Scotiabank Group

Global Views

Weekly commentary on economic and financial market developments

May 6, 2011

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

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

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

Watch For Quake Effects, Possible Chinese Tightening and Elevated Data Risk

- **Please see our full indicator, central bank, auction and event calendars on pp. A4-A9.**

All major regions of the global economy will be subjected to elevated data and event risk next week, which could make markets apprehensive toward the risk trade in favour of safe havens. Some portfolio protection may be wise. Markets will remain very sensitive to growth worries and will be able to pick up on the first influences of Japan's devastating shocks beginning to work their way through US, European, Asian and Canadian trade releases for March. There is also the risk of further Chinese policy tightening owing to the arrival of inflation figures and other key indicators. Each of the Fed, BoE and ECB will face updated growth and inflation views. The latter part of the week could see more encouraging US and European releases.

US markets will be a key focal point throughout the week, but the event risk that is front-loaded to the start of the week gives way to data risk later on when US trade, producer prices, retail sales, and CPI will be released. These will be the last inflation reports to exhibit upward commodity price pressures so markets could well look through several of them to an expected retreat the following month on much tamer price effects. Fed speak will represent high risk to markets as four speeches will be delivered on the economic and monetary policy outlook including ones by Richmond Fed President Jeffrey Lacker (alternate), Atlanta Fed President Dennis Lockhart (alternate), Minneapolis Fed President Narayana Kocherlakota (voting), and Philadelphia Fed President Charles Plosser (voting). The start of the week's focus will be upon the third meeting between President Obama and Chinese President Hu Jintao, and the yuan could be the focus. We continue to think some U.S. politicians are hammering away at the poorest measure — the managed nominal exchange rate — instead of the better real effective exchange rate (adjusted for relative prices and trade-weighted) that has appreciated by 22% since 2005. Fed research argues that this degree of appreciation impairs current account balances as a share of GDP within about a two-year lagged horizon. China's current account balance has slipped from over 10% of GDP in 2007 to half that today.

European markets will be facing large data risk throughout the week. Key will be German, French and euro zone GDP due out on Friday for 2010Q1, and consensus is expecting an acceleration from the Q4 softening but this may be short-lived into the second quarter as the lagged effects of the commodity shock are increasingly hitting a variety of global growth variables. Trade data for the UK and Germany for March may also exhibit a Japanese effect. German and French CPI on Wednesday and Thursday are likely to be the last reports facing upward pressures since they are for April before the sharp commodity correction, so markets could look through the reports. Key will be guidance from the BoE on updated growth and inflation forecasts due in Wednesday's quarterly inflation report, and the EU's semi-annual economic forecasts due out on Friday. Norges Bank is the only significant European central bank scheduled for a rate call, and a 25bps hike is expected.

Asia-Pacific markets will be focused on three factors. China's key batch release of monthly indicators occurs on Tuesday night for inflation and retail sales, and Monday night for trade data. These releases always represent significant market risk accompanied by the risk of additional PBoC tightening measures that could strike any time given that no formal schedule of announcements exists. A number of Asian economies release trade figures for March that will begin to reflect the Japanese shocks not least of which being Japan's trade figures themselves. Australian jobs on Wednesday night could be a regional bright spot buoying the A$ on commodity hiring. Consensus expects the Bank of Korea to hike, and Bank Indonesia to hold.

Canadian markets will largely follow the global tone next week with few points of macro differentiation. Trade will be the highlight, and since the figures are for March we'll be watching for early signs of disruptive effects stemming Japan's shocks on global supply chains and trading patterns. The direct effect is relatively modest since Japan only accounts for a low percentage of Canadian trade. But it's the indirect effect via disrupting all global supply chains that matters more. That will hit Q2 GDP but with early signs possibly hitting the March figures given the abruptness of the shock. Housing starts are unlikely to garner much attention, but a market test of BoC thinking arrives on Wednesday when Canada auctions 2 year notes.

Lat-Am markets will be focused on central banks in Chile and Peru with consensus expecting rate hikes.

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

Canada's New Majority Government — Picking Up the Budget Threads

- **Recent policy commitments in the March *Budget* and during the election could limit the flexibility of the new majority government if economic growth downshifts.**

Ottawa's Evolving Budget Arithmetic

	FY11e	FY12f	FY13f	FY14f	FY15f	FY16f	Cumulative FY11-FY16
				$ billions			
Budget Balance: *October 2010 Update*	**-45.4**	**-29.8**	**-21.2**	**-11.5**	**-1.7**	**2.6**	**-107.0**
Economic Improvement*	5.2	3.0	2.4	2.0	1.2	1.2	15.0
New Initiatives: October *Update* to March *Budget*	0.2	1.0	0.2	0.2	0	0	1.6
Revised *Pre-Budget* Balances	**-40.4**	**-27.8**	**-19.0**	**-9.7**	**-0.5**	**3.8**	**-93.6**
March Budget							
Savings from 2010 Strategic Reviews	0	0.2	0.3	0.6	0.5	0.5	2.13
"Tax Fairness" Adjustments (Closing "Loopholes")	0	0.2	0.7	1.1	1.0	1.0	4.0
Subtotal: Savings	**0**	**0.4**	**1.0**	**1.7**	**1.6**	**1.5**	**6.2**
Policy Initiatives	-0.1	-2.3	-1.4	-1.4	-1.3	-1.2	-7.7
Net Savings	**-0.1**	**-1.8**	**-0.4**	**0.3**	**0.2**	**0.3**	**-1.5**
Budget Balance: *March Budget*	**-40.5**	**-29.6**	**-19.4**	**-9.5**	**-0.3**	**4.2**	**-95.1**
Conservatives' April 2011 Platform							
Strategic and Operating Review Savings	-	-	1.0	2.0	4.0	4.0	11.0
Revised Budget Balances Before New Spending	**-40.5**	**-29.6**	**-18.4**	**-7.5**	**3.7**	**8.2**	**-84.1**
New Spending	-	-0.7	-1.7	-0.2	-0.9	-3.1	-6.6
Revised Budget Balances	**-40.5**	**-30.3**	**-20.1**	**-7.7**	**2.8**	**5.1**	**-90.7**

* Includes risk adjustment changes. In the October *Update,* the revenue adjustments for risk ($ billions) from FY11 to FY16, respectively, were -0.3, -1.5, -1.5, -1.1, -0.8 and -0.8. In the March *Budget,* the revenue adjustments for risk were -$1.5 billion annually from FY12 through

Source: Finance Canada and the Conservative Party of Canada.

In the March *Budget*, the broad range of small new initiatives appeared to make even more ambitious the Conservatives' commitment to balance the books by fiscal 2015-16 (FY16), at the latest, without resorting to tax hikes or slowing the growth of major transfers to persons and other levels of government *(see table below)*. Reassuring, therefore, was the *Budget* plan for a comprehensive one-year *Strategic and Operating Review* of direct program spending during FY12. With the objective of providing by FY15 ongoing annual savings equal to 5% of the $80 billion of program outlays subject to review, the resulting $4 billion represented significant insurance against unexpected budgetary pressures. Importantly, this insurance, beginning with projected savings of $1 billion in FY13, was not built into the March *Budget* estimates.

A key advantage of this exclusion was the leeway it offered if the accomplished savings were slower or smaller than anticipated. The government already has conducted one strategic spending review, stretching over the four years to 2010. This first review presumably implemented the easier reforms, leaving the second round of cutting costs by 5% more difficult. The first review sequentially worked though all of the federal Departments and agencies, assessing each area on the efficiency and effectiveness of its operations and its focus on core federal roles. The savings accomplished over this first four-year cycle are substantial. By FY12, including the results of the fourth strategic review in 2010, total savings of $1.4 billion are estimated, building to $1.8 billion by FY15. While the mandate of the second review to cover all direct program spending at once instead of over a second four-year cycle will be faster and may reveal new efficiencies, and the plan to access outside expertise may yield significant suggestions, the challenge is still steep.

In the Conservatives' election platform, the *Strategic and Operating Review* savings are incorporated in the budget calculations. This advances FY15 from the year a surplus might be accomplished to the year a surplus is projected. As well, incorporating the savings from this second review covers the Conservatives' platform promises. In FY12 and FY13, the major new initiative is $2.2 billion of federal transition

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

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assistance for Quebec for its adoption of a value-added tax, the *Quebec Sales Tax*, in 1992. To the Conservatives' credit, the other election measures until the books are balanced in FY15 are relatively small and few in number. Once a surplus is regained in FY15, however, several major initiatives are proposed, such as the Family Tax Cut that would allow some income splitting.

Many of the March *Budget* measures are potentially worthwhile, such as the two-year extension of the accelerated depreciation on manufacturers' machinery & equipment purchases that was due to expire after December 2011. Advantageous are measures with little or no explicit cost because they avoid additional interest expense. An example is the proposed *One-for-One Rule* that would eliminate an existing federal regulation for each new regulation introduced. In contrast, many of the Conservatives' recent measures relate to social programs or assistance and therefore possess an added element of fiscal risk because of the difficulties inherent in repealing them. Debate during the election of major policy decisions for the future, such as retaining 6% annual increases in the Canada Health Transfer after the *Health Accord* expires in March 2014, to some extent pre-empts a fuller discussion in the future of potential intergovernmental transfer reforms. As the Conservatives move forward on policy development for their majority mandate and re-introduce their March 2011 *Budget* next month with some updates, the backdrop, given the election debates, is altered, and their flexibility is somewhat more limited, particularly if the outlook for the Canadian economy softens from our current forecast.

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

Brazil Focused on Containing Inflation, Managing Excessive Currency Appreciation and Decelerating Credit Growth to Secure Sustainable Economic Expansion

Brazil is enjoying a positive economic momentum which should lead to a sustainable high-growth path over the next decade. The newly elected administration of President Dilma Rousseff, armed with a high degree of popular (and private sector) support, is fully aware that certain macroeconomic adjustments are to be made in order to avoid the potential triple risk of economic overheating, currency overvaluation and excess investor optimism. Under the clear leadership of the president, the Brazilian economic team has clearly identified two areas of immediate policy focus (and growing investor concern): inflation containment and asset bubble prevention. Demand-driven pressures stemming from a robust economic rebound from the 2008/09 shocks and cost-induced imbalances driven by tight labour market conditions and multiple commodity price shocks, have converged into a steady upward adjustment in inflationary expectations; indeed, the market-sensitive IPCA-based consumer price inflation rate reached 6.51% at the end of April (services inflation at 8.5%). Both the monetary authorities and local market participants are increasingly expecting that the headline inflation rate (on a year over year basis) will soon exceed the inflation target of 4.5% +/- 2%.

Given the highly indexed nature of the Brazilian economy, the government and the central bank are firmly determined to fight inflation and, through joint policy action, induce a decline in inflationary expectations in order to guide the headline rate towards the target range in 2012. President Rousseff continues to voice her commitment to control inflation by any means, even at the expense of decelerating the pace of economic growth, now estimated to range between 3.5% and 4% this year, down from a robust 7.5% expansion in 2010. The central bank will likely increase its short-term reference policy SELIC rate by 50 bps to 12.50% in the near term, a conventional monetary policy measure which will be complemented by fiscal adjustment (a sharp reduction in planned government expenditures now that elections are over) and other credit containment measures (adjustment in banking sector reserve requirements).

The current high-inflation outlook is co-habiting with an environment that attracts massive foreign capital flows, encouraging the Rousseff administration to focus on preventing the development of asset price inflation and capital market bubbles. Asian-induced demand, reinforced by cyclical recovery dynamics is extending commodity price gains with direct trade-related currency benefits. The Brazilian real (BRL), which appreciated 20% versus the US dollar (USD) since May 2010, recently broke through technical levels and traded as high as 1.55 per USD at the end of April (currently at 1.60). In addition, Brazil still maintains the highest interest rates within the G10 world, fuelling demand for carry-trade activity in a context of ample global liquidity, courtesy of US and European monetary stimuli; indeed, the Brazilian-US short-term rate spread of 1,200 bps is a powerful magnet towards real-denominated assets. Moreover, magnifying the risk of excess currency valuation, Brazil will receive massive foreign direct equity flows as a result of the 2014 Football World Cup, 2016 Olympic Games, pre-salt energy investment and basic infrastructure development needs. The introduction of a 6% financial transaction tax (IOF) on foreign purchases of Brazilian debt assets and net short FX positions represents a clear government drive to avoid excessive speculation-driven currency gains while decelerating the pace of domestic credit expansion.

Aron Gampel (416) 866-6259
aron_gampel@scotiacapital.com

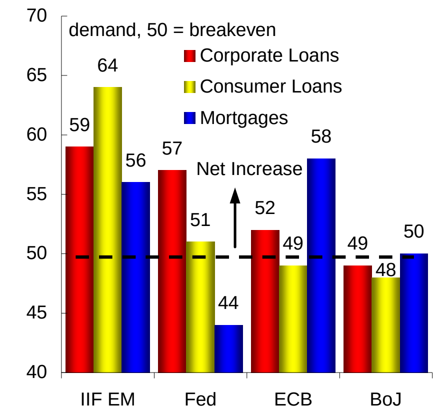
Bank Lending Conditions Still Supportive of Emerging Market Growth

- **Policy in the fast-growing emerging nations is shifting towards restraint to rein in growth and broadening price pressures, though the pace of monetary and fiscal adjustment is still relatively slow. Demand for consumer and corporate loans remains quite solid, highlighting the underlying momentum of economic activity. Nevertheless, some moderation in growth and inflation pressures can be expected as bank lending standards in the emerging markets are being tightened, albeit gradually.**

This time is different. Emerging countries are the drivers of global growth. Their economic, demographic, and financial sector vitality is integral to the rebound in global production and trade that is helping to rebalance activity worldwide. And their recycling of surplus savings is an important stabilizing factor — buying the bills and bonds of debt-heavy sovereign governments which have helped keep borrowing costs at pro-growth levels, and channelling direct investment that facilitates development in many countries in exchange for favourable longer-term returns.

