayed in comparison to that which occurred under volatility spikes of similar magnitude in the past, the size of the move more than made up for it as Asian FX downside volatility became very obvious as of the 9th of September.

This massive FX reaction, the most violent since the 2008 financial crisis, has led us to accordingly downgrade our outlook for the outright levels of Asian currencies versus the USD. However the general appreciatory path throughout the forecast horizon (from current levels) is preserved. This outlook is due to the still relatively robust growth outlook for Asia, particularly in the context of the recent US growth outlook revisions. Also, the very weak US monetary policy outlook, which is preserving current loose monetary policy settings at least through mid 2013, is also a key feature. In fact, we cannot deny that the large depreciation in the Asian currencies over the past month may raise some inflationary pressures down the road. This could suggest an eventual return to monetary tightening once global economic conditions stabilize. In addition, US external deficit financing requirements, relative to the demand for USD assets (particularly government assets) is also a longer term concern of ours. Finally the US fiscal trajectory and risks to the structural fiscal outlook hang in the background. Asian FX in our view remains a longer term attractive currency play relative to the USD, a key point to remember in the face of still very prominent financial market volatility.

Asian FX Weakens In Line With Financial Market Volatility

(Indices Plotted Relative to 3mth mov. avg.)



Source: Scotia FX Strategy

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Key Data Preview

CANADA

Canadian manufacturing shipments (Friday) rebounded by almost double that expected in July, supported by solid gains in auto and petroleum & coal shipments which accounted for just over half of the increase in the month. Indeed, July marked the first monthly gain in manufacturing shipments after supply-chain disruptions from the Spring Japanese disasters halted auto production, along with other related industries, and sent shipments spiraling downward. Now, with auto production back up and running, will we witness a second monthly gain? We think that there are risks on both sides, resulting in our print estimate of 0.0%. On the downside, crude oil prices plummeted during the month which tends to result in a decline in petroleum & coal shipments — albeit not necessarily of the same magnitude as the change in price. Secondly, there is an increased risk that the decline in auto production in July, which didn't translate into a decline in auto shipments, gets booked in August instead. Indeed, while in the past most changes in auto production in a given month were reflected in the auto shipments numbers that same month, since the Japanese disasters, there seems to be somewhat of a lag between the two components. In addition, there is a high base effect that will be difficult to repeat. On the other hand, unfilled orders have been rising for two consecutive months while auto production rose almost 10% in August, suggesting that shipments could gain modestly once again in August if all of the unfilled orders end up filled rather than cancelled. Having said all that, what matters more is what happened to real manufacturing shipments after a strong gain in July.

Canada's trade balance (Thursday) will likely not fare any better in August for four reasons. First, exports jumped 2.2% m/m in July, providing a high base effect for repetition into August. Second, while a decline in crude oil prices would normally extract a decent gain in crude oil export volumes, given the increased weakness in the U.S. economy which receives the majority of Canada's oil exports, the decline in prices could overwhelm the traditional volume offset. Third, the 7.6% m/m increase in auto exports in July will not likely be repeated as auto production moderates after a strong rebound following the supply chain disruptions in early Spring. Fourth, August marked one of the sharpest global equity sell-offs since the recent crisis in 2008/2009, resulting in a huge decline in consumer and business confidence in the U.S. (as well as many other countries around the world). This will likely result in much weaker demand for Canadian goods despite the fact that the Canadian dollar plunged 2.8% m/m in August given the huge lag effects on prices. On the import side of the picture, we'll be watching the machinery and equipment component closely given the unexpected decline in July and given its impact on business investment within the real GDP report. Indeed, as we pointed out in our article "Canadian Business Investment Will Probably Fall In Q3 — Adding To Growth Risks" (*Global Views*, Sept. 9. 2011), even if we witness just over 2% m/m gains in m&e imports in both August and September, as long as the July print is not revised, the quarter as a whole would still only net out to being flat. We are looking for a widening in the trade deficit after the huge narrowing in July. The real deficit will likely follow suit and it is this metric that impacts real GDP.

UNITED STATES

The **US trade deficit** (Thursday) will likely widen in August as exports deteriorate amid a sharp reduction in business and consumer confidence during the month and a large gain in July while import growth remains modest. Watch the real trade balance which will also likely widen after a narrowing in July.

US retail sales (Friday) are expected to rebound in September despite continued weakness in consumer confidence and further deterioration in financial markets during the month. Why? For one, retail sales stalled out in August which provides a low base effect from which to witness a rebound. Second, total vehicle sales soared 8% m/m, with part of that gain likely translating into an increase in auto sales. Third, incomes jumped 0.6% m/m during the month according to the September nonfarm payrolls report as both average hourly earnings and aggregate hours worked rebounded. Third, gasoline prices declined for the third consecutive month, providing American consumers with more money in their pockets although in absolute terms, gasoline prices are still pretty lofty. Fourth, the weather was beautiful in September. Fifth, given the sharp hit to consumer confidence in August, retailers likely increased discounts during the month which will likely have enticed consumers back to the malls. What this final point highlights though is that the price-adjusted retail sales numbers will be just as important, if not more important, than the nominal prints coming across the screens. Indeed, real sales have fallen in four of the past five months despite gains in nominal sales.

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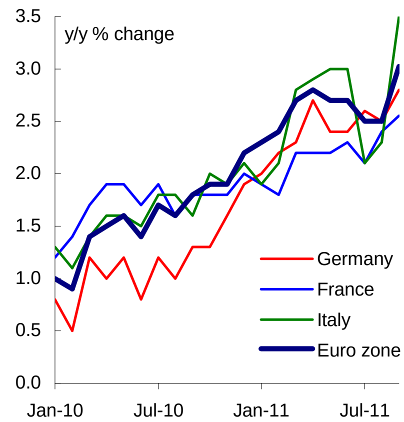
EUROPE

EU-Harmonized Inflation



Source: Bloomberg, Scotia Economics.

Several European nations will release inflation data for September next week, including Germany, France, Italy, Spain, Portugal, Ireland, Norway, and Sweden, as well as the euro zone as a whole. The flash CPI estimate for the currency union indicated that price gains accelerated to 3.0% y/y in September, a stronger pace than most analysts had anticipated. Inflationary pressures in the euro zone have intensified recently on the back of a weaker euro, stronger-than-expected labour market performance in some member countries, and a methodological adjustment in the CPI calculation. After rebounding from the summer sale period, which saw price growth slow to 2.5% y/y in both July and August, inflation will likely remain elevated through the remainder of the year before trending down in 2012 toward the European Central Bank's target of "below, but close to, 2%". We expect the final prints for Germany and Italy to confirm preliminary estimates of EU-harmonized inflation at 2.8% y/y and 3.5% y/y, respectively, for September. The first (and final) measure of French inflation will likely show a gain in the headline index of 2.6% y/y, an increase over the August rate of 2.4% y/y.

