

Global Views

Weekly commentary on economic and financial market developments

December 23, 2011

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Happy Holidays!

Best wishes for the holiday season from all of us.

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A Quiet Week Will Have Markets On China Watch

- Please see our full indicator, central bank, auction and event calendars on pp. A2-A6.

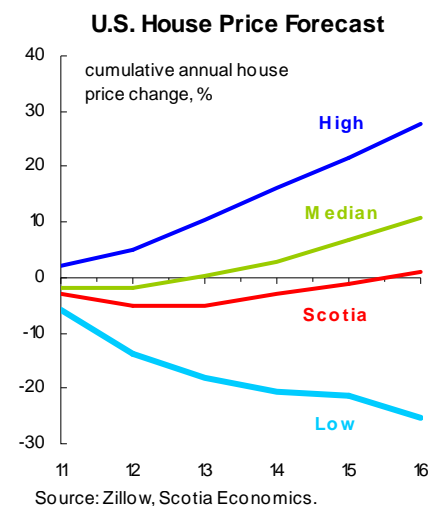
The shorts closed their positions on Friday December 16th before entering the holiday period and this past week and the next one are marked by thin trading volumes and light liquidity. In such markets, it doesn't take much to impress the broad risk tone. As evidence, global equities rallied hard this past week on thin news such as a slight up-tick in German business confidence that remains depressed and US housing starts that came in at the top of the volatile range within which they've trended since 2008. Expect more of the same over the next week.

A key risk over the western holiday period will be **China**. Last year, the People's Bank of China gift-wrapped a rate hike and delivered it on Christmas Day. This year the focus is upon easing, with the expectation that China could cut its required reserve ratio any day. If the decision is at all data dependent, then next Thursday's private PMI release may serve the purpose amid expectations it will contract for a third consecutive month. Aggressive policy easing by China could well mitigate hard landing concerns particularly as the Shanghai composite is now about 27% lower than its most recent high in April of this year. **Asian** markets will also be focused upon Japan as it releases November figures for housing starts, household spending, jobs, CPI and industrial production on Tuesday.

US markets will clearly be sensitive to possible developments elsewhere, but there are a couple of domestic data releases that could swing markets. First is the Conference Board's consumer confidence release for December on Tuesday. This may show further improvement given its weighting toward job markets that have been gradually on the mend. This confidence measure may be signalling improvements in job markets before nonfarm payrolls themselves. A recent paper by economists at the Philadelphia Fed notes that the average revision in months of job gains over time has been 18,000 but that the average upward revision in months of job gains since July 2009 has been double this amount as the rolling 90% confidence interval on nonfarm payroll revisions has ballooned to the widest in history. Additionally, it may well be that a US job market expansion faces a lower bar than the historical 400,000 threshold for initial jobless claims that used to define an expanding job market at readings below this figure. Economists at the St. Louis Fed have recently published estimates whereby they argue that the threshold dividing job market expansions and contractions is at 450,000 now compared to the historical 400,000 average. If so, then today's 380k mark for initial jobless claims combined with possibly greater upward revisions to nonfarm payrolls may herald better jobs numbers going forward. A remaining debate is whether claims are low due to reduced firings or because hiring is about to accelerate.

Other US data releases include pending home sales for November on Thursday. Following a sharp upside surprise to the October reading for pending home sales that came on the heels of three monthly contractions, markets will be keenly watching for evidence that a housing expansion has legs to it. This will complement Tuesday's release for the S&P/Case Shiller house price index's October reading. We participate as the only Canadian shop in the five year US house price forecast survey of 108 forecasters now conducted by Zillow.com (see accompanying chart), and the range of forecast outcomes is massive — cutting from a cumulative five year drop of about 25% to a cumulative 30% gain. The median cumulative house price change five years from now is 10.6% with a wide standard deviation of 8.2%. Regional surveys released by the Richmond, Dallas, Kansas City and Chicago Feds may also garner market attention.

European markets should be relatively quiet with just German CPI and retail sales on tap for Thursday and Friday respectively, plus auctions in France and Italy. **Canada** will follow the global market tone next week as there are no releases, auctions or events on tap.



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Global Housing Markets Limp Into The New Year

- **Weak economic growth, slumping consumer confidence, high unemployment and cautious bank lending are weighing heavily on global property markets.**

Housing markets across much of the developed world look set to end the year on a downbeat note. Real home prices were below year-ago levels in the third quarter in two-thirds of the markets we survey. Canada remained a notable outperformer, though activity here too shows some signs of cooling.

Weak market conditions will likely persist well into 2012. While the combination of low borrowing costs and lower home prices have bolstered housing affordability, there is insufficient domestic momentum in the majority of advanced nations to support a significant revival in demand. An oversupply of housing and a more cautious lending environment also will hold back the recovery.

Within Europe, the **French** housing market remains the most resilient. Average inflation-adjusted home prices were up 4.4% y/y in Q3, and are nearing pre-crisis record highs after a brief downturn in 2008-2009. Tight housing supply is underpinning prices, but these continuing gains appear unsustainable in an environment of high unemployment, government restraint and slowing regional exports. **Switzerland's** housing market also remains relatively buoyant, with average prices up 3.3% y/y in Q3.

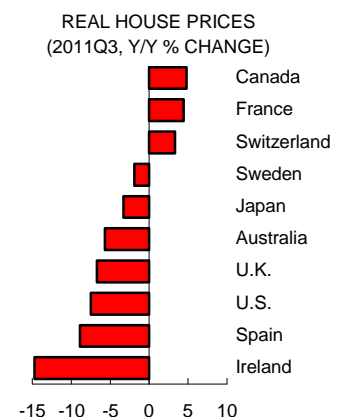
Most other markets in the region are mired in negative territory. **Ireland** still holds title to the weakest residential market in our sample, with average inflation-adjusted home prices down 14.7% y/y in Q3 and by a cumulative 44% from their early 2007 highs. The steep and continuous price declines of the past four years have essentially wiped out a decade of price appreciation.

Meanwhile, **U.K.** house prices are declining again after a brief recovery in 2010. Real home prices have contracted on a year-over-year basis for the past three quarters, falling 6.7% y/y in Q3. **Spain's** deep housing slump continues, with average prices down 8.9% y/y in Q3 and almost 25% from their early 2007 peak. Prices have also recently dipped into negative year-over-year territory in **Sweden**, consistently one of the region's better performing housing markets.

Housing activity in the Asia-Pacific region has also downshifted. In **Australia**, average inflation-adjusted home prices fell 5.7% y/y in Q3. Even so, the slowdown follows strong gains in 2010, leaving prices near record levels. While domestic economic conditions remain relatively solid, some potential buyers have been sidelined by deteriorating housing affordability and a more uncertain global outlook. There is still no end in sight to **Japan's** two-decade long property slump, with residential land prices down 3.3% y/y in Q3.

North America's two-track housing market remains in place. In the **United States**, average inflation-adjusted home prices fell 7.5% y/y in Q3, bringing the cumulative decline since the 2005 peak to over 30%. Despite near-record affordability, persistently high unemployment, tight credit conditions and a lingering oversupply of unsold and foreclosed properties suggest a sustainable recovery could still be several years away.

In contrast, the **Canadian** housing market remains an outperformer among advanced nations, with real home prices up 4.8% y/y in Q3. While the sector's continued buoyancy is impressive, monthly data through November suggest prices have leveled off since the spring, with conditions in the majority of local markets in 'balanced' territory. Ultra-low interest rates are still attracting buyers, but increased economic uncertainty combined with some recent slowing in the pace of hiring could dampen demand in the new year.



Source: Scotia Economics

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Chinese Investment Bubble?

- Talk of a generalized Chinese investment bubble seems absurd.

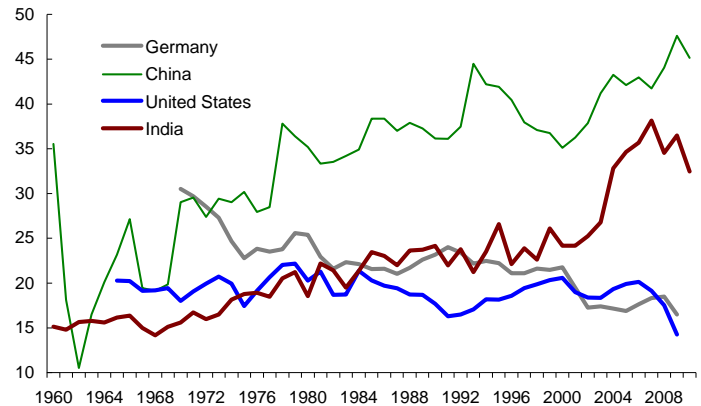
Among many concerns about the outlook for the Chinese economy is whether or not the country lies in the midst of a broadly defined investment bubble that runs deeper than housing excesses. On the surface, chart 1 may tend to answer with an emphatic 'yes' — China's pace of capital investment has long outstripped most other major economies.

To leave it at that, however, would be woefully inadequate. China's industrialization strategy was far behind the West and, until China shifted toward a manufactured exports growth strategy commencing in the 1990s and following the period of agricultural liberalization in the 1980s, China was a relative economic backwater. Many years of a torrid pace of investment activity were required to address the country's infrastructure shortfalls but the weak starting point makes it less than obvious that China has indeed over-invested in catching up.

So where does China stand today? Progress has certainly been made, but scaled to the size of its population and economy, China's broadly defined infrastructure remains sharply underdeveloped. Consider the charts on the following two pages. For one, little Canada with 33 million people has 1,400 airports. The U.S. with about 320 million people has about 15,000 airports. Massive China with 1.34 billion people has only 500 airports. Also, China has among the fewest kilometers of roads per 1,000 people of any country on the planet, and the same applies to kilometers of rail lines per capita and road density. Internet penetration rates are also very low compared to OECD countries. Electricity production in kilowatt hours per 1,000 people puts China toward the bottom of country rankings. As for health infrastructure, two measures we offer include hospital beds per 1,000 people where China ranks favourably, but just hope you don't need a doctor while lying in that bed.

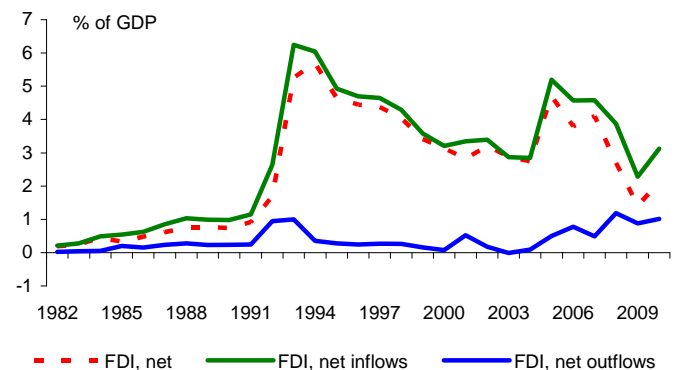
Each of these measures has pros and cons, and scaling to population or land mass isn't always without flaws. Our point, however, is that it is less than obvious that China is dealing with a massive economy-wide investment overhang across its broad economy. Even with the crisis-oriented stimulus that drove aggressive investment totaling about US\$600 billion in areas of infrastructure such as airports, roads, and telecommunications infrastructure, China ranks toward the bottom of the pack of countries by the measures we have evaluated. The lesson here relates to what areas China could stimulate without adding to housing excesses. Plentiful choices exist for directing stimulus toward domestic demand. Further, the tools for doing so exist by way of further cuts to required reserves ratios, macroprudential rules that relatively encourage some types of investment over others, and greater foreign investment incentives among others. In fact, FDI flows into China are comparatively modest to a country such as Canada (chart 2), and falling. In short, whereas the west manages to a short-term investment cycle, China has a long way to go in strategically managing toward longer-range plans.