In this different cycle, we expect that global growth will likely average around 4½% this year and next, down from about 5% in 2010. Output growth in the emerging countries should average about 6½% over the two years, roughly 4 percentage points higher than the debt-burdened growth trajectory that the developed nations are on.

Bank Lending Conditions



Large firms for corporate loans; total consumer lending for consumer loans. Source: The Institute of International Finance.

Nevertheless, there is recurring concern that the relatively stronger growth momentum of the emerging countries cannot be sustained, particularly if the acceleration in inflation pressures intensifies, and triggers a further and more significant tightening response by policymakers.

Consumer prices, already elevated by the strength of the growth performances in the larger and more dynamic emerging economies, are being aggravated by the sharp jump in food and oil costs, and in many areas, compounded by wage increases and standard of living adjustments. Headline consumer price inflation has climbed to 9.0% y/y in India, 6.3% in Brazil, 5.4% in China, and 4.3% in Russia.

Some governments have responded with price controls and/or subsidies to help stem the inflationary tide. But for the most part, monetary officials are beginning to rely more on interest rate hikes to curb the enthusiasm. The spotlight falls on China, at the top of the world's growth ladder, where the PBoC has raised its benchmark interest rate four times to 6.31% since last September, while boosting the reserve requirements of its major financial institutions to a lofty 20.5%, and allowing the yuan to appreciate 4½% to 6.493 vis-à-vis the U.S. dollar.

India surprised this week with a larger-than-expected 50bp increase in its benchmark rate to 7.25%, and indicated that its more aggressive stance would continue. Vietnam, another relatively strong growth and inflation performer, saw its rates rise a full percentage point to 14%. The Philippines and Malaysia each raised their rates 25 bp to 4.5% and 3.0% respectively. Brazil's benchmark rate now stands at a lofty 12%, with the real gaining over 2½% against the greenback since the beginning of the year. These developments contrast with the dearth of monetary tightening among the debt-heavy developed nations, who for the most part, are still relatively concerned about the durability of their respective recoveries, and only incipient inflationary pressures to-date.

Aron Gampel (416) 866-6259
aron_gampel@scotiacapital.com

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These monetary adjustments — and more in the future in conjunction with increasing fiscal restraint — are needed to ensure that rising living standards are not inflated away. Maintaining the purchasing power of households and business is key to rebalancing emerging economies towards domestic-led demand and away from export-led growth, especially at a time when many of the developed nations are and will be underperforming due to profound structural changes. However, it will take time for this restraint to work its way through the various economies.

According to an expanded survey by the Institute of International Finance in Washington, D.C. (IIF), bank lending conditions in the emerging markets continued to improve in Q1, though the pace of adjustment slowed modestly from the prior quarter. The result suggests that there is still considerable high-powered money in these countries in support of strong and sustainable economic growth. The survey also dovetails with those in the developed economies, the Untied States and Canada for example, where bank lending conditions continued to ease, albeit gradually, in the first quarter.

Loan demand remained quite strong throughout the emerging market regions — Asia, Latin America, Emerging Europe, and Africa and the Middle East. About half of the banks reporting indicated that demand increased for each type of loan — commercial & industrial, commercial real estate, residential real estate, and consumer — with the exception being Asia where the majority of responding banks reported that the demand for residential real estate loans had decreased. More than 60% of the responding banks revealed that the demand for consumer loans increased the most of the four categories, led by Asia where 88% of the banks reported stronger consumer loan demand, followed by 71% of Latin American banks.

About 56% of emerging market banks survey revealed that the demand for commercial & industrial loans had increased in the first three months of the year, led by Asia where 70% of the banks reported stronger demand. In comparison, April's Federal Reserve Survey of Senior Loan Officers indicated that 35% of financial institutions surveyed an increase in corporate loan demand.

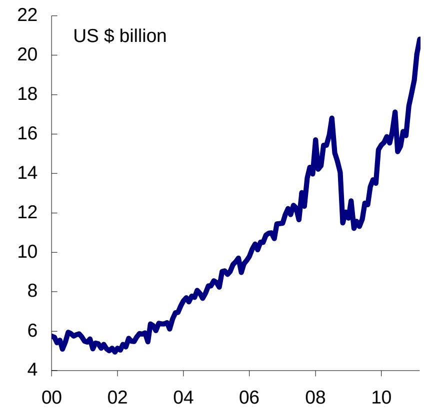
However, although credit standards were broadly in line during the first quarter relative to the final three months of 2010, regional differences have become quite evident. For example, banks in Asia are tightening lending standards, principally in the residential and commercial real estate sectors. Latin America banks tightened commercial & industrial loan standards, but eased standards for consumer loans and residential real estate. Emerging Europe banks adopted easier credit standards for all types of loans in the first quarter. Again for comparison purposes, the latest Fed survey revealed that no U.S. bank had tightened corporate lending standards.

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

Thailand's Export Outperformance Yet to be Derailed

- **Regional leadership in foreign shipments is explained by relative baht weakness and a persistent China-pull effect.**
- **Adverse impact from supply-chain disruptions yet to emerge.**

Thailand's Exports*

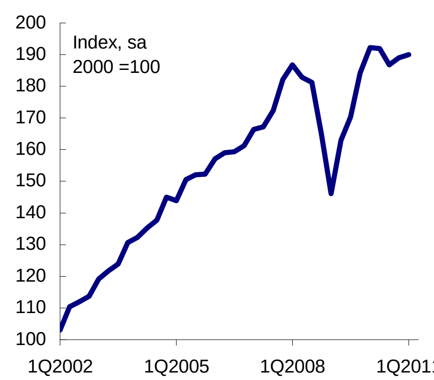


*s.a. Source: Bloomberg

Thailand's exports reached an all time high in the first quarter of 2011. The climb in the country's foreign sales persisted through the end of March notwithstanding the adverse shock to the region's supply chain due to the Japanese earthquake and ensuing tsunami early that month. In fact, the value of shipments abroad remained above US$20 billion in both February and March, rising through the latter month in seasonally adjusted terms (see first chart). There is yet no sign therefore that one of the economy's main engines (exports account for two-thirds of GDP), is losing momentum despite voiced concerns of spillover effects from Japan's disasters or a fall in demand due to efforts by China's policymakers to control inflationary pressures.

Thailand's export performance has been outstanding when compared with regional peers, but is particularly noteworthy given recent currency fluctuations. While the Thai baht (THB) has lately been gaining ground versus the US dollar, strengthening in the past two months as it regained early-year losses, the currency stands today practically flat vis-à-vis its end-2010 level. This has not been the case for Thailand's neighbors, as the Korean won (KRW), the Chinese yuan (CNY) and the Japanese yen (JPY), have strengthened by 3.8%, 1.7% and 1% respectively year-to-date (ytd) against the greenback. Given the structure of Thailand's international trade transactions, this implies that part of the country's export outperformance is explained by competitiveness gains as the THB has weakened vis-à-vis the country's main markets.

Thailand's Manufacturing Output



Source: Bloomberg and Scotia Economics.

China and Japan are Thailand's first and second trading partners (with shares of 17% and 11% of total exports, respectively), and sales to these jurisdictions have been mimicking overall export performance - Thai foreign sales to each of these countries reached all time highs in 1Q2011. In contrast, Thailand's exports to the US peaked in the third quarter of 2010. South Korea also registered rolling over sales to the US and rising exports to Japan in the first quarter; although Korean sales to China have recently edged down slightly (partly explained by competitiveness as the KRW has been leading regional gains on a ytd basis, having therefore strengthened against the CNY). The contrast highlights Thailand's regional export outperformance, and the effect that the pull from China continues to exert on Asia's main exporters.

A significant share of Thailand's exports is concentrated in manufacturing with motor vehicle production figuring prominently. Consistent with the behaviour of the country's shipments abroad, manufacturing output has been on the rise recently reaching towards the peak of the first quarter of 2010 (which coincidentally was the time of the Bangkok riots; see second chart).

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

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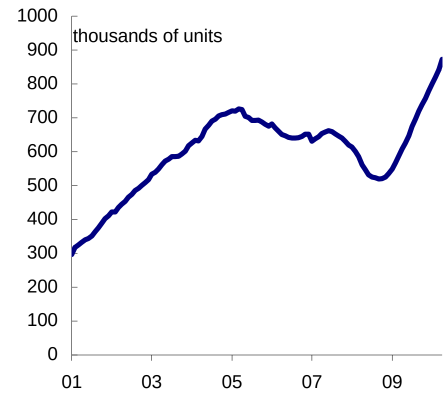
Such trends are further confirmed when looking at vehicle sales which have experienced an impressive climb since mid-2009 (see chart 3). The increase in auto sales has also resulted from the impressive rebound of local economic activity in 2010 as domestic demand indicators have been underpinned by gains in employment and abundant access to credit.

Looking ahead, however, it remains to be seen whether such stellar performance by Thailand's export and manufacturing sectors can continue given that the effect of supply-chain disruptions is already playing a role in car company production plans for the coming months. Indeed, the executive director of Thailand's Automotive Institute recognized recently that production plans through June might need to be halved because of a shortage of parts from Japan. This would imply a drop of over 200 thousand units over the next three months, pointing to manufacturing sector weakness ahead. The data has yet to reveal a change in trend.

Thailand's Automobile Sales



Source: Bloomberg.

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

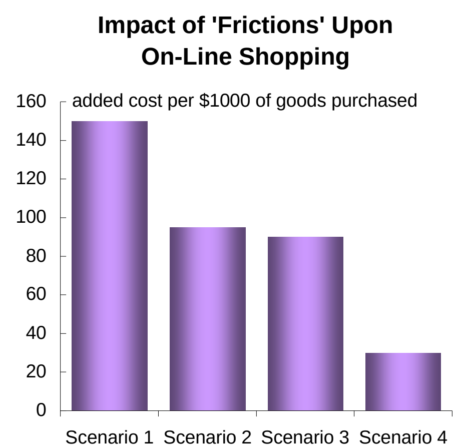
Derek Holt (416) 863-7707
derek_holt@scotiacapital.com

Why Canadian Retail Prices Will Always Be Higher Than US Prices

- **Border frictions the prime culprit.**

As a follow up to last week's article on CAD pass-through effects into core inflation, a natural question entails addressing the issue of persistently higher Canadian retail prices than what is available in the US and whether or not this gap can be expected to materially close. We live in a NAFTA world in which governments agreed not to impose duties on products exported across the NAFTA region if the products were manufactured within it. Thus, one's inclination might be to think that apart from shipping charges, there should be no added costs that differentiate Canadian from US retail prices, and to therefore express frustration over why Canadian retail prices are often higher than in the US. The reality remains very different. While we expect some pass-through effects from a higher currency that will moderate core inflation, this is likely to occur only in a limited sense.

Chart 1



Source: Scotia Capital Economics, CBSA.

A chief reason relates to border and financing frictions that limit the contestability of the Canadian marketplace by foreign imports. Policy contributes to this through duties on products made outside of North America (exempted by NAFTA), but there is enough of a role played by other firms facilitating the cross-border transactions that contributes to the end outcome that Canadians pay more for a basket of comparable retail prices than stateside.

Let's consider four illustrative scenarios (chart 1). The first one entails buying a good not made in the USA on-line from Canada while shopping on a US web site or by phone, shipping the product across the border and thus incurring customs brokerage fees, using a shipping company that charges higher brokerage and disbursement fees than the USPS/Canada Post, and paying with a credit card and thus incurring a currency exchange fee that can be 2-3% of the cost of the product and shipping. The latter fee is partly designed to compensate for FX risk between the point of purchase and payment of the credit card bill and is charged up-front. This route would add over $150 extra to the purchase price — or enough to thoroughly negate any possible price advantage over buying in Canada.

The second scenario only alters one assumption: that the good is made in the USA so duties are dropped. That drops the added cost to just under $100 for each $1000 worth of goods, or about $50 lower than the first scenario. The third scenario takes scenario 2 but assumes the USPS is used instead of a shipping company and the item is not made in the US, in which case the added cost drops to about $90. The final scenario we consider takes scenario 3 but buys a made in the USA item and ships it through the USPS in which case only about $30 gets added to the cost.

Note that throughout our scenarios we have excluded shipping costs and the GST. Such frictions will always ensure higher retail prices in Canada than in the US. Added points to consider could include that sometimes firms charge no shipping, but then again several US firms will not allow Canadians to shop on their US web sites and direct them to higher cost Canadian company sites, or they just flat out don't ship internationally. This is a global issue, however, in that border frictions act as a barrier to full contestability of retail markets across many countries.