LATIN AMERICA

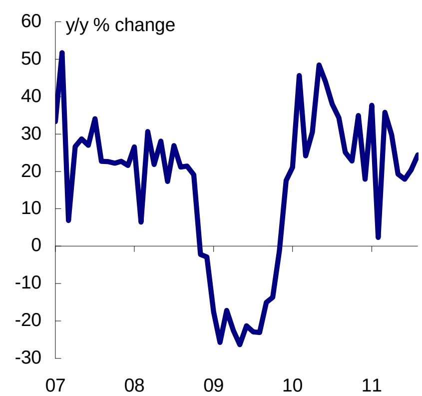
Brazilian Retail Sales

Source: Bloomberg.

Retail sales data for July suggested that Brazilian consumption (accounting for around 60.0% of the total economy) remains solid, but has shown some signs of deceleration. New numbers for August will be released on October 11th. In July, retail sales expanded by 7.1% y/y, the same growth rate as in June, while expanded retail sales (which include the auto sector and building materials) dropped from 9.3% y/y in June to 7.7% y/y in July. Retail sales have been showing a very gradual deceleration, mainly due to strong durable goods consumption. However, due to recent financial turmoil and a less optimistic economic outlook, consumers' confidence in the coming months could be negatively affected.

ASIA

China's Exports in U.S. dollars



Source: Customs General Administration PRC & Scotia Economics.

Chinese exports have been expanding at a 23% y/y rate so far in 2011. From here on, however, several headwinds are likely to lead to a more subdued expansion of the country's foreign sales. The implicit appreciation of the Chinese yuan (CNY) against most regional currencies within Asia has boosted the cost of China's products, at least until neighbouring currencies catch up with CNY's gains against the USD, as they are likely to have overshot. Importantly, Asia is China's main export destination. Moreover, sluggish growth prospects in the U.S. and Europe are also likely to put a dent in China's export growth, as the two regions represent about 45% of China's overall export market. These effects are not expected to reveal themselves immediately, but over time. We thus forecast the value of China's exports to have expanded at a 17% y/y rate in September.

Key Indicators for the week of October 10 - 14

North America

Country	Date	Time	Event	Period	BNS	Consensus	Latest
MX	10/10	09:00	Trade Balance (USD millions)	AUG F	--	--	-805.8
MX	OCT 10-17		ANTAD Same-Store Sales (YoY)	SEP	--	--	1.8
MX	OCT 10-14		Vehicle Domestic Sales (units, AMDA)	SEP	--	--	75680
MX	OCT 10-14		Vehicle Production (units, AMIA)	SEP	--	--	221637
MX	OCT 10-14		Vehicle Exports (units, AMIA)	SEP	--	--	170086
US	10/11	07:30	NFIB Small Business Optimism Index	SEP	--	--	88.1
CA	10/11	08:15	Housing Starts (000s)	SEP	187.0	189.0	184.6
MX	10/11	09:00	Gross Fixed Investment (YoY)	JUL	--	--	11.6
MX	10/11	10:00	Central Bank Announces International Reserves for Prev. Week				
US	10/11	10:00	IBD/TIPP Economic Optimism Index	OCT	--	38.0	39.9
US	10/11	14:00	Minutes of FOMC Meeting				
US	OCT 11-14		Monthly Budget Statement (USD billions)	SEP	--	-66.0	-134.2
US	10/12	07:00	MBA Mortgage Applications (WoW)	7-Oct	--	--	-4.3
CA	10/12	08:30	New Housing Price Index (MoM)	AUG	0.1	0.1	0.1
CA	10/12	08:30	New Housing Price Index (YoY)	AUG	--	2.3	2.3
MX	10/12	09:00	Industrial Production (YoY)	AUG	3.4	--	3.2
MX	10/12	09:00	Industrial Production (MoM)	AUG	--	--	0.5
CA	10/13	08:30	Int'l Merchandise Trade (CAD billions)	AUG	-1.2	-1.0	-0.8
US	10/13	08:30	Trade Balance (USD billions)	AUG	-47.0	-46.0	-44.8
US	10/13	08:30	Initial Jobless Claims (000s)	7-Oct	400.0	405.0	401.0
US	10/13	08:30	Continuing Claims (000s)	1-Oct	3700.0	--	3700.0
CA	10/14	08:30	Manufacturing Sales (MoM)	AUG	0.0	0.5	2.7
US	10/14	08:30	Import Price Index (MoM)	SEP	--	-0.4	-0.4
US	10/14	08:30	Import Price Index (YoY)	SEP	--	12.4	13.0
US	10/14	08:30	Advance Retail Sales (MoM)	SEP	0.6	0.6	0.0
US	10/14	08:30	Retail Sales Less Autos (MoM)	SEP	0.4	0.2	0.1
US	10/14	08:30	Retail Sales Ex Auto & Gas (MoM)	SEP	--	0.2	0.1
US	10/14	09:55	U. of Michigan Confidence Index	OCT P	--	60.0	59.4
US	10/14	10:00	Business Inventories (MoM)	AUG	--	0.4	0.4
MX	10/14	10:00	**Overnight Rate**		**4.50**	**--**	**4.50**