Chart 1 Emerging Capital Overhang in China?
Gross capital formation (% of GDP)



Source: World Bank and OECD National Accounts data files, Scotia Economics

Chart 2 Chinese Foreign Direct Investment

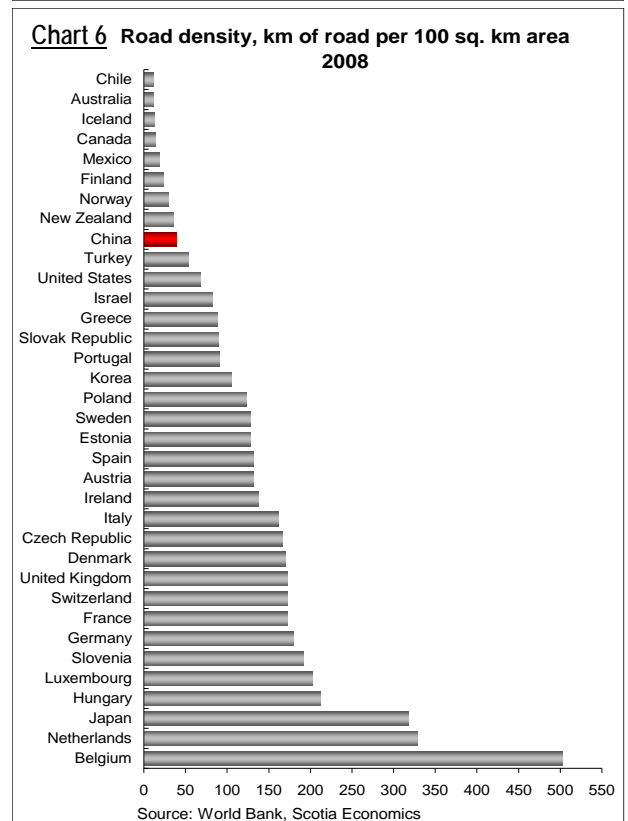
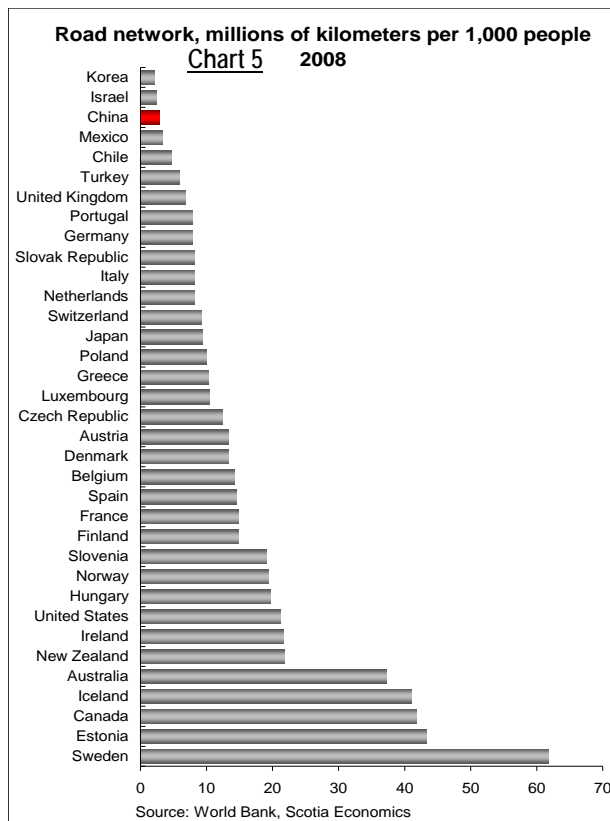
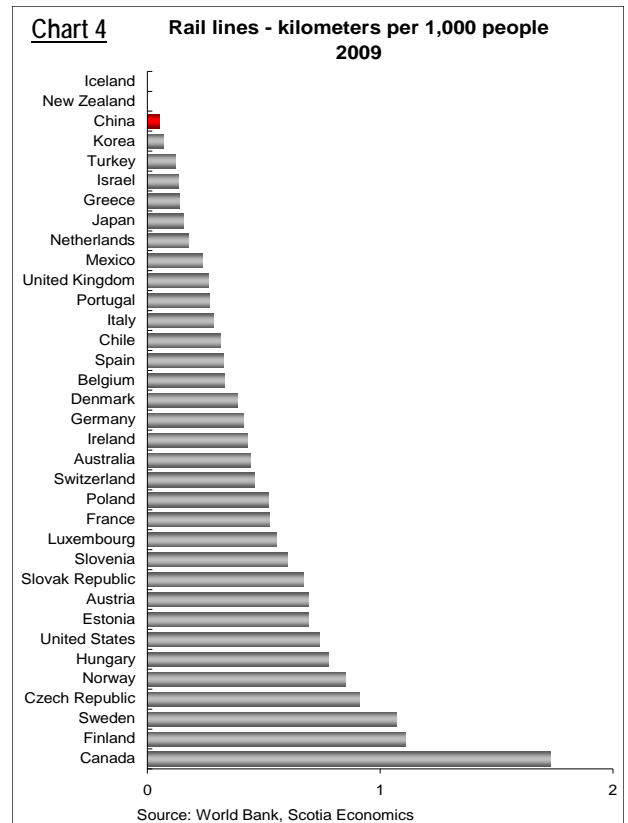
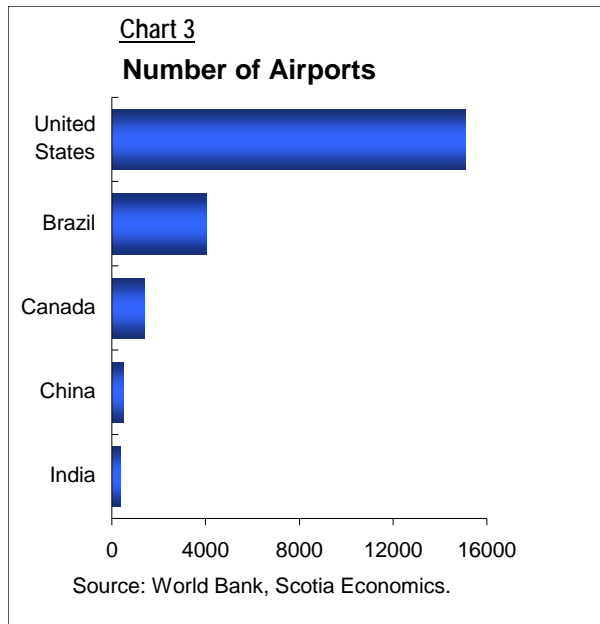


Source: World Bank, Scotia Economics

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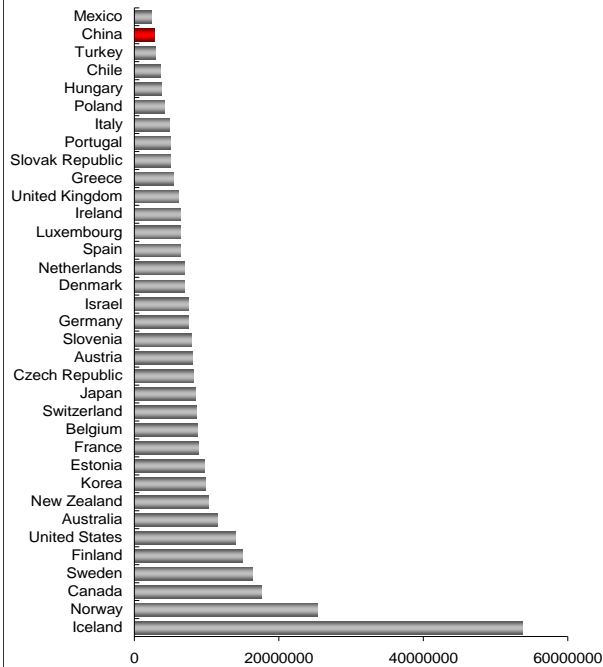


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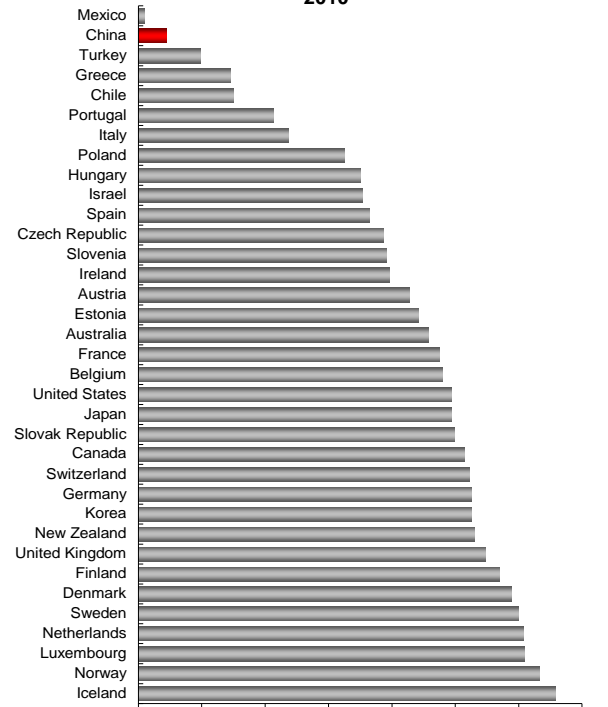
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Chart 7 Electricity production, kWh per 1,000 people
2010



