

## China

- China's annual economic growth is set to drop below 6% by 2021 on the back of global uncertainties, continued trade headwinds, and the economy's ongoing structural transition.
- Counter-cyclical fiscal policy is expected to provide support to the economy in the near-term, while economic reforms should improve longer-term growth prospects.
- The "phase one" trade deal between the US and China is a welcome development, yet the bilateral relationship will remain tenuous as negotiations move on to more challenging issues.
- Intensified inflationary pressures are expected to be transitory, allowing for further monetary policy easing.

### ECONOMIC GROWTH OUTLOOK

The Chinese economy's gradual growth slowdown is set to continue over the coming quarters, despite a recent stabilization in confidence indicators (chart 1) that reflects anticipated improvement in the bilateral trade relationship between China and the US (trade policy discussion to follow). The Chinese leadership is expected to set the 2020 real GDP growth target at around 6% y/y, marking a shift down from the 2019 goal of 6–6½%; the target will be unveiled at the National People's Congress in March 2020.

Regardless of the 2020 growth goal, it is clear that the Chinese economy's momentum is decelerating, as indicated by various high-frequency indicators such as retail sales, industrial profits, and industrial production (chart 2). While the muted trade performance (chart 3) is also contributing to such dynamics, the Chinese economy's continued structural change from an industrial and investment-focused economy to a services and consumer-driven one is leading to a slower—yet more sustainable—growth trajectory. We forecast that China's real GDP growth will decelerate from an estimated 6.1% y/y in 2019 to 5.8% by 2021.

The Chinese government will likely continue its efforts to support the economy through proactive fiscal policies that will complement more accommodative monetary conditions set by the Chinese central bank. We foresee further tax and fee cuts that will underpin the Chinese consumer; support measures for private sector enterprises; as well as additional infrastructure outlays by local governments that focus on urban transportation, utilities facilities, and rural development. In addition to targeted fiscal stimulus efforts, the Chinese leadership remains committed to advancing the country's economic development over the medium and long term. At the annual Central Economic Work Conference, held in December 2019, Chinese policymakers highlighted the need for promoting innovation, accelerating structural reforms and economic liberalization, reducing financial risks, as well as improving citizens' quality of life by policies that focus on the environment, employment, pension, healthcare and housing. We assess that such undertakings will play an important role in boosting China's longer-term growth potential and helping the economy avoid the middle-income trap.

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China	2018	2019e	2020f	2021f
Real GDP (annual % change)	6.6	6.1	6.0	5.8
CPI (y/y %, eop)	1.8	4.5	2.1	2.5
Central bank policy rate (% eop)	4.35	4.15	4.00	4.00
Chinese yuan (USDCNY, eop)	6.88	6.96	6.70	6.50

Source: Scotiabank Economics.

Chart 1

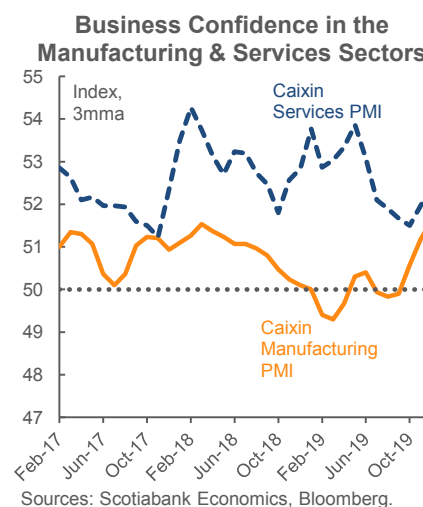
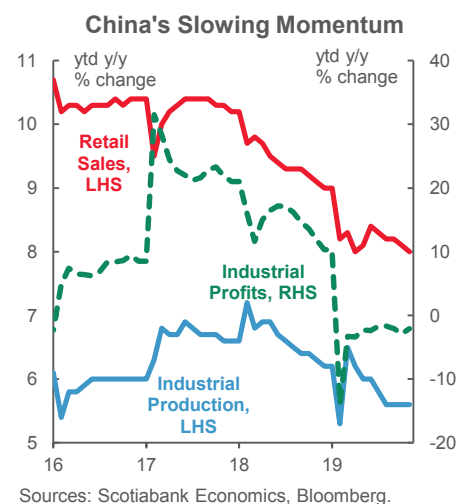


Chart 2



## TRADE POLICY OUTLOOK

The US and China are in the process of finalizing a “phase one” trade deal. We assess that the deal is a welcome development for China’s and the global economic outlook as it should boost confidence and provide some support to trade, yet we highlight that the bilateral US-China relationship will continue to be subject to substantial challenges for the foreseeable future. As a part of the deal, the US agreed not to impose additional tariffs in mid-December 2019 and promised to reduce the 15% tariff introduced in September 2019 to 7.5% on around USD 120 bn worth of imports from China. Nevertheless, 25% tariffs on around USD 250 bn of Chinese goods remain in place, highlighting that the tariff rollback is only modest. China, meanwhile, has agreed to raise its purchases of US goods substantially, including agricultural commodities. Moreover, China has also promised to address some of the US concerns regarding intellectual property rights, technology transfers, financial services sector access, exchange rate, trade expansion, as well as dispute resolution. However, details of such reforms are limited at the time of writing.