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

Key Indicators for the week of October 10 - 14

Europe

Country	Date	Time	Event	Period	BNS	Consensus	Latest
IR	OCT 07-12		CPI (EU Harmonised) (YoY)	SEP	--	--	1.0
IR	OCT 07-12		CPI (YoY)	SEP	--	--	2.2
GE	10/10	02:00	Exports SA (MoM)	AUG	1.2	1.1	-1.9
GE	10/10	02:00	Imports SA (MoM)	AUG	0.6	0.6	-0.5
GE	10/10	02:00	Current Account (EUR billions)	AUG	--	5.0	7.5
GE	10/10	02:00	Trade Balance (EUR billions)	AUG	8.0	9.0	10.4
FR	10/10	02:30	Bank of France Bus. Sentiment	SEP	--	--	97.6
FR	10/10	02:45	Industrial Production (MoM)	AUG	-1.0	-0.7	1.5
FR	10/10	02:45	Manufacturing Production (MoM)	AUG	--	0.2	1.4
SP	10/10	03:00	House transactions (YoY)	AUG	--	--	-34.8
SW	10/10	03:30	Industrial Prod. s.a. (MoM)	AUG	--	-1.5	2.8
NO	10/10	04:00	CPI (YoY)	SEP	--	1.3	1.3
NO	10/10	04:00	CPI Underlying (YoY)	SEP	--	1.0	0.8
IT	10/10	04:00	Industrial Production sa (MoM)	AUG	-0.1	0.2	-0.7
IT	10/10	04:00	Industrial Production wda (YoY)	AUG	--	-2.7	-1.6
UK	10/10	19:01	BRC Sales Like-For-Like (YoY)	SEP	--	-0.9	-0.6
UK	10/10	19:01	RICS House Price Balance (%)	SEP	-25.0	-24.0	-23.0
PO	10/10		Trade Balance (EUR millions)	AUG	--	--	-1215.0
IR	OCT 10-14		Industrial Production SA (YoY)	AUG	--	--	-5.4
IR	OCT 10-13		New Vehicle Licences (units)	SEP	--	--	5275.0
SP	10/11	03:00	CPI (EU Harmonised) (MoM)	SEP	1.2	1.2	0.0
SP	10/11	03:00	CPI (EU Harmonised) (YoY)	SEP F	3.0	3.0	3.0
SP	10/11	03:00	CPI (Core Index) (MoM)	SEP	--	0.1	0.2
SP	10/11	03:00	CPI (Core Index) (YoY)	SEP	--	1.6	1.6
SP	10/11	03:00	Consumer Price Index (MoM)	SEP	--	0.2	0.1
SP	10/11	03:00	Consumer Price Index (YoY)	SEP F	3.0	3.1	3.1
SW	10/11	03:30	CPI - Headline Rate (YoY)	SEP	--	3.3	3.4
SW	10/11	03:30	SW CPI - CPIF (YoY)	SEP	--	1.5	1.6
UK	10/11	04:30	Industrial Production (MoM)	AUG	-0.1	-0.2	-0.2
UK	10/11	04:30	Manufacturing Production (MoM)	AUG	-0.2	-0.2	0.1
GE	OCT 11-18		Wholesale Price Index (MoM)	SEP	--	--	0.1
FR	10/12	01:30	CPI - EU Harmonised (MoM)	SEP	0.1	0.1	0.6
FR	10/12	01:30	CPI - EU Harmonised (YoY)	SEP	2.6	2.6	2.4
FR	10/12	01:30	Consumer Price Index (MoM)	SEP	0.1	0.1	0.5
FR	10/12	01:30	Consumer Price Index (YoY)	SEP	2.3	2.5	2.2
FR	10/12	02:45	Current Account (EUR billions)	AUG	--	--	-4.5
UK	10/12	04:30	Claimant Count Rate (%)	SEP	4.9	5.0	4.9
UK	10/12	04:30	Jobless Claims Change (000s)	SEP	30.0	24.0	20.3
UK	10/12	04:30	Average Weekly Earnings (3M/YoY)	AUG	2.8	2.9	2.8
UK	10/12	04:30	Weekly Earnings exBonus (3M/YoY)	AUG	1.8	1.9	2.1
UK	10/12	04:30	ILO Unemployment Rate (3mths %)	AUG	8.0	8.0	7.9
EC	10/12	05:00	Euro-Zone Ind. Prod. sa (MoM)	AUG	--	-0.8	0.9
GE	10/13	02:00	Consumer Price Index (MoM)	SEP F	0.1	0.1	0.1
GE	10/13	02:00	Consumer Price Index (YoY)	SEP F	2.6	2.6	2.6
GE	10/13	02:00	CPI - EU Harmonised (MoM)	SEP F	0.1	0.1	0.1
GE	10/13	02:00	CPI - EU Harmonised (YoY)	SEP F	2.8	2.8	2.8
EC	10/13	04:00	ECB Publishes Oct. Monthly Report				
UK	10/13	04:30	Visible Trade Balance (GBP millions)	AUG	-8700.0	-8800.0	-8922.0
UK	10/13	04:30	Total Trade Balance (GBP millions)	AUG	-4300.0	-4250.0	-4450.0
PO	10/13	05:00	Consumer Price Index (YoY)	SEP	--	3.2	2.9
PO	10/13	05:00	CPI - EU Harmonised (YoY)	SEP	3.4	3.3	2.8
SP	10/13		Spain Business Confidence	3Q	--	--	-9.2
IT	10/14	04:00	Trade Balance (Total) (EUR millions)	AUG	--	--	1437.6
IT	10/14	04:00	Trade Balance Eu (EUR millions)	AUG	--	--	1773.0
NO	10/14	04:00	Existing Homes (QoQ)	3Q	--	--	2.8
EC	10/14	05:00	Euro-Zone CPI - Core (YoY)	SEP	1.5	1.5	1.2
EC	10/14	05:00	Euro-Zone CPI (MoM)	SEP	0.8	0.8	0.2
EC	10/14	05:00	Euro-Zone CPI (YoY)	SEP	3.0	3.0	2.5
EC	10/14	05:00	Euro-Zone Trade Balance (EUR millions, SA)	AUG	--	--	-2510.8
IT	10/14	05:00	CPI (NIC incl. tobacco) (MoM)	SEP F	0.1	0.1	0.1
IT	10/14	05:00	CPI (NIC incl. tobacco) (YoY)	SEP F	3.1	3.1	3.1
IT	10/14	05:00	CPI - EU Harmonized (MoM)	SEP F	1.9	1.9	1.9
IT	10/14	05:00	CPI - EU Harmonized (YoY)	SEP F	3.5	3.5	3.5