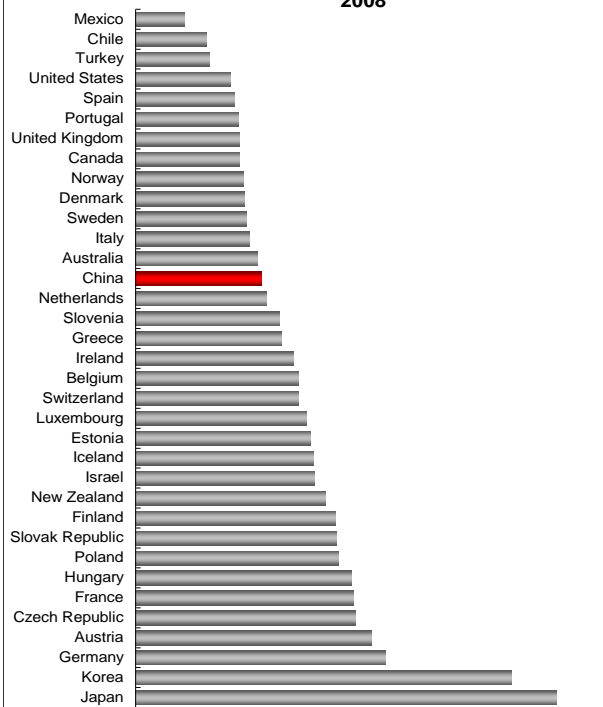
Source: World Bank, Scotia Economics

Chart 8 Internet users per 100 people
2010



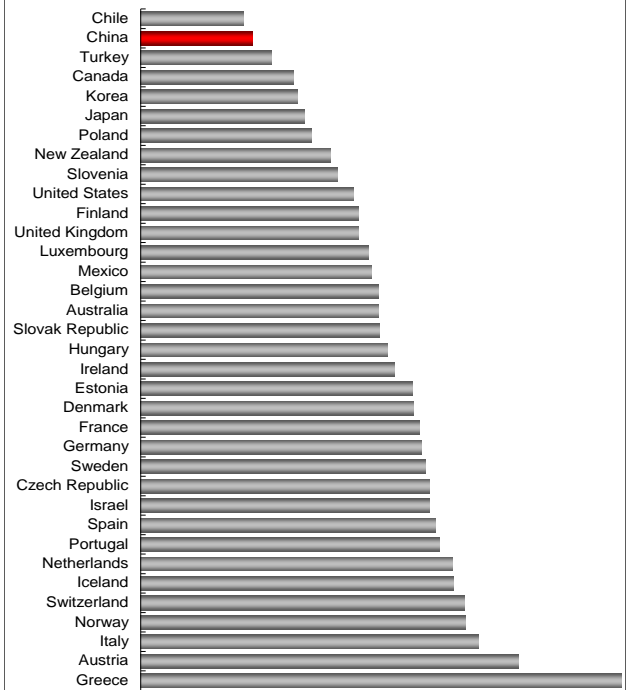
Source: World Bank, Scotia Economics

Chart 9 Hospital beds per 1000 people
2008



Source: World Bank, Scotia Economics

Chart 10 Physicians per 1000 people
2009



Source: World Bank, Scotia Economics

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Why Markets Were Unimpressed By The ECB Term Loan To Banks

- **Six reasons why markets were unimpressed by the ECB's 3-year term loans to European banks.**

Markets were unimpressed by the fact that bank borrowing from the ECB under its new 3-year term loan offered to banks at a 1% rate of interest and secured by broadened collateral eligibility came in at nearly double expectations. In total, €489 billion in loans were taken down by banks in the first of two waves of unlimited funding options. Why did markets have such a reaction?

First, signaling theory and plain old common sense would say that there is a signal being sent that the sheer size of the borrowing indicates a bigger than previously thought problem facing European bank funding. Essentially, banks have revealed themselves to have deeper challenges than expected and this is always the caveat to borrowing at a central bank's window. An optimist might say they simply borrowed twice the expected amount because they took advantage of cheap funding, but the US experience in this regard is telling in that during the crisis banks were able to borrow very cheaply through the Term Auction Facility and at the discount window but have done very little of such funding this year partly due to the stigma attached to it and partly because they simply don't need that form of short-term liquidity. The fact that Europe's banks are casting aside any such reservations says something to the market about the gravity of their situation.

Second, it seems to me that the debate over whether or not the ECB will sterilize its term loans to banks by withdrawing an offsetting amount of liquidity is a red herring. Markets lose either way, the only question is one of timing. Sterilize, and all that one is doing is shifting money around in buckets within the context of a zero sum game. Don't sterilize, and the near-term impact on markets may be positive but watch moral hazard take greater root. It may be that a fair portion of the ECB's term loans will not be sterilized as they have not been for such programs in the past, but if not, then the ECB is taking a step toward strengthening moral hazard within the eurozone and thus incurring potentially greater long run consequences. For one, if banks use the low interest proceeds to fund a carry trade into higher yielding European sovereign debt then it just perpetuates the problem that got us here in the first place. This compact between banks and sovereigns with the ECB's thin capital base serving as the match maker risks apathy across European political capitals with respect to doing what is necessary to improve upon their fiscal positions. Further, it keeps European banks addicted to ECB life lines as opposed to more aggressively restructuring themselves away from the model built upon funneling credit from the shorter-end of the curve to profligate governments.

Third, banks face an enormous refinancing problem for 2012. While temporarily aiding this through ECB borrowing is a near-term plus, they still have to pay back those funds such that this only helps to temporarily bridge over their refinancing headaches. It also says that while the short-term use of such loans may be to invest in sovereign bonds, this won't be where the funding will remain parked as banks will need to roll over funding. Also note that there is no hard evidence that banks are using such funds to buy sovereign bonds—and in fact, peripheral bonds sold off following the greater than expected term loans.

Fourth, the effects of the ECB's term loans represent one-off improvements to funding and liquidity positions and hence to broader markets. Following the second of the two planned term loans, markets will go back to pricing risk at the margin in the absence of any possible lift effect from term loans.

Fifth, capital remains a large problem for European banks and that's a very different animal to tame than liquidity management. That capital will be covered through lending less, selling assets to better capitalized global banks, cutting dividends, and/or through capital issuance. Either way, it will intensify deleveraging and downsides to European growth as we enter what will be a terrible year for European economic growth and earnings.

Finally, ECB hopes that banks will use the term loan proceeds to lend don't seem to make a whole lot of sense given such capital and refinancing challenges. Europe's banking system is shifting toward capital and liquidity hoarding in preparation for the enormous challenges that lie ahead.

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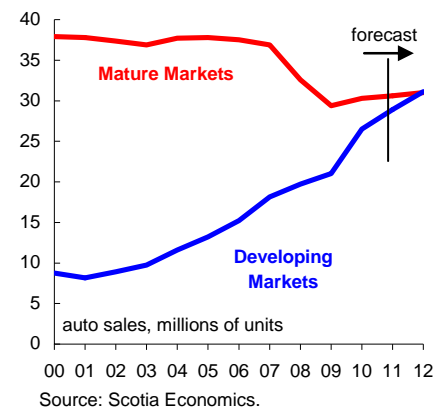
Record Global Car Sales In 2012

- **Gains will be driven by a rebound in Japan and stronger volumes in emerging nations and the United States.**

The cyclical recovery in global auto sales that began in mid-2009 remains intact, although gains have moderated from a 12% increase in 2010. We expect a further 4% advance in 2012, though there is the potential for more downside if the euro zone debt crisis does not stabilize.

A rebound from this year's tsunami-induced slump in Japan, and continued gains in emerging markets will lead the way. Purchases in the United States are also expected to climb to 13.5 million units — the highest level since 2007, as households and businesses replace their aging vehicles. Western Europe will remain the weak link, with volumes dragged down by declining sales in the debt-ridden Mediterranean nations. There is also a risk that the weakness could spread to the core countries of northern Europe, if the debt crisis is not contained.

Developing Market Volumes to Surpass Mature Countries in 2012



Global volumes will continue to be bolstered by strong employment growth and declining interest rates in emerging markets. This represents a sharp reversal from the past year, when most central banks in developing nations were raising rates to contain inflation. However, inflation has come off the boil enabling central banks to begin reducing interest rates. For example, inflation in China fell to 4.2% in November from a three-year high of 6.5% in July.

The direction for interest rates and the pace of monetary expansion are important drivers of global auto sales. Global short-term interest rates peaked in July and will continue to move lower in 2012. In addition, money supply growth internationally has accelerated recently, led by double-digit gains in emerging markets. Money supply trends lead global car sales by roughly six months, though the lead time is often shorter in emerging markets. In China, money supply trends lead car sales by roughly three months. Emerging market economies will also continue to substantially outpace economic growth in the advanced nations, another key factor underpinning strong auto sales.

After plunging by nearly 20% this year and slumping to the lowest level since 1987, car sales in Japan are expected to post a double-digit increase in 2012. However, despite this improvement the auto industry highlights the major shift taking place in global consumption patterns. In 2012, car sales in emerging nations will surpass purchases in the developed world for the first time on record. We project that car sales in developing nations will expand by 7% in 2012, climbing to 31 million units and exceed volumes in the mature markets of Western Europe, North America and Japan. Demographics are re-enforcing the outperformance of developing countries, as these nations are expected to account for virtually all of the increase in the global working age population over the next decade.

Purchases in the United States are expected to climb to 13.5 million units — the highest level since 2007, as households and businesses replace their aging vehicles. Vehicle scrappage rates have dropped to only 4% of the U.S. fleet, nearly 2 percentage points below the average of the past two decades. As a result, the average age of vehicles in the United States is approaching a record 11 years. Sales in Canada will likely climb to 1.61 million units next year, the fifth-best year on record, and in line with the 2000-08 average.

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Canadian Manufacturers Have The Capacity To Improve

- **After a period of declining productivity and capacity utilization, Canadian manufacturers appear to be taking the first steps towards improving competitiveness.**

Closing Canada's capacity gap and a further expanding investment in machinery and equipment will be key to Canada's success in the coming years. Boosting productivity and increasing competitiveness must remain a top priority in a high-dollar climate, in which more competitors are entering the global market. Fortunately, two positive developments bode well for future gains — rising capacity utilization and increased machinery and equipment investment.

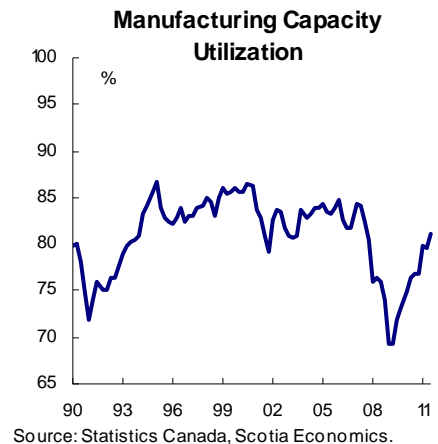
Excess capacity acts as a drag on productivity, as lower levels of production entail higher average costs due to smaller economies of scale. There has been improvement as of late, with manufacturing capacity utilization rates sustaining an upward climb in Q3, during which rates rose 1.6 percentage points to 81.1%, an over 10 percentage point increase from the 2nd quarter of 2009 when utilization rates slumped to their lowest levels on record.

Nonetheless, there remains considerable excess capacity in the Canadian manufacturing sector, with utilization rates sitting well below the 84% average set in the latter half of the 1990s and the all time high of 86% set in 2000. The global economic slowdowns that followed the dot-com bubble and the 2008 financial crisis, combined with the petro-loonie, created significant challenges over the past decade, contributing to a notable drop in capacity utilization.

However progress is being made, as several manufacturing sectors have managed to work through the pains of restructuring — a process that Statistics Canada estimates to have contributed to roughly 50% of the productivity loss in manufacturing over the past decade. Computer and electronic manufacturers are operating at 94%, after a slow recovery from the massive shock of the dot-com bubble. The transportation sector, dominated by auto production, has rebounded after a big tumble during the recession, with capacity rates now at pre-recessionary levels and production likely to expand an additional 6% over the coming year. The machinery and equipment sector is also on an upswing. Buoyed by capital intensive projects in Western Canada, capacity utilization has reached record levels, at 91% in Q3.

Underutilization also led to a period of under-investment, an additional dampener on productivity. Chart 2 shows that in the early 2000s manufacturers' investment in machinery and equipment dropped significantly, recovered slightly by mid-decade, before being interrupted by the financial crisis. The net effect was a further depletion of the capital stock. Machinery and equipment investment is strongly correlated to productivity. The combined factors of a depleting capital stock and low capacity utilization contributed to meager labour productivity growth averaging 0.9% annually from 2000 to 2010 in the manufacturing sector, one quarter of the 3.6% pace set in the 1990s.

