

Global Views

Weekly commentary on economic and financial market developments

August 5, 2011

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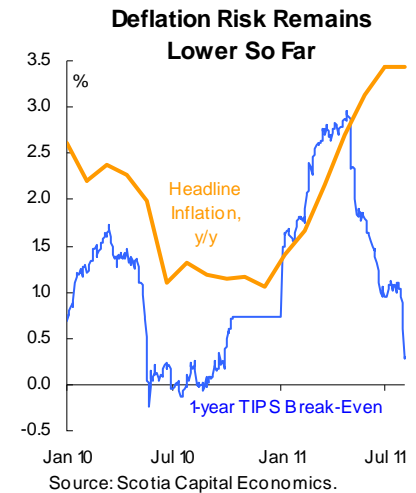
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All Eyes On The Fed — And China

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

Tuesday's **FOMC** will be the show stealer of the week as it lands at a point of deepened uncertainty over the economic and financial market outlook. As we argue on page 3, there is mixed evidence behind whether the Fed would be justified in a shift toward QE3 that we think is unlikely to arrive at least at this point. Markets may have pushed inflation expectations lower, but such measures are distorted by the safe-haven liquidity premium into nominal Treasuries versus real return bonds and are not a pure market-based inflation reading. Further, and in contrast, actual inflation is higher than the pre-QE2 environment (see chart). The Fed needed several months of soft actual inflation readings last year before embarking upon QE2, so at a minimum, we don't think the Fed would shift toward QE3 until late in the year or early next assuming that further weakness in actual inflation lies ahead; besides, the track record on QE2 has been less than impressive to say the least. That said, look for a more dovish statement including signaling a near-term forecast downgrade but optimism about an accelerated recovery into next year. That, combined with another signal that it is willing to do what it takes to ensure the recovery remains intact may be taken in a positive light. In practice, however, the Fed has few other practical tools it can use to exercise influence over the economy. Signalling a longer rate hold is already priced into markets since it costs only 28bps for Washington to borrow for two years. Continued coupon reinvestment will be emphasized, but the Fed's last real tool is to use communication as a form of guidance in an attempt to talk up the outlook into next year despite the tendency of the Fed's central tendency forecast to repeatedly over-estimate growth. Key data risk will be scarce but concentrated upon perhaps two moderately more encouraging releases in contrast to the tone of recent weeks. Consensus is looking for a small gain in retail sales (Friday) on the back of higher vehicle sales, and expects a smaller trade deficit partly given lower oil prices. Three auctions that might not have occurred in the absence of a debt ceiling deal will occur as 3s, 10s and 30s are auctioned off.



The second focus of the week will be placed squarely upon **China**. The country poses high data risk with markets sensitive to any miss or beat on evidence of slowing. Consensus is expecting firm readings for retail sales, industrial production and the trade surplus. CPI inflation has surged to 6.4% y/y which is the strongest since June 2008 and therefore any upside will be taken as limiting policy flexibility to counter a slowing global economy. The Bank of Korea is expected by consensus to raise rates on Thursday, but the global climate has clearly soured enough to likely leave them on hold along with Bank Indonesia. Australian jobs on Wednesday, and regional trade figures from Japan and the Philippines round out the indicator risk.

Europe will carry uncertain headline risk throughout the week in a continuation of the trend. The Bank of England's latest quarterly inflation report (Wednesday) could well be interpreted dovishly (see Alan Clarke's preview on pages 18-20). Norges Bank Governor Olsen already showed his hand on next week's rate meeting when he commented that "A restructuring of Greek debt would be a worrying step that would change the premise on which we base our forecasts" way back on June 29th. European data risk will be focused upon German and UK exports, UK industrial output, French GDP, CPI and industrial production. Italy auctions bills on Wednesday at a potentially dicey juncture, but it cancelled a bond auction as the government says it is flush with cash for now.

Canada will be quiet and left to generally follow the global tone next week. Only two second-tier indicators are due out. Housing starts (Tuesday) have been resilient to date but what is not clear is whether stronger new home construction of late is a sign of longer lived resilience, or whether starts are bound to soften later this year once the lagged effects of Spring purchase activity geared toward avoiding tighter mortgage rules fully drop out. I would think that housing will drop out as a significant GDP driver going forward given already-high construction, and demand exhaustion such as through an all-time record high home ownership rate. We're also expecting a larger trade deficit, and Canada conducts a three year note auction on Wednesday.

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Will The Fed Give A Nod At QE3 Next Week?

- We were less than enthusiastic about QE2, and today's parallels to last summer are mixed.

Will the Fed attempt to prime the pump again? QE3 debate is intensifying in advance of next Tuesday's FOMC meeting, following a steep equity correction, and before the August 26th Jackson Hole symposium. Recall that it was Bernanke's speech at last year's St. Louis Fed conference that kicked QE2 speculation into higher gear. The Fed seems to believe that QE2 did some good, so QE3 cannot be dismissed outright regardless of what you or we believe. That said, there are two key issues to consider.

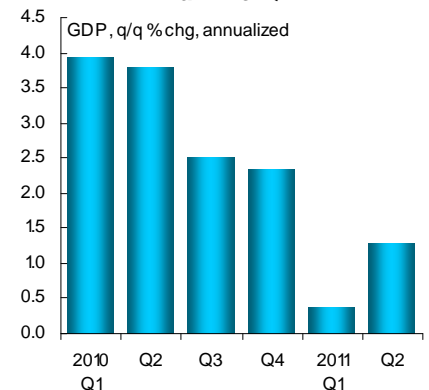
First, today's parallels to last summer are mixed. Growth is even weaker now, but deflation risk isn't as apparent yet. The US economy grew by 0.8% at an annualized rate over the first half of this year, so essentially moved sideways in line with our warnings throughout the past year that the wheels would fall off the economy into 2011 (chart 1). Further, one-year TIPS breakevens (an imperfect measure of the market's inflation expectations) currently sit at 0.3%, almost in line with the zero to slightly negative readings of last summer (chart 2). Two year inflation expectations sit at 1.21%, well above last summer's 0.5% range. Five year expectations are at 1.8% versus the 1.2% trough of a year ago. Ten year expectations sit at 2.2%, higher than last August's 1.6% zone. Non-market based measures, however, are materially firmer with the core (ex food and energy) personal consumption deflator rising by 1.3% y/y in contrast to last Fall's sub-1% readings, while headline has risen to 2.6% y/y from last November's 1.2% low (chart 3). Hard inflation data has not, as yet, plunged low enough to instill fear in the Fed's mind and the Fed remains optimistic about a rebound into next year. That might suggest we're not quite at the point of seeing the Fed embrace another round of QE since it needed many months of soft inflation readings before acting last year. Add to this the potentially market destabilizing effects of a sharply divided FOMC and criticism from abroad — whether justified or not in blaming the Fed for everything (not, in our view).

Second, QE1 made sense, but on QE2's effectiveness, I think supporters cherry pick the evidence. If QE2 really did boost equities and reverse last summer's deflation concerns, then to be consistent one would also have to look at what it may have done in other markets. If QE2 is also what boosted commodities, then the demand destruction that unfolded in the first half of this year was a growth inhibiting consequence. If QE2 boosted inflation expectations and raised the 30 year fixed mortgage rate last Fall and through much of the winter, then that didn't help the double dip in US housing. It's difficult to imagine how non-sterilized buying of Treasuries could have boosted equities and inflation expectations with surgical precision while affecting nothing else across the risk trade so to count some of its effects and not others is a tad disingenuous.

Regardless, I think broader forces were at play in driving each of these outcomes — and the USD and broad growth — that counted for much more than just QE2. The same logic would apply to an attempt at QE3; indeed, the outcome could be disastrous for the longer term bond market.

Chart #1

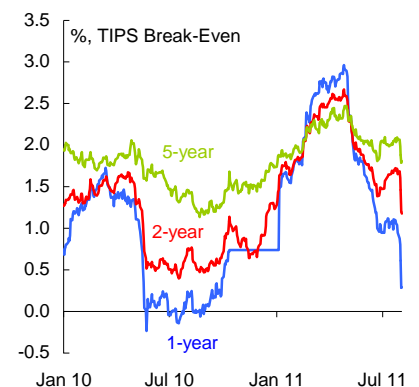
Growth Is Weaker Now Than Pre-QE2



Source: Scotia Capital Economics.

Chart #2

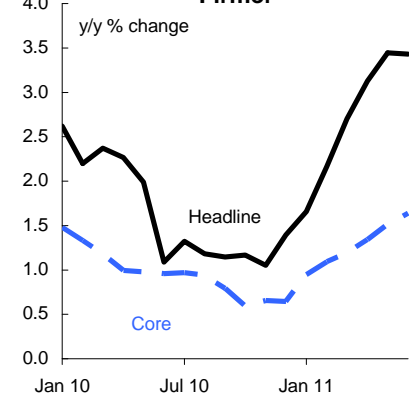
The Market Is Bringing Back Deflation Risk...



Source: Scotia Capital Economics.

Chart #3

... But Actual Inflation Remains Firmer



Source: Scotia Capital Economics.

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Annus Interruptus

Once again, we are lowering our forecast for output growth in many of the advanced nations in 2011, outside of Japan which is mounting a strong recovery from its early-year catastrophe, and maintaining a below-consensus forecast for next year. We have left unchanged our growth expectations in the major developing countries because of the continuing strength of domestic demand, notwithstanding the likelihood of reduced exports to the struggling European and U.S. economies. Global growth is now pegged modestly lower at 4.0% this year and 4.3% in 2012.

We have lowered our real GDP forecast for the United States by three-quarters of a percentage point this year to 1.8%. The pace of output was much weaker-than-expected in the first half of the year, owing in part to substantial downward revisions to the Q1 estimate as well as the generally softer tone to Q2 reports. With July indicators pointing to a more moderate Q3 rebound, the slower transition into the second half of the year brings down our estimate for 2012 growth by about a quarter of a percentage point to 2.5%.

The compounding effects of a number of factors affecting the United States — the early-year spike-up in gasoline and other commodity prices, the supply chain disruptions triggered by Japan's temporary production shutdowns, the slump in hiring, the renewed debt crisis in Europe, and more recently, the U.S. debt ceiling controversy — have conspired to further undermine consumer confidence and spending power. The compromise reached over the debt ceiling woes results in very modest additional federal spending restraint for fiscal 2012.

We are also lowering our forecast for the euro zone because of the intensifying pace of fiscal consolidation, not only in the peripheral countries, but in the big economies as well. The region's growth remains highly delineated, with Germany and France continuing to outperform both on a domestic demand and external trade basis.

As expected, production in the Asia-Pacific region is rebounding from the Japanese supply chain disruptions that began in mid-March and extended throughout the second quarter. We continue to forecast that China will remain a very strong performer despite ongoing efforts to control inflation and slow the pace of credit expansion.

The weaker U.S. performance will have a ripple effect on Canada through reduced trade and increased financial market volatility. However, domestic demand remains relatively strong compared to other developed countries, with spending supported by comparatively firmer job and income growth. Solid demand and high prices for commodities, underpinned by favourable conditions in the higher-growth developing nations, should continue to support resource-related developments, trade, and investments across Canada.

Reduced growth prospects, primarily in some of the debt-heavy developed economies, will likely take a toll on domestic business plans. However, corporate balance sheets are in relatively good shape, and profits have been supported by increasing productivity-enhancing investments and a sharp eye on costs. Firms will continue to focus on capital spending in the current uncertain marketplace, and take advantage of government incentives for M&E purchases.

Headline inflation is peaking for the time being around the world, alongside the modest retreat in commodity prices. At the same time, the upward trend in core prices will be constrained by the slower pace of recovery. In an environment where many of the largest economies internationally are having difficulty maintaining economic traction, and where business and consumer confidence is being aggravated by intensifying financial market volatility, central banks will find it hard to begin, or in some cases resume, the process of normalizing interest rates. Instead, short-term borrowing costs can be expected to remain low for longer. Government bond yields have retreated substantially in recent weeks amid slowing growth and increased fiscal stress. However, as the pace of economic activity begins to generate stronger momentum, bond yields are expected to resume their upward drift.

Heightened credit concerns are expected to weigh more heavily on the more highly indebted nations around the world. Although the U.S. dollar has benefitted from the renewed safe-haven inflows, the daunting fiscal challenge that confronts America should eventually re-instate a weakening bias in the currency. In contrast, the less indebted and more commodity-sensitive currencies (such as the Canadian and Australian dollars) should retain their strengthening bias, as will the currencies of the much stronger-growth developing economies, China and Brazil for example.

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A Break in the Inflationary Fight for Developing Country Central Banks

- Inflation in developing countries has been led by rising food and fuel costs, with locally generated price pressures lagging.
- The steep rise in global commodity prices has been interrupted.
- A less stringent monetary tightening phase is in the cards.

Inflation in developing countries will trend down in the second half of 2011. This expectation is underpinned by the fact that developing country inflationary trends have been led by food and fuel costs, with domestically generated price pressures lagging behind. Thus, an interruption in the steep rise in global commodity prices bodes favourably for a break in the inflationary spiral, with latest data pointing to developed country demand weakness further supporting our call.

We expect inflation in China and India to stay high or even rise in the next couple of months but then come down towards the end of the year, remaining elevated by historical standards. A similar story will play out in Brazil where core IPCA inflation has been highly correlated with fluctuations in tradable goods prices, with non-tradable goods inflation lagging.

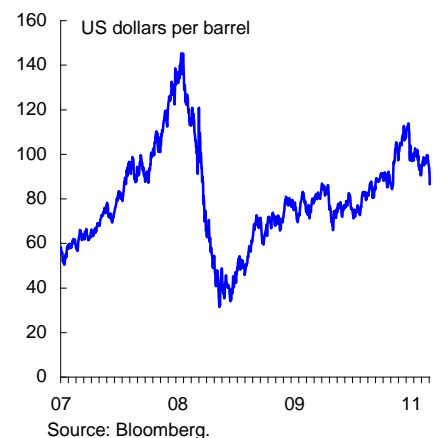
Agricultural Commodity Prices



International agricultural commodity prices have interrupted their steep rise. As observed in the adjacent chart where daily observations of international price quotations for wheat, rice and corn are plotted, yearly grain price increases have achieved peaks, with rice the latest to capitulate. There is certainly no warrantee that these trends will continue, but there is also some likelihood that they might, particularly in a scenario of lackluster developed country growth. The reason why this is important is because food prices have been a leader in inflationary trends in developing countries, still reporting double-digit annual gains in most cases, and continuing to affect price formation throughout local production chains.