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

Key Indicators for the week of October 10 - 14

Asia Pacific

Country	Date	Time	Event	Period	BNS	Consensus	Latest
ID	OCT 04-11		Consumer Confidence Index	SEP	--	--	110.6
ID	OCT 04-11		Net Foreign Assets (IDR Trillions)	SEP	--	--	1035.3
CH	OCT 09-15		Actual FDI (YoY)	SEP	--	--	11.1
IN	OCT 09-11		India Local Car Sales (units)	SEP	--	--	144516.0
SK	OCT 09-12		South Korea FDI (YoY)	3Q	--	--	20.3
NZ	OCT 09-13		REINZ Housing Price Index	SEP	--	--	3223.7
NZ	OCT 09-13		REINZ Housing Price Index (MoM)	SEP	--	--	0.5
NZ	OCT 09-13		REINZ House Sales (YoY)	SEP	--	--	21.1
SK	10/10	17:00	Producer Price Index (YoY)	SEP	--	--	6.6
NZ	10/10	17:45	NZ Card Spending - Retail (MoM)	SEP	--	1.1	-0.7
NZ	10/10	17:45	NZ Card Spending - Total (MoM)	SEP	--	--	-0.5
JN	10/10	19:50	Adjusted Current Account Total (JPY billions)	AUG	--	509.9	752.5
JN	10/10	19:50	Current Account Balance (YOY)	AUG	--	-63.6	-42.4
JN	10/10	19:50	Trade Balance - BOP Basis (JPY billions)	AUG	--	-692.3	123.3
AU	10/10	20:30	NAB Business Confidence	SEP	--	--	-8.0
AU	10/10	20:30	NAB Business Conditions	SEP	--	--	-3.0
PH	10/10	21:00	Total Exports (YoY)	AUG	--	-4.4	-1.7
PH	10/10	21:00	Total Monthly Exports 9USD millions)	AUG	--	--	4429.0
CH	OCT 10-15		Foreign Exchange Reserves (USD billions)	SEP	--	3300.0	3197.5
CH	OCT 10-15		New Yuan Loans (CNY billions)	SEP	--	550.0	548.5
CH	OCT 10-15		Money Supply - M0 (YoY)	SEP	--	--	14.7
CH	OCT 10-15		Money Supply - M1 (YoY)	SEP	--	12.1	11.2
CH	OCT 10-15		Money Supply - M2 (YoY)	SEP	--	14.0	13.5
ID	OCT 10-11		**Bank Indonesia Reference Rate**		**6.75**	**6.75**	**6.75**
JN	OCT 10-14		Machine Tool Orders (YoY)	SEP P	--	--	15.2
PH	OCT 10-11		Bank Lending Net of RRPs (YoY)	AUG	--	--	19.1
PH	OCT 10-11		Bank Lending (YoY)	AUG	--	--	23.6
MA	10/11	00:01	Industrial Production (YoY)	AUG	--	0.5	-0.6
MA	10/11	00:01	Manufacturing Sales Value (YoY)	AUG	--	--	10.8
JN	10/11	00:30	Bankruptcies (YoY)	SEP	--	--	-3.6
JN	10/11	01:00	Bank of Japan Monthly Economic Report				
JN	10/11	01:00	Consumer Confidence Index	SEP	--	37.2	37.0
SK	10/11	19:00	Unemployment Rate (%, SA)	SEP	--	3.2	3.1
AU	10/11	19:30	Westpac Consumer Confidence s.a. (MoM)	OCT	--	--	8.1
JN	10/11	19:50	Machine Orders (MoM)	AUG	--	3.9	-8.2
JN	10/11	19:50	Machine Orders (YOY)	AUG	--	-3.6	4.0
NZ	10/11	20:00	ANZ Consumer Confidence (MoM)	OCT	--	--	-0.6
AU	10/11	20:30	Home Loans (MoM)	AUG	--	1.0	1.0
AU	10/11	20:30	Investment Lending (MoM)	AUG	--	--	1.9
AU	10/11	20:30	Owner-Occupied Home Loan Value (MoM)	AUG	--	--	1.4
SK	10/11	23:00	Bank Lending to HH (KRW Trillions)	SEP	--	--	448.0
IN	10/12	01:30	Industrial Production (YoY)	AUG	--	--	3.3
NZ	10/12	17:30	Business NZ PMI	SEP	--	--	52.9
JN	10/12	19:50	Bank Lending Ex-Trusts (YoY)	SEP	--	-0.5	-0.5
JN	10/12	19:50	Bank Lending incl Trusts (YoY)	SEP	--	--	-0.5
JN	10/12	19:50	Tertiary Industry Index (MoM)	AUG	--	-0.3	-0.1
SK	10/12	20:00	Bank of Korea Monetary Policy Committee Meeting				
AU	10/12	20:30	Employment Change (000s)	SEP	--	10.0	-9.7
AU	10/12	20:30	Unemployment Rate (%)	SEP	--	5.3	5.3
AU	10/12	20:30	Full Time Employment Change (000s)	SEP	--	--	-12.6
AU	10/12	20:30	Part Time Employment Change (000s)	SEP	--	--	2.9
AU	10/12	20:30	Participation Rate (%)	SEP	--	65.6	65.6
SK	10/12	21:00	**South Korea 7-Day Repo Rate**		**3.25**	**3.25**	**3.25**
CH	10/12	22:00	Business Climate Index	3Q	--	--	135.6
CH	10/12	22:00	Trade Balance (USD billions)	SEP	--	16.9	17.8
CH	10/12	22:00	Exports (YoY)	SEP	17	20.8	24.5
CH	10/12	22:00	Imports (YoY)	SEP	22	24.6	30.2
SK	10/13	17:00	Export Price Index (MoM)	SEP	--	--	1.3
SK	10/13	17:00	Export Price Index (YoY)	SEP	--	--	1.8
SK	10/13	17:00	Import Price Index (MoM)	SEP	--	--	0.5
SK	10/13	17:00	Import Price Index (YoY)	SEP	--	--	10.0
JN	10/13	19:50	Domestic CGPI (MoM)	SEP	--	-0.2	-0.2
JN	10/13	19:50	Domestic CGPI (YoY)	SEP	--	2.5	2.6
NZ	10/13	22:00	Non Resident Bond Holdings (%)	SEP	--	--	62.5
CH	10/13	22:00	Consumer Price Index (YoY)	SEP	6.2	6.1	6.2
CH	10/13	22:00	Producer Price Index (YoY)	SEP	6.6	6.9	7.3
IN	10/14	02:30	Monthly Wholesale Prices (YoY)	SEP	--	--	9.8

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

Key Indicators for the week of October 10 - 14

Latin America

Country	Date	Time	Event	Period	BNS	Consensus	Latest
CO	OCT 06-11		Vehicle Sales (units)	SEP	--	--	28883.0
BZ	10/10	07:30	Central Bank Weekly Economists Survey		--		
BZ	10/10	10:00	Trade Balance (FOB) - Weekly	9-Oct	--	--	1126.0
BZ	10/11	08:00	Retail Sales (MoM)	AUG	--	0.1	1.4
BZ	10/11	08:00	Retail Sales (YoY)	AUG	--	7.1	7.1
BZ	10/11	08:00	Broad Retail Sales (YoY)	AUG	--	--	7.7
PE	10/11		Trade Balance (PEN millions)	AUG	--	--	1220.8
CL	10/12	07:30	Central Bank Economist Survey				
CL	10/13	17:00	**Nominal Overnight Rate Target**	14-Oct	**5.25**	**5.25**	**5.25**
CO	10/13	17:00	Trade Balance (USD millions)	AUG	--	--	545.7
CO	10/14		Monetary Policy Meeting Minutes				