Firms have since responded, with investment in machinery and equipment proving to be one of the major contributors to Canada's economic recovery, resuming the growth cycle of the early to mid-2000s. The strong Canadian dollar and favourable federal and provincial taxation policy helped machinery and equipment investment jump nearly 12% in 2010. Investment is on pace for another double-digit gain in 2011, as cash filled corporate balance sheets, a strong dollar, attractive borrowing costs and competitive pressures have encouraged a jump in capital expenditures. With machinery and equipment investment growth expected to outperform and capacity usage in many industries climbing towards peak levels, it appears Canada is making headway towards improving its lagging productivity performance.



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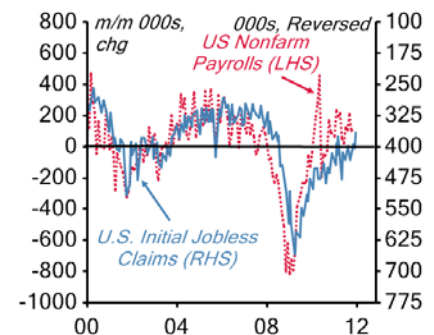
Do Low Jobless Claims Portend Stronger US Job Gains?

- There are three points drawn from recent research to consider.

With initial jobless claims sitting at their lowest point since April 2008, are nonfarm payrolls about to accelerate or do low claims just signal reduced job losses in a jobless recovery? There are three matters that may be of interest here. First, a recent research note by an economist at the St. Louis Fed is worth a gander (go here: <http://research.stlouisfed.org/publications/es/11/ES1140.pdf>). It addresses the issue of jobless recoveries — in other words, why recent cycles have witnessed delayed pick-ups in the pace of hiring following the resumption of growth in the wake of a recession. The argument here is that the long-term employment trend slowed markedly since 2000; thus, while operating at lower structural rates of job growth it takes longer for the recovery periods to recover lost jobs. The entry of women into the work force had boosted the structural rate of labour force expansion until this point. Their argument would support a sustained lower pace of job growth going forward.

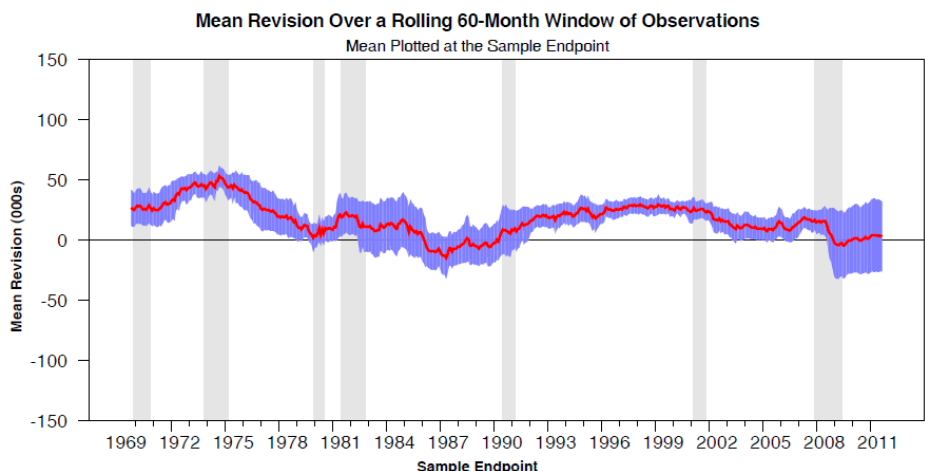
Two other points go against this. One concerns what is the trip point on initial jobless claims that motivates an acceleration in job growth. On that, we again turn to the St. Louis Fed's team of economists (see: <http://research.stlouisfed.org/publications/es/11/ES1141.pdf>). They use econometric tests to estimate that the past decade's dividing line at which initial jobless claims signal expanding or contracting job markets was 400,000 which is roughly in line with the historical average and rule of thumb that we have typically abided by. Yet they note that this trip point has gone through shifts over time, falling to as low as 325,000 from 1995-2006. Notably, they found that by 2008 — the year the crisis fully hit home — the trip point had risen to 450,000. Either way, recent sub-400k prints for jobless claims should be supportive of a pending acceleration in job growth.

US Initial Jobless Claims Continue to Point to Soft Nonfarm Payrolls Growth



Source: BLS Scotia Capital Economics

The third point concerns evidence that nonfarm payrolls perpetually understate the magnitude of the recovery until full revisions occur. A recent Philly Fed paper addressed this issue (go here: http://www.philadelphiafed.org/research-and-data/publications/research-rap/2011/revisions-to-nonfarm-payroll-employment.pdf?utm_source=E-mail&utm_medium=TM&utm_campaign=E-mail). It found that over the long term, the average upward monthly revision to nonfarm payrolls in months when they have risen works out to about 18,000. Notably, however, they figure today's average monthly revision is double that. Chart 2 is drawn from their piece and says it all through tracking a rolling 90% confidence interval surrounding mean monthly nonfarm payroll revisions and how this has widened out in the post-crisis period to the widest confidence interval on record. They note that the monthly revision since 2009 has pushed as high as 124k. That might mean that you should brace yourself for further material upward revisions to nonfarm payrolls in coming months that would be positive signals to equities about gradually mending US job markets.



The graph shows the mean revision and the corresponding 90 percent confidence interval. Shading indicates recessions.

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Oil Prices End 2011 On A Strong Note

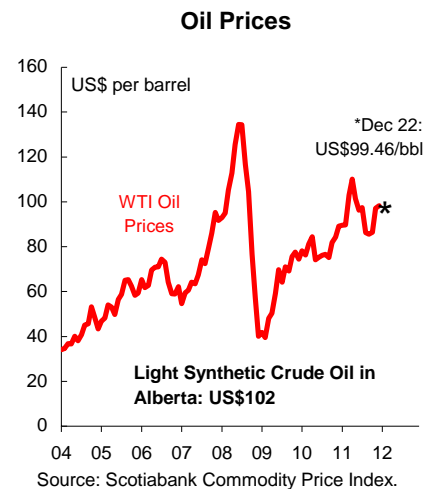
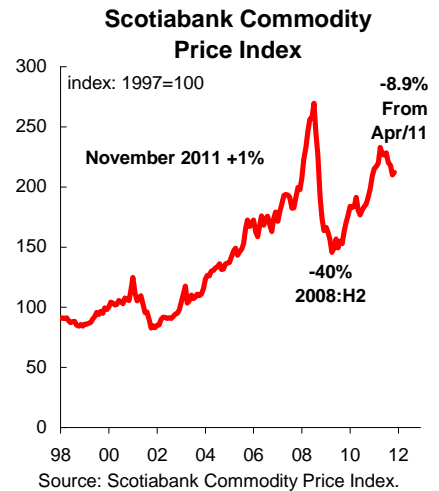
• Crude Oil — A Top ‘Pick’ for Investors in 2012.

After three consecutive monthly declines, Scotiabank’s Commodity Price Index was lifted in November (+1% m/m) by a sharp rally in the Oil & Gas sub-component (+4.6% m/m) and a moderate rebound in some base metal prices. Despite concern over financial and economic prospects in the Eurozone, Brent oil prices edged up from US\$110 per barrel in October to US\$111 in November and remain strong at US\$110 on December 22. Of the 32 commodities included in Scotiabank’s Commodity Price Index, oil is a top ‘pick’ for investors in 2012.

A ‘geopolitical risk premium’ in world oil prices resurfaced in early November, after an International Atomic Energy Agency Report on Iran’s alleged nuclear weapons ambitions. Tightening sanctions against Iran threaten to make it more difficult to pay for Iranian crude through the international banking system, though two of the largest buyers of Iranian crude (China — the largest — and India — the third largest) are unlikely to cut their purchases (a credit dispute will reduce China’s buying near-term). Any embargo of Iranian crude would drive prices dramatically higher. Iran is the second-biggest OPEC producer, with output of 3.55 mb/d and exports of 2.6 mb/d; offsetting the loss of this crude would test the excess capability of the major OPEC Gulf producers, estimated at 2.7 mb/d.

WTI oil prices jumped even more in November — from just over US\$86 to US\$97 — with the discount off Brent narrowing. This reflects the November 16 announcement that Enbridge, together with Enterprise Products Partners, will reverse the flow on the Seaway Crude Pipeline System, connecting Alberta and new U.S. mid-continent oil supplies arriving at Cushing, Oklahoma to Houston (the largest refining centre in the United States). World prices prevail on the U.S. Gulf Coast.

Global supply & demand conditions for oil are currently balanced. OPEC, at its December 14 meeting, agreed to maintain output near current levels of 30 mb/d in 2012:H1 — roughly equal to the recent ‘call’ for OPEC crude — and only slightly higher than our projected demand. OPEC will meet again on June 14, 2012. The net result, WTI oil prices should average a strong US\$95-100 in 2012 compared with US\$95 in 2011 and US\$79.53 in 2010.



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Effects Of Deleveraging On Latin American Banks

The following article was published on December 22, 2011.

Despite the large role that European banks play in Latin America, the impact of European deleveraging on Latin American credit conditions may be smaller than expected, both because Latin American banks are self-funded and because there are significant obstacles to withdrawing capital from subsidiaries. Selling equity participation in subsidiaries may actually be the quickest way to withdraw capital, as well as the least detrimental for Latin American economies.

Introduction

Much has been written about the expected deleveraging of European banks. For example, according to one estimate, new liquidity regulations in Basel III will require banks to obtain €2,700bn in wholesale funding between now and 2018 or to reduce the gap between loans and deposits by a commensurate amount.¹ More immediately, the European Banking Authority (EBA) estimates that banks will need €15bn in new capital as a buffer against sovereign debt exposure by June 2012, with Spanish banks accounting for €26bn of that amount. Also well-known is the fact that foreign banks play a large role in Latin America, such that any deleveraging could potentially have an effect on credit conditions in Latin America, producing both a generalized macroeconomic slowdown as well as particularly detrimental effects for corporates operating in credit-sensitive sectors. As shown in Figure 2, foreign bank positions in Latin America are on average 25% of GDP; European banks account on average for 16% of GDP.

Yet, little is known in the investor community about how bank parents interact with their subsidiaries and how bank regulators control those interactions, making it difficult to assess the likely magnitude of spillovers to Latin America. While aggregate data certainly demonstrate a deleveraging during the last crisis,² it is often hard to trace causation; did foreign banks lend less because of financial problems on their consolidated balance sheets or because lending became less attractive in the emerging market country? One ECB study got around that problem by comparing lending by foreign banks with financial problems (low equity capital and large losses on financial assets), by foreign banks without financial problems, and by domestic banks in central and eastern Europe, a region where foreign banks had significantly increased their presence. The study found that the rejection rate on loans increased from 23% to 39% in localities dominated by foreign banks with capital problems.³

In contrast to the case of Central and Eastern Europe, the impact in Latin America may be more limited. With a particular focus on Mexico, a country where foreign banks represent about three-quarters of the banking sector, we explain what factors impede these spillovers.