The second element is the behaviour of the global oil price, which has come off heights reached during the second quarter when the WTI hovered at over US\$100 per barrel (dbl). Current levels of around US\$90 dbl or lower will prove relevant particularly for oil importing countries. In India, for instance, rising fuel costs have recently become a leading factor in the inflationary spiral as the government attempts to phase out a subsidy scheme that causes havoc within public finances. Double-digit gains in transport costs in China have also been a key determinant of inflationary trends.

WTI Oil Price



Other factors, like base effects, will also play in favour of our call of lowering price pressures in the second half of 2011. However, the main point to take from the previous observations is that inflationary trends within these markets have not been led by domestically generated pressures, but inherited from an environment where commodity costs were pushed up as the world came out of the global recession two years ago.

Note that we are not saying that labour markets within these countries are not tight, or that capacity constraints are not being hit. No, these factors are certainly there, as non-food inflation, manufacturing costs,

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and non-tradable goods inflation have been on an upward trend in China, India and Brazil, respectively, but price gains in these categories have been lagging significantly the rhythm of advance in food or fuel costs.

Looking ahead, easing pressures on the commodity front will lead to a downturn in inflationary pressures in these emerging markets, with the monetary policy implications being straightforward. Monetary authorities will finally have some leeway in the anti-inflationary fight.

While full-fledged evidence of a switch in the monetary policy stance in developing countries is yet to emerge, there are some signs that such a change is in the cards. The Reserve Bank of India certainly did not indicate any lowering of the monetary guard in its latest press release, as Governor Subbarao expects wholesale price inflation to increase in the coming months on the back of the recent upward revision of the publicly administered price for diesel. However, the governor did foresee a capitulation of inflationary pressures once such one-off effects are absorbed by the system. The People's Bank of China has remained hawkish in its pronouncements within the context of still buoyant growth in investment spending depicting scant transmission of credit tightening towards economic activity.

Evidence from the latest minutes from the Banco do Brasil, however, does appear to indicate the central bank's recognition of the possibility that the international scenario could favour a shorter tightening cycle for the country's benchmark SELIC rate. Indeed, the demotion of the expression "for a long period" signals a switch in the policy outlook. Finally, in Turkey, where goods inflation is also running ahead of services (associated closely with local wage gains), the central bank decided this week to lower the benchmark one week repo rate by 50 basis points to 5.75%. While the determination surprised markets, the details of the latest monthly inflationary report do provide evidence that goods prices excluding gold came down during July, with the ticket for durable goods leading the way. While services costs accelerated, the pickup resulted from the lagged effect of fuel costs on transport services, providing further evidence that locally generated inflation is not the main driver.

While there is little doubt that high inflation remains the main concern of developing country central banks, latest data pointing to a weakening phase for developed country growth is forcing central bankers to add to the equation the probability of a fall in demand from rich markets, moving them away from the risk of excessive tightening. More evidence on this is likely to appear in the coming months.

A final point to note is that the argument above implies that notwithstanding the probable fall in price pressures in the medium term, inflation will likely remain elevated given prevailing low unemployment rates and positive output gaps in these emerging markets. A resurgence of the inflationary woes is therefore not unlikely.

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Europe's External Debt and Debt Management Profiles Are Much of The Problem

- The problems do indeed go far beyond a handful of peripherals.

Italy's circumstances are not as rosy as one is left to conclude following a recent pair of speeches by Italian Prime Minister Silvio Berlusconi in which he emphasized the country's strengths and dismissed market concerns as being driven purely by speculators.

Italy faces twin challenges. One is that while it has made efforts at fiscal repair, it is still heavily indebted to foreigners and heavily reliant upon capricious external funding sources. This lies in contrast to principally domestically funded debt markets in some other countries like Japan. Italy's total economy-wide external debt to GDP ratio stands at 118%, and just the sovereign component stands at a still large 53%. Chart 1 plots total external debt to GDP on the horizontal axis for a variety of countries against sovereign external debt to GDP on the vertical axis. We first ran this chart last year and have updated here. Italy's sovereign external debt to GDP is the fifth highest on a list of dubious companions. Spain's comparable ratios are 164% and 28% respectively. One can readily witness Europe's challenges through the cluster of economies that are relatively high on both counts including Belgium which is a renewed source of concern.

Beyond sovereign external debt is the external debt of banks (chart 2) and nonbank corporations. Banks are often responsible for much of the external debt of a nation, and with worries about contagion via cross-border bank holdings of distressed European debt, the concern is that at least some of this debt may become the debt of the sovereign as it has in some

Chart #1

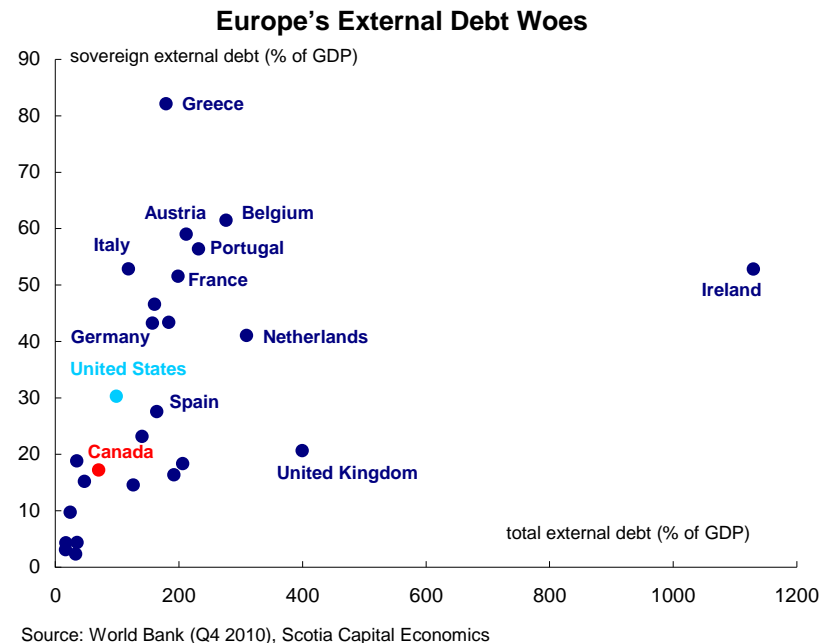
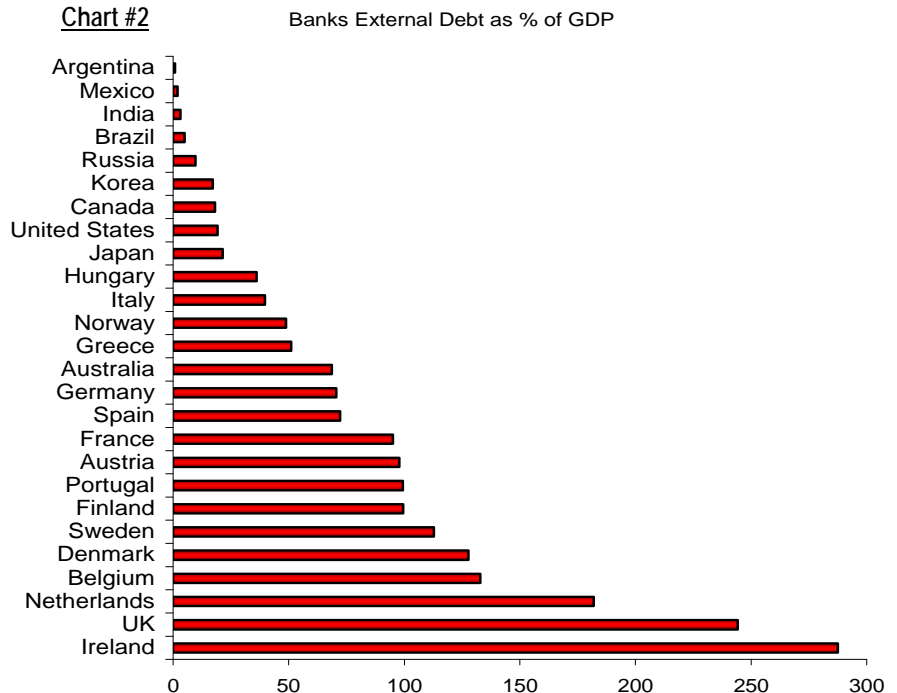


Chart #2



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countries already. In Italy's case, banks account for one-third of the country's entire external debt while non-bank and non-government entities account for the remaining 14%.

But the stock of Europe's indebtedness to foreigners is one thing. The maturity profile of this debt is another added dimension to risk. Combine a lot of foreign debt with a short maturity structure into uncertain markets and the results can be explosive. On that note, much of Italy's debt rolls over in the near term (chart 3). According to Bloomberg's debt distribution figures, Italy has €137 billion in bonds maturing over 2011H2, €260 billion in bonds maturing in 2012, and another €148 billion in 2013. Combined, that's one third of Italy's total domestic and foreign debt combined that has to be rolled over across just those two and a half years. Debt management is therefore one of the culprits behind Italy's market challenges, just as it is with Spain (chart 4). Contrast that to the UK which long ago lengthened its debt maturity profile (amid criticism at the time) and punted its refinancing needs much further down the road. Her Majesty's Treasury is looking rather brilliant these days.

Blame the supposedly irrational speculators if you must and do so in accordance with the political response to virtually every debt crisis over time, but it isn't the speculators who engineered such a massively concentrated bout of maturing debt that is a dicey game to face into volatile markets. Europe's problems are real, and management of its debt profile has sharply exposed itself to deepened market concern. Faced with the uncertainty of having to refinance into a softening global economy amid intensified concerns about global sovereign debt risk, it seems the market's response is prudent. This is especially so when combined with realization of how potentially inadequate the funding stability facility (EFSF) and other measures may be in relation to the risk that a sizeable issuer is shut out of capital markets at an escalating cost of borrowing. Indeed, while not just perhaps inadequate, the need for all of Europe's national legislatures to approve the recent expansion of Europe's stabilization apparatus offers added uncertainty.

Chart #3

Italy

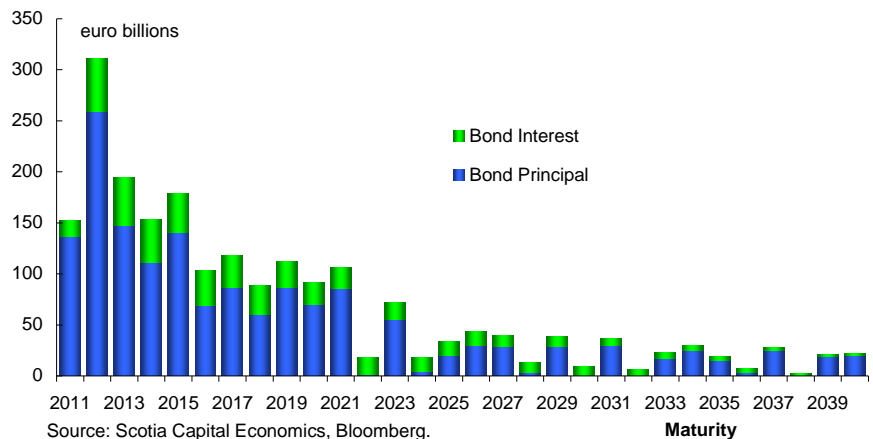
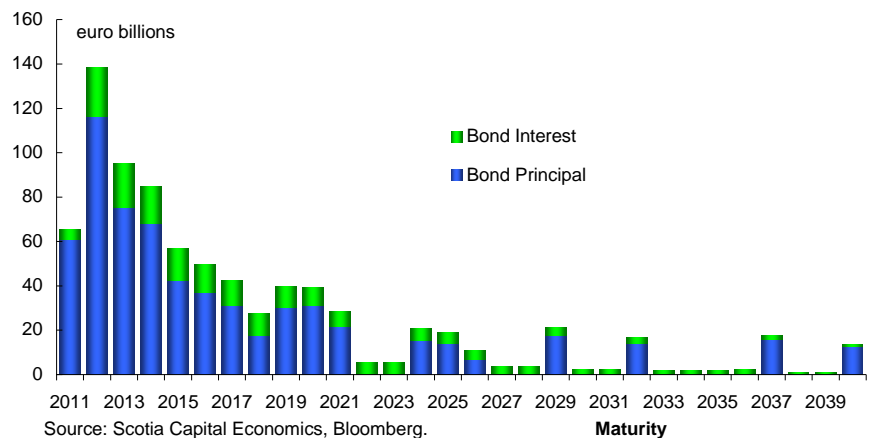


Chart #4

Spain



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Canadian Jobs Are More Robust Than You Think, But Incomes Are Not

- In reality, Canada gained more than the reported job figure for July and we expect further job gains ahead.

Two key developments stand out in Canada's job market that carry important forward looking interpretations. While employment came in weaker than expected in July (but in line with our call), the details point to a much stronger Canadian jobs market. The big worry, however, is the huge deceleration in wage growth, falling to 1.4% y/y from an already low 2.0% the previous month. This will have an impact not only on consumption and growth but on inflation numbers as well.

1. July Was Better Than The Headline, And A Solid Job Gain Could Lie Ahead

Canada probably gained something more like 37,000 jobs in July, or more than five times the reported figure. A key reason for reported headline job weakness relates to guidance that we provided in advance regarding the education sector. Education sector jobs fell 30,000 during July according to the Labour Force Survey. This was unlikely due to an actual decline as opposed to a technical distortion. Statistics Canada is having ongoing problems adjusting for contract shifts within the education sector during recent years. As contracts have shortened from Sept-Sept to Sept-June, education sector workers are more likely to report they are technically out of work during the traditional summer school shut down before their new shortened contract kicks in. As the sector embraces more contract and temporary workers, this reinforces such an effect.