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

Global Auctions for the week of October 10 - 14

North America

Country	Date	Time	Event
CA	10/11	10:30	Canada to Sell CAD8.9 Bln 98-Day Bills
CA	10/11	10:30	Canada to Sell CAD3.3 Bln 168-Day Bills
CA	10/11	10:30	Canada to Sell CAD3.3 Bln 350-Day Bills
US	10/11	11:00	U.S. Fed to Purchase USD2.25-2.75 Bln Notes/Bonds
US	10/11	11:30	U.S. to Sell 3-Month Bills
US	10/11	11:30	U.S. to Sell 6-Month Bills
US	10/11	13:00	U.S. to Sell 3-Year Notes
US	10/12	11:30	U.S. to Sell 4-Week Bills
CA	10/12	12:00	Canada to Sell 5-Year Notes
US	10/12	13:00	U.S. to Sell 10-Year Notes Reopening
US	10/13	11:00	U.S. Fed to Purchase USD4.25-5.00 Bln Notes/Bonds
US	10/13	13:00	U.S. to Sell 30-Year Bonds Reopening
US	10/14	11:00	U.S. Fed to Purchase USD4.25-5.00 Bln Notes/Bonds

Europe

Country	Date	Time	Event
GE	10/10	05:15	Germany to Sell EU4 Bln 6-Mth Bills
HU	10/10	05:30	Hungary to Sell 6-Week Bills
NE	10/11	04:00	Netherlands to Sell Up to EUR3 Bln 2.5% 2017 bond
IT	10/11	05:00	Italy to Sell Bills
NO	10/11	05:00	Norway to Sell NOK3 Bln 4.5% 2019 Bonds
GR	10/11	05:00	Greece to Sell Bills
SZ	10/11	05:30	Switzerland to Sell 6-Month Bills
UK	10/11	05:30	U.K. to Sell GBP900 Mln 1.125% I/L 2037 Bonds
HU	10/11	05:30	Hungary to Sell 3-Month Bills
TU	10/11	06:00	Turkey to Sell Zero Coupon 2013 Bonds
TU	10/11	06:00	Turkey to Sell 8% 2014 Bonds
TU	10/11	06:00	Turkey to Sell 8% 2014 Bonds
EC	10/11		ECB's Reserve Maintenance Period Ends
HU	10/12	04:30	Hungary's Central Bank to Sell 2-Week Bills
SW	10/12	05:10	Sweden to Sell Bills
GE	10/12	05:15	Germany to Sell Add'l EU2 Bln 30-Year Notes
SZ	10/12	05:30	Switzerland to Sell Bonds
HU	10/12	05:30	Hungary to Hold Exchange Offer Auction
RU	10/12	06:00	Russia to Sell Up to RUB10 Bln OFZ Notes
PD	10/12	06:30	Poland to Hold Exchange Offer Auctions
IT	10/13	05:00	Italy to Sell Bonds/Floating Rate Notes
UK	10/13	05:30	U.K. to Sell GBP2 Bln 4.25% 2039 Bonds
HU	10/13	05:30	Hungary to Sell 12-Month Bills
UK	10/14	06:10	U.K. to Sell Bills

Asia Pacific

Country	Date	Time	Event
CH	10/10	22:00	Agricultural Dev Bank to Sell CNY15 Bln 5-Year Bonds
JN	10/10	23:35	Japan to Sell 2-Month Bills
CH	10/11	23:00	China to Sell CNY30 Bln 7-Year Bonds
JN	10/11	23:35	Japan to Sell 3-Month Bills
JN	10/12	23:45	Japan to Sell 30-Year Bond

Source: Bloomberg, Scotia Economics.

Events for the week of October 10 - 14

North America

Country	Date	Time	Event
US	10/11	14:00	Fed Releases Minutes of Sep. 20 FOMC Meeting
CA	10/11		Newfoundland and Labrador Provincial Election
CA	10/11		Yukon Territorial Election
US	10/12	13:15	Fed's Pianalto Speaks at University of Akron
US	10/12	13:30	Fed's Plosser Speaks on Economy in Philadelphia
US	10/13	14:30	Fed's Kocherlakota Speaks in Sidney, Montana
MX	10/14	10:00	**Overnight Rate**

Europe

Country	Date	Time	Event
GE	OCT 07-08		CSU Party Hold Annual Congress in Nuremburg
FR	10/08	06:00	IMF Lagarde Meets France's Sarkozy in Paris
FR	10/09		Socialist Party Presidential Primaries Vote, 1st Round
GE	10/09	10:00	German Chancellor Merkel Meets President Sarkozy to Discuss Eurozone Debt Crisis
UK	10/10	10:00	Treasury Committee Hears Testimony from Banking Commission
UK	10/10		Parliament Reconvenes After Break for Party Conferences
PO	10/10		Bank of Portugal Releases Data on Banks
EC	10/11		European Commission Issues Quarterly Report on the Euro Area
EC	10/11		ECB's Reserve Maintenance Period Ends
PO	10/13	09:00	EFSF's Regling, ESMA's Maijoor Speak at Conference in Lisbon
EC	10/13		EU's Van Rompuy, Barroso, Poland's Tusk Speak in Brussels
EC	10/13		ECB's Constancio Takes Part in Brussels Roundtable
IT	10/14	05:00	Bank of Italy Releases August Public Finance Supplement
EC	10/14	07:00	EIB's Maystadt Speaks at Brussels Think Tank
IT	10/14	09:00	Bank of Italy Releases the Quarterly Economic Bulletin

Asia Pacific

Country	Date	Time	Event
NZ	10/10	18:30	Government Full-Year Financial Statements
ID	OCT 10-11		**Bank Indonesia Reference Rate**
JN	10/11	01:00	Bank of Japan Monthly Economic Report
AU	10/12	00:00	RBA's Debelle Gives Speech to Forex Market Conference, Sydney
JN	10/12	19:50	BOJ to Publish Minutes of Sept. 6-7 Board Meeting
NZ	10/13	22:00	Foreign Holdings of New Zealand Government Bonds

Latin America

Country	Date	Time	Event
CL	10/13	17:00	**Nominal Overnight Rate Target**

Source: Bloomberg, Scotia Economics.

Global Central Bank Watch

North America

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Bank of Canada – Overnight Target Rate	1.00	October 25, 2011	1.00	--
Federal Reserve – Federal Funds Target Rate	0.25	November 2, 2011	0.25	--
Banco de México – Overnight Rate	4.50	October 14, 2011	4.50	--

Employment reports in both Canada and the US came in much stronger than expected in September although the details painted two slightly different pictures. In Canada, the strong gains were focused on the self-employed and public sector with the private sector witnessing a decline in jobs. In addition, education employment accounted for almost two-thirds of the total gain due to distortions that won't likely be repeated next month, while hours worked deteriorated during the month. In the U.S., the details were not as gloomy as hours worked and wages were both up on the month while gains were more broadly based. Nonetheless, the report still reflects very soft job markets. As a result, neither report changes our current call for the BoC to remain on hold until the end of Q3 2012, with the Fed remaining on the sidelines until Q3 2013.