Looking beyond the “phase one” deal, it is clear that bilateral tensions will linger for an extended period of time. Negotiations of any subsequent deal will be even more challenging given the difficult issues that need to be solved, such as further enhancements to the “phase one” policies, industrial subsidies, security, technology and China’s technological aspirations. Above all, the fact that the world view and economic systems of the two countries are very different will continue to create tensions along the negotiation process. Therefore, we expect “phase two” talks to drag on beyond the US presidential election in November 2020, with the majority of tariffs remaining in place. Moreover, the risk of renewed escalation remains high.

## INFLATION AND MONETARY POLICY OUTLOOK

Inflationary pressures have intensified in China on the back of higher food—particularly pork—prices. Headline inflation has reached 4½% y/y, exceeding the government’s target of around 3% y/y (chart 4). We assess that the price pressures are transient, with headline inflation expected to decelerate back below the 3% mark before the end of 2020. Moreover, inflation further up the distribution chain remains non-existent, with annual producer price gains currently residing in negative territory.

As the uptick in headline inflation does not reflect demand-driven price pressures, the People’s Bank of China (PBoC) will likely see through it and maintain accommodative monetary conditions in the economy. Chinese policymakers are trying to find a balance between supporting economic growth via new lending and addressing systemic financial risks stemming from weak and overleveraged borrowers. Accordingly, the PBoC’s efforts to improve financial transparency and oversight are set to continue.

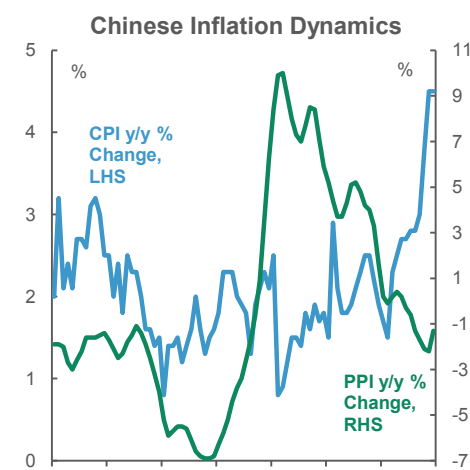
The PBoC has rolled out additional monetary stimulus by guiding interest rates gradually lower. The new benchmark lending rate, the 1-year Loan Prime Rate (LPR) has been lowered by 10 basis points to 4.15% since the interest rate reform in August 2019. We expect further cautious reductions in the months ahead. Moreover, monetary policy transmission will get a boost from the fact that since January 1, 2020 Chinese financial institutions have been required to link new loans to the LPR. The PBoC has also been easing monetary conditions by providing liquidity to the financial system and by implementing significant cuts to banks’ reserve requirement ratios. In January 2020, the reserve requirement ratio for large banks was lowered by 50 bps to 12.5%, which follows 150 bps of cuts over the course of 2019 (chart 5).

Chart 3



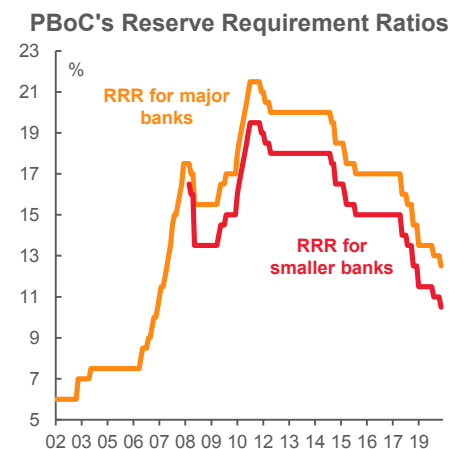
Sources: Scotiabank Economics, Bloomberg, Customs General Administration PRC.

Chart 4



Sources: Scotiabank Economics, Bloomberg.

Chart 5



Sources: Scotiabank Economics, the People's Bank of China, Bloomberg.