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

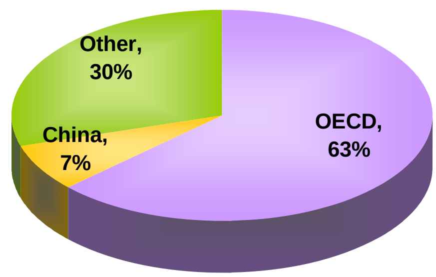
Alex Koustas (416) 866-4212
alex_koustas@scotiacapital.com

For U.S. Exporters It's Quality Over Quantity

- **Value-added goods will benefit from increased global demand, while exchange rate fluctuations take a back seat.**

Consumption has been a key driver for the economic recovery in the United States, as consumers opened their wallets in the latter half of 2010. Pent-up demand helped fuel notable retail sales gains, as Americans dipped into precautionary savings accumulated during the recession to fill outstanding needs or long-delayed discretionary expenditures. Consumption contributed 2.8% q/q annualized to U.S. GDP growth in Q4, accounting for 90% of total growth. Since then, savings rates have stabilized around 5.5%, and consumers appear to have once again started to exercise more caution in the face of rising fuel and food costs and a slowly recovering employment market, all while continuing their efforts to deleverage. As such, the American economy will need to increasingly lean on exports and business investment in order to sustain the momentum this year. We aim to examine the determinants of export growth, and which elements are likely to fuel demand.

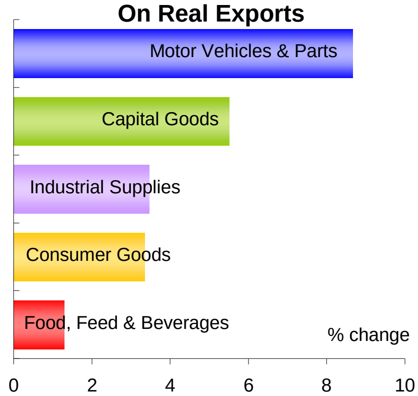
US Regional Export Breakdown



Source: US Census Bureau, Scotia Economics.

The consensus view is that growth in foreign markets — the wealth of "customers" — and real effective exchange rates — the price competitiveness of a nation's exports — serve as key determinants of export growth. A series of econometric tests were performed, with world economy and the exchange rate modeled against real export volumes. Real GDP, on a purchasing power parity basis for OECD nations and China was used as a proxy for our "global growth" variable, as these markets account for roughly 70% of U.S exports. The real effective exchange rate (REER) was also obtained from the OECD and serves as our second explanatory variable. Given that the data were only available on a calendar-year basis, pass-through of sticky prices (typically in the range of 2 to 4 quarters) was already accounted for and no lag was applied on the REER variable.

Impact of 1% World GDP Growth On Real Exports



Source: OECD, US Census Bureau, Scotia Economics

Unsurprisingly, global growth has a very significant effect on export volumes. Our estimates yielded robust results, and indicated that a 1% increase in our "global growth" variable results in a jump in exports of over 4%. This comes as a welcome sign for U.S. exporters given that global growth is expected to remain robust. Additional tests were run on a sector by sector basis (see chart 2) and revealed that value-added goods benefitted the most during periods of global economic expansion. With the U.S. being a technological leader in many areas of industry, it naturally follows that goods that are either exclusive or of significantly higher performance would benefit the most as they are more differentiated from competing exporters' offerings.

The real effective exchange rate not only displayed a very small coefficient, but in most cases proved to be statistically insignificant. This is not to say that relative pricing has no effect on export growth. However, the extent to which global growth rates outweigh the effects of the REER in our calculations provides evidence that global economic conditions will play a greater role in influencing the United States' recovery than relative price competitiveness. As such, the United States' technological edge in many sectors will need to be the key focus going forward, as demand will likely be determined by needs and quality, as opposed to pure export price competitiveness.

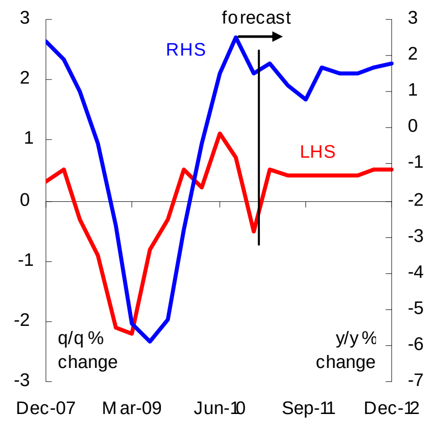
Tuuli McCully (416) 863-2859
tuuli_mccully@scotiacapital.com

Economic Conditions to Remain Subdued in the United Kingdom Through 2012

- **Sluggish real GDP growth, aggressive fiscal consolidation, and high inflation dominate the UK's economic outlook.**

The UK's economic growth outlook will remain relatively subdued through 2012. A temporary contraction in output in the final quarter of 2010 (real GDP dropped by 0.5% q/q, partly reflecting adverse weather conditions), was offset by a rebound of 0.5% q/q in the January-March period. While gradually improving labour market prospects (the ILO unemployment rate decreased to 7.8% in February) were reflected in consumer confidence in March, retail sales remain subdued (up by 0.2% m/m in March), highlighting the fact that the British consumer continues to be cautious. Nevertheless, the Royal wedding likely provided a boost to consumer spending in April. We assess that a modest improvement in private consumption – which accounts for two-thirds of GDP – is taking hold, counterbalancing some of the impact of reduced government spending. Aggressive fiscal consolidation and slower export sector momentum are expected to limit the nation's economic growth to 1.4% in 2011, following an expansion of 1.3% in 2010. Activity should pick up to 1.7% in 2012 as both the global and domestic recoveries become more broadly-based. Tough expenditure restraint dominates the UK's fiscal repair plan, with real government expenditure set to remain negative through 2012. The calendar year 2010 fiscal deficit, 10.4% of GDP, was the third highest in the European Union after Ireland and Greece. After contracting sharply due to recessionary conditions and tight credit availability, investment will continue to recover gradually in 2011-12. Net exports will contribute to growth throughout most of the forecast period as import demand remains relatively subdued.

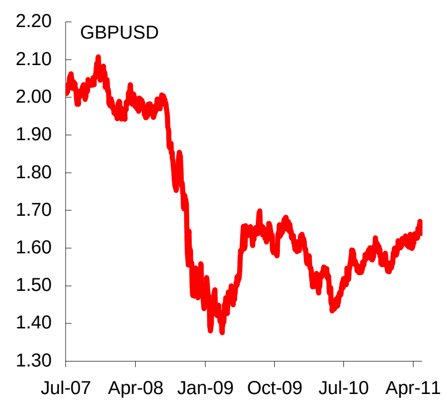
UK Real GDP Growth



Source: Bloomberg. Scotia Economics

The Bank of England (BoE) will continue to be challenged by the task of finding a balance between restoring growth and limiting inflationary pressures. Inflation eased in March to 4.0% y/y (but remains significantly above the official target of 2%), partly reflecting a base effect stemming from a large increase in the consumer price index a year earlier. Therefore, the deceleration will likely prove temporary, with inflation picking up again in the coming months before embarking on a more solid downward trajectory toward the end of 2011. We expect headline inflation to close the year at 3.7% y/y. Despite the fact that inflation expectations will likely rise in the coming months, we assess that the central bank will maintain its accommodative monetary policy stance in the near term; as expected, the Monetary Policy Committee left the benchmark interest rate — the Bank Rate — at 0.5% following its monthly meeting on May 5th. We expect that the BoE will begin a gradual process of monetary policy normalization in the third quarter of 2011, taking the Bank Rate to 1.0% by the end of the year, and to 2.0% by the end of 2012.

British Pound



Source: Bloomberg.

Short-term prospects for the British pound (GBP) are dampened by low economic growth, fiscal consolidation and high inflation. Nevertheless, the likelihood that the BoE will start tightening monetary conditions ahead of the US Federal Reserve should allow for the GBP to close the year at US$1.65 before appreciating to US$1.70 by end-2012.

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

The Not So Fast, Not So Furious: Money Demand in the United States

- **Cautious consumers, businesses and banks are keeping velocity of money depressed, but should this change, velocity could pick up quickly, benefitting the broader economy.**

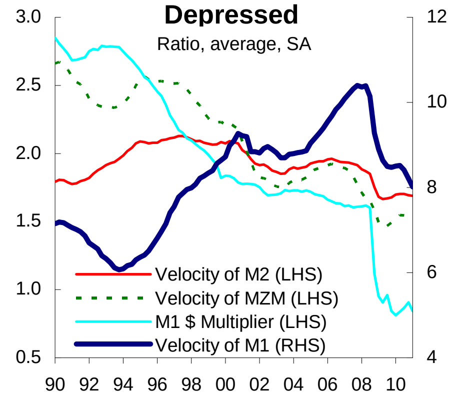
Despite the Fed's ongoing liquidity irrigation and signs that pockets of the U.S. macro economy are gradually taking a turn for the better, the velocity of money — the rate at which money changes hands in transactions — fails to garner speed, and is, by a number of measures of money supply, well below its long-run average (see chart 1).

Consumers, businesses and financial institutions remain cautious, keeping real money demand subdued. Consumers are rebuilding household balance sheets through saving and deleveraging, waiting for the labour market to show signs of sustained recovery. Near-record profits may have pushed businesses to step up investment in machinery & equipment, hiring activity and dividend payouts, but cash & liquid instruments still account for about 7% of nonfinancial corporations' overall assets, the most since 1963. And for the financial sector, although loan & investment activity has seen some improvement, excess reserves of depository institutions have edged back up since the beginning of the year, to a new record high of 95.2% (see chart 2), far above the historical average of 3%. The daily value and volume of transactions on Fedwire has bounced back somewhat, but given the size of reserve balances at the Fed, the ratio of the two — the turnover of reserve deposits — remains at historically low levels (see chart three). These figures suggest that banks remain reluctant to lend to households and smaller and medium size enterprises (SMEs). That said, this statement may be somewhat circular in logic, as part of the explanation lies in the also weak household demand for loans.

While real demand for money has yet to return to pre-recessionary levels, should sentiment pick up more sustainably — at consumer, business and bank level — velocity of money could turn around pretty quickly given money supply in the system, benefiting the broader economy. Velocity of money is a function of nominal GDP and money supply. Should sentiment strengthen, pushing money demand to become more interest rate elastic, velocity could accelerate as a symptom of improvement in money multipliers — the notion that banks can 'multiply' money — and their transmission effects into GDP.

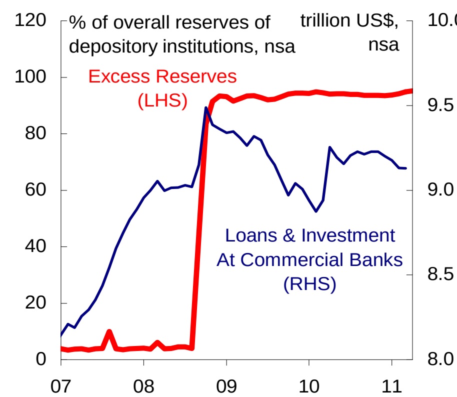
Depressed velocity supports our view that the Fed will keep rates on hold until at least early next year, and will not introduce any additional quantitative easing, after QE2 ends in June. Not reinvesting its maturing assets through purchases of Treasuries may be the first step in the Fed's exit strategy. Should velocity of money start to improve, the Fed has additional tools in its arsenal to help soak up any excess liquidity, including term deposits, reverse repos and a reduction of the Fed balance sheet, through sale of assets, such as mortgage-backed securities and housing-agency debt.

Velocity of Money Remains Depressed



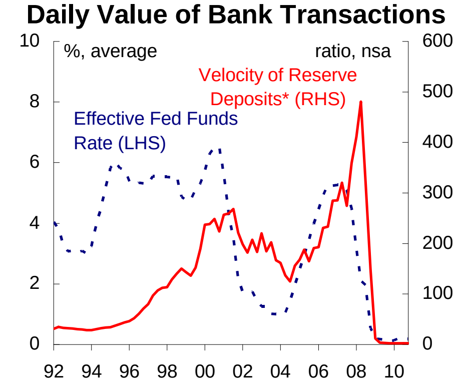
Source: Federal Reserve Bank of St. Louis, Scotia Economics.

Banks Continue To Hoard Cash



Source: BEA, Federal Reserve Bank of St. Louis, Scotia Economics.

Daily Value of Bank Transactions



* Fedwire transfers as % of Reserve Balances at the Fed
Source: Federal Reserve Bank of St. Louis, James Hamilton, Scotia Economics.

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

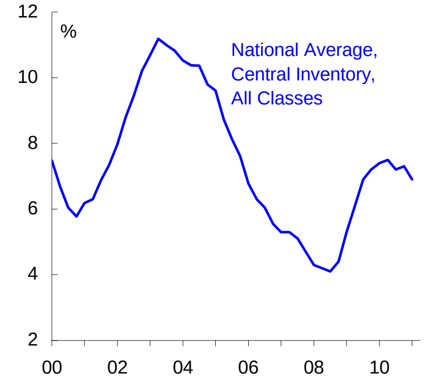
Canadian Office Markets Heating Up Again

- **Canadian office market activity has gathered further momentum in early 2011, continuing the impressive turnaround that began to emerge in the latter half of 2010.**

The strong resurgence in office market activity over the past several quarters stands out as one of the more notable and unexpected trends of the nascent economic recovery. Rising leasing demand helped push the national central office vacancy rate to just 6.9% in 2011Q1, down from 7.3% in the prior quarter and a cycle peak of 7.5% in mid-2010 (chart 1). The turnaround is broadly based regionally: vacancy rates in most major centres across the country are moving lower while rental rates are either stabilizing or once again moving higher.

Rising leasing demand mirrors the resilience in hiring in traditional office-based occupations, including finance & insurance and professional, scientific & technical services. The latter, which includes lawyers, accountants, engineers, consultants and software developers, has enjoyed particularly strong employment growth in recent years. They escaped the 2008-2009 recession with few job losses, and have been one of the leading creators of new jobs since (chart 2).