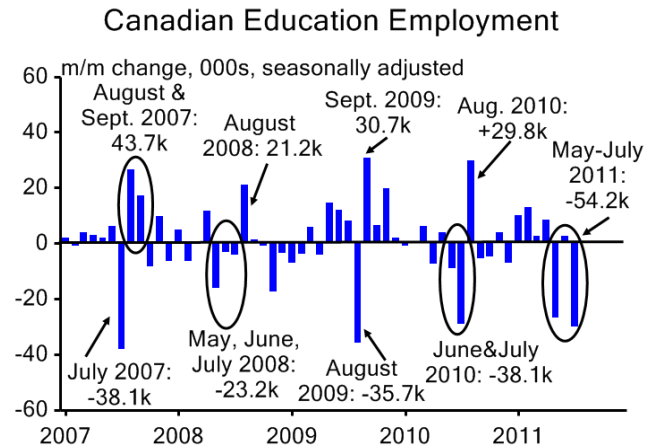
The result is witnessed in chart 1. Large declines have been repeatedly incurred in the early summer months since 2007 when the effect began, only to be followed by large gains in education sector employment right afterward. It's never certain whether that positive effect will unfold in August or September as the pattern has been somewhat inconsistent over time, but watch for a reversal toward a strong jobs print. This education sector effect also explains why the labour force contracted and the unemployment rate fell, since the education sector recorded a large seasonally adjusted drop of 45,000 from the labour force that was also likely an artificial effect.

2. Canadian Paycheques Aren't Going Anywhere

But what we give on optimism toward Canadian jobs, we take away when the attention shifts to incomes. It's not the body count that gets paid, it's how many hours are being worked and at what wage.

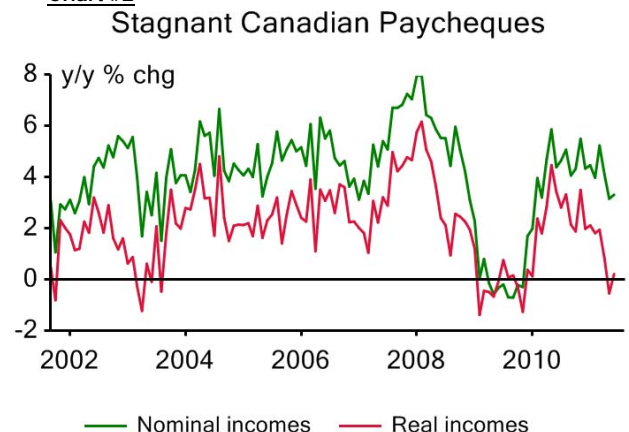
We're normally left with sharply lagged income data in Canada. Unlike the United States that offers monthly income figures, Canada is left with lagged quarterly income figures that currently only go up to 2011Q1. But we can develop an up to date monthly proxy for before-tax paycheques by simply multiplying aggregate hours worked across the

Chart #1



Source: Statistics Canada, Scotia Capital Economics

Chart #2



Source: Statistics Canada, Scotia Capital Economics

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Canadian economy by average hourly wages, both from the Labour Force Survey and available right up to July.

The result is found in the second chart. The green line shows growth in nominal (non-inflation adjusted) paycheques derived from labour market earnings defined as average total wages times total hours worked by all employed Canadians. While this has decelerated of late, the collapse in inflation adjusted growth in paycheques is shown as the red line and matters far more. Should headline inflation ease toward the 2% y/y mark as we are expecting into next year, this would still leave behind a very weak inflation-adjusted income story. Yes, wages are a lagging indicator, but it's surprising that they are still decelerating this far into a job market recovery.

There are two broad implications. One is that decelerating wage growth eases inflation pressures through cost-push channels and is dovish insofar as the BoC is concerned. Markets should be paying more attention to decelerating wage growth than to the headline body count in job reports.

The second point in the one-two punch is that consumers are being pinched and that will be further disinflationary in its effects. Indeed, the deceleration in real paycheques is consistent with a very weak domestic consumer this year. Total consumer spending only rose by 0.2% in 2011Q1 over 2010Q4 (at an annualized and seasonally adjusted rate), and while we don't have total Q2 consumption yet (Canada releases Q2 GDP on August 31st) we know that the retail sales picture remained weak into Q2. We have April and May inflation adjusted retail sales figures and, assuming a flat June in order to focus upon what we know by way of Q2 so far and the Q1 hand-off, Q2/Q1 real retail sales are shaping up to post a 1.3% q/q annualized decline against any hope for an acceleration in spending over the second quarter. For the year-to-date, real retail sales are tracking 2.5% lower than the level at which they entered 2011.

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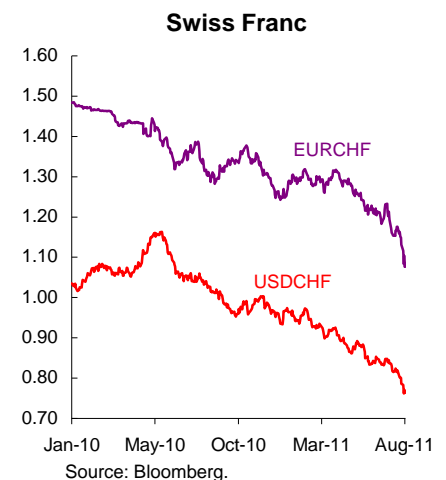
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Strong Economic Fundamentals Support Switzerland's Safe-Haven Status

- **The risk of central bank intervention to ease the Swiss franc's appreciation pressures remains elevated.**

Swiss monetary authorities are intensifying their fight against the Swiss franc's (CHF) appreciation pressures as they consider the CHF to be "massively overvalued". On August 3rd, the Swiss National Bank (SNB) cut the target rate for the three-month Libor to "as close to zero as possible" from 0.25%, and increased the supply of CHF liquidity. We expect the Swiss policymakers to maintain monetary conditions unchanged until the third quarter of 2012 when a symbolic rate hike to 0.25% will likely take place, indicating a return to a more normal monetary policy stance. Flows and fundamentals support a strong CHF, but valuation metrics suggest that the market has moved beyond reasonable levels. Though positive CHF flows are expected to continue, as we move into year-end, we would expect the CHF to stabilize.

The Swiss economy's solid economic fundamentals provide a framework for the currency's safe-haven status. The economy enjoys a strong external position with large trade and current account surpluses, with the latter averaging around 10% of GDP through 2012. Meanwhile, public finances are healthy with the government accounts in a balanced position and gross public debt relatively low at around 50% of GDP. The Swiss economy continues to perform robustly, with real GDP expansion likely to average 2.0% through 2012. Domestic demand remains supported by healthy balance sheets, an accommodative monetary policy and improving labour market conditions (the unemployment rate decreased to 2.8% in June from 3.8% at the beginning of the year). The export sector is performing relatively well despite currency strength, with exports in real terms increasing by 5.2% m/m in June. Despite the positive growth outlook, inflationary pressures remain virtually absent, mainly owing to the strong CHF; the harmonized consumer price index increased by 0.6% y/y in July, and we expect inflation to continue to hover around 1.0% through 2012. Switzerland's political outlook is dominated by the approaching general elections, scheduled for October 23rd; nevertheless, the country continues to enjoy a high degree of political stability.



Strength in the CHF has been unrelenting, with the currency appreciating 11% in 2010 vis-à-vis the US dollar, 22% on a year-to-date basis in 2011 and a stunning 107% since 2000 (in this same time period, the AUD has gained 60%, the CAD is up 48% and the GBP is flat). The currency is at new all time highs against all the majors and most of the minor currencies putting significant pressure on the overall economy. On a PPP basis the CHF is currently trading 37% above its value. The risk of SNB intervention is real, however, as this week's policy initiatives highlight the central bank is attempting alternative tools before turning to the often unsuccessful intervention policy. The most recent strength has been on the back of several factors, but the two most important are: 1) Diversification flows away from the USD and EUR as market participants search desperately for safe-haven investments – there have been similar developments in gold and the JPY. 2) The strong economic and sovereign status of Switzerland make it an attractive investment regardless of safe-haven flows. These are themes we expect to continue in the near-term, however, as we move into year-end we would expect markets to stabilize from today's levels. Accordingly, USDCHF is forecasted to close the year 0.77 and EURCHF at 1.16.

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Durable Goods Sector Lends A Helping Hand

- Durable goods benefit from solid emerging market demand and increased competitiveness, helping sustain the U.S. economic recovery.

Underlying details of the disappointing second-quarter GDP report revealed that exports and business investment took over as key drivers of growth from household spending, which saw its weakest performance in two years. Although durable goods — hit hard in the second quarter by supply-chain disruptions following Japan's earthquake — tend to be more volatile than non-durables and services (because they capture discretionary spending, more influenced by cyclical macroeconomic conditions), this segment stands out as a leader in the ongoing economic recovery.

Durable goods may average a seemingly modest 7% share of GDP, but this slice exceeds that of two-thirds of other industries. More importantly, they represent about half of all exports and business investment, considered key drivers of the recovery. Since bottoming in early 2009, durable goods exports have experienced a steep rebound — volumes sit 3.2% above their pre-recession peak — and show no sign of respite (see chart 1), helped by solid emerging market demand and improved competitiveness. Strong foreign sales have also created positive second-round effects, boosting domestic business investment in machinery & equipment and imports, since durable goods have a vertically specialized production chain that contains imported intermediate goods.

Digging deeper, we find that export-oriented durable goods industries — namely fabricated metal products and machinery — have become the pacesetters, leading the durables pack in several metrics, including export growth, employment, sales and corporate profits, while the housing-related durable goods sectors (e.g., furniture, wood products) continue to struggle (see chart 2). As a whole, the durable goods industry has added 317,000 workers since employment troughed in March of last year — 185,000 this year alone, over 16% of the overall gain in U.S. payrolls. Fabricated metal products and machinery-related companies account for 57% of this increase.

Aside from strong emerging market demand, durable goods exporters are also benefitting from a weaker U.S. dollar, improved labour productivity and more cost-conscious operations. Since bottoming in early 2009, productivity in the sector has gone up 15.9%, nearly double the gain registered by the overall private non-farm sector. Average weekly hours worked expanded 4.8%, triple the national average. What's more, pay increases did not outstrip productivity gains, but provide some offset to industry costs in light of elevated commodity prices.

The strength in the sector bodes well for the economy, and future employment prospects. Though volatile, the trend in durable goods orders — a good leading indicator of private non-farm employment, with a lead of up to a year (see chart 3) — points to a pick-up in employment growth in the months ahead. That's good news for the consumer, who accounts for two-thirds of the economy.

Chart #1
Exports Dominate Rebound in Durable Goods Demand

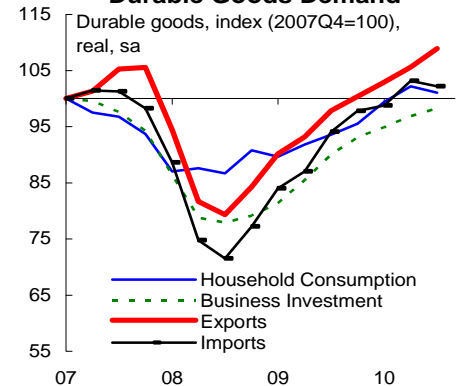


Chart #2
Durable Goods Exports Boost Employment

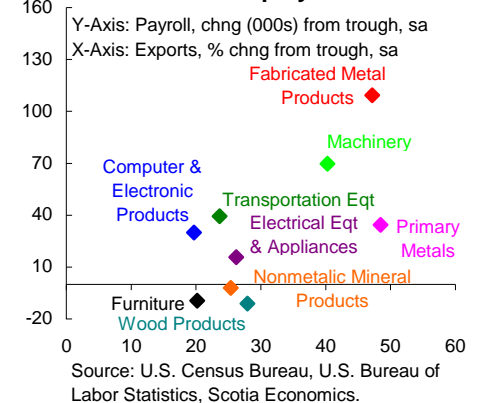
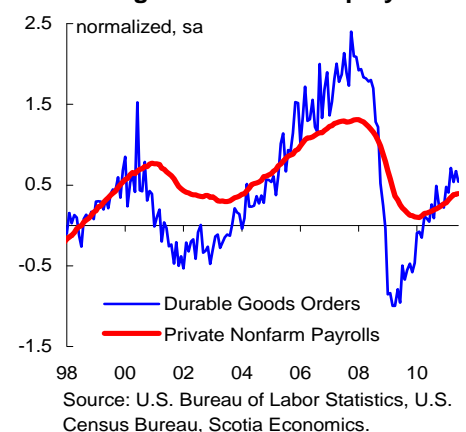


Chart #3
Durable Goods Orders, A Leading Indicator Of Employment



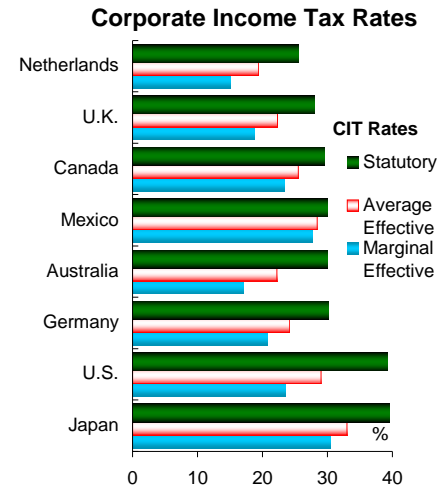
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Addressing U.S. Corporate Income Tax Reform

- The challenge of scaling back U.S. corporate and personal income tax expenditures, even if accompanied by tax rate reductions, is one of several factors arguing for progress on a comprehensive tax reform package, sooner rather than later.

As the credibility of the U.S. deficit reduction process falls under rating agency scrutiny, progress on substantive tax reform would stand out as a very positive development. Reforms that broaden the tax base, allowing lower income tax rates without revenue loss, typically spur economic growth and result in higher-than-expected medium-term revenues. All such upside revenue surprises could initially be allocated to trimming the deficit, and eventually to further tax rate reductions, a variation of the recent *Bipartisan Plan* proposal. In the April 21st *Global Views*, the difficulties in eliminating a number of U.S. personal income tax (PIT) expenditures were discussed. Addressing U.S. corporate income tax (CIT) expenditures also would result in some initially tough adjustments. The U.S. CIT framework is characterized by high CIT rates (*see graph*) applied to a relatively small tax base. For 2007, the Peterson Institute for International Economics estimates that the U.S. corporate tax base was just 13% of GDP compared with an unweighted OECD average (excluding the U.S.) of just over 22%. One reason is the systematic expansion of pass-through entities — firms not taxed at the business level, only at the individual level when earnings are distributed¹. The share of total business receipts earned by Subchapter S corporations¹, for example, has climbed from 3% in 1980 to 20% by 2007.



*Central & subcentral government tax rates.
 Source: OECD, K.A. Hassett and A. Mathur
 (February 2011), Peterson Institute for
 International Economics.