## Japan

- **Simultaneous domestic and external headwinds weigh on Japan's economic growth momentum.**
- **Loose monetary and fiscal policies will provide support to the economy.**

### ECONOMIC GROWTH OUTLOOK

The Japanese economy is weighed down by both domestic and external challenges. The near-term outlook for domestic demand remains fragile, reflecting the increase in the consumption tax rate from 8% to 10% in October 2019. The hike triggered a dip in consumer spending in the final months of 2019 following a pre-tax-hike spike (chart 1). Due to dropping domestic demand, real GDP is set to contract in the final quarter of 2019; the speed of consumer spending recovery will determine how the Japanese economy kicks off 2020. To offset the domestic demand-related weakness, the Japanese government has unveiled a fresh round of fiscal stimulus, totalling JPY13.2 trillion (USD 121 billion, equivalent to 2.4% of GDP). The package—approved by the Cabinet in early December—includes an extra budget for the current fiscal year (April–March) as well as additional spending planned for FY2020. The public outlays will help maintain growth momentum beyond the 2020 Summer Olympics in Tokyo, support businesses that are feeling headwinds related to trade and the consumption tax hike, and focus particularly on infrastructure related to natural disaster preparedness.

Japan's external sector continues to be negatively impacted by weak global demand, the electronics sector downturn, as well as adverse weather that has caused output disruptions. Indeed, the nation's exports have been below year-earlier levels since end-2018 (chart 1). While conditions will remain challenging in 2020, we expect a gradual recovery to unfold over the coming quarters, with sentiment boosted by both the newly-approved trade deal with the US and domestic stimulus efforts. We expect Japan's real GDP to grow by 0.9% y/y in 2020–21, in line with the estimated expansion in 2019.

### INFLATION AND MONETARY POLICY OUTLOOK

The Bank of Japan (BoJ) will likely maintain highly accommodative monetary conditions through 2021, continuing the policy outline of “Quantitative and Qualitative Monetary Easing with Yield Curve Control”. The central bank's forward guidance suggests that short- and long-term interest rates are expected to remain “at their present or lower levels” as monetary authorities continue their efforts to bring annual inflation toward the central bank's 2% target. Nevertheless, we note that the BoJ has fairly limited policy room left to step up its monetary stimulus efforts if needed. Low inflation will continue to trouble the BoJ over the foreseeable future as both domestic and global uncertainties weigh on economic growth prospects and demand-driven inflationary pressures. The CPI excl. fresh food—the BoJ's preferred inflation measure—currently hovers at 0.5% y/y, significantly below the 2% target (chart 2). While the inflation metric is set to pick up slightly in the near term as the implementation of the consumption tax rate hike in October 2019 feeds through to prices, we forecast that inflation will remain well below the 2% mark through 2021.

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Japan	2018	2019e	2020f	2021f
Real GDP (annual % change)	0.3	0.9	0.6	1.2
CPI (y/y %, eop)	0.3	0.9	0.6	0.8
Central bank policy rate (% eop)	-0.10	-0.10	-0.10	-0.10
Japanese yen (USD/JPY, eop)	110	108	105	102

Source: Scotiabank Economics.

Chart 1

#### Japan's Exports and Domestic Department Store Sales

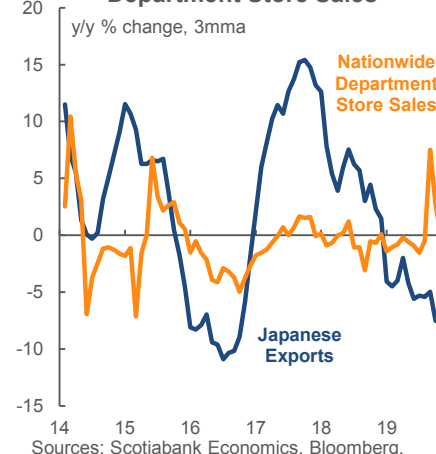
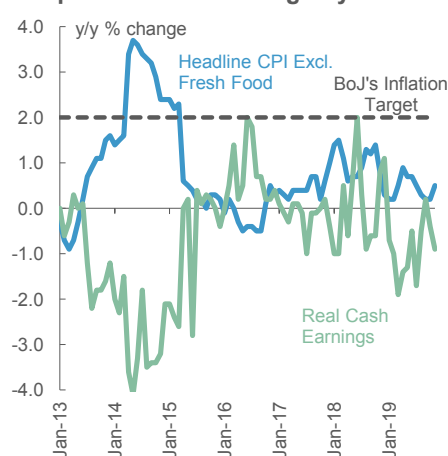


Chart 2

#### Japan's Inflation & Wage Dynamics



## India

- The economy is suffering from a combination of weak domestic demand and external sector challenges with only a gradual recovery in sight.
- Policymakers implement stimulus measures and reform initiatives to underpin the economy's recovery.
- Soaring food prices complicate the Reserve Bank of India's monetary policy stimulus efforts.

