# Weekly Trends

**On January 14, 2011, Scotia Economics will launch a new weekly report — *Global Views* — which consolidates contributions from Scotia's economists and market strategists and replaces *Weekly Trends*.**

## Highlights

*Week* — New forecasts reinforce old themes.

*Canada* — Moderate job growth to end the year.

*United States* — Yet another disappointing payroll release casts a shadow over some of the more upbeat reports of recent weeks.

*Mexico* — Industrial recovery doubles the U.S. pace.

*Latin America* — Brazilian domestic demand to lead growth.

*Europe* — Euro zone economy continues to move ahead despite sovereign credit concerns.

*Asia / Oceania* — Chinese costs to remain elevated but inflation could soon peak.

*Industry* — Global sales to rev up to record highs in 2011.

## Index



## New Releases

Global Forecast Update (01/07)

Foreign Exchange Outlook (January 2011)

Global Auto Report (01/05)

Auto News Flash (01/04)

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

**Scotia Economics**

# Forecasts

## Economic Performance (annual % change unless otherwise indicated)

| | 2000-09 | 2010e | 2011f | 2012f | 2000-09 | 2010e | 2011f | 2012f |
|---|---|---|---|---|---|---|---|---|
| | | Canada | | | | United States | | |
| Real GDP | 2.1 | 2.9 | 2.4 | 2.7 | 1.8 | 2.8 | 2.7 | 2.9 |
| Consumer Prices | 2.1 | 1.8 | 2.1 | 2.2 | 2.6 | 1.7 | 1.5 | 1.6 |
| Pre-tax Profits | 2.9 | 17.5 | 10.5 | 13.0 | 3.9 | 28.8 | 7.2 | 8.0 |
| Federal Budget Balance ($bn) | 2.0 | -43.0 | -29.0 | -21.0 | -318 | -1294 | -1180 | -1050 |
| Current Account Balance ($bn) | 14.1 | -56.6 | -64.8 | -58.8 | -574 | -486 | -518 | -528 |
| Merchandise Trade Balance ($bn) | 51.8 | -13.5 | -21.5 | -16.5 | -634 | -664 | -720 | -765 |
| Motor Vehicle Sales (000s)* | 1,591 | 1,560 | 1,590 | 1,605 | 15.8 | 11.5 | 12.7 | 13.5 |
| Motor Vehicle Production (000s)* | 2,474 | 2,200 | 2,400 | 2,500 | 10.9 | 7.8 | 8.4 | 8.8 |
| Housing Starts (000s)* | 201 | 190 | 175 | 175 | 1.54 | 0.59 | 0.68 | 0.90 |
| Employment | 1.6 | 1.6 | 1.2 | 1.4 | 0.1 | -0.5 | 1.2 | 1.7 |
| Jobs Created (000s)* | 244 | 275 | 207 | 234 | 0.19 | -0.65 | 1.58 | 2.26 |
| Unemployment Rate (%) | 7.0 | 8.0 | 7.7 | 7.5 | 5.5 | 9.6 | 9.3 | 8.7 |
| | | Mexico | | | | Euro zone | | |
| Real GDP | 1.9 | 5.1 | 3.5 | 4.0 | 1.2 | 1.9 | 1.4 | 1.6 |
| Consumer Prices | 4.9 | 4.5 | 4.0 | 3.5 | 2.1 | 2.2 | 2.3 | 2.3 |
| | | Latin America (Excl. Mexico) | | | | Asia | | |
| Real GDP | 3.4 | 6.2 | 4.6 | 4.4 | 4.9 | 6.5 | 5.4 | 5.8 |
| Consumer Prices | 7.9 | 9.5 | 8.9 | 6.9 | 1.5 | 1.9 | 2.5 | 2.4 |

**In the United States, millions.*

## Commodity Prices (US$ annual average)

| | 2000-09 | 2010e | 2011f | 2012f |
|---|---|---|---|---|
| Pulp (tonne) | 668 | 960 | 875 | 960 |
| Newsprint (tonne) | 572 | 607 | 685 | 710 |
| Lumber (mfbm) | 275 | 252 | 250 | 300 |
| Copper (lb) | 1.78 | 3.40 | 4.50 | 4.25 |
| Zinc (lb) | 0.73 | 0.98 | 1.03 | 1.05 |
| Nickel (lb) | 7.11 | 9.85 | 10.00 | 8.00 |
| WTI Oil (bbl) | 51.11 | 79 | 93 | 98 |
| Nymex Natural Gas (US$/mmbtu) | 5.95 | 4.40 | 4.40 | 4.75 |
| Wheat (tonne) | 231 | 310 | 370 | 350 |