Chart 1 - Office Vacancy Rate

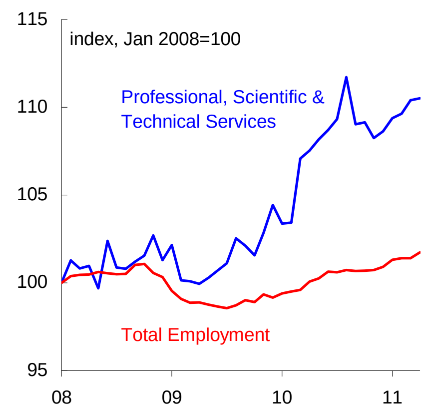


Source: Cushman & Wakefield, Scotia Economics.

The turnaround is even more remarkable in light of the substantial new supply of available space. A boom in office construction added roughly 10 million square feet of new central inventory in 2009 and 2010, the largest share concentrated in Toronto and Calgary. Yet this new space has essentially already been absorbed, and there are few major developments under construction beyond 2011. As a result, the likelihood of new projects being announced in the coming year has increased sharply.

Office availability is still well above the lows of 2008, when the national central vacancy rate dipped to around 4%. However, the industry skirted the sharp correction that had been feared at the onset of the financial crisis and global recession, and has recovered much faster than expected. Even at its cycle peak last year, the national vacancy rate was less than half the 16-17% level reached during the recession of the early 1990s.

Chart 2 - Employment



Source: Statistics Canada, Scotia Economics.

Commercial real estate activity typically lags economic recoveries, making the recent improvement particularly notable. Canada's central office market has emerged from the 2008-2009 recession showing among the tightest overall conditions in more than 25 years for the early stage of an expansionary cycle. Canadian firms are more confident about expanding their payrolls and real estate obligations, given strong corporate balance sheets and historically low borrowing costs. If sustained, this will go a long way to supporting a successful transition from consumer- and housing-driven growth toward a greater reliance on corporate Canada.

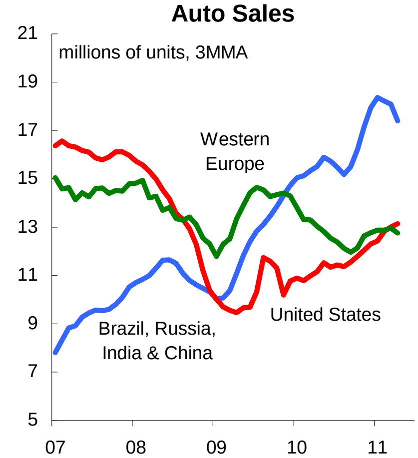
Carlos Gomes (416) 866-4735
carlos_gomes@scotiacapital.com

Large Developed Auto Markets Cushion Sales Moderation in BRIC Nations

- **Volumes rev up in the United States, Germany and the global luxury market.**

We estimate that based on the nations that have reported car sales for April, global vehicle sales were likely flat year-over-year last month, a significant moderation from strong increases since mid-2009. The slowdown reflects a 50% plunge in Japan in the aftermath of the March 11th earthquake and tsunami, as well as smaller gains in the emerging markets. In contrast, purchases in the developed nations are actually strengthening, led by the United States and Germany.

Car sales in Japan plunged to the lowest level on record in April, falling below an annualized 2 million units from a total of 4.2 million in all of 2010. Purchases dropped 51% below a year earlier, slumping to the lowest level since record-keeping began in 1968. Sales will remain weak for the next several months, as automakers continue to operate at only 50% of capacity.



Source: Scotia Economics.

Of greater concern may be the recent softness in key emerging nations. AvtoVaz — Russia's largest auto manufacturer — reported that its sales gains softened to only 6% year-over-year in April, from more than an 80% surge in the first quarter. However, it must be noted that the Kremlin's vehicle scrappage program, which has been boosting sales, began in mid-March 2010. Nevertheless, excluding Russia, sales in the other BRIC nations were roughly flat year-over-year last month, compared with a near double-digit increase in the first quarter.

Sales gains in India and Brazil eased to single-digit increases in April, in the face of rising interest rates, as their respective central banks attempt to contain rising inflationary pressures. However, based on data from several automakers, car sales in China likely declined below a year earlier in April (data will officially be reported next week). General Motors, Ford and Mazda indicate that their sales in China fell 6% below a year earlier in April, a significant reversal from an 8% increase in the first quarter, and outsized jumps of nearly 40% during the previous two years. The slowdown is concentrated only in mass-market vehicles and has not impacted the luxury models. In fact, luxury vehicles remain in the fast lane in China, with Mercedes-Benz reporting that its sales soared 53% year-over-year in April.

Emerging nations remain the auto industry's growth markets, as rising incomes lift vehicle penetration from the current low levels. However, near-term softness in these markets will be offset by a recovery in developed markets, such as the United States and Germany. In April, car and light truck sales in the United States jumped 18% above a year earlier, while volumes in Germany have advanced by 11% so far this year. In both countries, purchases are being supported by strengthening labour markets, declining unemployment and rising replacement demand. In particular, German unemployment has recently fallen below 3 million for the first time in nearly nineteen years. In the United States, stronger-than-expected job growth in recent months will reinforce consumer confidence and a willingness to spend on big-ticket items. The number of Americans planning to buy a vehicle has jumped to a record high, as the average age of the U.S. fleet is now above 10 years for the first time.

While there is some concern that high energy prices may potentially derail vehicle purchases, there is no evidence that high energy prices are denting the confidence of a typical U.S. vehicle-buying household. In fact, only Americans with annual incomes of US$25,000 or less have become more pessimistic as a result of the recent spike on oil prices. According to J.D. Power, the median household income for new vehicle buyers in the United States exceeded US$80,000 last year.

After A Two-Year Hiatus, Inflation Returning To Centre Stage

- **Price pressures are building around the world and policy is shifting from more to less accommodation. While the largest gains in consumer price inflation have been in the faster-growing emerging economies, the sharp rise in commodity prices is contributing to a renewed, albeit gradual, upswing in the developed world as well.**
- **This month Scotia Economics lifted the forecast for consumer price inflation in a number of countries, both emerging and developed.**

For the most part, emerging economies weathered the global downturn better than their debt-heavy developed counterparts, and have recovered at a much faster rate. They are now, however, more susceptible to inflationary pressures because domestic credit conditions are still quite accommodative, economic growth is stronger, capacity utilization is tighter, and buoyant labour markets are putting pressure on wages. The steady rise in commodity prices, partly a function of growing demand for oil and food in emerging markets, has been compounded by increased geopolitical tensions and adverse agricultural growing conditions, which have aggravated supplies. Emerging market officials have begun to rein in inflation, though the incremental adjustments, and modest currency appreciation, have yet to have a measurable impact.

Most developed economies are also witnessing increased price pressures, though inflation is rebounding from much lower levels and at a slower pace. Policymakers have been slow to reduce monetary and fiscal stimulus, reflecting the concern that underlying growth potential is being constrained by a combination of excessive levels of household debt, lingering housing market weakness, soft employment gains, and the rehabilitation of the financial sector. Despite historically large output gaps, price pressures have re-emerged as sharply higher prices for many key commodities pass through the production chain. Wage pressures are still relatively modest, though labour shortages — principally in the commodity-producing regions, but also in higher-growth export-sensitive sectors — are beginning to resurface.

Global inflationary pressures are likely to persist. In large part this reflects the underlying resilience of the global economy in the face of sluggish household and business spending, intensifying fiscal consolidation, and more recently, manufacturing disruptions related to the earthquake in Japan. Around the world, purchasing managers continue to report a high level of activity, thanks largely to the ongoing strength in demand emanating from emerging markets, a development that will likely keep commodity prices at elevated levels. In this environment, officials in emerging economies will continue to tighten policy, and favour stronger domestic currencies, though the adjustments will likely remain gradual in support of growth. Because the developed nations are on slower growth and inflation trajectories, the adjustment process will be more challenging and comparatively less aggressive.

Spotlight on Canada

Canada's latest consumer inflation report has raised some alarm bells. Headline inflation jumped to a 2½-year high of 3.3% y/y in March, breaching the upper limit of the Bank of Canada's target range. Not surprisingly, the main drivers were rising costs for energy and, more recently, food. Excluding energy and food, inflation is tracking more than a percentage point lower. However, there is evidence that increasing energy and non-energy commodity prices may be beginning to infiltrate broader price trends, with core inflation also jumping in March. While there are some temporary factors obscuring year-over-year comparisons, price gains were widespread.

For the time being, continued excess capacity, Canadian dollar strength, limited retail pricing power and well-anchored inflation expectations should keep underlying price pressures in check. Nonetheless, the trend is biased upward as excess capacity is gradually absorbed, and rising manufacturing costs continue to pressure wholesale and retail margins. Headline inflation may well edge higher before stabilizing in the second half of the year. While the transmission of oil prices to consumer inflation is fairly immediate, rising agriculture prices take longer to feed into retail food prices. This implies that the surge in agricultural prices since last May is just now beginning to appear on grocery store shelves. Assuming commodity prices settle around current levels, headline inflation should converge back to core price trends in 2012.

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

Which Markets Should Fear Peru's Humala?

The following article was published on May 4, 2011.

Even though Humala's lead has decreased in recent polls, he remains a significant threat in the eyes of many investors. In this article, we consider whether Humala's moderation is real. While his personal background suggests reasons for caution, we would still anticipate a focus on his more popular and moderate proposals, at least at the start of his administration. Peruvian markets have responded differently to Humala's rise. Mining investments underperformed by 14%, the currency underperformed by 10%, and 5Y CDS underperformed by 2%. We discuss how a Humala presidency would affect these and other asset classes.

True intentions

To assess how a victory by Humala would affect markets, we start with a discussion of which Humala will assume office. Is it the old Humala who allies with Chavez to fight multinationals and scares foreign investors with his radical rhetoric? Or is it the new Humala who wants merely to increase social services for the elderly and poor? The new Humala is currently airing a television commercial where he sits with a boardroom of his new advisors, many of them ministers and central bank governors from former administrations without radical leanings.

There is no easy answer here. Certainly, winning the election must have been one factor that motivated the moderation, and the Peruvian public seems sceptical. In the Imasen poll published on Sunday, 60% of respondents said they had little to no faith in what Humala says. Nevertheless, we cannot dismiss the possibility that Humala's meetings with international advisors, businessmen, and local economists have had an impact. At minimum, he must recognize by now that the Venezuelan model is a failure.

How can we gauge Humala's true intentions based on something other than what he says or does during the campaign? His personal background, is one starting point, and it paints an unusual picture. We begin with the more troubling factors. His father, Isaac Humala, is a Marxist and is a founder of a movement preaching the supremacy of the native Peruvian "copper-skinned" race. Ollanta was named by his father in honor of an ethnic warrior in a book written in the Quechua language in the 18th century. Ollanta's career was spent mostly in the military, where he served for about twenty years starting in the early 1980s. He won fame and approval from some for a failed coup he led against Alberto Fujimori in 2000, which he justified by accusations of electoral fraud and corruption perpetrated by the Fujimori administration. Humala was arrested but ultimately pardoned by Interim-President Paniagua, and subsequently returned to active military duty. At the end of 2004, Humala was involuntarily retired from the military. Hours after Humala received news of his retirement while stationed in South Korea, his brother Antauro started a second uprising against President Toledo in Peru. When that operation failed and Antauro was arrested, Antauro told journalists that the operation was ordered by Ollanta, a charge that Ollanto would later deny. The best interpretation of these events is that Humala cares deeply about his country and is willing to risk his career on the country's behalf. The alternate interpretation is of course that Humala does not believe in democracy and seeks out opportunities to seize power, whether through military means before, or through elections now.

There are also some positive factors in Humala's background worth mentioning. Ollanta attended a private Peruvian-Japanese school, the same school where many of the children of the social elite studied. He sends his own children to an upper class school as well, and his wife delivered their recent baby at an upperclass maternity clinic. In this sense, he does not reject the upper class lifestyle. More importantly, Humala has shown some pragmatism in the face of radical ideas. Since 2005, he has been estranged from his more radical father and brother. He demonstrated significant flexibility in adapting his campaign to public opinion, and his policy agenda, at least at the start, may be pragmatic as well, focusing on initiatives that would receive broad support rather than those that would weaken his popularity.

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

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Much negative attention has been devoted to Humala's government plan. Remember that the plan is 198 pages long, and was not written by Ollanta himself. It bears the name of his economic advisor, Felix Jimenez, as the coordinator for the plan. Humala himself does not seem to have much experience or interest in business and economics. He completed a master's degree in political science in Peru in 2002, followed by studies in international law in Paris. Humala's wife studied sociology, and then studied for a doctorate in political science. As such, he would need to rely on his economic advisors in order to implement policy. If the introduction of less radical advisors over the past few weeks is not just an electoral trick, then these advisors once in government should be able to temper any radical leanings.

Obstacles to radical reform

We also would expect Humala to be pragmatic with regards to Congress and the country's institutions, which would pose some obstacles to parts of his agenda. These obstacles include: (1)his party will only have 24% of Congress (2) the Constitution prevents radical reforms (3)Central Bank board members must be approved by Congress (4)a dozen bi-lateral trade agreements would have to be renegotiated (5)the loss of an investment grade rating would be bad for his popularity. Some observers worry that the easiest way for Humala to overcome these obstacles would be to do away with Congress and the existing Constitution altogether. There is even reason to think that the public would support such measures. Ipsos-Apoyo's last poll found that 63% of Peruvians want to change the Constitution, a shocking idea in the US where the Constitution is over 200 years old, but unsurprising in Peru, where the Constitution was enacted in 1993 by Fujimori to give himself more power after he dissolved Congress.