### ECONOMIC GROWTH OUTLOOK

India's current economic growth performance is soft, highlighting the need for continued fiscal and monetary stimulus efforts by the country's policymakers. Real GDP grew by only 4.5% y/y in the third quarter of 2019—the slowest pace since early-2013—reflecting muted consumer spending and fixed investment growth (chart 1). We estimate that real GDP gains averaged only 5.1% y/y in 2019. Nevertheless, we assess that India is on the verge of a gradual recovery—with annual output gains likely to reach 6.2% and 7.2% in 2020 and 2021, respectively—implying that the economy will remain below its estimated potential growth of 7–7½% for several quarters yet.

Household spending growth will play a key role in India's economic outlook, yet its momentum—both rural and urban—remains muted. Weak demand dynamics combined with the Indian financial sector's troubles are reflected in a continued downward trend in credit growth (chart 2). Business confidence indicators are showing tentative signs of stabilization, boosted by authorities' monetary and fiscal stimulus efforts as well as the 2019 corporate tax reform that reduced India's corporate tax rates from 30% to 22%. We expect gradually improving sentiment to lead to a measured recovery in fixed investment growth and industrial activity in the near term. For the time being though, India's industry remains in the doldrums with vehicle production and output in eight core industries (electricity, steel, refinery products, crude oil, coal, cement, natural gas and fertilizers) contracting (chart 3). India's domestic demand weakness is accompanied by external sector challenges that reflect softer global demand conditions.

Monetary and fiscal support will help with India's nascent recovery. We expect fiscal policy to remain growth supportive in the foreseeable future; the Union Budget for FY2020–21 (April–March) will be unveiled in early February and will likely include measures that address faltering household spending. Nevertheless, we note that the nation's room for significant fiscal stimulus is limited on the back of already weak public finances and downward pressure on tax revenue. In fact, we assess that it is highly unlikely that India will be able to meet the fiscal year 2019–20 (April–March) central government budget deficit target of 3.3% of GDP. Moreover, we note that the fiscal shortfall remains significantly bigger at the general government level, around 7½% of GDP in FY2019–20.

In recent months, the Indian government has made several policy announcements and implemented structural changes to help the economy perform better, including the aforementioned corporate tax reform, public sector bank

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India	2018	2019e	2020f	2021f
Real GDP (annual % change)	7.4	5.1	6.2	7.2
CPI (y/y %, eop)	2.1	6.1	4.3	4.9
Central bank policy rate (% eop)	6.50	5.15	4.90	5.50
Indian rupee (USDINR, eop)	69.8	71.4	70.0	69.0

Source: Scotiabank Economics.

Chart 1

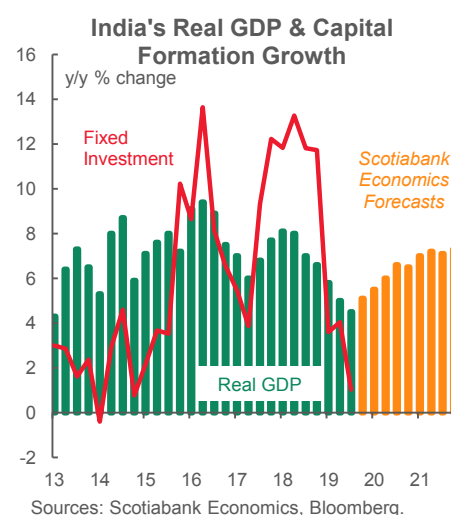
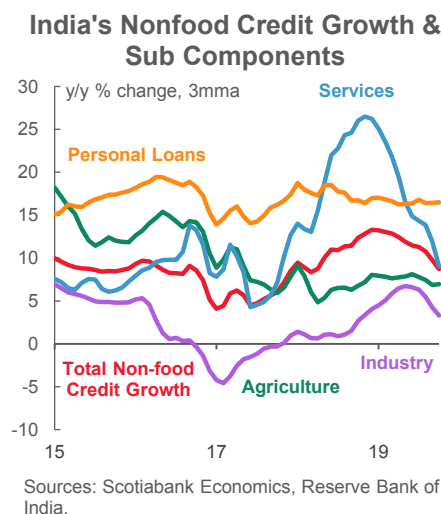


Chart 2





recapitalization and consolidation, FDI liberalization, support for several industries—such as automotive, real estate, and manufacturing industries—and a rollback of a tax surcharge on foreign portfolio investment. Nevertheless, more structural reforms are needed, particularly regarding the complex labour laws that keep the size of Indian manufacturing firms relatively small and prevent them from fully benefiting from the economies of scale. Indeed, expansion of the manufacturing industry and creation of jobs are critical for the economy's outlook; according to the World Bank, around eight million new jobs need to be created annually in India just to absorb new entrants to the labour force. Nevertheless, we expect only modest progress on the reform front. Even though Prime Minister Narendra Modi's Bharatiya Janata Party-led government holds a majority in the lower house (Lok Sabha), its minority position in the upper house (Rajya Sabha) slows policy execution and reform implementation.