Yet the potential advantages of finding room to lower U.S. CIT rates through narrowing tax expenditures are significant — especially since the U.S. is relatively unique around the world in not trimming its statutory CIT rates over the past 2½ decades. The Peterson Institute estimates that a ten percentage point cut in the federal CIT rate would lift the equilibrium level of private business capital stock just over 6%. In addition to higher profits and dividends, the higher capital stock would spur greater employment and additional wage growth, recouping through the PIT any CIT shortfalls.

Beyond domestic corporate tax issues, are the complicated trade-offs arising from the taxation of profits of U.S. corporations earned abroad. Most nations have adopted territorial taxation, taxing profits earned at home, but not abroad. In contrast, U.S. corporations are taxed on their worldwide income with a credit for foreign taxes, but U.S. taxation of foreign subsidiary income is deferred until the income is repatriated to the U.S. For the handful of other countries taxing worldwide income, such as Chile, Ireland, Israel, Mexico, Poland and South Korea, CIT rates are lower. The result is that corporations are discouraged from locating their head offices in the U.S. because their foreign subsidiary income, if repatriated, is taxed at relatively high rates. For firms with a U.S. head office, the current tax framework discourages reinvestment of their foreign earnings at home. The revenue cost of allowing CIT to be deferred on foreign subsidiary income not repatriated is estimated at roughly US\$40 billion for fiscal 2012. The President's various proposals to narrow this CIT expenditure would have to be accompanied by quite a significant tax rate decline (given that the rate applies to both domestic and offshore earnings) to avoid further deterring multinational corporations from U.S. head office locations. The stakes are high in this adjustment given the evidence that U.S.-based multinational corporations facilitate greater U.S. goods & services exports. Inadvertently limiting the expansion of U.S. multinational corporations might hamper the achievement of the President's goal, announced in January 2010, of doubling U.S. goods & services export receipts by mid-decade.

¹ Includes general and limited partnerships, limited liability corporations and partnerships and Subchapter S corporations.

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A Potential Canada-India 'Free Trade Agreement' — A Win-Win For Both Countries

With the G7 economic expansion likely to be in the slow lane for some time — curbed by austerity programs to pare high government deficits and debt — it is vital that Canadians seek out export and direct investment opportunities in the 'emerging world' — especially Asia-Pacific and Latin America.

The Canadian economy has performed well since the Great Recession of 2008:H2, though Canada's trade performance has lost some ground, shifting from a massive \$45 bn surplus in 2008 to a slight deficit position in 2010 and 2011 YTD (-\$9 bn). The commodity & material sectors — including resource-based manufacturing — continue to loom large, accounting for about 50% of Canada's merchandise trade exports in 2011 YTD, with energy (oil, refined products, natural gas, coal & electricity) by far the largest contributor at \$106.5 bn (24% of the total). However, natural gas export prices and volumes have lost ground (partly due to low-cost shale developments south of the border). An exceptionally weak U.S. market for building materials continues to be a major challenge for Canada's lumber & OSB producers, despite successful export expansion to China. Auto parts exports would also benefit from stepped-up international market development.

In this environment, a free trade agreement with India on goods & services (including financial) combined with an investment accord, would be particularly welcome, opening up valuable opportunities for Canadian exporters and equally valuable opportunities for India. Canada's Ministry of International Trade began negotiations with India in November 2010 and will resume discussions this Fall, hoping to conclude an agreement by 2013.

Two sectors, with particular interest to Canadians, stand to benefit:

- 1) **wood products — such as lumber, OSB, other panelboards, pallets & assembled floor panels** — goods subject to a 'standard' import tariff of 10%. With India's 1.186 bn population (2010), this sector could represent a growth industry for Canadians; a major West Coast forest products producer has already expressed an interest; and
- 2) **the power industry** — engineering services for generation & electricity transmission, aluminium ingots (currently subject to a 5% tariff), aluminium structures & towers (10%), nuclear reactors & parts (7.5%) and turbines & boilers (7.5%). Canada's uranium & nuclear industry is looking forward to a 'nuclear bilateral co-operation agreement' with India (likely to be completed soon). If India is to maintain its rapid growth rate — averaging 8.5% per annum from 2006-10 — massive investment in power infrastructure will be needed.

Direct investment by Indian companies has recently picked up noticeably — in pulp & paper in Atlantic Canada and in the iron ore & steel industries of Ontario and Nunavut (Mary's River Iron Ore — likely to become one of the world's largest, highest-quality deposits). Canadian mining, oil & gas and energy service providers could offer valuable input in India.

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Diverging Global Tourism Flows

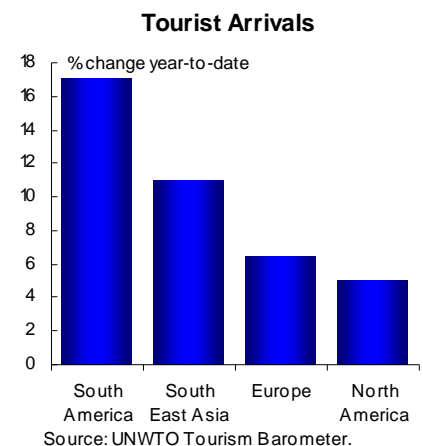
- **The global tourism market continues to sustain momentum amid increasing headwinds, though regional performance varies significantly.**

Emerging markets are fuelling global traffic, whereas consumer spending and confidence remain subdued in both North America and Europe. Overall, the World Tourism Organization predicts travel receipts will increase by a healthy 4½ % in 2011, roughly in line with pre-recession growth. South America and South East Asia are leading the way. These regions have become increasingly popular destinations for North American and European visitors over the past decade, a trend that has continued this year with arrivals in both regions jumping by double digits. In contrast, North America will be largely reliant on emerging market traffic to drive growth in its tourism industry, as domestic and cross-border travel are lagging in a period of high fuel prices and heightened border security.

United States — International Arrivals Fuel Growth

The overall outlook for the U.S. tourism market remains fairly optimistic. Aided by a weaker U.S. dollar, growth is being driven primarily by increased international traffic, particularly from Asia and Latin America. International visits are up 2.2% year-to-date as of May, building on a strong rebound in 2010. The U.S. Department of Commerce forecasts international visits to jump 6% this year.

As a result, some pricing power has returned to the U.S. lodging market, with revenue per average room (RevPar) up 8.8% y/y in June — continuing a climb that dates back to March of last year. However, room rates remain considerably below their 2008 peak and group tour rates are still a bargain, with hotels trying to improve occupancy. Industry estimates forecast average daily rates to increase 3-5% in 2011, with RevPar advancing 5-7.5% as room demand outpaces new supply.



However, a sluggish U.S. job market and volatile equity markets will challenge domestic travel, which accounts for 80% of total traffic. Early-year gains are now being eroded by higher fuel costs that are squeezing consumers' budgets, with small market tourism locations being the most affected. Americans have already started to pull back on their car travel time, with Memorial Day and Independence Day statistics both pointing to a slight drop-off in car traffic from a year earlier.

Canada — Strong Dollar Widens Travel Deficit

The strong loonie is weighing on inbound traffic to Canada — arrivals are down 2% year-to-date — shifting the national tourism balance further into deficit. A large part of the loss stems from a 2.5% drop in overnight traffic from the U.S., a trend that has contributed to Canada's weak international tourism performance over the past five years. Americans account for over 70% of international overnight stays, and a strong dollar along with increased border security have discouraged growth. Furthermore, the Canadian Tourism Commission's Competitive Price Index indicates that travel to Canada has become increasingly pricey relative to other major destinations.

Given weaker international performance, domestic travel has been the main driver of demand, pushing occupancy rates and RevPar upwards — up 3% and 6% through May respectively — but traffic will be constrained by rising domestic airfares and fuel costs. Meanwhile, Canadians find themselves in a good position to travel abroad, as the strong Canadian dollar has lowered the cost of traveling to many international markets, including the United States, putting pressure on domestic travel. Canadian travelers' favourite locations include the Southern United States, Cuba and Continental Europe, all of which have seen an increase in Canadian traffic this summer.

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While the Mexican paper company's margins remain volatile, leverage has been significantly reduced and debt covenants now offer more protection than they have in previous issues, suggesting that its bonds may fare better than before. We would wait until the uncertainty around margins is resolved and the current market environment improves before investing.

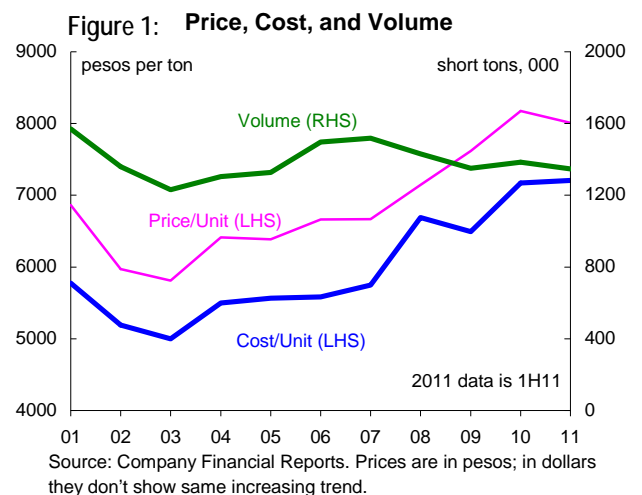
Remembering the past

The Mexican paper maker Bio Pappel, formerly called Durango, has had a troubled history with its bonds. In 2002, hurt by falling prices for its final products as well as depressed volumes that accompanied the economic recession in the US, the company was unable to meet its financial obligations. It restructured its debt in 2005 by extending maturities, and giving equity to both bondholders and bank creditors. In October 2008, the company again filed for bankruptcy, troubled by high raw materials prices and energy costs, as well as competition in the marketplace. Management was aggressive in the second reorganization, with the press reporting buybacks of the company's bonds at highly depressed prices on the secondary market, as well as the voting of intercompany debt by management in order to control the reorganization process; these actions were permitted under the indenture and under Mexican bankruptcy law, but nevertheless angered some international creditors. In assessing the company's bonds today, the first question that investors with a recollection of these episodes might ask is what has changed today.

Company economics

According to management, the top two costs for the firm are raw materials (fiber) and energy, currently accounting for 62% and 12% of total unit costs. These commodity prices are of course highly cyclical, as are the prices of the firm's finished goods. The problem for the firm is that these price and cost movements are not entirely synchronized, as shown in Figure 1. With operating margins averaging 6% over the last decade, and having fallen to 4% in the first half of 2011, there is simply not much cushion to absorb the relative price changes of commodity inputs vs. outputs. Production volumes are also cyclical of course, but it is the gross margins that are most concerning right now.

We worry that the firm's changeover to solely recycled paper inputs a few years ago will expose it to even more volatility in gross margins. In a competitive market, we would expect the prices of finished paper products to adjust in response to movements in the cost of inputs. As a result, firms should eventually recover what they lose in higher inputs costs through higher prices, though that process is obviously imperfect. When a firm's input mix and technology is significantly different from that used by other competitors, its input prices may become less synchronized with finished good prices. That means the possibility of some very profitable years but also some unprofitable ones—a volatility that would surely be a negative for bondholders.



As shown in Figure 2 on the following page, prices for recycled inputs are extremely volatile. After falling from 120 to 20 in 2008 they have since risen to 160. Those price changes are significantly greater in percentage terms than those of many non-recycled inputs. The explanation often cited here for the recent increase in recycled input prices is that freight from the US to China is extremely cheap, since ships from China arrive full, but then often leave empty. As a result, it is cost effective for China to import recycled

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materials from the US, and that demand from China drives up input prices in North America. The long-term outlook here is uncertain, and depends on the ability of the Chinese to encourage domestic recycling and on the efforts of Bio Pappel to increase recycling in Mexico. Some paper industry analysts think the problem could get worse before it gets better.

Better leverage and protections

On the positive side, the company has reduced its leverage significantly. Although some of that reduction may have been accomplished to the detriment of previous creditors, at this point debt is one-half to one-third the levels we saw in the past (see Figure 3). As a result, the last twelve months of interest costs represent only 2% of annual revenues, which seems small, though the interest coverage ratio is more risky, with a current 4.0 level.

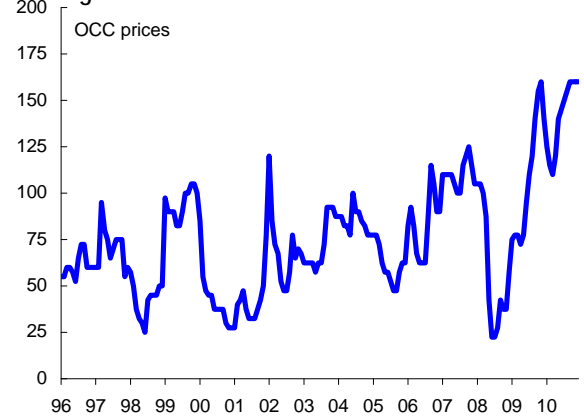
Also notable are the increased protections found in the covenants on the new bonds, perhaps inserted to avoid the problems we saw with the defaulted bonds. First, there are significant restrictions on debt repurchases. The company and its affiliates are only permitted to buy back outstanding notes at par through a pro-rata offer to all bondholders. They may not repurchase discounted debt on the secondary market, nor may they vote any bonds they repurchase. Second, inter-company debt is clearly subordinated to the bonds, and voting rights for the intercompany debt will be given to the bond Trustee in any bankruptcy proceeding. Third, debt is mostly limited to current levels, which we view as preferable to the leverage ratio limitations found in the previous bonds and the interest coverage limitations found in the 2003 bonds. Considering the high volatility of profits, we would have worried under the old covenants that the company could increase debt in good times and then have trouble paying in bad times.

Conclusion

Thus, in assessing the key drivers of solvency going forwards, we are concerned about the volatility of margins, but comforted by lower leverage as well as covenants that should provide some protection to creditors in the event of bankruptcy. It is impressive that the company managed to earn high profits even at the bottom of the global economic cycle in 2009, suggesting that the restructured company is not as cyclical as some may fear. Nevertheless, 2011 trends in profit margins are worrisome, and the current level of market uncertainty may not be supportive of risky trades. We will continue to follow the company in order to find an attractive entry point.