Amid global economic uncertainty and financial market volatility, as well as stable local inflation and recent Mexican peso depreciation, we anticipate that the central bank of Mexico will maintain its monetary policy rate unchanged at 4.50%. Current volatile conditions will likely set a more cautious tone to Banco de Mexico's announcement.

Europe

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
European Central Bank – Refinancing Rate	1.50	November 3, 2011	1.50	--
Bank of England – Bank Rate	0.50	November 10, 2011	0.50	0.50
Swiss National Bank – Libor Target Rate	0.00	December 15, 2011	0.00	--
Central Bank of Russia – Refinancing Rate	8.25	October 21, 2011	8.25	--
Hungarian National Bank – Base Rate	6.00	October 25, 2011	6.00	6.00
Central Bank of the Republic of Turkey – 1 Week Repo Rate	5.75	October 20, 2011	5.75	--

Surprising most analysts who had expected smaller-scale action at a later date, the Bank of England's (BoE) Monetary Policy Committee decided on October 6th to resume its intervention activity with an injection of £75 billion into the asset purchase program. The BoE opted to keep the benchmark bank rate on hold at 0.50%. The European Central Bank (ECB) also refrained from cutting rates on October 6th, though it did implement standard measures to boost liquidity. With the new president, Mario Draghi, taking over the ECB presidency at the next meeting and inflation still elevated, it is unlikely that interest rates will be changed in November. However, we do not discount the possibility of an interest rate cut in December this year or early 2012.

Asia Pacific

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Bank of Japan – Target Rate	0.10	November 15, 2011	0.10	--
Reserve Bank of Australia – Cash Target Rate	4.75	October 31, 2011	4.75	--
Reserve Bank of New Zealand – Cash Rate	2.50	October 26, 2011	2.50	2.50
People's Bank of China – Lending Rate	6.56	TBA	--	--
Reserve Bank of India – Repo Rate	8.25	October 25, 2011	8.25	--
Hong Kong Monetary Authority – Base Rate	0.50	TBA	0.50	--
Central Bank of China Taiwan – Discount Rate	1.88	December 30, 2011	1.88	--
Bank Negara Malaysia – Overnight Policy Rate	3.00	November 11, 2011	3.00	--
Bank of Korea – Bank Rate	3.25	October 12, 2011	3.25	3.25
Bank of Thailand – Repo Rate	3.50	October 19, 2011	3.25	--
Bank Indonesia – Reference Interest Rate	6.75	October 11, 2011	6.75	6.75
Central Bank of the Philippines – Overnight Policy Rate	4.50	October 20, 2011	4.50	--

The Bank of Korea will likely keep the benchmark monetary policy interest rate unchanged after its monetary policy setting meeting next week. While inflation readings remain above the central bank's comfort zone, they have recently started to come down on the back of lower pressures on food costs. A significantly weaker Korean won will have a more meaningful growth enhancing effect over the coming months. Bank Indonesia will also maintain its monetary stance unchanged given the high level of uncertainty still present in the global economic arena.

Latin America

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Banco Central do Brasil – Selic Rate	12.00	October 19, 2011	11.50	--
Banco Central de Chile – Overnight Rate	5.25	October 13, 2011	5.25	5.25
Banco de la República de Colombia – Lending Rate	4.50	October 28, 2011	4.50	--
Banco Central de Reserva del Perú – Reference Rate	4.25	November 10, 2011	4.25	--

We expect the central bank of Chile to keep its reference rate unchanged at 5.25% on October 13th. Inflation currently stands slightly above the mid point of the official target range (2%-4%), at 3.2% y/y, with inflation expectations for the next 11 months easing from 3.2% at the time of the previous survey to 3.0% at the latest reading. Additionally, Chilean peso depreciation and current volatility could also support the central bank's neutral monetary policy stance.

Africa

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
South African Reserve Bank – Repo Rate	5.50	November 10, 2011	5.50	--

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

Forecasts as at October 7, 2011*	2000-09	2010	2011f	2012f	2000-09	2010	2011f	2012f
Output and Inflation (annual % change)		Real GDP				Consumer Prices[2]		
World[1]	3.6	5.2	3.8	3.8				
Canada	2.1	3.2	2.1	1.7	2.1	1.8	2.9	2.0
United States	1.7	3.0	1.7	1.5	2.6	1.6	2.8	1.9
Mexico	1.7	5.4	3.7	2.9	4.9	4.4	3.4	4.0
United Kingdom	1.9	1.8	0.7	0.7	1.9	3.7	4.4	2.1
Euro zone	1.4	1.8	1.6	1.1	2.0	2.2	2.6	1.5
Japan	0.6	4.0	0.3	3.2	-0.3	-0.4	1.1	1.3
Australia	3.1	2.7	2.9	3.0	3.2	2.7	2.8	2.5
China	9.4	10.4	9.1	8.9	2.0	4.6	5.0	4.5
India	7.4	9.0	7.9	8.3	22.5	32.2	7.5	6.0
Korea	4.4	6.2	4.7	5.0	3.1	3.5	3.7	3.3
Thailand	4.1	7.9	4.5	4.8	2.6	3.0	3.5	2.8
Brazil	3.3	7.5	3.5	4.0	6.7	5.9	6.5	6.0
Chile	3.7	5.2	6.5	4.8	3.5	1.4	3.5	3.3
Peru	5.2	8.8	6.2	5.6	2.5	2.1	3.8	2.7
Central Bank Rates (%, end of period)	11Q1	11Q2	11Q3f	11Q4f	12Q1f	12Q2f	12Q3f	12Q4f
Bank of Canada	1.00	1.00	1.00	1.00	1.00	1.00	1.25	1.75
Federal Reserve	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
European Central Bank	1.00	1.25	1.50	1.50	1.50	1.50	1.50	1.50
Bank of England	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Swiss National Bank	0.25	0.25	0.00	0.00	0.00	0.00	0.25	0.25
Bank of Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Reserve Bank of Australia	4.75	4.75	4.75	4.75	4.75	5.00	5.00	5.00
Exchange Rates (end of period)								
Canadian Dollar (USDCAD)	0.97	0.96	1.05	1.02	1.00	0.99	0.98	0.98
Canadian Dollar (CADUSD)	1.03	1.04	0.95	0.99	1.00	1.01	1.02	1.02
Euro (EURUSD)	1.42	1.45	1.34	1.40	1.42	1.42	1.40	1.40
Sterling (GBPUSD)	1.60	1.61	1.56	1.60	1.61	1.62	1.63	1.64
Yen (USDJPY)	83	81	77	80	82	83	84	85
Australian Dollar (AUDUSD)	1.03	1.07	0.97	1.00	1.02	1.04	1.06	1.08
Chinese Yuan (USDCNY)	6.5	6.5	6.4	6.3	6.2	6.1	6.0	5.9
Mexican Peso (USDMXN)	11.9	11.7	13.9	12.9	12.9	12.7	12.7	12.7
Brazilian Real (USDBRL)	1.63	1.56	1.88	1.80	1.79	1.77	1.76	1.75
Commodities (annual average)	2000-09	2010	2011f	2012f				
WTI Oil (US$/bbl)	51	79	92	92				
Brent Oil (US$/bbl)	50	80	108	104				
Nymex Natural Gas (US$/mmbtu)	5.95	4.40	4.25	4.50				
Copper (US$/lb)	1.78	3.42	4.05	4.05				
Zinc (US$/lb)	0.73	0.98	1.00	1.01				
Nickel (US$/lb)	7.11	9.89	10.50	9.00				
Gold, London PM Fix (US$/oz)	522	1,225	1,565	1,675				
Pulp (US$/tonne)	668	960	980	1,000				
Newsprint (US$/tonne)	572	607	643	690				
Lumber (US$/mfbm)	275	254	255	260				