Latin American banks are self-funded

The starting point for assessing the impact on Latin America is realizing that Latin American banks are largely self-funded. For example, Figure 1 shows that deposit growth in Latin America for three major international banks where we could get data has kept up with loan growth.

In Mexico, we have found that loans from foreign parents to their subsidiaries have not played a significant role in the development of those subsidiaries (Figure 3). According to Banxico data, the net exposure of Mexican

Figure 1. Loans and Deposits in Latin America by major banks

	2010	2009	2008
BBVA Loans	70	61	62
BBVA Deposits	72	63	57
Santander Loans	123	96	89
Santander Deposits	124	97	96
HSBC Loans	43	33	34
HSBC Deposits	47	36	36

Source: Consolidated annual reports, figures are in billions of Euros.

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banks to foreign banks is generally small, varying between positive USD \$6bn and negative \$6bn over the past four years, only a few percentage points of the approximately \$170bn in the portfolio of Mexican banks. At the start of 2007, Mexican banks were net creditors of \$5bn with respect to banks abroad, demonstrating further that the Mexican banks were financed locally. At the peak of the financial crisis, Mexican banks had lent an additional \$7bn to banks abroad, but that position did not last long. For the first eight months of 2011 for which Banxico provides data, Mexican banks owed a stable \$6bn to foreign banks.

Thus, the good news is that we do not have to worry that foreign banks will stop sending capital to their subsidiaries, thus hampering lending going forwards. As we have explained, such capital flows have not been the primary source of bank funds in Latin America. Instead, there is some reason to worry that relatively healthy Latin American subsidiaries will send liquidity back to their parents at the expense of additional lending, or that those subsidiaries will weaken their balance sheet such that they are less able to weather a shock in their own countries.

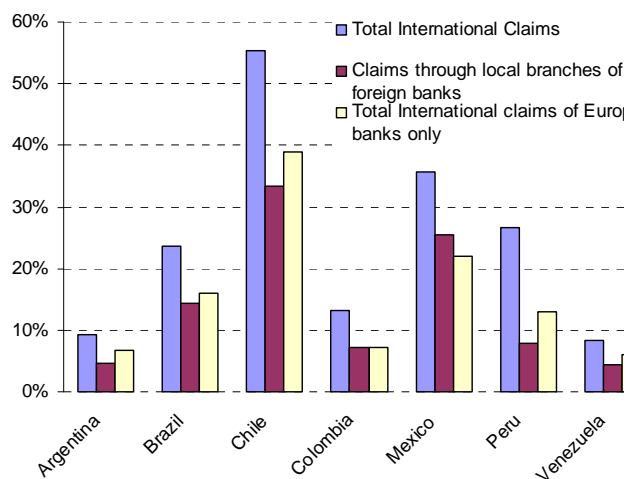
Can Latam banks rescue their European parents?

As shown in Figure 4, capital ratios at Mexico's largest banks are fairly healthy. While they are not quite at the record highs we saw in 2010, capital ratios are still high in three of the four banks relative to levels in previous years.

Those ratios suggest subsidiaries have some excess capital to transfer to their home countries. Moreover, there are perhaps a dozen different ways for banks to transfer assets between subsidiaries. Dividends are perhaps the best known, but these are not that large. For example, Bancomer (BBVA's subsidiary in Mexico) pays approximately \$1bn USD in dividends to BBVA. That is a significant outflow of capital, but those flows are fairly stable. It pales in comparison to Bancomer's loan portfolio of \$44bn, and the amount it could increase or decrease that portfolio. Other methods include purchasing assets from the parent, repo transactions, depositing excess funds with the parent, and paying parents for certain administrative services.

The good news for Latin American economies (and bad news for multinational banks) is that all of these transactions are carefully monitored by the regulators. In many cases, there are no formal restrictions against these types of transfers as long as capital ratios remain high and the transfers are not too large relative to the bank's capital. For example, in Mexico, dividends and loans to related parties are prohibited only when the

Figure 2. Role of foreign banks (as % of GDP)



Source: BIS, IIF, Scotia Capital

Figure 3. Net position w/respect to foreign banks



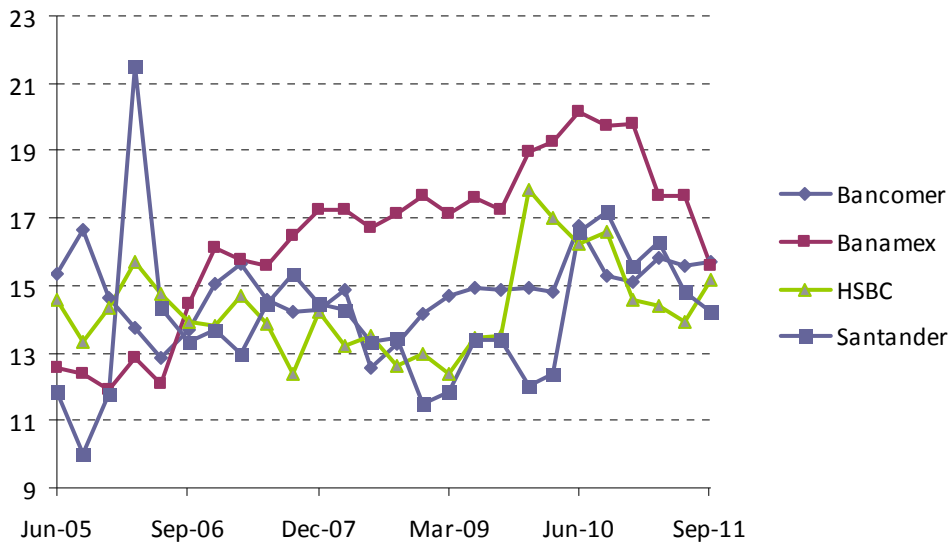
Source: Banxico; Graph shows net position of Mexican banks with respect to foreign banks. Positive number means Mexican banks are net creditors to foreign banks.

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Figure 4. Total capital ratios (Tier 1 and Tier 2) of Mexico's largest multinational banks



Source: CNBV

capital ratio falls below 8% or when these are greater than 25% of Tier 1 capital. Despite this lack of formal restrictions, banks are generally averse to significantly increasing transactions with related parties. We imagine that this is due to a combination of fear of the regulator's powers of moral suasion, the role of independent directors on the boards of bank subsidiaries, and the potential response in local funding markets. On the latter point, Banco Santander in Mexico had trouble issuing debt in September—it issued only MXN 2.8bn rather than the expected 5bn, and the resultant spread came out at 50bp instead of the expected 30bp. Such problems would have been much greater had the market gotten word of any new transactions with the parent company.

One transaction that is occurring and that the regulator can do little about is the transfer of certain loans from the books of the parent to that of the subsidiary. It is common practice for the largest companies in Latin America to receive loans not from the local subsidiary but the foreign parent bank. As the cheapest location of funding moves from the parent's home country to that of the Latin American subsidiary, it is only natural for the bank to shift the loan from the books of the parent to that of the subsidiary. Considering that the subsidiary is adding loans to its books from the strongest companies in its country, it is hard to see what grounds regulators would have to object. Nevertheless, there remains the possibility that new lending to the largest companies will crowd-out lending to other local firms. In assessing the potential magnitude of this effect, we found in annual reports the amount of local currency cross-border lending by the parent banks to Latin America. These numbers at the end of 2010 were €5bn for BBVA, €14bn for Santander, and €26bn for Citibank. Nevertheless, loans can be booked in a variety of ways and we are not sure these numbers are complete.

Conclusion

We are left with an interesting incongruity. Capital ratios imposed by European regulators are based on consolidated figures, presumably on the assumption that the bank can easily transfer capital between subsidiaries as necessary to cover losses. That would suggest a European bank could meet certain capital targets by slowing lending in Latin America, improving its ratios there to compensate for poorer ratios in

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Europe. In contrast, Latin American regulators want to keep their local banks healthy, and have little to gain from allowing an outflow of bank capital. We are not sure how much power they ultimately have, but it does seem that large transfers of capital could be difficult to execute, making the use of consolidated capital ratios questionable.

Another relevant theme here is short-term liquidity vs. long term capital needs. Obviously, on a consolidated basis, moving loans from one book to another makes no difference with regards to capital ratios, but it does help with immediate liquidity needs and allows the firm to benefit from differences in funding costs. Wednesday's news about the unprecedented €489bn loaned to banks by the ECB at low interest rates for a three-year term should alleviate some concerns about funding costs.

Recent divestments by HSBC in Chile and Santander in Colombia and Chile demonstrate that some of the factors we have mentioned here may have led the parent banks to decide that the easiest way to get capital out is to sell equity participation in non-core subsidiaries. Such sales may actually be good news for Latin America, especially when the acquirer is a stronger bank with the resources to continue expanding credit. In this sense, fears of the impact of European deleveraging on Latin American credit conditions may be exaggerated.

Endnotes:

¹ "Rocks for jocks: A Wall St. guide to Pemex," Scotia Capital, April 20, 2010.

² A replacement rate of 100% would signify that Pemex is finding enough new oil to compensate for the oil it is extracting, making stable oil production likely.

³ Alexander Popov and Gregory F. Udell, "Cross-Border Banking and the International Transmission of Financial Distress during the crisis of 2007-2008," Working Paper No. 1203, June 2010.

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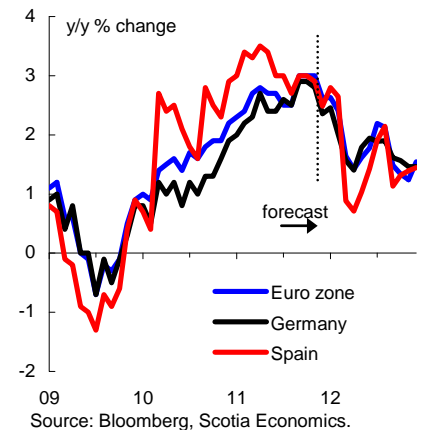
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Key Data Preview

EUROPE

Preliminary December inflation estimates will be reported next week for Germany (Thursday) and Spain (Friday). Inflation eased by 0.1 percentage point in both nations in November, to 2.8% y/y in Germany and 2.9% in Spain. We expect a more pronounced drop in December, to 2.4% and 2.5%, implying monthly gains of 0.8% m/m and 0.2% for Germany and Spain, respectively. With inflation in France and Italy also expected to moderate this month, we are looking for an end-of-year rate of 2.6% y/y for the euro zone overall (down from 3.0% in October and November). Though inflation will remain elevated for several months to come on buoyant commodity prices and indirect taxes (largely a result of accelerated fiscal consolidation plans), it will ease markedly toward the end of 2012. The headline euro zone rate should fall below the ECB's target rate of "below, but close to, 2%" before next year's end. Underlying wage and cost pressures will remain muted in a context of very weak growth in Europe, as well as slowing momentum globally.