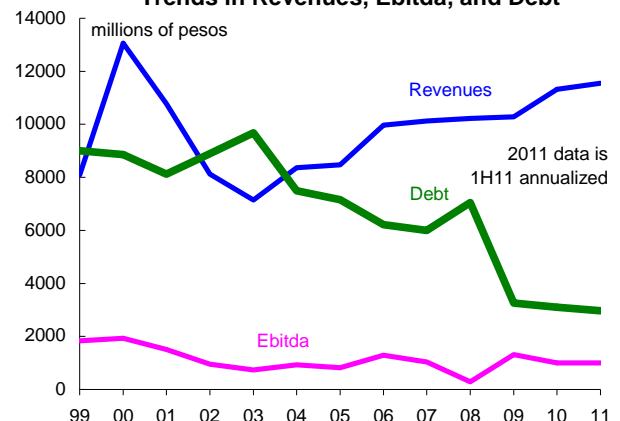
This article was written jointly with Leonor Lopez.

Figure 2: Recycled Input Prices



Source: Bloomberg. Pulp and Paper Network: OCC - Texas.

Figure 3: Trends in Revenues, Ebitda, and Debt



Source: Company financial reports.

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The View from Europe — Inflation Report Preview

- The August BoE *Inflation Report* is likely to show a more dovish stance than in May. At this stage we doubt there is enough movement to suggest that another round of QE is imminent. However, we expect further evolution in that direction and QE2 could become more plausible by end-year, especially if domestic growth fails to rebound during Q3, financial market turbulence intensifies and signs of slowdown overseas become more widespread.

August BoE Inflation Report — Baby Step Closer to QE

We expect the *Inflation Report* to show an evolution in the MPC's stance in the dovish direction. With regards to the Bank's updated projections we expect:

- 2011 GDP growth to be revised lower;
- Growth during 2012 *should be* revised slightly lower, though we suspect the Bank will stubbornly hang on to its optimistic outlook;
- The projection of near term inflation will remain broadly unchanged
- **The 2-year-ahead inflation projection will be revised lower.**

The takeaway message should be that no rate hike is likely any time soon and there is an increasing chance that the BoE re-engages in QE around the turn of the year.

GDP forecast likely to be revised down

In August the BoE projected that the economy would grow by an average of 1.8% y/y during 2011. This week the OBR conceded that its forecast of 1.7% y/y on average for this year was no longer realistic since it required a spectacular rebound during H2. We expect the Bank to trim its 2011 GDP projection by around ½% point, down to 1.3% y/y.

We suspect that the Bank will remain too optimistic on growth, particularly for 2012. The Bank's latest projection is for growth on average of 2.5% y/y during 2012 — we expect growth of just 1.5% y/y. Although we doubt the Bank will trim its 2012 growth forecast much (if at all) at this stage, that will leave room for further downward revisions at future *Inflation Reports*. At the very least that should ensure that Bank Rate does not rise any time soon. Moreover, it will add to the case for more QE at subsequent *Inflation Reports*.

Near-term Inflation Projection

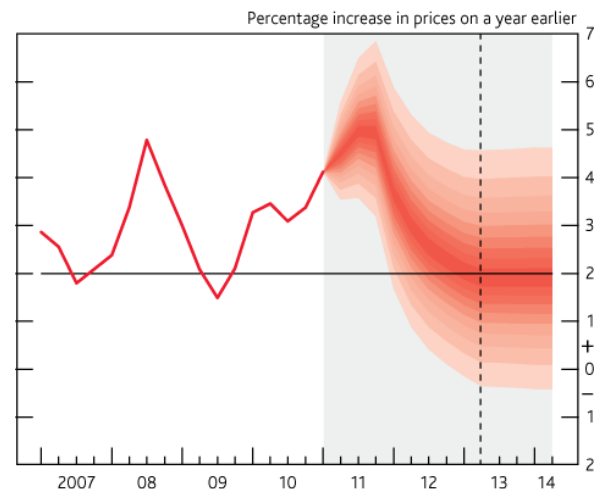
Over the last 9 Inflation Reports we have seen the near-quarter inflation projection pushed up by an average of 0.43 percentage points per quarter. However, for the first time since February 2009 the Bank's one quarter ahead inflation projection is unlikely to be revised higher and has actually been fractionally too high.

Given the upcoming utility bill hikes, the peak in inflation is yet to come. We expect CPI inflation to briefly move above 5% y/y in September and October, before falling back below 5% y/y. The peak in the Bank's inflation projection last time was 4.96% y/y. Since this is a quarterly average, they probably won't have to push this any higher, though that is a risk.

2-Year Ahead Inflation Projection

Chart 1 shows that at the time of the May *Inflation Report*, the mid-point of the Bank's projection for CPI inflation 2-

Chart 1: BoE CPI Inflation Projection May-11
(Market Rate expectations)



Source: Bank of England

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years ahead (based on market rate expectations) was 1.9% y/y, though with the risk distribution skewed to the upside. Based on unchanged interest rates, the projection 2 years ahead was 2.34% y/y.

Table 1 summarises the key changes in the main determinants of the Bank's inflation projection since May. A likely downward revision to the Bank's growth outlook, coupled with the fall in oil prices and weaker equities since May should bear down on the medium term inflation projection. However, these are likely to be partly offset by the moderate depreciation in the GBP exchange rate and the fall in market interest rate expectations.

Table 1: Evolution in the key inputs into the BoE Inflation Projection

		May	Now	% Chg	Impact on BoE Inflation Projection
Oil*	Spot (USD)	123.5	117	-5.3	-0.15
	Spot (GBP)	74.9	72.1	-3.7	
GBP*	Effective GBP	78.9	78.6	-0.4	0.04
Near quarter inflation fcast		4.5	4.4	0	0
GDP forecast	2011	1.8	1.3	-0.5	-0.15
	2012	2.5	2.2	-0.3	
FTSE All-Share*		3122	3015	-3.4	-
10y Gilt Yield*	Spot	3.57	3.14	-0.4	+
1-Yr Ahead Mkt rate exp		0.5	0	-0.5	0.15
					-0.11
* 15 working day average					

Source: Bloomberg, Macrobond and Scotia Capital

The MPC will have to exercise considerable judgement in factoring in the latter. The recent MPC minutes noted that the weaker exchange rate and later assumption for the first rate hike argued for upward pressure on the medium term inflation projection.

However, the Bank will have to take account of exactly why some of these markets have behaved the way they have done. The reason that the market has pushed back the timing of the first rate hike, why gilt yields have fallen to historical lows and oil has come off its high is that the global recovery is at risk of stalling and the financial markets are on the brink of meltdown. In our view, this is not a positive growth story or something that argues for pushing up the medium term inflation projection.

The net result is that **we expect the 2-year-ahead inflation projection based on market rate expectations to be nudged down by around 0.1 percentage point to 1.8% y/y** — a reasonable margin below the 2% target. Meanwhile the projection based on unchanged Bank rate is likely to be revised down by a little more (since it will not have to take account of the sharp fall in interest rate expectations), though still leaving it fractionally above the 2% target. In both cases, we suspect the Bank will modify the risk distribution such that the bias is more heavily to the downside.

Indeed, the Bank's 'ribbon' chart that shows the probability that inflation will be above target is also likely to show a moderate downward shift in our view (Chart 2 on the following page). That will take it back broadly into line with where it was in February — some way short of justifying an immediate restarting of QE at this stage.

Given renewed market tensions, the deterioration in both the domestic and overseas growth outlook, coupled with the likely revisions to the BoE's projections, we believe that there is a strong chance that the hawks no

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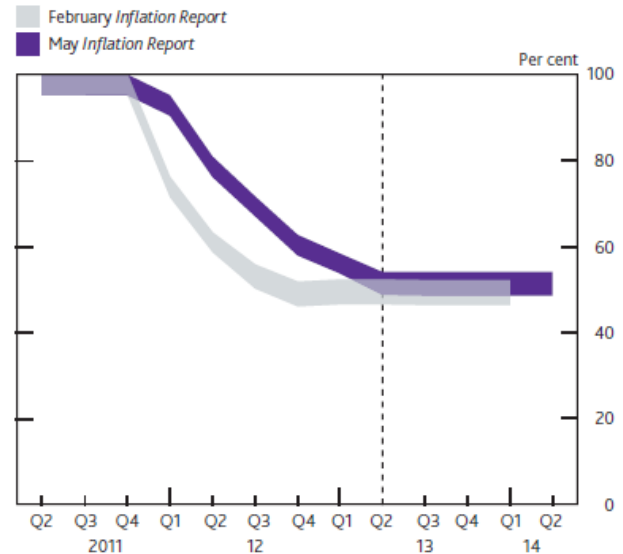
longer voted for a rate hike at the August meeting. Nonetheless, there is still some way to go before QE2 becomes realistic. If GDP growth fails to rebound in Q3 from the artificially depressed pace recorded during Q2 then the case for more QE will build significantly. The upward surprise in the CIPS services survey this week was welcome news. However, we believe we will need much more news in this direction in order to be consistent with the sort of growth profile that the Bank is likely to present on Wednesday.

Growth aside, the biggest obstruction to further QE is the likelihood that inflation will rise to above 5% y/y in the coming months. This is pre-programmed and there is nothing the MPC can do about it. However, given the concerns among some MPC members that this poses an upward risk to inflation expectations and wage demands there is likely to be considerable resistance to further policy easing, even if growth disappoints. Hence at this stage our base case is that QE2 will not be delivered, though we expect the market to continue to price this in.

Conclusion

We expect the thrust of the August *Inflation Report* to be more dovish than in May. However, it is likely to represent a baby step closer to another round of QE rather than a leap in that direction. We suspect that the Bank will remain too optimistic with regards to GDP growth both in the near term and further ahead. This should leave room for further dovish evolution in the Bank's stance in subsequent *Inflation Reports* and speculation of another round of QE is unlikely to go away any time soon.

Chart 2: Probability Inflation Will be Above Target



Source: Bank of England

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ECB Meeting August 2011 — October Rate Hike Probability Has Reduced Significantly

- **As widely expected, the ECB kept rates unchanged at 1.50% at its last meeting but the tone of the press conference suggests that the central bank has shifted on the dovish side. Rising nervousness on the growth outlook and the decisions to restart all instruments to provide liquidity illustrate this move. As a result, the prospect to see a rate hike in October has been significantly reduced and we could see the ECB pausing for some months.**
- **This prospect to see an end in the tightening cycle and the announcement of enhancing liquidity measures failed nonetheless to ease market risk aversion as indications that the restart of the bond purchases program was not a unanimous one raised suspicions regarding the true commitment of the central bank on this program as well as the future management of the EFSF where future intervention in the secondary market will need a unanimous decision. As a result, a strong act will be needed to send a convincing signal to the market.**

The ECB kept rates unchanged at 1.50% as widely expected under a unanimous decision. Beyond this, the tone of the comments was very much on the dovish side compared to one month ago, raising the probability that rates could be kept on hold for longer than previously assumed.

This more dovish stance came despite continued indications that “risk to price stability remains on the upside”. However, with EMU inflation still above the 2% level (2.5% y/y on the July flash estimate), a change on this point was not to be expected. Actually, it is on the growth scenario that the ECB is showing more nervousness with indications that risk to the downside has intensified.

Mr. Trichet indicated that they will wait for further information, especially ahead of next month’s updated growth & inflation forecasts. He also hinted that Q2 GDP data to be released over the coming 2 weeks could be crucial. While it could be argued that these comments are vague enough to offer ample manoeuvring room for the ECB to still adjust rates higher in October, it is difficult for the central bank to be more explicit having raised rates last month. It is nonetheless worth noticing that these latest comments of high uncertainty and the need to wait for further data are reminiscent of those seen at the September 2007 press conference which marked a pause for many months in the ECB tightening cycle at that time.

In addition, there is a strong likelihood that September’s GDP growth forecasts will be revised down compared to current assumptions of a mid-point at 1.9% for this year and 1.7% for 2012. While Mr. Trichet indicated that current data still validate the prospect to see some growth in Q2 (albeit at a much lower pace than in Q1), all leading business and consumer surveys have turned worse than expected which will undermine the ECB’s assumption of an improving trend in GDP growth in Q3/Q4.

Financial market turbulence and rising uncertainties have also been strong enough to push the ECB to enhance all its non-standard measures through full allotment for three-month operations up to the end of the year (vs. in Q3 previously) and resume six-month operations as well as the bond purchase program. While Mr. Trichet justified the move by the need to allow a smooth transmission of monetary policy, the fact that all programs were reactivated is an additional illustration of rising worries at the central bank. Most of the attention at the press conference was, with no surprise, on the reactivation of the bond purchases program which is seen as key to ease pressures at a time when the possibility of the EFSF to act on the secondary market is not yet in action. However, indications that the decision was not unanimous put into question the capacity of the ECB or the EFSF to be efficient and quick enough. As a result, risk aversion will ease only if strong action in terms of intervention is taken. So ECB weekly financial statements are likely to be closely scrutinized by the markets over the coming weeks.

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Key Data Preview

CANADA

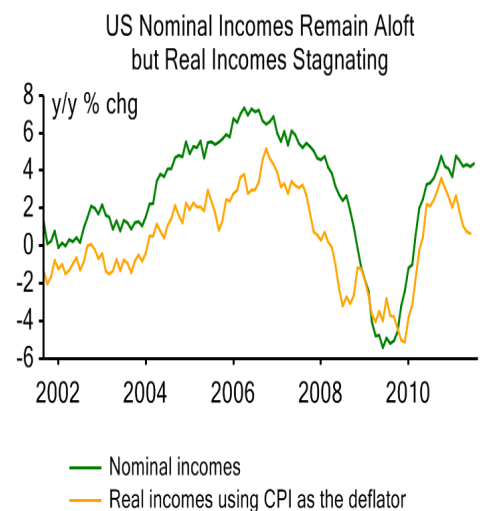
Canadian housing starts (Tuesday) will likely remain relatively flat in July with a slight tilt to the upside after building permit volumes increased ever so slightly in June. While we are expecting home construction to subside over the coming months given the fact that we are at cycle tops on several housing and consumption metrics, the recent tightening in mortgage rules has provided a lift to housing starts in recent months. While these rules came into effect in mid-March and mid-April, they were announced in mid-January, providing many prospective homebuyers a chance to get into the market ahead of the legislation change. In addition, exceptions were made “to satisfy a binding purchase and sale, financing or refinancing agreement entered into” before the legislation came into force. As a result, housing starts have increased almost 20% since January but this also suggests that we should start to witness a deceleration in home construction starting in the late summer and fall.