### INFLATION AND MONETARY POLICY OUTLOOK

The Reserve Bank of India (RBI) is supporting the economy with monetary stimulus. Between February and October 2019, the benchmark repo rate was reduced in five consecutive monetary policy meetings by a total of 135 basis points (chart 4). Against expectations, the RBI left the key interest rate unchanged at 5.15% following the December 5, 2019 meeting, yet the central bank maintained its "accommodative" policy stance. Monetary authorities assessed that there is monetary policy space left for further interest rate reductions. Indeed, given India's weak economic growth momentum and transient inflationary pressures, we assess that the RBI's monetary easing cycle is not over yet; we forecast one more 25 bps benchmark interest rate cut before mid-2020.

The RBI's policymakers have emphasized that the central bank's main objective is inflation-targeting; accordingly, they want to have greater clarity on inflationary developments before stimulating the economy further. The policymakers have also highlighted that the prior cuts would continue to be transmitted into lower lending rates. The Indian economy continues to struggle with weak monetary policy transmission, partly reflecting the challenges of the country's financial sector. Following the December policy meeting, the RBI assessed that the 135 bps of easing in 2019 had reduced the weighted average lending rates on new rupee loans by only 44 bps, though they expected the transmission to improve in the near term.

India's inflation dynamics have become more complex recently with headline inflation accelerating sharply. Inflation will likely hover near the upper limit of the RBI's annual target of 4%  $\pm$  2% over the coming months. The pick-up is largely due to a surge in food prices (chart 5) that reflects an erratic monsoon rainfall. Meanwhile, core inflation remains contained at around 3½% y/y on the back of weak demand-driven price pressures.

We expect the current headline price pressures to be transitory. Nevertheless, various simultaneous factors will influence India's inflation outlook: 1) the government's fiscal trajectory; 2) prices of vegetables and other food items; 3) rising inflation expectations by households; 4) volatile domestic financial markets; 5) weakness in domestic demand and its impact on core inflation; and 6) international oil prices. While we closely monitor the aforementioned developments, we forecast India's inflation rate to return toward the 4% y/y mark in 2021.

Chart 3

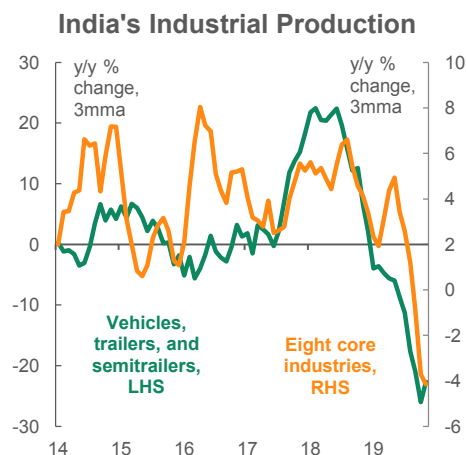


Chart 4

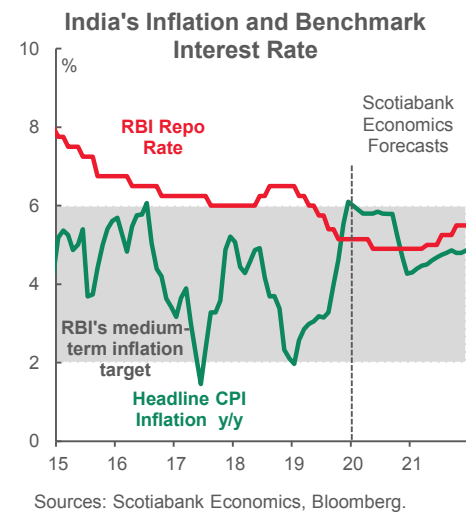
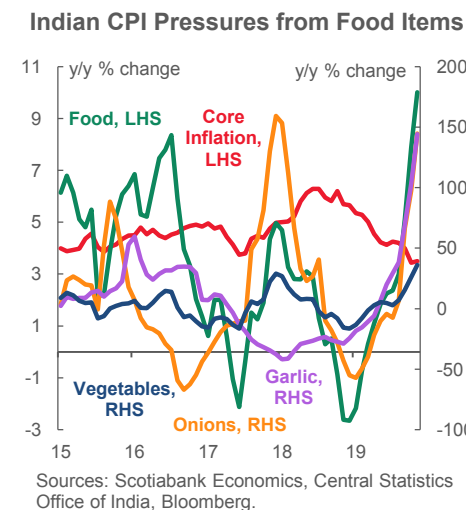