[1] World GDP for 2000-09 are IMF PPP estimates; 2010e-12f are Scotia Economics' estimates based on a 2010 PPP-weighted sample of 38 countries.

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

* See Scotia Economics 'Global Forecast Update' (www.scotiacapital.com/English/bns_econ/forecast.pdf) for additional forecasts & commentary.

Canada	2010	11Q1	11Q2	Latest	
Real GDP (annual rates)	3.2	3.6	-0.4		
Current Acc. Bal. (C$B, ar)	-50.9	-40.3	-61.3		
Merch. Trade Bal. (C$B, ar)	-9.0	6.9	-14.4	-9.0	(Jul)
Industrial Production	4.9	5.7	2.3	1.5	(Jul)
Housing Starts (000s)	192	178	193	185	(Aug)
Employment	1.4	1.9	1.6	1.8	(Sep)
Unemployment Rate (%)	8.0	7.8	7.5	7.1	(Sep)
Retail Sales	5.5	2.5	4.0	3.9	(Jul)
Auto Sales (000s)	1561	1573	1572	1584	(Jul)
CPI	1.8	2.6	3.4	3.1	(Aug)
IPPI	1.0	4.1	5.0	-5.2	(Aug)
Pre-tax Corp. Profits	21.2	12.9	14.8		

United States	2010	11Q1	11Q2	Latest	
Real GDP (annual rates)	3.0	0.4	1.3		
Current Acc. Bal. (US$B, ar)	-471	-478	-472		
Merch. Trade Bal. (US$B, ar)	-646	-729	-762	-728	(Jul)
Industrial Production	5.3	5.3	3.8	3.3	(Aug)
Housing Starts (millions)	0.58	0.58	0.57	0.57	(Aug)
Employment	-0.8	0.9	0.9	1.1	(Sep)
Unemployment Rate (%)	9.6	8.9	9.1	9.1	(Sep)
Retail Sales	6.8	8.6	8.1	7.5	(Aug)
Auto Sales (millions)	11.6	13.0	12.1	13.0	(Sep)
CPI	1.6	2.1	3.4	3.8	(Aug)
PPI	4.2	4.9	7.0	6.5	(Aug)
Pre-tax Corp. Profits	25.0	2.8	1.3		

Mexico	2010	11Q1	11Q2	Latest	
Real GDP	5.4	4.6	3.3		
Current Acc. Bal. (US$B, ar)	-5.7	-4.2	-10.4		
Merch. Trade Bal. (US$B, ar)	-3.0	7.6	5.7	-9.7	(Aug)
Industrial Production	6.0	5.2	3.4	3.2	(Jul)
CPI	4.2	3.5	3.3	3.1	(Sep)

Brazil	2010	11Q1	11Q2	Latest	
Real GDP	6.7	3.8	2.7		
Current Acc. Bal. (US$B, ar)	-47.4	-58.3	-43.4		
Merch. Trade Bal. (US$B, ar)	20.2	12.7	39.3	36.9	(Sep)
Industrial Production	10.5	2.6	0.6	1.0	(Aug)
CPI	5.1	6.8	6.5	7.2	(Sep)

Chile	2010	11Q1	11Q2	Latest	
Real GDP	5.2	10.0	6.8		
Current Acc. Bal. (US$B, ar)	3.0	0.7	0.1		
Merch. Trade Bal. (US$B, ar)	11.6	16.5	15.5	3.9	(Sep)
Industrial Production	0.5	11.7	7.8	1.7	(Aug)
CPI	1.4	2.9	3.3	3.3	(Sep)

Italy	2010	11Q1	11Q2	Latest	
Real GDP	1.2	1.0	0.8		
Current Acc. Bal. (US$B, ar)	-0.07	-0.12	-0.08	0.03	(Jul)
Merch. Trade Bal. (US$B, ar)	-39.1	-77.2	-45.6	24.6	(Jul)
Industrial Production	6.5	2.2	1.9	-1.3	(Jul)
CPI	1.6	2.3	2.7	2.9	(Aug)

Germany	2010	11Q1	11Q2	Latest	
Real GDP	3.6	4.6	2.8		
Current Acc. Bal. (US$B, ar)	187.6	194.8	156.6	128.5	(Jul)
Merch. Trade Bal. (US$B, ar)	201.5	209.3	208.4	174.7	(Jul)
Industrial Production	10.1	12.8	8.0	7.9	(Aug)
Unemployment Rate (%)	7.7	7.3	7.1	6.9	(Sep)
CPI	1.1	2.1	2.3	2.6	(Sep)

France	2010	11Q1	11Q2	Latest	
Real GDP	1.4	2.2	1.7		
Current Acc. Bal. (US$B, ar)	-44.5	-59.7	-106.5	-23.7	(Jul)
Merch. Trade Bal. (US$B, ar)	-39.0	-54.2	-52.0	-41.6	(Aug)
Industrial Production	5.1	4.8	2.2	3.7	(Jul)
Unemployment Rate (%)	9.8	9.7	9.7	9.9	(Aug)
CPI	1.5	1.8	2.1	2.2	(Aug)

Euro Zone	2010	11Q1	11Q2	Latest	
Real GDP	1.7	2.4	1.6		
Current Acc. Bal. (US$B, ar)	-77	-169	-163	-54	(Jul)
Merch. Trade Bal. (US$B, ar)	32.0	-68.5	-9.1	56.8	(Jul)
Industrial Production	7.4	6.5	4.0	4.2	(Jul)
Unemployment Rate (%)	10.1	9.9	9.9	9.9	(Aug)
CPI	1.6	2.5	2.8	2.5	(Aug)