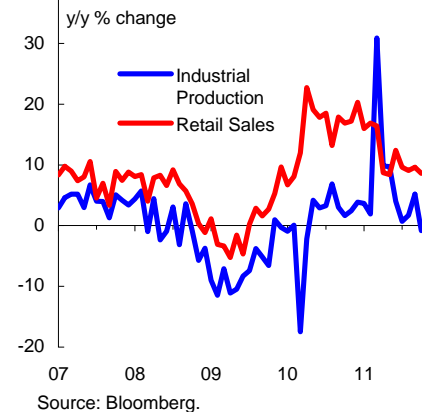
Euro Zone Inflation



LATIN AMERICA

The Chilean economy has been showing mixed signs: on one hand the industrial sector has declined significantly, while on the other, local demand remains steady. Industrial production and retail sales for November will be released on December 29th. In October, industrial production fell at a rate of 0.8% y/y, the first decline since the earthquake, while retail sales grew 8.6% with the durable goods component reaching its lowest rate of the year. It seems that confidence is starting to be adversely affected by the international environment, which could dampen consumption and thereby weaken the overall growth pattern. Additionally, headline inflation currently stands at the upper limit of the central bank's target range (2-4%), mainly driven by food and energy costs, which will also weigh on local consumption.

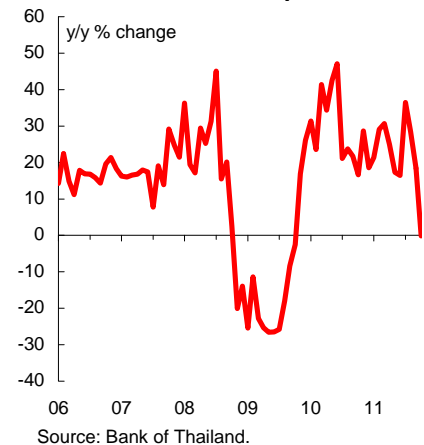
Chile Industrial Production & Retail Sales



ASIA

Thailand's trade figures will be reported next week. The nation's exports slumped in October on the back of the effects of excessive flooding. While a rebound is expected in the coming months, the numbers for November will likely continue to display a weak performance, particularly given the evidence from other countries like Japan where supply restrictions continued to affect activity on car and electronics manufacturing assembly lines. We thus anticipate a minor expansion of 1.2% y/y in Thailand's export values. Reports of a rebound in output from affected plants imply that the effects of the floods will be temporary, leading to a quick recovery in the country's export capacity and output performance early in the New Year.

Thailand's Exports



Key Indicators for the week of December 26 - 30

North America

Country	Date	Time	Event	Period	BNS	Consensus	Latest
US	12/27	09:00	S&P/CS 20 City (MoM)	OCT	-0.4	-0.2	-0.6
US	12/27	09:00	S&P/CS Composite-20 (YoY)	OCT	--	-3.2	-3.6
US	12/27	10:00	Consumer Confidence	DEC	56.5	58.5	56.0
MX	12/27	10:00	International Reserves Weekly (US\$ mns)	23-Dec	--	--	140848
US	12/27	10:00	Richmond Fed Manuf. Index	DEC	--	5.0	0.0
US	12/27	10:30	Dallas Fed Manf. Activity	DEC	--	4.5	3.2
US	12/29	08:30	Initial Jobless Claims (000s)	23-Dec	370	372	364
US	12/29	08:30	Continuing Claims (000s)	16-Dec	3600	3579	3546
US	12/29	09:45	Chicago Purchasing Manager	DEC	--	60.3	62.6
US	12/29	10:00	Pending Home Sales (MoM)	NOV	2.5	1.5	10.4
US	12/29	11:00	Kansas City Fed Manf. Activity	DEC	--	6.0	4.0
MX	12/29	15:30	Budget Balance YTD (MXN bns)	NOV	--	--	-179.9
US	12/30	10:00	NAPM-Milwaukee	DEC	--	58.3	56.7

Europe

Country	Date	Time	Event	Period	BNS	Consensus	Latest
FR	12/26	12:00	Jobseekers- Net Change (000s)	NOV	--	--	34.4
SP	12/28	03:00	Mortgages on Houses (YoY)	OCT	--	--	-42.0
SW	12/28	03:30	Household Lending (YoY)	NOV	--	--	5.5
SW	12/28	03:30	Retail Sales s.a. (MoM)	NOV	--	--	0.4
GE	12/29	03:00	CPI - Saxony (MoM)	DEC	--	--	-0.1
GE	12/29	03:00	CPI - Saxony (YoY)	DEC	--	--	2.6
SP	12/29	03:00	Retail Sales (Real) (YoY)	NOV	--	--	-6.9
SW	12/29	03:30	Trade Balance (SEK bns)	NOV	--	--	7.8
IT	12/29	04:00	Business Confidence	DEC	--	93.8	94.4
GE	12/29	04:00	CPI - Brandenburg (MoM)	DEC	--	--	0.2
GE	12/29	04:00	CPI - Brandenburg (YoY)	DEC	--	--	2.6
GE	12/29	04:00	CPI - Hesse (MoM)	DEC	--	--	0.0
GE	12/29	04:00	CPI - Hesse (YoY)	DEC	--	--	2.3
GE	12/29	06:00	CPI - Bavaria (MoM)	DEC	--	--	0.0
GE	12/29	06:00	CPI - Bavaria (YoY)	DEC	--	--	2.5
GE	12/29		CPI - EU Harmonised (MoM)	DEC P	0.8	0.8	0.0
GE	12/29		CPI - EU Harmonised (YoY)	DEC P	2.4	2.4	2.8
GE	12/29		Consumer Price Index (MoM)	DEC P	0.8	0.8	0.0
GE	12/29		Consumer Price Index (YoY)	DEC P	2.1	2.2	2.4
GE	12/29		CPI - Baden Wuerttemberg (MoM)	DEC	--	--	0.0
GE	12/29		CPI - Baden Wuerttemberg (YoY)	DEC	--	--	2.5
GE	12/29		CPI - North Rhine-West. (MoM)	DEC	--	--	-0.1
GE	12/29		CPI - North Rhine-West. (YoY)	DEC	--	--	2.1
UK	12/30	02:00	Nat'wide House prices sa (MoM)	DEC	0.2	0.0	0.4
SP	12/30	03:00	Consumer Price Index (YoY)	DEC P	2.5	2.5	2.9
SW	12/30	03:30	Wages - Non-Manual Workers (YoY)	OCT	--	--	2.2
IT	12/30	04:00	PPI (MoM)	NOV	--	0.2	-0.2
IT	12/30	04:00	PPI (YoY)	NOV	--	4.5	4.7
UK	12/30	04:30	BoE Housing Equity Withdrawal (£ bns)	3Q	--	-9.0	-9.1
PO	12/30		Industrial Production (MoM)	NOV	--	--	0.7
PO	12/30		Retail Sales (MoM)	NOV	--	--	-3.2
SP	12/30		Current Account (€ bns)	OCT	--	--	-3.6
GE	12/30	00:00	Retail Sales (MoM)	NOV	0.5	0.2	-0.2

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Key Indicators for the week of December 26 - 30

Asia Pacific

Country	Date	Time	Event	Period	BNS	Consensus	Latest
TH	DEC 25-28		Total Capacity Utilization ISIC	NOV	--	--	46.4
TH	DEC 25-28		Mfg. Production Index ISIC (SA)	NOV	--	--	122.1
SK	12/26	16:00	SK Consumer Confidence	DEC	--	--	103
JN	12/26	18:50	Corp Service Price Index (YoY)	NOV	--	0.0	0.1
CH	12/26	21:00	Industrial Profits YTD (YoY)	NOV	--	--	25.3
JN	12/26	23:00	Vehicle Production (YoY)	NOV	--	--	20.3
CH	DEC 26-31		Leading Index	NOV	--	--	100.4
JN	12/27	00:00	Construction Orders (YoY)	NOV	--	--	24.3
JN	12/27	00:00	Annualized Housing Starts (mns)	NOV	--	0.802	0.774
JN	12/27	00:00	Housing Starts (YoY)	NOV	--	-4.9	-5.8
JN	12/27	00:00	Small Business Confidence	DEC	--	--	45.8
TA	12/27	03:00	Leading Index (MoM)	NOV	--	--	-0.2
TA	12/27	03:00	Coincident Index (MoM)	NOV	--	--	-0.6
SK	12/27	16:00	Business Survey- Manufacturing	JAN	--	--	83.0
SK	12/27	16:00	Business Survey- Non-Manufacturing	JAN	--	--	82.0
JN	12/27	18:30	Overall Household Spending (YoY)	NOV	--	-1.2	-0.4
JN	12/27	18:30	Jobless Rate	NOV	--	4.5	4.5
JN	12/27	18:30	Tokyo CPI (YoY)	DEC	--	-0.6	-0.8
JN	12/27	18:30	Natl CPI (YoY)	NOV	--	-0.4	-0.2
JN	12/27	18:30	Natl CPI Ex-Fresh Food (YoY)	NOV	--	-0.2	-0.1
JN	12/27	18:30	Natl CPI Ex Food, Energy (YoY)	NOV	--	-1.1	-1.0
JN	12/27	18:50	Retail Trade SA (MoM)	NOV	--	-0.5	1.4
JN	12/27	18:50	Large Retailers' Sales (YoY)	NOV	--	-1.6	-1.4
JN	12/27	18:50	Industrial Production (MoM)	NOV P	--	-0.8	2.2
PH	12/27	20:00	Total Imports (YoY)	OCT	--	--	11.7
PH	12/27	20:00	Trade Balance (US\$ mns)	OCT	--	--	-1238.0
SK	12/28	18:00	Current Account (US\$ mns)	NOV	--	--	4231.3
SK	12/28	18:00	Goods Balance (US\$ mns)	NOV	--	--	3647.3
SK	12/28	18:00	Industrial Production (MoM)	NOV	--	0.5	-0.7
SK	12/28	18:00	Leading Index (YoY)	NOV	--	--	1.0
TA	12/29	02:30	Benchmark Interest Rate	29-Dec	1.88	1.88	1.88
HK	12/29	03:30	Exports (YoY)	NOV	--	0.5	11.5
HK	12/29	03:30	Imports (YoY)	NOV	--	2.0	10.9
HK	12/29	03:30	Trade Balance (HK\$ bns)	NOV	--	-28.1	-23.1
SK	12/29	18:00	Consumer Price Index (MoM)	DEC	0.1	0.2	0.1
SK	12/29	18:00	Consumer Price Index (YoY)	DEC	--	4.0	4.2
SK	12/29	18:00	Core Consumer Price Index (YoY)	DEC	--	--	3.5
CH	12/29	20:35	MNI December Business Condition Survey				
CH	12/29	21:30	HSBC Manufacturing PMI	DEC	48.5	--	47.7
TH	12/30	02:30	Total Exports (YoY)	NOV	1.2	--	-0.1
TH	12/30	02:30	Total Imports (YoY)	NOV	17.3	--	20.6
TH	12/30	02:30	Total Trade Balance (US\$ mns)	NOV	-200	--	1013
TH	12/30	02:30	Current Account Balance (US\$ mns)	NOV	--	-739.0	39.0
TH	12/30	02:30	Business Sentiment Index	NOV	--	--	36.7
HK	12/30	04:00	Govt Monthly Budget Surp/Def (HK\$ bns)	NOV	--	--	28.1
IN	12/30	06:30	Current Account Balance (US\$ bns)	3Q	--	-19.5	-14.2