Chart 5



## South Korea

- **South Korea's export-oriented economy continues to face headwinds, yet a modest recovery is in sight with the help of stimulative policies.**
- **Muted demand-driven price pressures keep inflation low, allowing for accommodative monetary conditions.**

### ECONOMIC GROWTH OUTLOOK

The South Korean economy continues to be weighed down by the external sector's challenges. The nation's exports have been below year-earlier levels since the end of 2018 (chart 1) on the back of weaker global demand and the supply chain ripple effects from the US-China trade conflict. Moreover, the global electronics sector downturn continues, reflecting softer Chinese demand and oversupply conditions in the semiconductor sector, which is adjusting to a longer replacement cycle of smartphones.

External sector challenges have spilled over to domestic demand, as reflected by slower momentum in household spending and fixed investment. However, both consumer and business confidence indicators have bottomed out, pointing to a gradual recovery in the months ahead. South Korea's state budget for 2020, passed by the National Assembly in December, remains expansionary. Indeed, public outlays are set to rise by 9.1% y/y in 2020, with focus on such areas as R&D, industrial and export sector support as well as health, welfare, and employment. The government aims to frontload the spending in early 2020—with 70% of the budget to be spent in the first half of the year—in order to maximize the stimulative impact on the economy. The growth-supportive fiscal policies will complement the Bank of Korea's (BoK) monetary easing efforts, helping with the country's economic recovery.

We estimate that South Korea's real GDP grew by slightly less than 2% in 2019. A modest recovery is in sight over the coming quarters with output gains expected to average 2½% y/y in 2020–21.

### INFLATION AND MONETARY POLICY OUTLOOK

South Korea's monetary conditions will remain accommodative for an extended period of time. The BoK lowered the benchmark interest rate by 50 basis points to 1.25% between July and October, 2019 (chart 2). The central bank will likely leave the policy rate unchanged over the near term, as it assesses the impact of the recent rate cuts and monitors how global trade uncertainties evolve. Nevertheless, BoK Governor Lee Ju-yeol has emphasized that the central bank has room for further policy action if needed. Indeed, developments on the US-China trade front will play a key role in future monetary policy decisions as the South Korean economy continues to feel the adverse impact of trade-related challenges.

Against the backdrop of economic weakness, South Korea's inflationary pressures remain low, with headline inflation closing 2019 at less than 1% y/y. Core inflation is equally muted (chart 2). We do not expect annual headline inflation to reach the BoK's 2% y/y target before 2021, allowing the BoK to maintain a loose monetary policy stance.

### CONTACTS

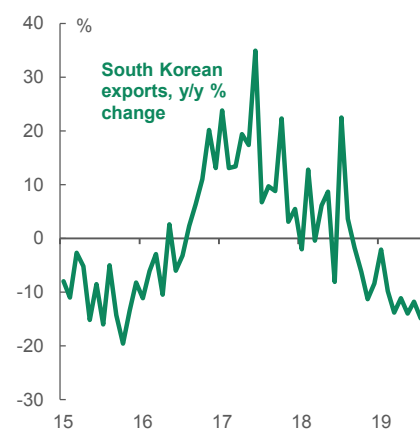
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South Korea	2018	2019e	2020f	2021f
Real GDP (annual % change)	2.7	1.8	2.1	2.5
CPI (y/y %, eop)	1.3	0.7	1.6	2.1
Central bank policy rate (% eop)	1.75	1.25	1.25	1.50
South Korean won (USD/KRW, eop)	1,116	1,156	1,120	1,080

Source: Scotiabank Economics.

Chart 1

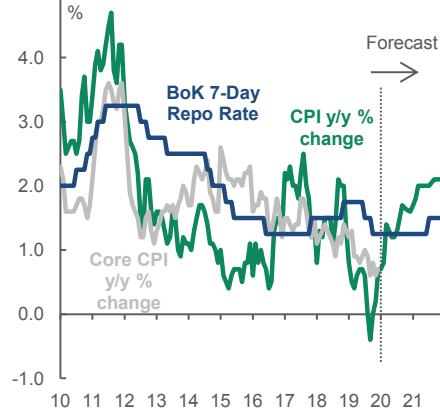
#### South Korea Total Export Growth



Sources: Scotiabank Economics, Bloomberg.