## Financial Markets (end of period, % unless otherwise indicated)

| | 10Q4f | 11Q1f | 11Q2f | 11Q3f | 11Q4f | 12Q1f | 12Q2f | 12Q3f | 12Q4f |
|---|---|---|---|---|---|---|---|---|---|
| CANADA | | | | | | | | | |
| 3-month T-bill | 1.05 | 1.05 | 1.10 | 1.30 | 1.70 | 2.20 | 2.30 | 2.30 | 2.30 |
| 5-year Canada | 2.42 | 2.45 | 2.50 | 2.60 | 2.65 | 2.75 | 2.85 | 2.95 | 3.00 |
| 10-year Canada | 3.12 | 3.20 | 3.25 | 3.40 | 3.50 | 3.60 | 3.65 | 3.80 | 4.00 |
| UNITED STATES | | | | | | | | | |
| 3-month T-bill (Yield) | 0.12 | 0.15 | 0.20 | 0.30 | 0.40 | 0.90 | 1.40 | 1.90 | 2.20 |
| 5-year Treasury | 2.00 | 2.00 | 2.10 | 2.20 | 2.25 | 2.40 | 2.55 | 2.70 | 2.85 |
| 10-year Treasury | 3.29 | 3.35 | 3.40 | 3.65 | 3.75 | 3.85 | 3.90 | 4.10 | 4.25 |
| CANADIAN-US SPREADS | | | | | | | | | |
| 3-month T-bill | 0.93 | 0.90 | 0.90 | 1.00 | 1.30 | 1.30 | 0.90 | 0.40 | 0.10 |
| 5-year | 0.42 | 0.45 | 0.40 | 0.40 | 0.40 | 0.35 | 0.30 | 0.25 | 0.15 |
| 10-year | -0.17 | -0.15 | -0.15 | -0.25 | -0.25 | -0.25 | -0.25 | -0.30 | -0.25 |
| Canadian Dollar (USDCAD) | 1.00 | 1.00 | 0.99 | 0.98 | 0.96 | 0.96 | 0.95 | 0.95 | 0.94 |
| Canadian Dollar (CADUSD) | 1.00 | 1.00 | 1.01 | 1.02 | 1.04 | 1.04 | 1.05 | 1.05 | 1.06 |
| Yen (USDJPY) | 81 | 82 | 83 | 84 | 84 | 86 | 87 | 89 | 90 |
| Euro (EURUSD) | 1.34 | 1.33 | 1.33 | 1.35 | 1.37 | 1.39 | 1.41 | 1.43 | 1.45 |
| Sterling (GBPUSD) | 1.56 | 1.58 | 1.60 | 1.61 | 1.63 | 1.65 | 1.67 | 1.69 | 1.70 |
| Mexican Peso (USDMXN) | 12.3 | 12.5 | 12.6 | 12.7 | 12.8 | 12.9 | 13.0 | 13.1 | 13.2 |

## The Week | Past, Present & Prospects

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

### New Forecasts Reinforce Old Themes

Global growth is estimated to have advanced 4.9% in 2010, building upon the turnaround that began in mid-2009. This was a comparatively strong performance, notwithstanding the renewed slowing in U.S. activity last summer and fall, repeated sovereign debt problems in Europe, and some policy firming in a few high-growth emerging economies in order to rein in emerging inflationary pressures.

Nevertheless, the outlook brightened late last year as the Fed signalled an extended period of low short-term borrowing costs and introduced 'QE2', Washington instituted another round of fiscal stimulus¸ the EU, the ECB, and the IMF defused the latest flare-up in Europe's recurring sovereign debt problems, and the continued strong performances in many of the large and fast-growing emerging nations provided expanded export opportunities for many slower-paced developed countries.

In view of these developments, we now expect global output to grow by 4.2% and 4.4% respectively in 2011 and 2012. Although the differential in performance between emerging and advanced economies will persist, the gap has narrowed because of the improving momentum in some of the developed countries, particularly the United States where we now expect real GDP to expand 2.7% this year and a further 2.9% in 2012. U.S. consumer spending is likely to grow by roughly 3% this year and next, almost double the gain in 2010. Likewise, business investment, largely on machinery & equipment, will continue to build on last year's estimated 15% average gain, with expenditures expected to increase a further 10% this year and 6½% in 2012.