While Peruvian political views have certainly been shaped by the country's recent history, Peruvians are not anti-democracy or anti-markets in general. According to Latinbarometro, 61% of Peruvians think democracy is the best form of government, which is equivalent to the average score for Latin America. With regards to Venezuela, only 23% of Peruvians think that Venezuela has a positive role in Latin America; thus Venezueal's approval in Peru is lower than Venezuela's approval in any other Latin American country surveyed. Going through the variety of questions in the Latinbarometro polls, Peruvians generally rank in line with other Latin American countries, sometimes better, and sometimes worse with regards to democratic institutions and the role of government. The part of the poll that most jumps out, and that explains recent electoral results, is that Peruvians are particularly unhappy with their economic situation with only 18% saying they are satisfied or very satisfied, in contrast to 30% for Latin America and 47% for Brazil. Thus, the risk here is not that Peru wants to abandon democracy, but rather that economic aspirations may lead them down a mistaken political path. While that risk will always exist, we do not think it is the most likely scenario.

Effects by Asset Class

So far, all Peruvian securities have responded negatively to the news, but the response has not been the same across asset classes, as shown in Figure 1.

Figure 1. Performance of Peruvian assets since end of February

	Absolute bp	Absolute %	Relative bp	Relative %
Peru 5Y CDS	29	-1.3%	43	-2.0%
Peru 26Y External Bond	24	-3.4%	45	-5.8%
Peru 10Y Local Bond	65	-5.0%	84	-5.7%
Peru FX Depreciation		-1.7%		-9.8%
Foreign Mining Investments		-19.8%		-13.9%
Peruvian Equity		-10.0%		-5.6%

Source: Bloomberg. "Absolute" means actual changes in bps or in % of price. Relative changes are calculated in comparison with a relevant peer. The peer is Brazil for CDS, external bonds, and equities. Colombia is used as the peer for local bonds and FX. Mining investments are North American listed companies with 100% NAV in Peru—peers are several similar companies with less than 20% NAV in Peru. Calculated as of the afternoon of May 4, 2011.

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

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Since markets move for a variety of reasons, and Humala's campaign occasionally likes to blame external factors for the decline in Peruvian markets, we show not just the absolute change since Humala started rising in the polls, but also the underperformance relative to other Latin American countries. That latter analysis shows a larger decline in fixed income markets and especially in the currency, but a smaller decline in equity markets.

5Y CDS and external debt

We start with the asset that we think should be least affected, 5Y CDS. Repudiating the external debt is not on the table, and there would be few benefits of such an action. Surely, even if Humala did not have much respect for debt contracts, he would see that he is better off economically by paying. According to S&P, Peru's gross debt to GDP is only 23% and annual interest payments are 1.4%. By borrowing an extra 3% per year, Humala could both pay the interest and have additional funds for social programs. Increasing the debt of course increases the probability of default, but only marginally so in the first five years; thus, the widening in CDS should be small. A pro-longed buildup of debt after five years would certainly increase default risks to the external debt in the long-term, justifying a steepening of the spread curve; nevertheless, EM curve slopes often respond more to technical than fundamental factors in such cases.

Mining companies

On the other extreme are mining companies that we, and the market, think should be most affected. For mining companies with existing projects in Peru, it almost doesn't matter who wins the election. The idea of a windfall tax on mining originally proposed by Humala has proven so popular that Fujimori has also adopted it. An increase in taxes seems inevitable. Once we consider how much gold and silver prices have risen this year alone, a moderate increase in taxes would not significantly affect the solvency of the mining companies but it would reduce the profit flows to equity holders. New taxes would require approval by Congress through a simple majority, which seems easily attainable. Some large mining companies have guarantees of tax stability in their contracts, with the majority of those contracts expiring in 2012 and 2013. In order to circumvent this restriction over the past few years, companies have paid "voluntary" additional taxes to the government as the price of metals rose, and presumably these schemes could be extended.

FX

The obvious effect on the currency of a leftist President in the short-run stems from the fact that FDI will dry up and portfolio investors will pull out. In the long-run, lower investment in mining means lower exports of metals which are so crucial to the balance of payments. There are three mitigating factors to consider, however. First, of the USD $7.3bn FDI that occurred in 2010, $5.7bn was reinvested dividends; we also know from the balance of payments that there was $9.9bn of foreign income in 2010. What is likely happening here is that mining companies earn high profits and reinvest half of those profits into expansion. Taxing those profits does not directly lead to any outflow of dollars from the country; in fact it forces those dollars to stay in the country by giving them to the government. Second, a moderate windfall tax, if backed by credible promises of tax stability in the future, need not deter new investment, since the ventures would still be profitable. Third, the central bank would certainly intervene; it has shown itself in the past to be quite good quite good at minimizing volatility in the currency and it has the highest reserves relative to GDP in Latin America to accomplish that goal. The Central Bank sold dollars for the first time in years on April 14th in the amount of $91 million, followed by another sale on April 27th of $492 million to relieve currency pressure. Continued central bank intervention would surely slow and perhaps prolong any depreciation.

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

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Soberanos (local currency bonds)

The soberanos would be affected by the same factors as the external debt, in the sense that the desire to increase social spending may prompt increased debt issuance to fund that spending, thereby increasing default probabilities and long-term inflation premia. Since inflation is a less costly way to reduce the debt burden than an outright default, the risks to the local debt are greater and yields should widen more than the external debt. There is also an additional technical factor here. As of the end of February, 47% of the soberanos were owned by non-residents, mostly purchased in 2010 in order to speculate on the currency appreciation, as the Central Bank had closed most other routes for short term currency trades. That percentage fell by only 1% in March, and our traders in Lima estimate that, based on the flows they have seen, non-resident ownership actually increased by 1% in April, despite Humala's gains. We worry that if Humala were to win, many foreign investors would pull out, with a large impact on prices. Local institutions would take up some of the bond sold, but not before prices fell substantially.

Local equity

In the trade-off between reducing inequality and promoting growth, the pendulum certainly swings towards the former under a Humala government. We imagine that could be particularly problematic for a country like Peru, were equity prices were probably incorporating high expected economic growth rates based on the historical trends.

Conclusion

Humala's lead may have diminished somewhat in recent days, falling from a 6% lead on April 24th, to a lead of only 1% to 4% in more recent polls. Yet, we expect the campaigns to continue to evolve, and there is still time for new developments. Ipsos-Apoyo will publish new polls every Sunday from May 8th to May 29th. Substantial uncertainty remains regarding Humala's ultimate aims, and we are not sure if there is anything he can do to reassure sceptics while the campaign is in full swing.

Endnotes:

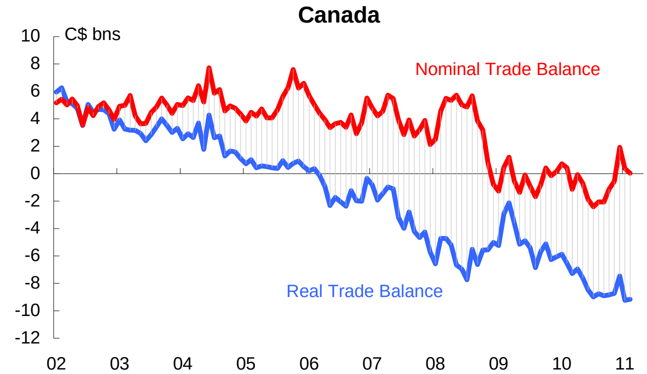
[1] Fujimori's 53% is not much better. Probably, most Peruvians did not believe her belated apology for the errors of her father's administration
[2] This section draws extensively from a biography of Humala prepared by the Barcelona Center for International Affairs. www.cidob.org/es/documentacion/biografias_lideres_politicos/america_del_sur/peru/ollanta_humala_tasso
[3] http://www.latinobarometro.org/latino/LATContenidos.jsp

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

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

Key Data Preview

CANADA

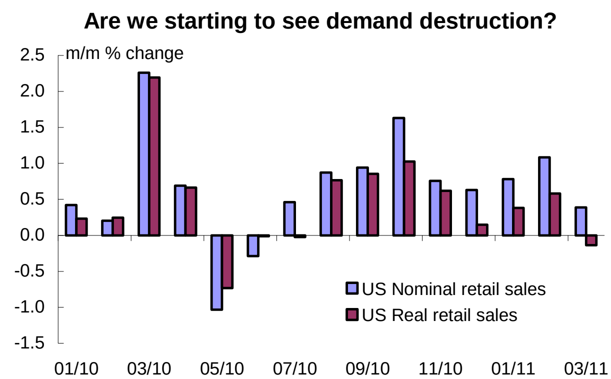


Source: Statistics Canada, Scotia Capital Economics

Canadian housing starts (Monday) will likely post its first decline in April in three months after building permit volumes plunged over 20% in February — the lag between starts and permits is roughly two months — with weakness in both singles and multiples. And, while we may see a partial rebound in May, this downward trend will likely continue in the months ahead as tighter mortgage regulations come into effect, reducing demand in a market that is already witnessing record high homeownership rates and home prices.

After four months of growth, Canadian exports plunged almost 5% m/m in February, dragged down by a decline in energy and automotive product volumes as the Canadian dollar appreciated by 3%, the largest monthly gain since September of last year. This has raised some concerns that Canada's trade sector may not be able to provide the lift to economic growth that many had been anticipating. And indeed, further appreciation in the Canadian dollar in recent months, together with weaker US growth prospects, makes it hard to see any substantial improvement on this front. As such, the real trade deficit is the measure to watch as it continues to breach new record highs (see chart). Nonetheless in nominal terms, after such a strong decline in February and another 10% gain in crude oil prices during the month, exports will likely rebound in March, and at a faster pace than imports, leading to a modest widening in the **nominal trade balance (Wednesday)** in March back into surplus territory (see chart). The wild card will be whether supply chain disruptions from the March 11 Japanese earthquake end up having an impact on the trade numbers in this report or whether they get pushed off into Q2 as the Bank of Canada has projected.

UNITED STATES



Source: US Census Bureau, Scotia Capital Economics

Higher commodity prices and strong consumption will likely have import growth increasing at a faster pace than exports in March, resulting in a widening **US trade deficit** (Wednesday). Nonetheless, a large risk remains that the recent earthquake in Japan could negatively impact the US trade picture.

Advanced retail sales (Thursday) rose once again in March but in volumes terms, sales fell for the first time in almost a year as higher prices accounted for all of the increase during the month. This suggests that the unexpected increase in personal consumption in Q1 may have been more focused in January and February, with consumer demand starting to wane in March as higher energy and food costs eat away at disposable income. While we will have to wait to see whether this trend does indeed continue into April in real terms, in nominal terms we will likely see further gains during the month as prices continued to accelerate. We could also see a rebound in auto sales after a decline in March given tighter supply on the back of the Japanese earthquake which has reduced auto production substantially.

The recent run-up in commodities, especially food and gasoline, has not as yet filtered down into either finished **producer prices** (Thursday) or **consumer prices** (Friday) as businesses are unable to pass on higher costs. And, we expect this trend to continue into April, especially after this week's nonfarm payrolls report highlighted that wage growth still remains minimal despite recent gains in economic growth. While there is a risk we could start to see some pass-through at any point as profit margins continue to get squeezed, the decline in March retail sales volumes suggests that if businesses try to pass on higher costs to consumers, they may end up regretting their decision and reversing course. As such, while we continue to see higher headline producer and consumer prices in April as gasoline and food costs continue to ramp up during the month, core price measures will likely remain well contained.

Daniela Blancas (416) 862-3908 daniela_blancas@scotiacapital
Tuuli McCully (416) 863-2859 tuuli_mccully@scotiacapital.com
Oscar Sánchez (416) 862-3174 oscar_sanchez@scotiacapital.com

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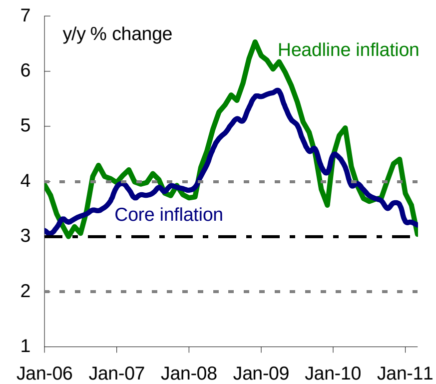
MEXICO

Mexican Headline and Core Inflation



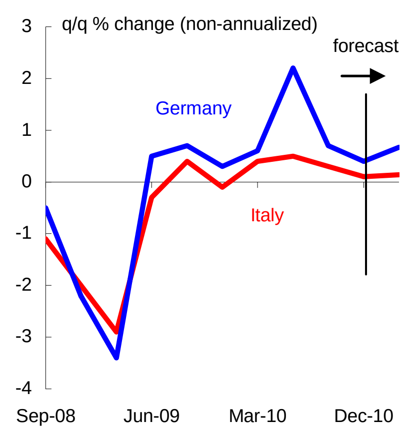
Source: Banco de Mexico

Next week (May 9th to 13th), Mexico will release inflation data for April, as well as information regarding vehicle production, trade balance, gross fixed investment and industrial production. Markets will be focusing specially on inflation numbers; even though energy and food prices have increased worldwide, Mexican inflation has been on a downward trend. In the last 6 months, prices have declined significantly from 4.32% y/y in November 2010 to 3.04% y/y in March 2011. This was the lowest level for local inflation since May 2006 and is now positioned at the mid-point of the central bank's inflation tolerance range.