Chart 2

#### South Korea's Inflation And Benchmark Interest Rate



Sources: Scotiabank Economics, Bloomberg.

## Australia

- Australia's economic growth is expected to pick up in 2020, yet momentum is set to remain below the economy's potential.
- Labour and housing market dynamics will likely pull the Australian consumer in opposite directions.
- Below-target inflation allows for accommodative monetary policy; fiscal stimulus space exists if needed.

### ECONOMIC GROWTH OUTLOOK

The Australian economy has shifted to a lower economic growth trajectory on the back of global growth concerns and soft domestic demand momentum. We estimate that Australia's real GDP expanded by only 1.8% y/y in 2019, well below the nation's estimated potential growth of 2¾%. Nevertheless, accommodative monetary policy, tax cuts, public infrastructure outlays, and a recovering housing market should help the economy to regain momentum—albeit only gradually—over the coming quarters, with output gains likely to average 2.3% y/y in 2020–21.

Despite weak global demand dynamics, Australia's external sector is contributing to growth thanks to a weaker Australian dollar, improved terms of trade, and solid commodities demand in China (chart 1). Meanwhile, Australia is less integrated into the Asia-Pacific manufacturing supply chains than many of its regional peers, which insulates the country from some of the ripple effects stemming from the US-China trade conflict.

On the domestic demand side, the outlook for the Australian consumer—which accounts for close to 60% of the nation's GDP—is impacted by two key factors: the labour market and the residential real estate market, which are giving mixed signals about future spending prospects with the former moderating and the latter strengthening. Meanwhile, the impact of wildfires on consumer confidence and the economy at large has yet to transpire.

Some signs of softening in Australia's labour market have started to emerge, yet employment conditions still remain solid by historical standards. Over the past six months to November, an average of 17,000 new jobs has been added to the economy every month, down from the 25,500 average recorded in the preceding 6-month period. Furthermore, the share of full-time jobs in new positions has decreased, while the unemployment rate has crept up slightly yet this partially reflects higher labour force participation (chart 2). We expect some further softening in the labour market over the coming quarters, which will keep a lid on wage growth and consumer spending growth.

Meanwhile, consumer confidence will be supported by the continued rebound in Australia's residential property market (chart 3), which reflects lower interest rates, relaxation of home loan lending restrictions, and recent income tax cuts. House prices in large cities have recorded monthly price gains since July 2019, though large regional differences remain in place. We remain cautious on the sustainability of the price recovery against the backdrop of high household debt

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Australia	2018	2019e	2020f	2021f
Real GDP (annual % change)	2.7	1.8	2.1	2.5
CPI (y/y %, eop)	1.8	1.6	1.9	2.1
Central bank policy rate (% eop)	1.50	0.75	0.50	0.50
Australian dollar (AUDUSD, eop)	0.70	0.68	0.72	0.74

Source: Scotiabank Economics.

Chart 1

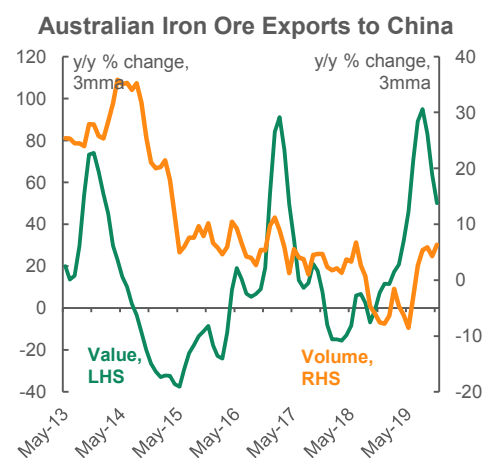
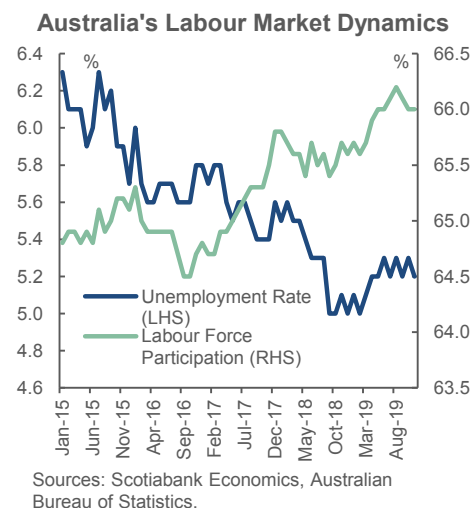


Chart 2



levels, muted income growth, weaker employment gains, and associated affordability challenges. At the same time, however, limited future supply will provide some support to the market as a meaningful recovery in housing starts has not yet transpired (chart 4).