Canada's trade deficit (Thursday) improved in May after a large deterioration in April as export growth modestly outpaced gains in imports. Nonetheless, on a price-adjusted basis, this led to the first narrowing in the real trade deficit in five months although it wasn't enough to lift May real GDP into positive territory. The picture in June is not as rosy with an expected widening in the nominal — and potentially real — trade deficit, creating a drag on Q2 and June growth. While the Canadian dollar declined in both May and June, Canadian exports will likely weaken during the month as crude oil prices dipped 5% while demand from the U.S. likely softened amid weak U.S. consumption, especially for large ticket items such as autos. Import growth will also likely remain soft — although slightly stronger than exports — given weak retail sales figures and extremely sluggish wage growth. In fact, on a price-adjusted basis, wages remain negative in Canada, suggesting further downsides to consumption in the months ahead.

UNITED STATES

The big question for next week's **U.S. trade report** (Thursday) is how much did prices shift in June. We already know that real exports jumped 6.0% q/q annualized in Q2 while imports rose a more modest 1.3%, with net exports contributing 0.6% to growth, almost half of the total gain. On the nominal front, results have been more volatile with a sea-saw pattern in terms of monthly gains. And, this pattern will likely continue into June with exports witnessing a rebound after a decline in May while imports will likely weaken after a +2.5% gain the previous month. On the import front, a weak US consumer, lower crude oil prices and base effects should provide the impetus behind the decline in June while exports, on the other hand, will continue to be supported by a weak U.S. dollar and relatively strong non-European global demand. As a result, we are looking for a narrowing in the trade deficit in June.

U.S. retail sales (Friday) will likely spike higher on the headline after total vehicle sales surged 7% m/m after two months of weakness although some of the gains come on the back of increased incentives, suggesting a more tepid increase in the value of auto sales. Nonetheless, this puts headline retail sales growth ahead of core sales (ex-autos) which will likely remain quite modest. While a decline in gasoline prices will likely account for some of the weakness given the 10% weight in overall sales, we may also witness a rebound in discretionary sales such as furniture and electronics after three months of weakness as lower gasoline prices provide consumers with a bit more pocket money. Nonetheless, the underlying fundamentals will likely keep spending constrained as wage growth, while up in July, still remains relatively sluggish and employment growth is still not fast enough yet to bring the unemployment rate down. As a result, incomes continue to get hit, with growth decelerating since the beginning of the year, while the savings rate remains above 5%. While we do not obtain the price-adjusted numbers within this report, the St. Louis Fed tends to release them shortly after and we will be looking closely at the results after April and May registered a decline while June was flat, suggesting that much of the increase we have witnessed over the past few months has been entirely related to higher prices.



Source: BLS, Scotia Capital Economics

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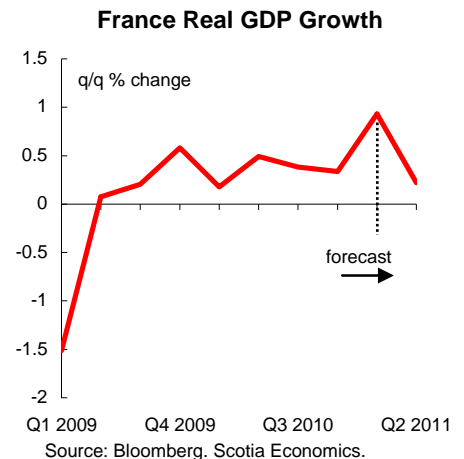
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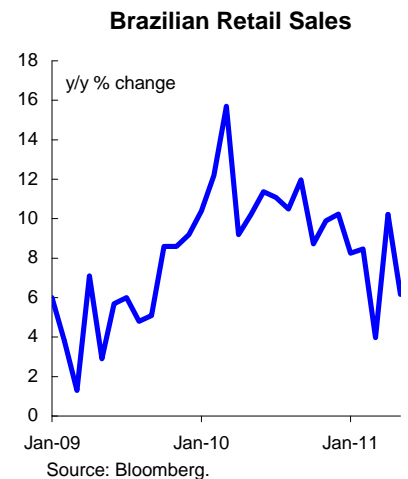
EUROPE

Preliminary estimates for France's second quarter real GDP growth will be released on August 12th. We anticipate a significant slowdown from the strong first quarter growth of 0.9% q/q (non-annualized) to 0.2% q/q. The French economy is the second largest in the euro zone, accounting for 21% of the total regional output. We expect the country's real GDP to expand by 1.9% this year and 1.4% in 2012. Private spending, which accounts for 60% of GDP, together with investment, will be the main growth drivers through 2012. Nevertheless, on the back of prospects for fiscal tightening, private spending will continue to recover only gradually, responding to improving employment conditions and normalization in credit flows. Robust emerging market demand will continue to support the export sector; nevertheless, investment-related import demand will prevent the external sector from contributing materially to real GDP growth through 2012.



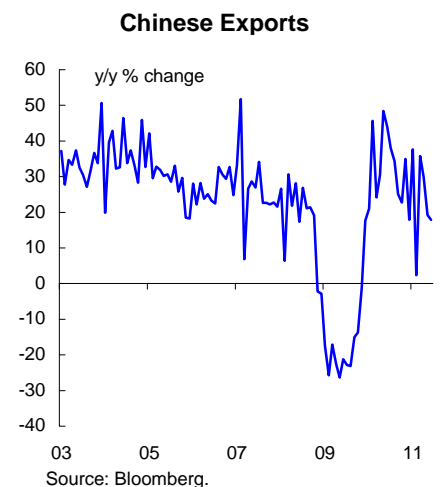
LATIN AMERICA

Brazilian economic indicators have regained importance for the regional investor amid concerns regarding economic performance in the global economy. Retail sales for June will be released on Thursday, August 11th, and we expect consumption growth to remain strong, albeit decelerate somewhat, reacting to authorities' measures to avoid an overheating of the economy. In May, retail sales grew by 6.2% y/y, a deceleration from the 10.2% y/y achieved in April. Additionally (and supporting our view of a more sustainable economic growth going forward), industrial production in June, released at the beginning of the month, decreased 1.6% against the previous month and slightly increased by 0.9% on a yearly basis.



ASIA

We expect Chinese exports to have remained range-bound during July having expanded at a 17.3% y/y rate, a slight deceleration from the 17.9% y/y advance in June. The weakness of the global recovery should be affecting sales of mainland sourced goods slightly. Imports likely continued to gallop along on the back of relatively elevated costs for materials and fuel and persistent demand supported by investment spending. We expect imports to have expanded at a 25% y/y rate leading to a US\$24.9 billion trade surplus in July.



Key Indicators for the week of August 8 - 12

North America							
Country	Date	Time	Event	Period	BNS	Consensus	Latest
MX	AUG 8-15		ANTAD Same-Store Sales (YoY)	JUL	--	--	4.2
MX	AUG 8-15		Vehicle Exports (AMIA)	JUL	--	--	188223
MX	AUG 8-15		Vehicle Domestic Sales (AMDA)	JUL	--	--	68365
MX	AUG 8-15		Vehicle Production (AMIA)	JUL	--	--	229769
US	08/09	07:30	NFIB Small Business Optimism	JUL	--	90.0	90.8
CA	08/09	08:15	Housing Starts (000s)	JUL	202.0	193.2	200.8
US	08/09	08:30	Unit Labor Costs (QoQ SAAR)	2Q P	--	2.3	0.7
US	08/09	08:30	Nonfarm Productivity (QoQ SAAR)	2Q P	--	-0.9	1.8
MX	08/09	09:00	Trade Balance (US\$ mns)	JUN F	--	--	107.9
MX	08/09	09:00	Consumer Prices (MoM)	JUL	0.5	0.3	0.0
MX	08/09	09:00	Consumer Prices (YoY)	JUL	3.5	3.6	3.3
MX	08/09	09:00	Consumer Prices Core (MoM)	JUL	0.3	0.2	0.2
US	08/09	14:15	FOMC Rate Decision	9-Aug	0.25	0.25	0.25
US	08/10	07:00	MBA Mortgage Applications (WoW)	5-Aug	--	--	7.1
MX	08/10	09:00	Gross Fixed Investment (YoY)	MAY	--	--	7.1
US	08/10	10:00	Wholesale Inventories (MoM)	JUN	--	1.0	1.8
MX	08/10	11:00	Central Bank 2Q Inflation Report				
US	08/10	14:00	Monthly Budget Statement (US\$ bns)	JUL	--	-140.0	-43.1
CA	08/11	08:30	New Housing Price Index (MoM)	JUN	0.2	--	0.4
CA	08/11	08:30	Int'l Merchandise Trade (C\$ bns)	JUN	-1.2	-1.0	-0.8
US	08/11	08:30	Trade Balance (US\$ bns)	JUN	-46.7	-47.7	-50.2
US	08/11	08:30	Initial Jobless Claims (000s)	5-Aug	400	401	400
US	08/11	08:30	Continuing Claims (000s)	30-Jul	3700	3738	3730
MX	08/11	09:00	Industrial Production (YoY)	JUN	4.3	--	4.6
MX	08/11	09:00	Industrial Production (MoM)	JUN	--	--	1.1
US	08/12	08:30	Advance Retail Sales (MoM)	JUL	0.7	0.5	0.1
US	08/12	08:30	Retail Sales Less Autos (MoM)	JUL	0.2	0.2	0.0
US	08/12	09:55	U. of Michigan Confidence	AUG P	--	63.0	63.7
US	08/12	10:00	Business Inventories (MoM)	JUN	--	0.6	1.0

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Key Indicators for the week of August 8 - 12

Europe							
Country	Date	Time	Event	Period	BNS	Consensus	Latest
IR	AUG 6-7		Consumer Confidence	JUL	--	--	56.3
UK	08/07	19:01	Lloyds Employment Confidence	JUL	--	--	-50.0
FR	08/08	02:30	Bank of France Bus. Sentiment	JUL	--	--	99.2
EC	08/08	04:30	Sentix Investor Confidence	AUG	--	3.4	5.3
UK	08/08	19:01	BRC Sales Like-For-Like (YoY)	JUL	--	-0.5	-0.6
UK	08/08	19:01	RICS House Price Balance (%)	JUL	-30.0	-27.5	-27.0
GE	08/09	02:00	Exports SA (MoM)	JUN	--	-1.0	4.4
GE	08/09	02:00	Imports SA (MoM)	JUN	--	-1.5	3.8
GE	08/09	02:00	Current Account (€ bns)	JUN	--	11.0	6.9
GE	08/09	02:00	Trade Balance (€ bns)	JUN	--	14.0	14.8
FR	08/09	02:45	Central Govt. Balance (€ bns)	JUN	--	--	-68.4
UK	08/09	04:30	Industrial Production (MoM)	JUN	0.6	0.4	0.9
UK	08/09	04:30	Manufacturing Production (MoM)	JUN	0.2	0.2	1.8
UK	08/09	04:30	Visible Trade Balance (£ mns)	JUN	-8100	-8100	-8478
PO	08/09		Trade Balance (€ mns)	JUN	--	--	-1651
GE	08/10	02:00	Consumer Price Index (MoM)	JUL F	0.4	0.4	0.4
GE	08/10	02:00	Consumer Price Index (YoY)	JUL F	2.4	2.4	2.4
GE	08/10	02:00	CPI - EU Harmonised (MoM)	JUL F	0.5	0.5	0.5
GE	08/10	02:00	CPI - EU Harmonised (YoY)	JUL F	2.6	2.6	2.6
FR	08/10	02:45	Industrial Production (MoM)	JUN	-0.1	-0.7	2.0
FR	08/10	02:45	Current Account (€ bns)	JUN	--	--	-5.5
FR	08/10	02:45	Manufacturing Production (MoM)	JUN	--	-0.1	1.5
UK	08/10	05:30	Bank of England Inflation Report				
IR	08/10	06:00	Industrial Production SA (MoM)	JUN	--	--	0.4
NO	08/10	08:00	Norwegian Deposit Rates	10-Aug	--	2.50	2.25
UK	AUG 10-17		Nationwide Consumer Confidence	JUL	--	--	51.0
GE	08/11	02:00	Wholesale Price Index (MoM)	JUL	--	--	-0.6
SW	08/11	03:30	CPI - Headline Rate (MoM)	JUL	--	-0.1	-0.2
SW	08/11	03:30	CPI - Headline Rate (YoY)	JUL	--	--	3.1
SW	08/11	03:30	SW CPI - CPIF (MoM)	JUL	--	--	-0.3
SW	08/11	03:30	SW CPI - CPIF (YoY)	JUL	--	--	1.5
EC	08/11	04:00	ECB Publishes Aug. Monthly Report				
IR	08/11	06:00	CPI (EU Harmonised) (MoM)	JUL	--	--	-0.2
IR	08/11	06:00	CPI (EU Harmonised) (YoY)	JUL	--	--	1.1
IR	08/11	06:00	CPI (MoM)	JUL	--	--	-0.1
IR	08/11	06:00	CPI (YoY)	JUL	--	--	2.7
FR	08/12	01:30	CPI - EU Harmonised (MoM)	JUL	-0.1	-0.3	0.1
FR	08/12	01:30	CPI - EU Harmonised (YoY)	JUL	2.5	2.3	2.3
FR	08/12	01:30	Consumer Price Index (MoM)	JUL	-0.3	-0.3	0.1
FR	08/12	01:30	Consumer Price Index (YoY)	JUL	2.0	2.2	2.1
FR	08/12	01:30	Gross Domestic Product (QoQ)	2Q P	0.2	0.3	0.9
FR	08/12	02:45	Non-Farm Payrolls (QoQ)	2Q P	--	--	0.4
FR	08/12	02:45	Wages (QoQ)	2Q P	--	--	1.0
SP	08/12	03:00	CPI (EU Harmonised) (MoM)	JUL	-0.2	-1.2	-0.2
SP	08/12	03:00	CPI (EU Harmonised) (YoY)	JUL F	3.0	3.0	3.0
SP	08/12	03:00	CPI (Core Index) (MoM)	JUL	--	-0.5	-0.1
SP	08/12	03:00	CPI (Core Index) (YoY)	JUL	--	1.7	1.7
SP	08/12	03:00	Consumer Price Index (MoM)	JUL	--	-0.5	-0.1
SP	08/12	03:00	Consumer Price Index (YoY)	JUL F	--	3.1	3.1
IT	08/12	04:00	Trade Balance (Total) (€ mns)	JUN	--	--	-2407
EC	08/12	05:00	Euro-Zone Ind. Prod. SA (MoM)	JUN	--	0.0	0.3
IT	08/12	05:00	CPI (NIC incl. tobacco) (MoM)	JUL F	0.3	0.3	0.3
IT	08/12	05:00	CPI (NIC incl. tobacco) (YoY)	JUL F	2.7	2.7	2.7
IT	08/12	05:00	CPI - EU Harmonized (MoM)	JUL F	-1.7	-1.7	-1.7
IT	08/12	05:00	CPI - EU Harmonized (YoY)	JUL F	2.1	2.1	2.1