Mexico has not yet been affected by higher oil and food prices as some of the energy tariffs are smoothly controlled by the government; nonetheless the latest data showed an increase of almost 5.0% y/y in these prices. The appreciation of the Mexican peso has also helped in containing inflationary pressures. At the core level, which is the most relevant indicator for Banco de Mexico's monetary policy, prices have been decreasing too, reaching 3.21% y/y in March. Despite the fact that inflation and inflation expectations have remained in the central bank's comfort zone, the inflation pattern could be jeopardized by persistently high food prices and by another round of turbulence in financial markets that could translate into MXN's volatility. We expect inflation to reverse and close 2011 at 4.1%.

EUROPE

Real GDP Growth



Source: Bloomberg.

Germany, accounting for 27% of the euro zone economy, will remain the engine of growth in the region. The preliminary estimate for German real GDP growth in the first quarter of 2011 will be released on May 13th. We assess that output advanced by 0.7% q/q (and 4.0% y/y), supported by robust exports (reflecting a strong automotive sector) and a pickup in investment. Consumer spending likely remained modest, while public expenditure continues to reflect the government's target to balance the fiscal account in the medium term (the 2010 fiscal deficit was a modest 3.3% of GDP in 2010). We expect the German economy to grow by 2.7% in 2011, compared with the euro zone average of 1.4%.

The Italian economy maintains its gradual recovery. We estimate that output advanced by 0.1% q/q (and 1.1% y/y) in the first quarter of the year; the first estimate for Italian real GDP in the January-March period will be released on May 13th. The Italian economy will likely expand by a modest 0.9% this year, reflecting the government's focus on fiscal consolidation.

Daniela Blancas (416) 862-3908 daniela_blancas@scotiacapital
Tuuli McCully (416) 863-2859 tuuli_mccully@scotiacapital.com
Oscar Sánchez (416) 862-3174 oscar_sanchez@scotiacapital.com

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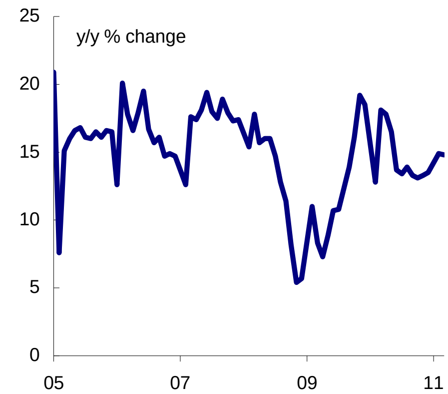
ASIA

China's industrial output likely continued its upward trend in April, underpinned by export resilience and rising momentum in the domestic construction sector. Export growth close to the 30% y/y rate will continue to support manufacturing activity in China. While activity in developed country markets remains conditioned on employment gains, China's main export market is the rest of Asia where, with the exception of Japan, economic momentum remains buoyant. Moreover, the relative weakness of the Chinese yuan (CNY) against the country's neighbours in Asia continues to support the upward trend in foreign sales. On the local market, although authorities have been aiming at lowering credit supply, conditions on the ground remain buoyant as the push ahead on public housing projects is supporting the construction sector. We look for a 15% yearly advance in Chinese industrial production in April.

China's Industrial Output



Source: Scotia Economics.

Key Indicators for the week of May 9 - 13

North America

Country	Date	Time	Event	Period	BNS	Consensus	Latest
CA	05/09	08:15	Housing Starts (000s)	APR	181	184.0	185.1
MX	05/09	10:00	Consumer Prices Core (MoM)	APR	0.2	0.1	0.3
MX	05/09	10:00	Consumer Prices (MoM)	APR	0.08	0.0	0.2
MX	05/10	11:15	Vehicle Exports (AMIA)	APR	- -	--	192783
MX	05/10	11:15	Vehicle Domestic Sales (AMDA)	APR	- -	--	75125
MX	05/10	11:15	Vehicle Production (AMIA)	APR	- -	--	240080
US	05/10	08:30	Import Price Index (MoM)	APR	2.0	1.8	2.7
MX	05/10	09:00	Trade Balance (US$ mns)	MAR F	- -	--	1445.1
US	05/10	10:00	Wholesale Inventories (MoM)	MAR	- -	1.0	1.0
US	05/11	07:00	MBA Mortgage Applications (WoW)	6-May	- -	--	4.0
CA	05/11	08:30	Int'l Merchandise Trade (C$ bns)	MAR	0.2	0.5	0.0
US	05/11	08:30	Trade Balance (US$ bns)	MAR	-48	-47.0	-45.8
MX	05/11	09:00	Gross Fixed Investment (YoY)	FEB	- -	7.9	9.2
MX	05/11	13:00	Central Bank 1Q Inflation Report				
US	05/11	14:00	Monthly Budget Statement (US$ bns)	APR	- -	-65.0	-188.2
CA	05/12	08:30	New Housing Price Index (MoM)	MAR	0.1	0.3	0.4
US	05/12	08:30	Initial Jobless Claims (000s)	7-May	425	420	474
US	05/12	08:30	Continuing Claims (000s)	30-Apr	3650	--	3733
US	05/12	08:30	Producer Price Index (MoM)	APR	0.6	0.7	0.7
US	05/12	08:30	PPI Ex Food & Energy (MoM)	APR	0.3	0.2	0.3
US	05/12	08:30	Advance Retail Sales (MoM)	APR	0.7	0.6	0.4
US	05/12	08:30	Retail Sales Less Autos (MoM)	APR	0.5	0.6	0.8
US	05/12	08:30	Retail Sales Ex Auto & Gas (MoM)	APR	- -	0.5	0.6
MX	05/12	09:00	Industrial Production (MoM)	MAR	- -	--	-0.4
US	05/12	10:00	Business Inventories (MoM)	MAR	- -	0.9	0.5
US	05/13	08:30	Consumer Price Index (MoM)	APR	0.4	0.4	0.5
US	05/13	08:30	CPI Ex Food & Energy (MoM)	APR	0.1	0.2	0.1
US	05/13	08:30	Consumer Price Index (YoY)	APR	3.1	3.1	2.7
US	05/13	08:30	CPI Ex Food & Energy (YoY)	APR	1.2	1.3	1.2

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

Key Indicators for the week of May 9 - 13

Europe

Country	Date	Time	Event	Period	BNS	Consensus	Latest
FI	05/09	02:00	Trade Balance (€ mns)	MAR P	- -	--	-13.0
GE	05/09	02:00	Exports SA (MoM)	MAR	- -	1.1	2.8
GE	05/09	02:00	Imports SA (MoM)	MAR	- -	0.8	4.0
GE	05/09	02:00	Current Account (€ bns)	MAR	- -	13.3	8.9
GE	05/09	02:00	Trade Balance (€ bns)	MAR	- -	11.8	12.1
FR	05/09	02:30	Bank of France Bus. Sentiment	APR	- -	110.0	110.0
EC	05/09	04:30	Sentix Investor Confidence	MAY	- -	13.8	14.2
UK	05/09	19:01	RICS House Price Balance (%)	APR	- -	-23.0	-23.0
FR	05/10	02:45	Industrial Production (MoM)	MAR	- -	0.4	0.4
FR	05/10	02:45	Manufacturing Production (MoM)	MAR	- -	0.4	0.7
SW	05/10	03:30	Industrial Prod. s.a. (MoM)	MAR	- -	0.4	1.1
SW	05/10	03:30	Industrial Orders s.a. (MoM)	MAR	- -	--	0.2
IT	05/10	04:00	Industrial Production sa (MoM)	MAR	- -	0.8	1.4
GE	05/11	02:00	Consumer Price Index (MoM)	APR F	- -	0.2	0.2
GE	05/11	02:00	Consumer Price Index (YoY)	APR F	- -	2.4	2.4
GE	05/11	02:00	CPI - EU Harmonised (MoM)	APR F	0.2	0.2	0.2
GE	05/11	02:00	CPI - EU Harmonised (YoY)	APR F	2.6	2.6	2.6
FR	05/11	02:45	Current Account (€ bns)	MAR	- -	--	-5.2
SP	05/11	03:00	House transactions (YoY)	MAR	- -	--	10.5
UK	05/11	04:30	Visible Trade Balance (£ mns)	MAR	- -	-7500	-6776
UK	05/11	04:30	Trade Balance Non EU (£ mns)	MAR	- -	-3500	-2849
UK	05/11	04:30	Total Trade Balance (£ mns)	MAR	- -	-3250	-2443
PO	05/11		**Poland Base Rate Announcement**	MAR	**4.00**	**4.00**	**4.00**
FR	05/12	01:30	CPI - EU Harmonised (MoM)	APR	0.4	0.4	0.9
FR	05/12	01:30	CPI - EU Harmonised (YoY)	APR	2.3	2.3	2.2
FR	05/12	01:30	Consumer Price Index (MoM)	APR	- -	0.4	0.8
FR	05/12	01:30	Consumer Price Index (YoY)	APR	- -	2.1	2.0
SP	05/12	03:00	CPI (EU Harmonised) (MoM)	APR	- -	0.9	2.4
SP	05/12	03:00	CPI (Core Index) (MoM)	APR	- -	1.0	0.5
SP	05/12	03:00	Consumer Price Index (MoM)	APR	- -	1.2	0.7
SW	05/12	03:30	CPI Level	APR	- -	311.4	310.1
SW	05/12	03:30	CPI - Headline Rate (MoM)	APR	- -	0.4	0.7
SW	05/12	03:30	CPI - Headline Rate (YoY)	APR	- -	3.3	2.9
UK	05/12	04:30	Industrial Production (MoM)	MAR	- -	0.8	-1.2
UK	05/12	04:30	Manufacturing Production (MoM)	MAR	- -	0.3	0.0
EC	05/12	05:00	Euro-Zone Ind. Prod. sa (MoM)	MAR	- -	0.3	0.5
NO	05/12	08:00	**Norwegian Deposit Rate**	12-May	**- -**	**2.25**	**2.00**
FR	05/13	01:30	Gross Domestic Product (QoQ)	1Q P	0.4	0.6	0.4
GE	05/13	02:00	GDP s.a. (QOQ)	1Q P	0.7	0.9	0.4
FR	05/13	02:45	Non-Farm Payrolls (QoQ)	1Q P	- -	0.3	0.2
FR	05/13	02:45	Wages (QoQ)	1Q P	- -	0.6	0.3
SP	05/13	03:00	GDP (Constant SA) (QoQ)	1Q P	- -	0.2	0.2
SW	05/13	03:30	Industry Capacity (ratio)	1Q	- -	--	89.0
IT	05/13	04:00	GDP sa and wda (QoQ)	1Q P	0.1	0.3	0.1
EC	05/13	05:00	Euro-Zone GDP s.a. (QoQ)	1Q A	0.5	0.6	0.3
PO	05/13	05:00	GDP (QoQ)	1Q P	- -	--	-0.3
GR	05/13		GDP QoQ	1Q P	- -	--	-3.8

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

Key Indicators for the week of May 9 - 13

Asia Pacific

Country	Date	Time	Event	Period	BNS	Consensus	Latest
TA	05/09	04:00	Total Trade Balance (US$ bns)	APR	- -	1.8	1.8
TA	05/09	04:00	Total Exports (YoY)	APR	- -	18.0	16.7
TA	05/09	04:00	Total Imports (YoY)	APR	- -	24.0	16.7
PH	05/09	21:00	Total Exports (YoY)	MAR	- -	7.5	8.3
PH	05/09	21:00	Total Monthly Exports (US$ mns)	MAR	- -	--	3865
AU	05/09	21:30	Trade Balance (AU$ mns)	MAR	- -	500	-205
CH	05/09	22:00	Trade Balance (US$ bns)	APR	- -	3.2	0.1
CH	05/09	22:00	Exports (YoY)	APR	27	29.5	35.8
CH	05/09	22:00	Imports (YoY)	APR	25	28.9	27.3
NZ	MAY 9-11		REINZ Housing Price Index (MoM)	APR	- -	--	0.5
CH	05/10	22:00	Producer Price Index (YoY)	APR	- -	7.0	7.3
CH	05/10	22:00	Industrial Production (YoY)	APR	15	14.6	14.8
CH	05/10	22:00	Consumer Price Index (YoY)	APR	4.9	5.2	5.4
CH	05/10	22:00	Fixed Assets Inv Excl. Rural YTD (YoY)	APR	- -	24.9	25.0
CH	05/10	22:00	Retail Sales (YoY)	APR	18	17.6	17.4
JN	05/11	19:50	Current Account Total (¥ bns)	MAR	- -	1750	1641
JN	05/11	19:50	Current Account Balance (YOY)	MAR	- -	-32.0	3.0
JN	05/11	19:50	Trade Balance - BOP Basis (¥ bns)	MAR	- -	305.0	723.3
AU	05/11	21:30	Part Time Employment Change	APR	- -	--	5.7
AU	05/11	21:30	Full Time Employment Change	APR	- -	--	32.1
AU	05/11	21:30	Employment Change	APR	- -	17.0	37.8
AU	05/11	21:30	Participation Rate	APR	- -	65.8	65.8
AU	05/11	21:30	Unemployment Rate	APR	- -	4.9	4.9
ID	MAY 11-12		**Bank Indonesia Reference Rate**	12-May	**6.75**	**6.75**	**6.75**
JN	05/12	02:00	Machine Tool Orders (YoY)	APR P	- -	--	49.6
SK	05/12	21:00	**South Korea 7-Day Repo Rate**	13-May	**3.00**	**3.25**	**3.00**
HK	05/13	04:30	GDP sa (QoQ)	1Q	- -	1.2	1.5