Australia's fiscal policy remains prudent. The centre-right Liberal-National Coalition government led by Prime Minister Scott Morrison maintains its commitment to bringing the budget to a surplus position in the current fiscal year (July–June). We note that the nation has sufficient fiscal room to provide further support to the economy if needed to complement the Reserve Bank of Australia's (RBA) monetary stimulus efforts. While private sector business investment plans remain soft on the back of persistent uncertainty about the economy's outlook, public sector outlays—particularly focusing on transport infrastructure—will support construction activity over the coming quarters.

### INFLATION AND MONETARY POLICY OUTLOOK

Australia's headline inflation remains below the RBA's 2–3% annual inflation target, with prices rising by 1.7% y/y in the third quarter of 2019 (chart 5). Demand-driven price pressures will likely remain largely absent in the foreseeable future; we expect headline inflation to accelerate only gradually, reaching the lower end of the RBA's target range in early 2021.

Enabled by low inflationary pressures, the RBA remains committed to supporting the economy through accommodative monetary policy. The central bank has lowered the benchmark cash rate by 75 basis points since June 2019 (chart 5). Following the most recent monetary policy meeting in early December, the RBA left the key rate unchanged at 0.75% in order to assess the impact of recent rate cuts. Nevertheless, RBA Governor Philip Lowe has highlighted that the RBA is prepared to ease monetary policy further if needed to reach full employment in the economy and to bring inflation toward the target. Governor Lowe has also indicated that the central bank would consider quantitative easing—i.e. purchasing of government bonds in the secondary market—in a situation where the cash rate had reached 0.25%. However, he has emphasized that conditions for implementing such policy measures have not been reached, and the near-term outlook does not indicate a need for such action either.

International developments—particularly the US-China trade talks—will play a role in Australia's monetary policy outlook, as they will influence consumer and business confidence and spending decisions. Additionally, the wildfires as well as domestic labour market conditions will factor into the RBA's policy conduct. While global downside risks have lately diminished somewhat, we maintain our expectation that Australia's labour market will fail to strengthen in the near term. Accordingly, we assess that the RBA will cut the benchmark interest rate one more time in this easing cycle, taking the cash rate to 0.50% in the first half of 2020.

Chart 3

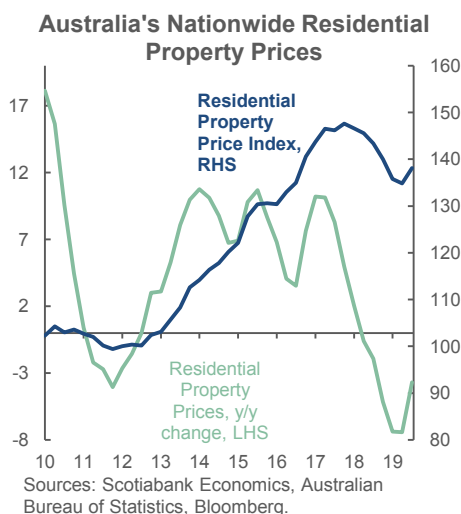


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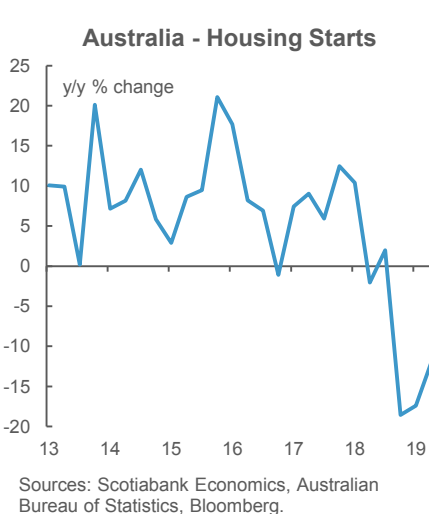
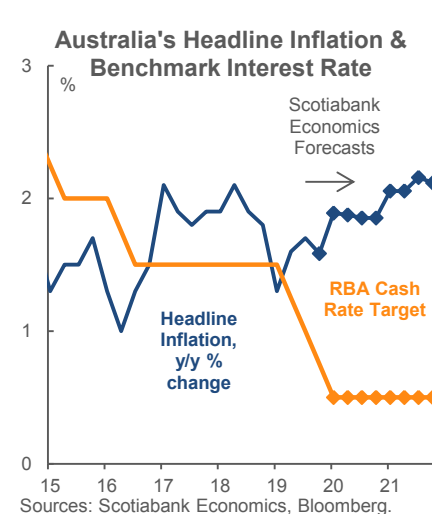


Chart 5





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