United Kingdom	2010	11Q1	11Q2	Latest	
Real GDP	1.8	1.6	0.6		
Current Acc. Bal. (US$B, ar)	-71.6	-74.0			
Merch. Trade Bal. (US$B, ar)	-153.0	-142.4	-160.3	-172.6	(Jul)
Industrial Production	2.1	2.0	-0.8	-0.7	(Jul)
Unemployment Rate (%)	7.9	7.7	7.8	7.9	(Jun)
CPI	3.3	4.1	4.4	4.5	(Aug)

Japan	2010	11Q1	11Q2	Latest	
Real GDP	4.0	-0.7	-1.1		
Current Acc. Bal. (US$B, ar)	195.9	193.9	74.7	149.5	(Jul)
Merch. Trade Bal. (US$B, ar)	74.8	31.8	-55.0	-45.7	(Aug)
Industrial Production	16.6	-2.5	-7.0	-0.8	(Aug)
Unemployment Rate (%)	5.1	4.7	4.6	4.3	(Aug)
CPI	-0.7	-0.5	-0.4	0.2	(Aug)

Australia	2010	11Q1	11Q2	Latest	
Real GDP	2.7	1.0	1.4		
Current Acc. Bal. (US$B, ar)	-32.9	-41.7	-22.4		
Merch. Trade Bal. (US$B, ar)	19.3	22.0	49.5	45.7	(Aug)
Industrial Production	4.5	-4.7	-3.3		
Unemployment Rate (%)	5.2	5.0	4.9	5.3	(Aug)
CPI	2.8	3.3	3.6		

China	2010	11Q1	11Q2	Latest	
Real GDP	10.3	9.7	9.5		
Current Acc. Bal. (US$B, ar)	305.4				
Merch. Trade Bal. (US$B, ar)	181.5	-8.2	186.0	213.1	(Aug)
Industrial Production	13.5	14.8	15.1	13.5	(Aug)
CPI	4.6	5.4	6.4	6.2	(Aug)

South Korea	2010	11Q1	11Q2	Latest	
Real GDP	6.2	4.2	3.4		
Current Acc. Bal. (US$B, ar)	28.2	10.4	22.0	4.8	(Aug)
Merch. Trade Bal. (US$B, ar)	41.2	29.1	33.4	17.2	(Sep)
Industrial Production	16.6	11.2	6.7	5.1	(Aug)
CPI	3.0	4.5	4.2	4.3	(Sep)

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

Source: Bloomberg, Scotia Economics.

Interest Rates (%, end of period)

Canada	11Q2	11Q3	Sep/30	Oct/07*	United States	11Q2	11Q3	Sep/30	Oct/07*
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	0.83	0.82	0.82	0.75	3-mo. T-bill	0.01	0.02	0.02	0.01
10-yr Gov't Bond	3.11	2.16	2.16	2.27	10-yr Gov't Bond	3.16	1.92	1.92	2.08
30-yr Gov't Bond	3.55	2.77	2.77	2.84	30-yr Gov't Bond	4.37	2.91	2.91	3.04
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US$B)	60.4	62.3	64.3	(Aug)	FX Reserves (US$B)	128.3	136.6	138.7	(Jul)
Germany					**France**				
3-mo. Interbank	1.51	1.51	1.51	1.52	3-mo. T-bill	1.18	0.38	0.39	0.48
10-yr Gov't Bond	3.03	1.89	1.89	2.00	10-yr Gov't Bond	3.41	2.60	2.60	2.75
FX Reserves (US$B)	64.8	66.0	67.2	(Aug)	FX Reserves (US$B)	61.0	60.3	56.5	(Aug)
Euro-Zone					**United Kingdom**				
Refinancing Rate	1.25	1.50	1.50	1.50	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	1.72	1.46	1.06	0.95	3-mo. T-bill	4.85	4.85	4.85	4.85
FX Reserves (US$B)	319.9	317.2	319.3	(Aug)	10-yr Gov't Bond	3.38	2.43	2.43	2.45
					FX Reserves (US$B)	75.3	79.7	82.5	(Aug)
Japan					**Australia**				
Discount Rate	0.30	0.30	0.30	0.30	Cash Rate	4.75	4.75	4.75	4.75
3-mo. Libor	0.13	0.13	0.13	0.13	10-yr Gov't Bond	5.21	4.22	4.26	4.24
10-yr Gov't Bond	1.14	1.03	1.03	0.99	FX Reserves (US$B)	33.3	40.3	42.1	(Aug)
FX Reserves (US$B)	1080.6	1100.8	1173.9	(Aug)					

Exchange Rates (end of period)

USDCAD	0.96	1.05	1.05	1.03	¥/US$	80.56	77.06	77.06	76.71
CADUSD	1.04	0.95	0.95	0.97	US¢/Australian$	107.22	96.62	96.62	98.54
GBPUSD	1.605	1.558	1.558	1.563	Chinese Yuan/US$	6.46	6.38	6.38	6.36
EURUSD	1.450	1.339	1.339	1.349	South Korean Won/US$	1068	1178	1178	1178
JPYEUR	0.86	0.97	0.97	0.97	Mexican Peso/US$	11.714	13.897	13.897	13.268
USDCHF	0.84	0.91	0.91	0.92	Brazilian Real/US$	1.563	1.879	1.879	1.762

Equity Markets (index, end of period)

United States (DJIA)	12414	10913	10913	11198	U.K. (FT100)	5946	5128	5128	5319
United States (S&P500)	1321	1131	1131	1167	Germany (Dax)	7376	5502	5502	5703
Canada (S&P/TSX)	13301	11624	11624	11747	France (CAC40)	3982	2982	2982	3099
Mexico (Bolsa)	36558	33503	33503	33467	Japan (Nikkei)	9816	8700	8700	8606
Brazil (Bovespa)	62404	52324	52324	52652	Hong Kong (Hang Seng)	22398	17592	18011	17707
Italy (BCI)	1039	796	796	782	South Korea (Composite)	2101	1770	1769	1760

Commodity Prices (end of period)

Pulp (US$/tonne)	1035	990	990	990	Copper (US$/lb)	4.22	3.23	3.23	3.29
Newsprint (US$/tonne)	640	640	640	640	Zinc (US$/lb)	1.05	0.86	0.86	0.84
Lumber (US$/mfbm)	237	240	240	239	Gold (US$/oz)	1505.50	1620.00	1620.00	1652.00
WTI Oil (US$/bbl)	95.42	79.20	79.20	83.49	Silver (US$/oz)	35.02	30.45	30.45	31.98
Natural Gas (US$/mmbtu)	4.37	3.67	3.67	3.51	CRB (index)	338.05	298.15	298.15	305.72

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

Emerging Markets Strategy

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Fixed Income Strategy

Foreign Exchange

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