Latin America

Country	Date	Time	Event	Period	BNS	Consensus	Latest
BZ	05/09	07:30	Central Bank Weekly Economists Survey				
CL	05/09	07:30	Trade Balance (US$ mns)	APR	- -	1800.0	1217.3
CL	05/09	07:30	Total Exports (US$ mns)	APR	- -	--	7251.3
CL	05/09	07:30	Total Imports (US$ mns)	APR	- -	--	6034.0
CL	05/09	07:30	Copper Exports (US$ mns)	APR	- -	--	3876.5
CL	05/10	07:30	Central Bank Economist Survey				
PE	05/11		Trade Balance (PEN mns)	MAR	- -	--	797.2
BZ	05/12	08:00	Retail Sales (MoM)	MAR	- -	1.5	-0.4
BZ	05/12	08:00	Retail Sales (YoY)	MAR	- -	4.8	8.2
CL	05/12	17:00	**Nominal Overnight Rate Target**	12-May	**4.75**	**4.75**	**4.50**
PE	05/12		**Reference Rate**	MAY	**4.00**	**--**	**4.00**
CO	05/13		Monetary Policy Meeting Minutes				

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

Global Auctions for the week of May 9 - 13

North America

Country	Date	Time	Event
US	05/09	11:00	U.S. Fed to Purchase USD6-8 Bln Notes/Bonds
US	05/09	11:30	U.S. to Sell 3-Month Bills
US	05/09	11:30	U.S. to Sell 6-Month Bills
CA	05/10	10:30	Canada to Sell CAD7.7 Bln 98-Day Bills
CA	05/10	10:30	Canada to Sell CAD2.9 Bln 182-Day Bills
CA	05/10	10:30	Canada to Sell CAD2.9 Bln 364-Day Bills
US	05/10	11:00	U.S. Fed to Purchase USD5-7 Bln Notes/Bonds
US	05/10	11:30	U.S. to Sell 4-Week Bills
US	05/10	13:00	U.S. to Sell 3-Year Notes
US	05/11	11:00	U.S. Fed to Purchase USD6-8 Bln Notes/Bonds
CA	05/11	12:00	Canada to Sell 2-Year Notes
US	05/11	13:00	U.S. to Sell 10-Year Notes
US	05/12	13:00	U.S. to Sell 30-Year Bonds

Europe

Country	Date	Time	Event
GE	05/09	05:15	Germany to Sell EU5 Bln 6-Mth Bills
FR	05/09	09:00	France to Sell Bills
SZ	05/10	05:30	Switzerland to Sell 3-Month Bills
UK	05/10	05:30	U.K. to Sell GBP1.2 Bln 1.875% I/L 2022 Bonds
IT	05/11	05:00	Italy to Sell Bills
SW	05/11	05:10	Sweden to Sell Bills
GE	05/11	05:15	Germany to Sell EU7 Bln 2-Year Notes
SZ	05/11	05:30	Switzerland to Sell Bonds
SW	05/12	05:10	Sweden to Sell I/L Bonds
UK	05/12	05:30	U.K. to Sell GBP2 Bln 4.25% 2040 Bonds
IC	05/12	06:45	Iceland to sell Bills
IT	05/13	05:00	Italy to Sell Bonds/Floating Rate Notes
UK	05/13	06:10	U.K. to Sell Bills

Asia Pacific

Country	Date	Time	Event
SK	05/08	22:30	Korea to Sell KRW2 Tln 5-Year Bonds
HK	05/08	23:30	Hong Kong to Sell HKD9 Bln 182-D Bills
TH	05/09	23:00	Bank of Thailand to Sell THB25 Bln 28D Bills
TH	05/09	23:00	Bank of Thailand to Sell THB22 Bln 91D Bills
TH	05/09	23:00	Bank of Thailand to Sell THB15 Bln 182D Bills
TH	05/09	23:00	Bank of Thailand to Sell THB25 Bln Bonds 3-Yr Bonds
JN	05/09	23:35	Japan to Sell 6-Month Bills
PH	05/10	01:30	Philippines Plans to Sell PHP9.0 Bln 7-Yr Bonds Due 2018
JN	05/10	04:00	Japan Auction for Enhanced-Liquidity
ID	05/10	04:30	Indonesia to Sell 5-Yr to Maturity Government Sukuk
ID	05/10	04:30	Indonesia to Sell 10-Yr to Maturity Government Sukuk
ID	05/10	04:30	Indonesia to Sell 15-Yr to Maturity Government Sukuk
CH	05/10	23:00	China to Sell 7 Year Bond
TH	05/10	23:00	Thailand to Sell THB10 Bln Bonds due 2021
CH	05/10	23:00	China to Increase CNY 30Bln 7-Year Bonds
JN	05/10	23:35	Japan to Sell 3-Month Bills
IN	05/11	07:30	India to Sell INR 20Bln 182-Day Bills
IN	05/11	07:30	India to Sell INR 50Bln 91-Day Bills
NZ	05/11	22:30	New Zealand Plans to Sell Government Bonds
JN	05/11	23:45	Japan to Sell 10-Year Bond
TH	05/12	23:00	Bank of Thailand to Sell THB25 Bln 28D Bills
TH	05/12	23:00	Bank of Thailand to Sell THB22 Bln 91D Bills
TH	05/12	23:00	Bank of Thailand to Sell THB15 Bln 182D Bills
TH	05/12	23:00	Bank of Thailand to Sell THB12 Bln Bonds due 2014

Source: Bloomberg, Scotia Economics.

Events for the week of May 9 - 13

North America

Country	Date	Time	Event
US	05/10	09:30	Fed's Duke Speaks on Community Development in St. Louis
US	05/10	12:45	Fed's Lacker Speaks on Economic Outlook in Arlington, VA
US	05/11	12:15	Fed's Lockhart Speaks on U.S. Economic Outlook in Atlanta
US	05/11	13:00	Fed's Kocherlakota Speaks on Monetary Policy in New York
US	05/12	08:30	Fed's Plosser Speaks on Economic Outlook in Aventura, Florida
US	05/12	10:00	Bernanke, Bair Testify at Senate Hearing on Systemic Risk

Europe

Country	Date	Time	Event
GE	05/09		German Economy Minister Bruederle Hosts Energy Meeting
IT	05/10	04:15	ECB's Bini Smaghi Speaks at Festival of Europe in Florence
GE	05/10	05:00	Chancellor Merkel Talks to Foreign Press Association in Berlin
	05/11	04:15	ECB's Coene Speaks at Brussels Finance Conference
UK	05/11	05:30	Bank of England Releases Quarterly Inflation Report
EC	05/11	05:45	ECB's Bini Smaghi Speaks in Prato, Italy
EC	05/11	06:30	ECB's Stark Speaking in London
EC	05/11	11:15	ECB's Orphanides Speaks at Brussels Finance Conference
PD	05/11		Poland Base Rate Announcement
EC	05/12	05:00	ECB Publishes May Monthly Report
EC	05/12	05:30	ECB's Gonzalez-Paramo Speaks in Madrid
NO	05/12	08:00	Norwegian Deposit Rates
EC	05/13	03:50	ECB's Ordonez Speaks in Madrid
EC	05/13	04:00	ECB's Trichet Speaks in Madrid
EC	05/13	05:00	ECB's Bini Smaghi Speaks in Florence
EC	05/13	12:30	ECB's Stark Speaks in Aachen, Germany
EC	05/13		EU Trade Ministers Meet in Brussels
EC	05/13		EU Issues Semi-Annual Economic Forecasts

Asia Pacific

Country	Date	Time	Event
ID	MAY 11-12		Bank Indonesia Reference Rate
SK	05/12	21:00	South Korea 7-Day Repo Rate

Latin America

Country	Date	Time	Event
CL	05/12	17:00	Nominal Overnight Rate Target
PE	05/12		Reference Rate

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	May 31, 2011	1.00	--
Federal Reserve – Federal Funds Target Rate	0.25	June 22, 2011	0.25	--
Banco de México – Overnight Rate	4.50	May 27, 2011	4.50	--

As we have been arguing for some time, the Bank of Canada will likely remain on the sidelines until October of this year and the Fed will remain on hold until at least Q1 2012. Financial market developments this week, as well as the release of April employment reports in both Canada and the U.S., provide even further support for this view as wage pressures and commodity price gains subsided. In addition, signs that global economic growth may be slowing has skewed the tail risk of both of our calls to later rather than earlier.

Europe

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
European Central Bank – Refinancing Rate	1.25	June 9, 2011	1.25	--
Bank of England – Bank Rate	0.50	June 9, 2011	0.50	0.50
Swiss National Bank – Libor Target Rate	0.25	June 16, 2011	0.25	--
Central Bank of Russia – Refinancing Rate	8.25	May 27, 2011	8.25	--
Hungarian National Bank – Base Rate	6.00	May 16, 2011	6.00	--
Central Bank of the Republic of Turkey – 1 Week Repo Rate	6.25	May 25, 2011	6.25	--

As expected, the European Central Bank and the Bank of England left their benchmark interest rates unchanged at 1.25% and 0.5%, respectively, following their monthly policy meetings on May 5th. We expect both central banks to raise the key rates in the third quarter of 2011.

Asia Pacific

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Bank of Japan – Target Rate	0.10	May 20, 2011	0.10	--
Reserve Bank of Australia – Cash Target Rate	4.75	June 7, 2011	4.75	--
Reserve Bank of New Zealand – Cash Rate	2.50	June 8, 2011	2.50	--
People's Bank of China – Lending Rate	6.31	TBA	--	--
Reserve Bank of India – Repo Rate	7.25	TBA	7.25	--
Hong Kong Monetary Authority – Base Rate	0.50	TBA	0.50	--
Central Bank of China Taiwan – Discount Rate	1.75	June 24, 2011	1.75	--
Bank Negara Malaysia – Overnight Policy Rate	3.00	July 7, 2011	3.00	--
Bank of Korea – Bank Rate	3.00	May 12, 2011	3.00	3.25
Bank of Thailand – Repo Rate	2.75	June 1, 2011	2.75	--
Bank Indonesia – Reference Interest Rate	6.75	May 12, 2011	6.75	6.75

The Bank of Korea (BoK) will likely pause next week. Falling core and headline inflation during March within a context of won strength would justify such a decision. Core inflation is reaching back towards the central bank's 3% target. Notwithstanding the level of headline inflation that surpasses the BoK's comfort range around the target, won strength will continue to carry some of the heavy imported inflationary weight.

Latin America

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Banco Central do Brasil – Selic Rate	12.00	June 8, 2011	12.25	--
Banco Central de Chile – Overnight Rate	4.50	May 12, 2011	4.75	4.75
Banco de la República de Colombia – Lending Rate	3.75	May 30, 2011	3.75	--
Banco Central de Reserva del Perú – Reference Rate	4.00	May 12, 2011	4.00	--

After resuming monetary tightening in January, the central bank of Peru may opt for a temporary pause and leave the reference rate unchanged at 4.0% on May 12th, given that the FX market has shown high volatility due to uncertainties stemming from the presidential elections. Chile will also hold a monetary policy meeting that day; we expect the Chilean central bank to continue to tighten monetary conditions and hike the policy rate by another 25 basis points to 4.75%.