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Key Indicators for the week of August 8 - 12

Asia Pacific

Country	Date	Time	Event	Period	BNS	Consensus	Latest
JN	08/07	19:50	Bank Lending Ex-Trusts (YoY)	JUL	--	--	-0.6
JN	08/07	19:50	Bank Lending incl Trusts (YoY)	JUL	--	--	-0.6
JN	08/07	19:50	Current Account Total (¥ bns)	JUN	--	652.8	590.7
JN	08/07	19:50	Adjusted Current Account Total (¥ bns)	JUN	--	961.0	391.0
JN	08/07	19:50	Current Account Balance (YoY)	JUN	--	-40.1	-51.7
JN	08/07	19:50	Trade Balance - BOP Basis (¥ bns)	JUN	--	113.1	-772.7
JN	08/08	00:30	Bankruptcies (YoY)	JUL	--	--	1.5
JN	08/08	01:00	Eco Watchers Survey: Current	JUL	--	50.0	49.6
JN	08/08	01:00	Eco Watchers Survey: Outlook	JUL	--	--	49.0
TA	08/08	04:00	Total Trade Balance (US\$ bns)	JUL	--	1.4	1.4
TA	08/08	04:00	Total Exports (YoY)	JUL	--	8.7	10.8
TA	08/08	04:00	Total Imports (YoY)	JUL	--	11.1	12.5
AU	08/08	21:30	Home Loans (MoM)	JUN	--	0.8	4.4
AU	08/08	21:30	Investment Lending (MoM)	JUN	--	--	4.4
AU	08/08	21:30	Owner-Occupied Home Loan Value (MoM)	JUN	--	--	2.2
AU	08/08	21:30	NAB Business Confidence	JUL	--	--	0.0
AU	08/08	21:30	NAB Business Conditions	JUL	--	--	2.0
CH	08/08	22:00	Producer Price Index (YoY)	JUL	7.5	7.5	7.1
CH	08/08	22:00	Industrial Production (YoY)	JUL	15	14.6	15.1
CH	08/08	22:00	Consumer Price Index (YoY)	JUL	6.4	6.4	6.4
CH	08/08	22:00	Fixed Assets Inv Excl. Rural YTD (YoY)	JUL	26	25.5	25.6
CH	08/08	22:00	Retail Sales (YoY)	JUL	18	17.7	17.7
ID	AUG 8-9		Bank Indonesia Reference Rate	9-Aug	6.75	6.75	6.75
JN	08/09	01:00	Consumer Confidence	JUL	--	37.0	35.3
JN	08/09	02:00	Machine Tool Orders (YoY)	JUL P	--	--	53.5
JN	08/09	19:50	Housing Loans (YoY)	2Q	--	--	2.7
JN	08/09	19:50	Domestic CGPI (MoM)	JUL	--	0.0	-0.1
JN	08/09	19:50	Domestic CGPI (YoY)	JUL	--	2.6	2.5
AU	08/09	20:30	Westpac Consumer Confidence s.a. (MoM)	AUG	--	--	-8.3
PH	08/09	21:00	Total Exports (YoY)	JUN	--	-5.3	-3.1
PH	08/09	21:00	Total Monthly Exports (US\$ mns)	JUN	--	--	4108.0
CH	08/09	22:00	Trade Balance (US\$ bns)	JUL	24.9	27.4	22.3
CH	08/09	22:00	Exports (YoY)	JUL	17.3	17.0	17.9
CH	08/09	22:00	Imports (YoY)	JUL	25	22.0	19.3
CH	AUG 9-15		Actual FDI (YoY)	JUL	--	--	2.8
NZ	AUG 9-11		REINZ Housing Price Index (MoM)	JUL	--	--	1.3
NZ	AUG 9-11		REINZ House Sales (YoY)	JUL	--	--	14.2
MA	08/10	00:01	Industrial Production (YoY)	JUN	--	-1.2	-5.1
NZ	08/10	18:30	Business NZ PMI	JUL	--	--	54.3
JN	08/10	19:50	Machine Orders (MoM)	JUN	--	1.8	3.0
SK	08/10	21:00	South Korea 7-Day Repo Rate	11-Aug	3.25	3.38	3.25
AU	08/10	21:00	Consumer Inflation Expectation (%)	AUG	--	--	3.4
NZ	08/10	21:00	ANZ Consumer Confidence Index	AUG	--	--	109.4
NZ	08/10	21:00	ANZ Consumer Confidence (MoM)	AUG	--	--	-2.8
AU	08/10	21:30	Employment Change (000s)	JUL	--	10.0	23.4
AU	08/10	21:30	Unemployment Rate	JUL	--	4.9	4.9
AU	08/10	21:30	Full Time Employment Change (000s)	JUL	--	--	59.0
AU	08/10	21:30	Part Time Employment Change (000s)	JUL	--	--	-35.6
TH	08/10	23:30	Consumer Confidence Economic	JUL	--	--	72.3
CH	AUG 10-15		New Yuan Loans (CNY bns)	JUL	--	550.0	633.9
SK	08/11	17:00	Export Price Index (MoM)	JUL	--	--	-0.7
SK	08/11	17:00	Import Price Index (MoM)	JUL	--	--	-0.4
JN	08/12	00:30	Industrial Production (MoM)	JUN F	--	--	3.9
JN	08/12	00:30	Capacity Utilization (MoM)	JUN	--	--	12.8
IN	08/12	01:30	Industrial Production (YoY)	JUN	--	5.8	5.6
HK	08/12	04:30	GDP SA (QoQ)	2Q	--	-1.0	2.8

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Key Indicators for the week of August 8 - 12

Latin America							
Country	Date	Time	Event	Period	BNS	Consensus	Latest
BZ	08/08	07:30	Central Bank Weekly Economists Survey				
CL	08/08	08:00	CPI (MoM)	JUL	--	0.2	0.2
CL	08/08	08:00	CPI (YoY)	JUL	--	2.9	3.4
CL	08/08	08:30	Trade Balance (US\$ mns)	JUL	--	1400.0	594.6
CL	08/08	08:30	Total Exports (US\$ mns)	JUL	--	--	6387.9
CL	08/08	08:30	Total Imports (US\$ mns)	JUL	--	--	5793.3
BZ	08/08	10:00	Trade Balance (FOB) - Weekly (US\$ mns)	7-Aug	--	--	1.0
CO	08/08	17:00	Exports FOB (US\$ mns)	JUN	--	--	4703.9
CL	08/10	08:30	Central Bank Economist Survey				
BZ	08/11	08:00	Retail Sales (MoM)	JUN	--	0.1	0.6
BZ	08/11	08:00	Retail Sales (YoY)	JUN	--	6.4	6.2
BZ	08/11	08:00	Broad Retail Sales (YoY)	JUN	--	--	12.8
PE	08/11		Trade Balance (PEN mns)	JUN	--	--	659.0
PE	08/11		Reference Rate	AUG	4.25	4.25	4.25
CO	08/12	17:00	Trade Balance (US\$ mns)	JUN	--	--	12.7
CO	08/12		Monetary Policy Meeting Minutes				

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

Global Auctions for the week of August 8 - 12

North America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
US	08/08	11:00	U.S. Fed to Purchase USD0.25-0.50 Bln TIPS
US	08/08	11:30	U.S. to Sell 3-Month Bills
US	08/08	11:30	U.S. to Sell 6-Month Bills
US	08/09	11:30	U.S. to Sell 4-Week Bills
US	08/09	13:00	U.S. to Sell 3-Year Notes
CA	08/10	12:00	Canada to Sell 3-Year Notes
US	08/10	13:00	U.S. to Sell 10-Year Notes
US	08/11	13:00	U.S. to Sell 30-Year Bonds

Europe

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
GE	08/08	05:15	Germany to Sell EU4 Bln 6-Mth Bills
FR	08/08	09:00	France to Sell Bills (BTF)
SZ	08/09	05:30	Switzerland to Sell 3-Month Bills
IT	08/10	05:00	Italy to Sell Bills
RU	08/10	06:00	Russia to Sell Up to RUB20 Bln OFZ Notes
UK	08/11	05:30	U.K. to Sell GBP825 Mln 0.625% I/L 2042 Bonds
IT	08/12	05:00	Italy Cancels Bond Auction
UK	08/12	06:10	U.K. to Sell Bills

Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
CH	08/07	23:00	China Muni to Sell CNY22 Bln 5-Year Bonds
JN	08/08	23:35	Japan to Sell 3-Month Bills
JN	08/08	23:45	Japan to Sell 40-Year Bond
CH	08/09	23:00	China to Sell 30 Year Bond
JN	08/09	23:35	Japan to Sell 2-Month Bills
JN	08/10	23:45	Japan to Sell 5-Year Bond

Source: Bloomberg, Scotia Economics.

Events for the week of August 8 - 12

North America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
US	08/06	09:30	Fed's Lockhart Gives Commencement Speech in Athens, Ga.
US	08/09	14:15	FOMC Rate Decision
US	08/12	10:00	Fed's Dudley to Speak on Regional Economy in New York

Europe

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
PO	08/08		Bank of Portugal Releases Data on Banks
UK	08/10	05:30	Bank of England Releases Quarterly Inflation Report
NO	08/10	08:00	Norwegian Deposit Rates

Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
NZ	08/05		RBNZ Governor Bollard Speech (off the record)
ID	08/09		Bank Indonesia Reference Rate
JN	08/09	19:50	BOJ to Publish Minutes of July 11-12 Board Meeting
SK	08/10	21:00	South Korea 7-Day Repo Rate

Latin America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
BZ	08/09	07:30	COPOM Monetary Policy Meeting Minutes
PE	08/11		Reference Rate
CO	08/12		Monetary Policy Meeting Minutes

Source: Bloomberg, Scotia Economics.

Global Central Bank Watch

North America

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Bank of Canada – Overnight Target Rate	1.00	September 7, 2011	1.00	--
Federal Reserve – Federal Funds Target Rate	0.25	August 9, 2011	0.25	0.25
Banco de México – Overnight Rate	4.50	August 26, 2011	4.50	--

While the Canadian jobs picture is stronger than this week's July report would suggest, a sharp deceleration in wage growth during the month will ease inflation pressures and put downward pressure on consumption, providing the Bank of Canada with further room to keep rates on hold into next year. In the U.S., while nonfarm payrolls came in much stronger than expected in July with wage growth accelerating, contrary to the Canadian picture, job growth is still not fast enough to put sustained material downward pressure on the unemployment rate, keeping the Fed on the sidelines.

Europe

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
European Central Bank – Refinancing Rate	1.50	September 8, 2011	1.50	--
Bank of England – Bank Rate	0.50	September 8, 2011	0.50	0.50
Swiss National Bank – Libor Target Rate	0.00	September 15, 2011	0.00	--
Central Bank of Russia – Refinancing Rate	8.25	September 1, 2011	8.25	--
Hungarian National Bank – Base Rate	6.00	August 23, 2011	6.00	6.00
Central Bank of the Republic of Turkey – 1 Week Repo Rate	5.75	August 23, 2011	5.75	--

The European Central Bank kept the main refinancing rate unchanged at 1.50% on August 4th, indicating increased concerns among policymakers regarding economic growth prospects. We therefore assess that the probability of a rate hike in October has decreased.

Asia Pacific

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Bank of Japan – Target Rate	0.10	September 7, 2011	0.10	--
Reserve Bank of Australia – Cash Target Rate	4.75	September 6, 2011	5.00	4.75
Reserve Bank of New Zealand – Cash Rate	2.50	September 14, 2011	2.50	--
People's Bank of China – Lending Rate	6.56	TBA	--	--
Reserve Bank of India – Repo Rate	8.00	TBA	7.75	--
Hong Kong Monetary Authority – Base Rate	0.50	TBA	0.50	--
Central Bank of China Taiwan – Discount Rate	1.88	September 30, 2011	--	--
Bank Negara Malaysia – Overnight Policy Rate	3.00	September 8, 2011	3.00	--
Bank of Korea – Bank Rate	3.25	August 10, 2011	3.25	3.38
Bank of Thailand – Repo Rate	3.25	August 24, 2011	3.25	--
Bank Indonesia – Reference Interest Rate	6.75	August 9, 2011	6.75	6.75
Central Bank of the Philippines – Overnight Policy Rate	4.50	September 8, 2011	4.50	--

We stand behind our expectation of no move by South Korea's central bank this coming week. While inflation, and particularly core inflation, has continued to rise, the won has also been scoring solid gains. In the midst of global uncertainty about industrial performance and Bank of Japan's intervention to weaken the yen, we would argue that this would be the wrong time for tighter conditions in South Korea. We do expect a future tightening move, but not this coming week. Bank Indonesia will likely leave rates unchanged following the monetary session next week.

Latin America

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Banco Central do Brasil – Selic Rate	12.50	August 31, 2011	12.50	--
Banco Central de Chile – Overnight Rate	5.25	August 18, 2011	5.25	--
Banco de la República de Colombia – Lending Rate	4.50	August 19, 2011	4.50	--
Banco Central de Reserva del Perú – Reference Rate	4.25	August 11, 2011	4.25	4.25

We expect the central bank of Peru to keep its reference rate unchanged at 4.25%. Headline inflation remained close to the upper limit of the central bank's tolerance range at 2.91% y/y in June; meanwhile, inflationary pressures at the core side are building up. However, recent volatility in financial markets together with some signs of a slowdown in the Peruvian economy will make the central bank to be more cautious.