Latin America

Country	Date	Time	Event	Period	BNS	Consensus	Latest
BZ	12/27	08:00	Trade Balance (FOB) - Weekly (US\$ mns)	25-Dec	--	--	542.0
CL	12/28	06:30	Central Bank Meeting Minutes				
CO	12/28	11:00	Urban Unemployment Rate	NOV	--	10.0	10.2
CL	12/29	07:00	Industrial Production (YoY)	NOV	--	0.4	-0.8
CL	12/29	07:00	Industrial Sales (YoY)	NOV	--	1.5	-0.6
CL	12/29	07:00	Unemployment Rate	NOV	--	7.2	7.2
CL	12/29	07:00	Copper Production Total	NOV	--	--	466822
CL	12/29	07:00	Retail Sales (YoY)	NOV	--	8.5	8.6

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Global Auctions for the week of December 26 - 30

North America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
US	12/27	11:30	U.S. to Sell 3-Month Bills
US	12/27	11:30	U.S. to Sell 6-Month Bills
US	12/28	11:00	U.S. Fed to Sell USD 8.00-8.75 Bln Notes
US	12/28	11:30	U.S. to Sell 4-Week Bills

Europe

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
SZ	12/27	05:30	Switzerland to Sell 3-Month Bills
HU	12/27	05:30	Hungary to Sell 3-Month Bills
HU	12/28	04:30	Hungary's Central Bank to Sell 2-Week Bills
IT	12/28	05:00	Italy to Sell EUR 9 Bln 179-Day Bills
IT	12/28	05:00	Italy to Sell Up to EUR 2.5 Bln Zero 2013 Bonds
IT	12/29	05:00	Italy to Sell Floating 2018 Bonds on Dec. 29
IT	12/29	05:00	Italy to Sell 6% 2014 Bonds on Dec. 29
IT	12/29	05:00	Italy to Sell 5% 2022 Bonds on Dec. 29
IT	12/29	05:00	Italy to Sell 4.75% 2021 Bonds on Dec. 29
HU	12/29	05:30	Hungary to Sell Bonds
UK	12/30	06:10	U.K. to Sell GBP500 Mln 27-Day Bills
UK	12/30	06:10	U.K. to Sell GBP1 Bln 90-Day Bills
UK	12/30	06:10	U.K. to Sell GBP1 Bln 181-Day Bills

Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
TA	12/25	23:30	Taiwan to Sell TWD35 Bln 10-Yr Bonds
SK	12/26	21:30	Korea to Sell KRW1.05 Tln 20-Year Bonds
TH	12/26	22:00	Bank of Thailand to Sell THB16 Bln 28D Bills
TH	12/26	22:00	Bank of Thailand to Sell THB20 Bln 91D Bills
TH	12/26	22:00	Bank of Thailand to Sell THB20 Bln 182D Bills
SI	12/26	23:00	Singapore to sell 91-Day T-Bills
IN	12/28	04:30	India to sell INR 40Bln 91-Day bills
IN	12/28	04:30	India to sell INR 40Bln 364-Day bills

Source: Bloomberg, Scotia Economics.

Events for the week of December 26 - 30

Europe

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
IT	12/29	06:00	Prime Minister Monti Holds Year-End Press Conference in Rome

Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
TA	12/29	02:30	Benchmark Interest Rate

Latin America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
CL	12/28	06:30	Central Bank 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>
<i>Bank of Canada – Overnight Target Rate</i>	1.00	January 17, 2012	1.00	--
<i>Federal Reserve – Federal Funds Target Rate</i>	0.25	January 25, 2012	0.25	--
<i>Banco de México – Overnight Rate</i>	4.50	January 20, 2012	4.50	--

The BoC can seek a little more comfort in the most recent inflation report compared to the general tendency for inflation to surprise to the upside over the prior couple of reports. Indeed, the BoC will need several more soft readings for its October MPR forecast for headline inflation to drop to 1% y/y by next summer and for core inflation not to challenge the 2% target until the end of 2013 to come true. We maintain that a BoC rate cut is a low probability as it requires an abrupt global liquidity shock and inflation to track much lower and continue tracking much lower instead of rising again into 2012H2 and 2013 as the BoC currently anticipates. In the U.S., we continue to expect the Federal Reserve to keep the fed funds rate on hold at 0-0.25% until at least Q3 2013. However, the current FOMC voting structure will shift at the first FOMC meeting next year (January 25, 2012), ushering in a more dovish committee composition to replace this year's more hawkish tilt. As a result, the bar will be lowered regarding further unconventional monetary policy easing.

Europe

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
<i>European Central Bank – Refinancing Rate</i>	1.00	January 12, 2012	1.00	1.00
<i>Bank of England – Bank Rate</i>	0.50	January 12, 2012	0.50	0.50
<i>Swiss National Bank – Libor Target Rate</i>	0.00	March 15, 2012	0.00	--
<i>Central Bank of Russia – Refinancing Rate</i>	8.00	January 28, 2012	8.00	--
<i>Hungarian National Bank – Base Rate</i>	7.00	January 22, 2012	7.00	--
<i>Central Bank of the Republic of Turkey – 1 Week Repo Rate</i>	5.75	January 25, 2012	5.75	--

Asia Pacific

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
<i>Bank of Japan – Target Rate</i>	0.10	January 24, 2012	0.10	--
<i>Reserve Bank of Australia – Cash Target Rate</i>	4.25	February 6, 2012	4.25	4.00
<i>Reserve Bank of New Zealand – Cash Rate</i>	2.50	January 25, 2012	2.50	--
<i>People's Bank of China – Lending Rate</i>	6.56	TBA	--	--
<i>Reserve Bank of India – Repo Rate</i>	8.50	January 24, 2012	8.50	--
<i>Hong Kong Monetary Authority – Base Rate</i>	0.50	TBA	0.50	--
<i>Central Bank of China Taiwan – Discount Rate</i>	1.88	December 29, 2011	1.88	1.88
<i>Bank Negara Malaysia – Overnight Policy Rate</i>	3.00	January 31, 2012	3.00	--
<i>Bank of Korea – Bank Rate</i>	3.25	January 12, 2012	3.25	--
<i>Bank of Thailand – Repo Rate</i>	3.25	January 25, 2012	3.25	--
<i>Bank Indonesia – Reference Interest Rate</i>	6.00	January 12, 2012	6.00	--
<i>Central Bank of the Philippines – Overnight Policy Rate</i>	4.50	January 19, 2012	4.50	--

Latin America

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
<i>Banco Central do Brasil – Selic Rate</i>	11.00	January 18, 2012	11.00	--
<i>Banco Central de Chile – Overnight Rate</i>	5.25	January 12, 2012	5.25	--
<i>Banco de la República de Colombia – Lending Rate</i>	4.75	January 23, 2012	4.75	--
<i>Banco Central de Reserva del Perú – Reference Rate</i>	4.25	January 12, 2012	4.25	--

Africa

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
<i>South African Reserve Bank – Repo Rate</i>	5.50	January 19, 2012	5.50	--

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Forecasts as at December 1, 2011*

	2000-10	2011f	2012f	2013f	2000-10	2011f	2012f	2013f
Output and Inflation (annual % change)								
	Real GDP				Consumer Prices²			
World ¹	3.7	3.8	3.7	4.0				
Canada	2.2	2.3	1.8	2.4	2.1	3.0	1.8	2.0
United States	1.8	1.8	1.8	2.2	2.5	3.2	1.8	2.1
Mexico	2.1	3.9	2.9	3.7	4.9	3.6	4.0	4.1
United Kingdom	1.9	0.8	0.8	1.8	2.1	4.4	2.1	2.5
Euro zone	1.4	1.6	0.0	1.3	2.1	2.6	1.5	1.8
Japan	0.9	0.1	3.2	1.8	-0.3	0.2	0.4	0.5
Australia	3.1	2.1	4.2	3.3	3.1	3.0	2.8	2.5
China	9.5	9.1	8.9	8.5	2.3	5.0	4.5	4.3
India	7.5	7.6	8.1	8.0	6.4	8.1	6.5	6.0
Korea	4.6	3.8	4.3	4.5	3.1	3.7	3.3	3.0
Thailand	4.1	2.8	3.5	4.5	2.6	3.5	3.0	2.8
Brazil	3.7	3.5	4.0	4.5	6.6	6.5	5.7	5.0
Chile	3.8	6.5	4.7	5.8	3.3	3.5	2.8	3.8
Peru	5.5	6.9	5.5	5.6	2.4	4.8	3.5	2.5
Central Bank Rates (% end of period)	11Q4f	12Q1f	12Q2f	12Q3f	12Q4f	13Q1f	13Q2f	13Q3f
Bank of Canada	1.00	1.00	1.00	1.00	1.00	1.00	1.50	2.00
Federal Reserve	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.75
European Central Bank	1.00	0.75	0.75	0.75	0.75	0.75	0.75	1.00
Bank of England	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75
Swiss National Bank	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25
Bank of Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.25
Reserve Bank of Australia	4.50	4.25	4.25	4.25	4.25	4.25	4.50	4.50
Exchange Rates (end of period)								
Canadian Dollar (USDCAD)	1.04	1.02	1.01	0.99	0.98	0.98	0.97	0.97
Canadian Dollar (CADUSD)	0.96	0.98	0.99	1.01	1.02	1.02	1.03	1.03
Euro (EURUSD)	1.30	1.29	1.28	1.27	1.25	1.25	1.26	1.28
Sterling (GBPUSD)	1.55	1.56	1.59	1.62	1.63	1.65	1.66	1.67
Yen (USDJPY)	78	78	80	80	82	83	83	84
Australian Dollar (AUDUSD)	1.00	1.02	1.04	1.06	1.08	1.09	1.09	1.10
Chinese Yuan (USDCNY)	6.3	6.3	6.2	6.1	6.1	6.0	6.0	5.9
Mexican Peso (USDMXN)	13.5	13.5	13.2	13.0	13.0	13.1	13.2	13.3
Brazilian Real (USDBRL)	1.80	1.79	1.77	1.76	1.75	1.77	1.80	1.82
Commodities (annual average)	2000-10	2011f	2012f	2013f				
WTI Oil (US\$/bbl)	54	95	95	104				
Brent Oil (US\$/bbl)	52	111	108	110				
Nymex Natural Gas (US\$/mmbtu)	5.81	4.05	3.50	4.25				
Copper (US\$/lb)	1.93	4.00	4.00	3.50				
Zinc (US\$/lb)	0.75	0.99	0.99	1.10				
Nickel (US\$/lb)	7.36	10.35	9.00	8.00				
Gold, London PM Fix (US\$/oz)	586	1,565	1,675	1,600				
Pulp (US\$/tonne)	694	977	912	950				
Newsprint (US\$/tonne)	575	640	680	725				
Lumber (US\$/mfbm)	273	255	260	300				

¹ World GDP for 2000-10 are IMF PPP estimates; 2011-13f are Scotia Economics' estimates based on a 2010 PPP-weighted sample of 38 countries.