Africa

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
South African Reserve Bank – Repo Rate	5.50	May 12, 2011	5.50	5.50

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

	2000-09	2010	2011f	2012f	2000-09	2010	2011f	2012f
Output and Inflation (annual % change)		**Real GDP**				**Consumer Prices[2]**		
World[1]	3.6	4.9	4.4	4.4				
Canada	2.1	3.1	2.9	2.6	2.1	1.8	2.8	2.3
United States	1.8	2.9	2.6	2.8	2.6	1.6	2.8	2.0
Mexico	1.9	5.5	4.3	3.8	4.9	4.4	4.1	4.1
United Kingdom	2.7	1.3	1.4	1.7	2.2	3.7	3.7	2.9
Euro zone	1.2	1.7	1.4	1.6	2.1	2.2	2.5	2.3
Japan	0.7	3.9	1.0	2.9	-0.3	-0.5	0.5	1.2
Australia	3.0	2.8	3.8	3.5	3.2	2.7	2.8	2.5
China	10.2	10.3	9.5	9.7	2.0	3.3	5.0	4.5
India	7.2	8.7	8.5	8.8	5.7	9.4	7.5	6.0
Korea	4.5	6.3	5.5	5.3	3.2	3.5	3.3	3.0
Brazil	2.9	7.5	4.0	4.5	6.6	5.9	6.5	5.5
Chile	3.6	5.2	6.0	5.5	3.7	3.0	4.5	3.5
Peru	5.1	8.8	7.0	7.2	2.5	2.1	3.5	3.0

Central Bank Rates (%, end of period)	11Q1	11Q2f	11Q3f	11Q4f	12Q1f	12Q2f	12Q3f	12Q4f
Bank of Canada	1.00	1.00	1.00	1.50	2.00	2.25	2.25	2.25
Federal Reserve	0.25	0.25	0.25	0.25	0.75	1.25	1.75	2.00
European Central Bank	1.00	1.25	1.50	1.75	2.00	2.25	2.50	2.50
Bank of England	0.50	0.50	0.75	1.00	1.25	1.50	1.75	2.00
Swiss National Bank	0.25	0.25	0.25	0.50	0.50	0.75	0.75	1.00
Bank of Japan	0.10	0.10	0.10	0.10	0.10	0.25	0.25	0.50
Reserve Bank of Australia	4.75	5.00	5.25	5.50	5.75	6.00	6.25	6.50
Exchange Rates (end of period)								
Canadian Dollar (USDCAD)	0.97	0.95	0.94	0.93	0.94	0.94	0.93	0.92
Canadian Dollar (CADUSD)	1.03	1.05	1.06	1.08	1.06	1.06	1.08	1.09
Euro (EURUSD)	1.42	1.47	1.49	1.50	1.48	1.48	1.50	1.50
Sterling (GBPUSD)	1.60	1.64	1.64	1.65	1.65	1.67	1.69	1.70
Yen (USDJPY)	83	79	82	84	86	87	89	90
Australian Dollar (AUDUSD)	1.03	1.07	1.08	1.09	1.09	1.10	1.10	1.11
Chinese Yuan (USDCNY)	6.5	6.4	6.2	6.1	6.0	5.9	5.8	5.8
Mexican Peso (USDMXN)	11.9	11.6	11.8	12.0	12.1	12.0	12.1	12.3
Brazilian Real (USDBRL)	1.63	1.59	1.59	1.60	1.62	1.65	1.67	1.70

Commodities (annual average)	2000-09	2010	2011f	2012f
WTI Oil (US$/bbl)	51	79	105	110
Brent Oil (US$/bbl)	50	80	118	122
Nymex Natural Gas (US$/mmbtu)	5.95	4.40	4.40	4.75
Copper (US$/lb)	1.78	3.42	4.40	4.15
Zinc (US$/lb)	0.73	0.98	1.09	1.09
Nickel (US$/lb)	7.11	9.89	11.25	8.90
Gold, London PM Fix (US$/oz)	522	1,225	1,530	1,500
Pulp (US$/tonne)	668	960	1,018	1,050
Newsprint (US$/tonne)	572	607	660	705
Lumber (US$/mfbm)	275	254	270	300

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

Canada	2010	10Q3	10Q4	Latest	
Real GDP (annual rates)	3.1	1.8	3.3		
Current Acc. Bal. (C$B, ar)	-50.0	-67.9	-44.2		
Merch. Trade Bal. (C$B, ar)	-9.0	-26.2	0.9	0.4	(Feb)
Industrial Production	4.8	7.9	6.1	5.0	(Feb)
Housing Starts (000s)	192	192	179	185	(Mar)
Employment	1.4	1.8	1.7	1.7	(Apr)
Unemployment Rate (%)	8.0	8.0	7.7	7.6	(Apr)
Retail Sales	5.5	4.0	5.3	3.7	(Feb)
Auto Sales (000s)	1560	1609	1553	1573	(Feb)
CPI	1.8	1.8	2.3	3.3	(Mar)
IPPI	1.1	1.1	2.7	-5.0	(Mar)
Pre-tax Corp. Profits	18.4	15.3	16.2		

United States	2010	10Q3	10Q4	Latest	
Real GDP (annual rates)	2.9	2.6	3.1	1.7	(Q1-A)
Current Acc. Bal. (US$B, ar)	-470	-502	-453		
Merch. Trade Bal. (US$B, ar)	-647	-683	-625	-712	(Feb)
Industrial Production	5.3	6.7	6.2	5.9	(Mar)
Housing Starts (millions)	0.59	0.59	0.53	0.55	(Mar)
Employment	-0.8	-0.1	0.5	1.1	(Apr)
Unemployment Rate (%)	9.6	9.6	9.6	9.0	(Apr)
Retail Sales	6.8	5.8	8.1	7.3	(Mar)
Auto Sales (millions)	11.5	11.6	12.3	13.1	(Apr)
CPI	1.6	1.2	1.3	2.7	(Mar)
PPI	4.2	3.8	3.9	5.8	(Mar)
Pre-tax Corp. Profits	36.8	34.8	16.1		

Mexico					
Real GDP	5.5	5.3	4.6		
Current Acc. Bal. (US$B, ar)	-5.7	-7.7	-14.5		
Merch. Trade Bal. (US$B, ar)	-3.1	-9.2	-4.6	17.3	(Mar)
Industrial Production	6.1	6.2	4.7	5.2	(Feb)
CPI	4.2	3.7	4.2	3.0	(Mar)

Brazil					
Real GDP	6.7	5.9	4.2		
Current Acc. Bal. (US$B, ar)	-47.4	-46.1	-48.0		
Merch. Trade Bal. (US$B, ar)	20.2	19.3	30.0	22.4	(Apr)
Industrial Production	10.5	8.2	3.7	0.5	(Mar)
CPI	5.1	5.0	6.1	6.5	(Mar)

Chile					
Real GDP	5.2	6.9	5.8		
Current Acc. Bal. (US$B, ar)	3.6	-0.2	4.9		
Merch. Trade Bal. (US$B, ar)	11.6	14.7	17.7	14.6	(Mar)
Industrial Production	0.6	4.4	2.7	1.5	(Feb)
CPI	1.4	2.2	2.5	3.2	(Apr)

Italy					
Real GDP	1.2	1.4	1.5		
Current Acc. Bal. (US$B, ar)	-0.07	-0.05	-0.08	-0.10	(Feb)
Merch. Trade Bal. (US$B, ar)	-36.6	-22.9	-44.4	-59.5	(Feb)
Industrial Production	6.5	7.5	5.1	2.4	(Feb)
CPI	1.6	1.6	1.8	2.5	(Mar)

Germany					
Real GDP	3.5	3.9	4.0		
Current Acc. Bal. (US$B, ar)	187.9	165.7	250.8	145.8	(Feb)
Merch. Trade Bal. (US$B, ar)	201.5	207.6	219.8	184.9	(Feb)
Industrial Production	10.1	10.2	11.8	10.9	(Mar)
Unemployment Rate (%)	7.7	7.6	7.5	7.1	(Apr)
CPI	1.1	1.2	1.5	2.4	(Apr)

France					
Real GDP	1.7	2.0	1.7		
Current Acc. Bal. (US$B, ar)	-54.3	-41.8	-94.9	-65.3	(Feb)
Merch. Trade Bal. (US$B, ar)	-38.6	-42.2	-38.6	-49.3	(Mar)
Industrial Production	5.7	5.0	5.7	5.6	(Feb)
Unemployment Rate (%)	9.8	9.8	9.6	9.5	(Mar)
CPI	1.5	1.5	1.6	2.0	(Mar)

Euro Zone					
Real GDP	1.7	1.9	2.0		
Current Acc. Bal. (US$B, ar)	-77	-43	-41	-156	(Feb)
Merch. Trade Bal. (US$B, ar)	0.0	43.0	53.2	-16.2	(Feb)
Industrial Production	7.5	7.3	8.1	7.6	(Feb)
Unemployment Rate (%)	10.0	10.0	10.0	9.8	(Mar)
CPI	1.6	1.7	2.0	2.7	(Mar)

United Kingdom					
Real GDP	1.3	2.5	1.5		
Current Acc. Bal. (US$B, ar)	-56.1	-55.7	-62.3		
Merch. Trade Bal. (US$B, ar)	-151.4	-159.3	-169.6	-131.1	(Feb)
Industrial Production	2.0	3.0	3.3	2.4	(Feb)
Unemployment Rate (%)	7.9	7.8	7.9	7.8	(Jan)
CPI	3.3	3.1	3.4	4.1	(Mar)

Japan					
Real GDP	4.0	4.7	2.5		
Current Acc. Bal. (US$B, ar)	195.9	227.5	176.9	238.6	(Feb)
Merch. Trade Bal. (US$B, ar)	74.4	72.7	61.3	14.1	(Mar)
Industrial Production	16.6	13.3	6.8	-12.9	(Mar)
Unemployment Rate (%)	5.1	5.0	5.0	4.6	(Mar)
CPI	-0.7	-0.8	0.1	0.0	(Mar)

Australia					
Real GDP	2.7	2.7	2.7		
Current Acc. Bal. (US$B, ar)	-31.8	-29.2	-34.4		
Merch. Trade Bal. (US$B, ar)	19.2	27.8	25.6	5.3	(Feb)
Industrial Production	4.3	4.2	-0.3		
Unemployment Rate (%)	5.2	5.2	5.2	4.9	(Mar)
CPI	2.8	2.8	2.7		

China					
Real GDP	10.3	9.6	9.8		
Current Acc. Bal. (US$B, ar)	30.5				
Merch. Trade Bal. (US$B, ar)	182.1	259.9	248.5	1.7	(Mar)
Industrial Production	13.5	13.3	13.5	14.8	(Mar)
CPI	4.6	3.6	4.6	5.4	(Mar)

South Korea					
Real GDP	6.2	4.4	4.7		
Current Acc. Bal. (US$B, ar)	28.2	39.7	36.6	17.2	(Mar)
Merch. Trade Bal. (US$B, ar)	41.2	42.5	52.1	69.9	(Apr)
Industrial Production	16.6	12.9	9.9	8.9	(Mar)
CPI	3.0	2.9	3.6	4.2	(Apr)

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

Source: Bloomberg, Scotia Economics.

Interest Rates (%, end of period)

Canada	10Q4	11Q1	Apr/29	May/06*	United States	10Q4	11Q1	Apr/29	May/06*
BoC Overnight Rate	1.00	1.00	1.00	1.00	Fed Funds Target Rate	0.25	0.25	0.25	0.25
3-mo. T-bill	1.05	0.96	0.99	0.98	3-mo. T-bill	0.12	0.09	0.04	0.01
10-yr Gov't Bond	3.12	3.35	3.21	3.22	10-yr Gov't Bond	3.29	3.47	3.29	3.20
30-yr Gov't Bond	3.53	3.76	3.69	3.59	30-yr Gov't Bond	4.33	4.51	4.40	4.33
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US$B)	59.4	57.0	60.4	(Mar)	FX Reserves (US$B)	122.1	121.4	128.3	(Mar)
Germany					**France**				
3-mo. Interbank	0.96	1.26	1.38	1.34	3-mo. T-bill	0.40	0.80	0.98	1.00
10-yr Gov't Bond	2.96	3.35	3.24	3.17	10-yr Gov't Bond	3.36	3.71	3.56	3.51
FX Reserves (US$B)	62.4	62.3	64.8	(Mar)	FX Reserves (US$B)	52.2	55.8	61.0	(Mar)
Euro-Zone					**United Kingdom**				
Refinancing Rate	1.00	1.00	1.25	1.25	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	0.82	0.90	1.28	0.85	3-mo. T-bill	4.85	4.85	4.85	4.85
FX Reserves (US$B)	300.1	300.2	319.9	(Mar)	10-yr Gov't Bond	3.40	3.69	3.57	3.39
					FX Reserves (US$B)	67.2	68.3	75.3	(Mar)
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	0.14	0.14	0.13	10-yr Gov't Bond	5.55	5.49	5.43	5.43
10-yr Gov't Bond	1.13	1.26	1.23	1.15	FX Reserves (US$B)	38.1	38.7	33.3	(Mar)
FX Reserves (US$B)	1077.4	1061.5	1080.6	(Mar)					

Exchange Rates (end of period)

USDCAD	1.00	0.97	0.95	0.96	¥/US$	81.12	83.13	81.19	80.58
CADUSD	1.00	1.03	1.06	1.04	US¢/Australian$	102.33	103.29	109.71	107.74
GBPUSD	1.561	1.603	1.671	1.644	Chinese Yuan/US$	6.61	6.55	6.49	6.49
EURUSD	1.338	1.416	1.481	1.451	South Korean Won/US$	1126	1097	1072	1083
JPYEUR	0.92	0.85	0.83	0.86	Mexican Peso/US$	12.340	11.905	11.496	11.609
USDCHF	0.94	0.92	0.87	0.88	Brazilian Real/US$	1.661	1.632	1.575	1.604

Equity Markets (index, end of period)

United States (DJIA)	11578	12320	12811	12727	U.K. (FT100)	5900	5909	6068	5954
United States (S&P500)	1258	1326	1364	1350	Germany (Dax)	6914	7041	7514	7480
Canada (S&P/TSX)	13443	14116	13945	13592	France (CAC40)	3805	3989	4107	4054
Mexico (Bolsa)	38551	37441	36963	35403	Japan (Nikkei)	10229	9755	9672	9859
Brazil (Bovespa)	69305	68587	66133	64677	Hong Kong (Hang Seng)	23035	23528	23806	23159
Italy (BCI)	1048	1120	1148	1123	South Korea (Composite)	2051	2107	2208	2147

Commodity Prices (end of period)

Pulp (US$/tonne)	960	990	990	990	Copper (US$/lb)	4.42	4.26	4.25	3.99
Newsprint (US$/tonne)	640	640	640	640	Zinc (US$/lb)	1.10	1.05	1.01	0.95
Lumber (US$/mfbm)	308	290	238	236	Gold (US$/oz)	1405.50	1439.00	1535.50	1486.50
WTI Oil (US$/bbl)	91.38	106.72	113.93	100.66	Silver (US$/oz)	30.63	37.87	48.70	34.20
Natural Gas (US$/mmbtu)	4.41	4.39	4.70	4.32	CRB (index)	332.80	359.43	370.56	343.63

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

Scotia Economics

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

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