Africa

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
South African Reserve Bank – Repo Rate	5.50	September 22, 2011	5.50	--

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

	2000-09	2010	2011f	2012f	2000-09	2010	2011f	2012f
Output and Inflation (annual % change)								
	Real GDP				Consumer Prices²			
World ¹	3.6	5.1	4.0	4.3				
Canada	2.1	3.2	2.6	2.4	2.1	1.8	2.9	2.1
United States	1.7	3.0	1.8	2.5	2.6	1.6	2.8	2.0
Mexico	1.7	5.4	3.9	3.5	4.9	4.4	3.6	3.8
United Kingdom	1.7	1.4	1.2	1.5	1.9	3.7	4.4	2.1
Euro zone	1.1	1.7	1.7	1.5	2.0	2.2	2.5	2.1
Japan	0.6	4.0	0.3	3.5	-0.3	0.0	0.8	1.3
Australia	3.1	2.7	3.4	3.0	3.2	2.7	2.8	2.5
China	9.4	10.4	9.3	9.5	2.0	4.6	5.0	4.5
India	7.4	9.0	8.3	8.5	6.2	9.5	7.5	6.0
Korea	4.4	6.2	5.0	5.3	3.1	3.5	3.7	3.3
Brazil	3.3	7.5	4.0	4.5	6.7	5.9	6.5	5.5
Chile	3.6	5.8	6.5	5.5	3.5	1.4	4.0	3.5
Peru	5.2	8.8	6.0	5.8	2.5	2.1	4.0	3.7
Central Bank Rates (% end of period)	11Q1	11Q2	11Q3f	11Q4f	12Q1f	12Q2f	12Q3f	12Q4f
Bank of Canada	1.00	1.00	1.00	1.00	1.00	1.50	2.00	2.25
Federal Reserve	0.25	0.25	0.25	0.25	0.25	0.25	0.75	1.25
European Central Bank	1.00	1.25	1.50	1.75	2.00	2.00	2.00	2.00
Bank of England	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25
Swiss National Bank	0.25	0.25	0.00	0.00	0.00	0.00	0.25	0.25
Bank of Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Reserve Bank of Australia	4.75	4.75	5.00	5.25	5.50	5.75	6.00	6.25
Exchange Rates (end of period)								
Canadian Dollar (USDCAD)	0.97	0.96	0.96	0.96	0.95	0.95	0.94	0.94
Canadian Dollar (CADUSD)	1.03	1.04	1.04	1.04	1.05	1.05	1.06	1.06
Euro (EURUSD)	1.42	1.45	1.45	1.50	1.48	1.46	1.43	1.40
Sterling (GBPUSD)	1.60	1.61	1.61	1.63	1.65	1.67	1.69	1.70
Yen (USDJPY)	83	81	79	80	82	83	84	85
Australian Dollar (AUDUSD)	1.03	1.07	1.08	1.09	1.09	1.10	1.10	1.11
Chinese Yuan (USDCNY)	6.5	6.5	6.4	6.3	6.2	6.1	6.0	5.9
Mexican Peso (USDMXN)	11.9	11.7	12.0	12.0	12.1	12.1	12.2	12.4
Brazilian Real (USDBRL)	1.63	1.56	1.57	1.60	1.61	1.62	1.64	1.65
Commodities (annual average)	2000-09	2010	2011f	2012f				
WTI Oil (US\$/bbl)	51	79	97	100				
Brent Oil (US\$/bbl)	50	80	111	114				
Nymex Natural Gas (US\$/mmbtu)	5.95	4.40	4.40	4.75				
Copper (US\$/lb)	1.78	3.42	4.35	4.30				
Zinc (US\$/lb)	0.73	0.98	1.05	1.06				
Nickel (US\$/lb)	7.11	9.89	11.25	9.35				
Gold, London PM Fix (US\$/oz)	522	1,225	1,540	1,650				
Pulp (US\$/tonne)	668	960	984	1,045				
Newsprint (US\$/tonne)	572	607	650	715				
Lumber (US\$/mfbm)	275	254	265	270				

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	10Q4	11Q1	Latest	United States	2010	10Q4	11Q1	Latest
Real GDP (annual rates)	3.2	3.1	3.9		Real GDP (annual rates)	3.0	2.3	0.4	1.3 (Q2-A)
Current Acc. Bal. (C\$B, ar)	-50.9	-41.1	-35.7		Current Acc. Bal. (US\$B, ar)	-471	-449	-477	
Merch. Trade Bal. (C\$B, ar)	-9.0	1.5	6.4	-9.8 (May)	Merch. Trade Bal. (US\$B, ar)	-646	-637	-730	-779 (May)
Industrial Production	4.6	6.0	5.3	8.0 (May)	Industrial Production	5.3	6.2	5.3	3.4 (Jun)
Housing Starts (000s)	192	179	178	201 (Jun)	Housing Starts (millions)	0.58	0.54	0.58	0.63 (Jun)
Employment	1.4	1.7	1.9	1.5 (Jul)	Employment	-0.8	0.5	0.9	1.0 (Jul)
Unemployment Rate (%)	8.0	7.7	7.8	7.2 (Jul)	Unemployment Rate (%)	9.6	9.6	8.9	9.1 (Jul)
Retail Sales	5.5	5.3	2.5	8.2 (May)	Retail Sales	6.8	8.1	8.6	8.5 (Jun)
Auto Sales (000s)	1561	1554	1572	1656 (Apr)	Auto Sales (millions)	11.6	12.3	13.0	12.2 (Jul)
CPI	1.8	2.3	2.6	3.1 (Jun)	CPI	1.6	1.3	2.1	3.6 (Jun)
IPPI	1.0	2.6	4.0	-5.2 (Jun)	PPI	4.2	3.8	4.9	7.0 (Jun)
Pre-tax Corp. Profits	21.2	19.1	13.4		Pre-tax Corp. Profits	25.0	1.1	2.8	
Mexico					Brazil				
Real GDP	5.4	4.4	4.6		Real GDP	6.7	4.2	3.8	
Current Acc. Bal. (US\$B, ar)	-5.6	-14.0	-5.5		Current Acc. Bal. (US\$B, ar)	-47.4	-48.0	-58.3	
Merch. Trade Bal. (US\$B, ar)	-3.0	-4.2	7.6	1.3 (Jun)	Merch. Trade Bal. (US\$B, ar)	20.2	29.9	12.6	37.6 (Jul)
Industrial Production	6.0	4.8	5.3	12.9 (May)	Industrial Production	10.5	3.6	2.5	0.7 (Jun)
CPI	4.2	4.2	3.5	3.3 (Jun)	CPI	5.1	6.1	6.8	6.4 (Jun)
Chile					Italy				
Real GDP	5.2	5.8	9.8		Real GDP	1.2	1.5	1.0	
Current Acc. Bal. (US\$B, ar)	3.1	4.9	2.9		Current Acc. Bal. (US\$B, ar)	-0.07	-0.07	-0.12	-0.09 (May)
Merch. Trade Bal. (US\$B, ar)	11.6	17.7	17.4	7.1 (Jun)	Merch. Trade Bal. (US\$B, ar)	-39.1	-46.3	-77.2	-41.4 (May)
Industrial Production	0.5	2.7	11.7	4.0 (Jun)	Industrial Production	6.5	5.3	2.3	0.3 (Jun)
CPI	1.4	2.5	2.9	3.4 (Jun)	CPI	1.6	1.8	2.3	2.7 (Jun)
Germany					France				
Real GDP	3.5	3.8	4.8		Real GDP	1.4	1.4	2.2	
Current Acc. Bal. (US\$B, ar)	188.0	251.7	194.8	118.7 (May)	Current Acc. Bal. (US\$B, ar)	-44.5	-86.6	-59.7	-167.9 (May)
Merch. Trade Bal. (US\$B, ar)	201.5	219.8	209.3	220.8 (May)	Merch. Trade Bal. (US\$B, ar)	-39.5	-39.7	-54.5	-46.7 (Jun)
Industrial Production	10.1	11.7	12.8	6.6 (Jun)	Industrial Production	5.1	4.6	4.9	10.5 (May)
Unemployment Rate (%)	7.7	7.4	7.3	7.0 (Jul)	Unemployment Rate (%)	9.8	9.7	9.7	9.7 (Jun)
CPI	1.1	1.5	2.1	2.4 (Jul)	CPI	1.5	1.6	1.8	2.1 (Jun)
Euro Zone					United Kingdom				
Real GDP	1.7	1.9	2.4		Real GDP	1.4	1.5	1.6	
Current Acc. Bal. (US\$B, ar)	-77	-41	-169	-315 (May)	Current Acc. Bal. (US\$B, ar)	-71.6	-72.2	-74.0	
Merch. Trade Bal. (US\$B, ar)	32.0	53.2	-68.5	26.4 (May)	Merch. Trade Bal. (US\$B, ar)	-153.0	-171.9	-142.4	-166.0 (May)
Industrial Production	7.4	8.1	6.6	13.5 (May)	Industrial Production	2.1	3.3	2.0	1.0 (May)
Unemployment Rate (%)	10.1	10.0	9.9	9.9 (Jun)	Unemployment Rate (%)	7.9	7.9	7.7	7.7 (Apr)
CPI	1.6	2.0	2.5	2.7 (Jun)	CPI	3.3	3.4	4.1	4.2 (Jun)
Japan					Australia				
Real GDP	4.0	2.4	-0.7		Real GDP	2.7	2.7	1.0	
Current Acc. Bal. (US\$B, ar)	195.9	176.8	193.9	87.3 (May)	Current Acc. Bal. (US\$B, ar)	-31.8	-37.4	-37.9	
Merch. Trade Bal. (US\$B, ar)	74.7	60.5	31.8	-28.5 (Jun)	Merch. Trade Bal. (US\$B, ar)	19.3	26.1	21.9	39.4 (Jun)
Industrial Production	16.6	6.8	-2.5	-1.7 (Jun)	Industrial Production	4.3	0.0	-5.4	
Unemployment Rate (%)	5.1	5.0	4.7	4.6 (Jun)	Unemployment Rate (%)	5.2	5.2	5.0	4.9 (Jun)
CPI	-0.7	0.1	0.0	0.2 (Jun)	CPI	2.8	2.7	3.3	
China					South Korea				
Real GDP	10.3	9.8	9.7		Real GDP	6.2	4.7	4.2	
Current Acc. Bal. (US\$B, ar)	305.4				Current Acc. Bal. (US\$B, ar)	28.2	36.6	10.4	35.9 (Jun)
Merch. Trade Bal. (US\$B, ar)	181.5	246.8	-6.8	267.3 (Jun)	Merch. Trade Bal. (US\$B, ar)	41.2	52.1	29.5	86.7 (Jul)
Industrial Production	13.5	13.5	14.8	15.1 (Jun)	Industrial Production	16.6	9.9	11.2	6.1 (Jun)
CPI	4.6	4.6	5.4	6.4 (Jun)	CPI	3.0	3.6	4.5	4.7 (Jul)

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

Source: Bloomberg, Scotia Economics.

Interest Rates (% , end of period)

Canada	11Q1	11Q2	Jul/29	Aug/05*	United States	11Q1	11Q2	Jul/29	Aug/05*
BoC Overnight Rate	1.00	1.00	1.00	1.00	Fed Funds Target Rate	0.25	0.25	0.25	0.25
3-mo. T-bill	0.95	0.90	0.92	0.83	3-mo. T-bill	0.09	0.01	0.09	0.01
10-yr Gov't Bond	3.35	3.11	2.88	2.55	10-yr Gov't Bond	3.47	3.16	2.80	2.47
30-yr Gov't Bond	3.76	3.55	3.35	3.15	30-yr Gov't Bond	4.51	4.37	4.12	3.74
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US\$B)	60.4	62.3	62.3	(Jun)	FX Reserves (US\$B)	128.3	136.6	136.6	(Jun)
Germany					France				
3-mo. Interbank	1.26	1.51	1.60	1.46	3-mo. T-bill	0.80	1.18	0.95	0.81
10-yr Gov't Bond	3.35	3.03	2.54	2.37	10-yr Gov't Bond	3.71	3.41	3.23	3.17
FX Reserves (US\$B)	64.8	66.0	66.0	(Jun)	FX Reserves (US\$B)	61.0	60.3	60.3	(Jun)
Euro-Zone					United Kingdom				
Refinancing Rate	1.00	1.25	1.50	1.50	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	0.90	1.72	0.90	0.85	3-mo. T-bill	4.85	4.85	4.85	4.85
FX Reserves (US\$B)	319.9	317.2	317.2	(Jun)	10-yr Gov't Bond	3.69	3.38	2.86	2.71
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	0.14	0.13	0.13	0.13	10-yr Gov't Bond	5.49	5.21	4.90	4.48
10-yr Gov't Bond	1.26	1.14	1.08	1.01	FX Reserves (US\$B)	33.3	40.3	40.3	(Jun)
FX Reserves (US\$B)	1080.6	1100.8	1100.8	(Jun)					

Exchange Rates (end of period)

USDCAD	0.97	0.96	0.96	0.98	¥/US\$	83.13	80.56	76.76	78.48
CADUSD	1.03	1.04	1.05	1.02	US\$/Australian\$	103.29	107.22	109.93	104.57
GBPUSD	1.603	1.605	1.643	1.638	Chinese Yuan/US\$	6.55	6.46	6.44	6.44
EURUSD	1.416	1.450	1.440	1.419	South Korean Won/US\$	1097	1068	1054	1067
JPYEUR	0.85	0.86	0.90	0.90	Mexican Peso/US\$	11.905	11.714	11.735	11.982
USDCHF	0.92	0.84	0.79	0.76	Brazilian Real/US\$	1.632	1.563	1.549	1.586

Equity Markets (index, end of period)

United States (DJIA)	12320	12414	12143	11357	U.K. (FT100)	5909	5946	5815	5292
United States (S&P500)	1326	1321	1292	1195	Germany (Dax)	7041	7376	7159	6281
Canada (S&P/TSX)	14116	13301	13048	12214	France (CAC40)	3989	3982	3671	3304
Mexico (Bolsa)	37441	36558	35999	33213	Japan (Nikkei)	9755	9816	9833	9300
Brazil (Bovespa)	68587	62404	58823	52164	Hong Kong (Hang Seng)	23528	22398	22440	20946
Italy (BCI)	1120	1039	968	887	South Korea (Composite)	2107	2101	2133	1944

Commodity Prices (end of period)

Pulp (US\$/tonne)	990	1035	1035	1035	Copper (US\$/lb)	4.26	4.22	4.41	4.17
Newsprint (US\$/tonne)	640	640	640	640	Zinc (US\$/lb)	1.05	1.05	1.12	1.03
Lumber (US\$/mfbm)	290	237	256	242	Gold (US\$/oz)	1439.00	1505.50	1628.50	1658.75
WTI Oil (US\$/bbl)	106.72	95.42	95.70	86.13	Silver (US\$/oz)	37.87	35.02	39.63	39.24
Natural Gas (US\$/mmbtu)	4.39	4.37	4.15	3.96	CRB (index)	359.43	338.05	342.08	327.16

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

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