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

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

Canada	2010	11Q2	11Q3	Latest	United States	2010	11Q2	11Q3	Latest
Real GDP (annual rates)	3.2	-0.5	3.5		Real GDP (annual rates)	3.0	1.3	1.8	
Current Acc. Bal. (C\$B, ar)	-50.9	-64.5	-48.5		Current Acc. Bal. (US\$B, ar)	-471	-499	-441	
Merch. Trade Bal. (C\$B, ar)	-9.0	-13.9	1.8	-10.6 (Oct)	Merch. Trade Bal. (US\$B, ar)	-646	-762	-727	-705 (Oct)
Industrial Production	4.9	2.4	3.5	5.2 (Sep)	Industrial Production	5.3	3.8	3.7	8.5 (Nov)
Housing Starts (000s)	192	192	204	181 (Nov)	Housing Starts (millions)	0.58	0.57	0.62	0.69 (Nov)
Employment	1.4	1.6	1.5	3.1 (Nov)	Employment	-0.8	0.9	1.1	2.1 (Nov)
Unemployment Rate (%)	8.0	7.5	7.2	7.4 (Nov)	Unemployment Rate (%)	9.6	9.1	9.1	8.6 (Nov)
Retail Sales	5.5	4.1	4.1	4.4 (Oct)	Retail Sales	6.8	8.1	8.3	14.6 (Nov)
Auto Sales (000s)	1561	1574	1604	1634 (Oct)	Auto Sales (millions)	11.6	12.1	12.4	13.6 (Nov)
CPI	1.8	3.4	3.0	5.3 (Nov)	CPI	1.6	3.4	3.8	4.8 (Nov)
IPPI	1.0	5.1	5.3	-4.7 (Oct)	PPI	4.2	6.9	6.8	9.1 (Nov)
Pre-tax Corp. Profits	21.2	15.1	17.0		Pre-tax Corp. Profits	25.0	1.3	3.7	
Mexico					Brazil				
Real GDP	5.4	3.2	4.5		Real GDP	6.9	2.9	2.0	
Current Acc. Bal. (US\$B, ar)	-5.7	-11.9	-15.0		Current Acc. Bal. (US\$B, ar)	-47.4	-43.4	-42.0	
Merch. Trade Bal. (US\$B, ar)	-3.0	5.7	-15.3	-5.6 (Oct)	Merch. Trade Bal. (US\$B, ar)	20.2	39.3	40.3	7.0 (Nov)
Industrial Production	6.0	3.5	3.4	3.3 (Oct)	Industrial Production	10.5	0.6	0.1	-2.7 (Oct)
CPI	4.2	3.3	3.4	7.5 (Nov)	CPI	5.1	6.5	7.1	12.5 (Nov)
Chile					Italy				
Real GDP	5.2	6.6	4.8		Real GDP	1.4	0.7	0.2	
Current Acc. Bal. (US\$B, ar)	3.0	1.0	-11.6		Current Acc. Bal. (US\$B, ar)	-0.07	-0.08	-0.04	-0.04 (Oct)
Merch. Trade Bal. (US\$B, ar)	11.6	14.8	3.6	7.9 (Nov)	Merch. Trade Bal. (US\$B, ar)	-39.1	-45.6	-18.8	-17.7 (Oct)
Industrial Production	0.5	7.8	2.4	-0.8 (Oct)	Industrial Production	6.5	1.6	-0.1	-3.2 (Oct)
CPI	1.4	3.3	3.1	3.9 (Nov)	CPI	1.6	2.7	2.9	5.0 (Nov)
Germany					France				
Real GDP	3.6	2.9	2.6		Real GDP	1.4	1.6	1.6	
Current Acc. Bal. (US\$B, ar)	188.2	156.6	169.8	169.6 (Oct)	Current Acc. Bal. (US\$B, ar)	-44.5	-81.9	-48.6	-113.9 (Oct)
Merch. Trade Bal. (US\$B, ar)	201.9	212.0	225.5	205.4 (Oct)	Merch. Trade Bal. (US\$B, ar)	-39.0	-52.8	-50.1	-54.7 (Oct)
Industrial Production	10.1	8.1	8.1	4.0 (Oct)	Industrial Production	4.6	1.9	2.8	1.8 (Oct)
Unemployment Rate (%)	7.7	7.1	7.0	6.9 (Nov)	Unemployment Rate (%)	9.8	9.7	9.8	9.8 (Oct)
CPI	1.1	2.3	2.5	3.1 (Nov)	CPI	1.5	2.1	2.1	3.9 (Nov)
Euro Zone					United Kingdom				
Real GDP	1.8	1.6	1.4		Real GDP	2.1	0.6	0.5	
Current Acc. Bal. (US\$B, ar)	-77	-120	-56	29 (Oct)	Current Acc. Bal. (US\$B, ar)	-56.9	-40.3	-113.3	
Merch. Trade Bal. (US\$B, ar)	32.0	-15.3	9.5	22.2 (Oct)	Merch. Trade Bal. (US\$B, ar)	-152.5	-162.7	-177.3	-142.9 (Oct)
Industrial Production	7.4	4.2	4.0	1.6 (Oct)	Industrial Production	1.9	-1.3	-1.3	-1.7 (Oct)
Unemployment Rate (%)	10.0	9.9	10.1	10.2 (Oct)	Unemployment Rate (%)	7.9	7.8	8.2	8.3 (Sep)
CPI	1.6	2.8	2.7	4.7 (Nov)	CPI	3.3	4.4	4.7	7.6 (Nov)
Japan					Australia				
Real GDP	4.5	-1.7	-0.8		Real GDP	2.6	1.9	2.5	
Current Acc. Bal. (US\$B, ar)	195.9	75.4	153.5	87.9 (Oct)	Current Acc. Bal. (US\$B, ar)	-35.2	-18.3	-33.8	
Merch. Trade Bal. (US\$B, ar)	74.6	-54.7	-31.5	-83.2 (Nov)	Merch. Trade Bal. (US\$B, ar)	19.3	50.3	43.4	32.5 (Oct)
Industrial Production	16.6	-7.0	-2.0	0.1 (Oct)	Industrial Production	4.3	-1.6	0.8	
Unemployment Rate (%)	5.1	4.6	4.4	4.5 (Oct)	Unemployment Rate (%)	5.2	4.9	5.2	5.3 (Nov)
CPI	-0.7	-0.4	0.1	-0.2 (Oct)	CPI	2.8	3.6	3.5	
China					South Korea				
Real GDP	10.4	9.5	9.1		Real GDP	6.2	3.4	3.5	
Current Acc. Bal. (US\$B, ar)	305.4				Current Acc. Bal. (US\$B, ar)	29.4	22.0	27.6	50.8 (Oct)
Merch. Trade Bal. (US\$B, ar)	181.5	185.9	250.5	174.3 (Nov)	Merch. Trade Bal. (US\$B, ar)	41.2	33.4	25.2	42.4 (Nov)
Industrial Production	13.5	15.1	13.8	12.4 (Nov)	Industrial Production	16.6	6.7	5.4	7.6 (Oct)
CPI	4.6	6.4	6.1	4.2 (Nov)	CPI	2.9	4.0	4.3	6.9 (Nov)

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

Source: Bloomberg, Scotia Economics.

Interest Rates (% , end of period)

Canada	11Q2	11Q3	Dec/15	Dec/22*	United States	11Q2	11Q3	Dec/15	Dec/22*
BoC Overnight Rate	1.00	1.00	1.00	1.00	Fed Funds Target Rate	0.25	0.25	0.25	0.25
3-mo. T-bill	0.83	0.82	0.83	0.80	3-mo. T-bill	0.01	0.02	-0.01	0.00
10-yr Gov't Bond	3.11	2.16	1.93	1.96	10-yr Gov't Bond	3.16	1.92	1.91	1.95
30-yr Gov't Bond	3.55	2.77	2.53	2.50	30-yr Gov't Bond	4.37	2.91	2.92	2.98
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US\$B)	62.3	63.5	65.2	(Oct)	FX Reserves (US\$B)	136.6	137.4	137.4	(Sep)
Germany					France				
3-mo. Interbank	1.51	1.51	1.42	1.41	3-mo. T-bill	1.18	0.38	0.08	-0.03
10-yr Gov't Bond	3.03	1.89	1.95	1.94	10-yr Gov't Bond	3.41	2.60	3.09	3.07
FX Reserves (US\$B)	66.0	66.9	67.1	(Oct)	FX Reserves (US\$B)	60.3	51.8	52.9	(Oct)
Euro-Zone					United Kingdom				
Refinancing Rate	1.25	1.50	1.00	1.00	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	1.72	1.46	0.57	0.51	3-mo. T-bill	4.85	4.85	4.85	4.85
FX Reserves (US\$B)	317.2	311.0	315.3	(Oct)	10-yr Gov't Bond	3.38	2.43	2.10	2.05
Japan					FX Reserves (US\$B)	79.7	78.9	80.5	(Oct)
Discount Rate	0.30	0.30	0.30	0.30	Australia				
3-mo. Libor	0.13	0.13	0.13	0.13	Cash Rate	4.75	4.75	4.50	4.25
10-yr Gov't Bond	1.14	1.03	0.98	0.98	10-yr Gov't Bond	5.21	4.22	3.73	3.75
FX Reserves (US\$B)	1100.8	1160.7	1167.5	(Oct)	FX Reserves (US\$B)	40.3	39.7	42.8	(Oct)

Exchange Rates (end of period)

USDCAD	0.96	1.05	1.04	1.02	¥/US\$	80.56	77.06	77.86	78.17
CADUSD	1.04	0.95	0.97	0.98	US\$/Australian\$	107.22	96.62	99.22	101.35
GBPUSD	1.605	1.558	1.551	1.568	Chinese Yuan/US\$	6.46	6.38	6.37	6.34
EURUSD	1.450	1.339	1.302	1.305	South Korean Won/US\$	1068	1178	1163	1156
JPYEUR	0.86	0.97	0.99	0.98	Mexican Peso/US\$	11.714	13.897	13.915	13.825
USDCHF	0.84	0.91	0.94	0.94	Brazilian Real/US\$	1.563	1.879	1.860	1.852

Equity Markets (index, end of period)

United States (DJIA)	12414	10913	11869	12169	U.K. (FT100)	5946	5128	5401	5457
United States (S&P500)	1321	1131	1216	1255	Germany (Dax)	7376	5502	5731	5852
Canada (S&P/TSX)	13301	11624	11504	11863	France (CAC40)	3982	2982	2999	3072
Mexico (Bolsa)	36558	33503	36007	36914	Japan (Nikkei)	9816	8700	8377	8395
Brazil (Bovespa)	62404	52324	56331	57293	Hong Kong (Hang Seng)	22398	17592	18027	18378
Italy (BCI)	1039	796	783	803	South Korea (Composite)	2101	1770	1819	1847

Commodity Prices (end of period)

Pulp (US\$/tonne)	1035	970	920	920	Copper (US\$/lb)	4.22	3.23	3.29	3.40
Newsprint (US\$/tonne)	640	640	640	640	Zinc (US\$/lb)	1.05	0.86	0.85	0.84
Lumber (US\$/mfbm)	237	240	245	--	Gold (US\$/oz)	1505.50	1620.00	1574.00	1606.50
WTI Oil (US\$/bbl)	95.42	79.20	93.87	99.51	Silver (US\$/oz)	35.02	30.45	28.80	29.30
Natural Gas (US\$/mmbtu)	4.37	3.67	3.13	3.17	CRB (index)	338.05	298.15	294.45	305.62

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

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Scotia Economics

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