The macro-economic environment has also improved for Canada, with our forecast for real GDP lifted slightly to 2.4% and 2.7% respectively over the next two years. Similar to the U.S. outlook, consumer spending and business investment are making the biggest contributions to output growth, though less on the consumer side with households constrained by high levels of personal indebtedness, and more on the business side. Canadian firms are increasingly taking advantage of accelerated depreciation allowances for machinery & equipment purchases this year, a stronger currency and large cash balances, to bolster their productivity-enhancing investments. But a further deterioration in net exports will have a far greater impact, subtracting over a percentage point from Canadian output growth this year.

Monetary policy is expected to remain highly supportive of growth throughout the developed world during this period of ongoing volatility in the global economy, as well as in financial and currency markets. Most central banks, including the Bank of Canada, are likely to remain on hold until the fourth quarter of this year when they will either resume or begin the process of normalizing short-term interest rates. In contrast, the Fed and the Bank of Japan are likely to defer any meaningful tightening until 2012. Although rising energy and food prices around the globe are beginning to push consumer prices somewhat higher, underlying price trends are expected to remain quite low in most countries where markets are highly competitive, where fiscal restraint is beginning to bite, and where housing price weakness persists. More significant tightening in monetary policies are expected in the high-growth emerging economies which are more inflation prone.

Government bond yields are again moving higher, and curves have steepened, against the backdrop of increased sovereign risk and improving economic prospects. We now expect that the benchmark U.S. 10-year Treasury bond yield will move up to 3¾% by the end of this year, and around 4¼% by the end of 2012, abetted by emerging inflationary signals, increased public and private sector credit demands, and ongoing credit quality concerns.

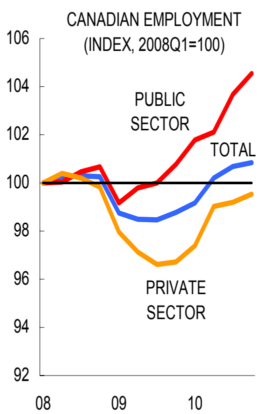
Improved U.S. growth prospects, the upward tilt in bond yields, and recurring sovereign risk concerns in Europe, have provided some renewed support for the greenback. However, a rapidly rising debt burden and the absence of a longer-term fiscal plan will continue to put intermittent downward pressure on the U.S. dollar. Although sovereign debt concerns continue to put the euro at periodic risk, the region's faster progress towards meeting its fiscal challenges should help stabilize and eventually bolster the currency's longer-term prospects vis-à-vis the greenback. The Canadian dollar should continue to gain ground versus its U.S. counterpart as monetary policy normalizes and fiscal consolidation takes hold this year. for a more complete perspective on foreign exchange trends, please refer to our January 2011 *Foreign Exchange Outlook* at http://www.scotiacapital.com/English/bns_econ/fxout.pdf. ■

# Canada

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

## Don't Call it A Full Comeback, Yet

The Canadian job market finished off with some moderate gains in the final quarter of 2010, providing some positive momentum into 2011. Overall 275,000 jobs were created last year, topping off a full recovery of all jobs lost over the course of the recession. December saw an additional 22,000 jobs added, a 0.2% m/m gain, with the manufacturing sector showing some life with a 3.8% m/m jump, while the trade sector dragged down the total somewhat with a 0.8% m/m loss. While much has been made of Canada's impressive labour market recovery, especially when compared to many of its OECD counterparts, there still remain several hurdles that will challenge growth in 2011.




Full-time employment is, in most cases, the preferred option for workers when taking into account income stability and the additional benefits provided. It also serves as a barometer for the health of the labour market, as confident firms are more likely to hire on a full-time basis, than those that face uncertainty. While Canada did manage to recover all jobs lost on a net basis, only 54% of the 350,000 full-time jobs lost in 2009 have been regained.

Job conversion rates from part-time to full-time recently improved in Q4, but significant progress has yet to be made. Although firms are showing increased confidence, as evidenced by the Canadian Federation of Independent Business' *Business Sentiment Index,* hiring intentions still remain fairly weak with businesses focusing on investment over labour at the moment.

Another major issue in 2011 will be the sources of job creation. Public sector employment surged in 2010, with a gain of 105,000 jobs easily offsetting the 12,000 jobs lost in 2009. However, the private sector did not fair as well, with only 54% of jobs lost in 2009 being regained. With governments at all levels facing a period of fiscal restraint, the baton will now be passed to the private sector to boost employment.

Neil Tisdall (416) 866-6252
neil_tisdall@scotiacapital.com

### Review

**IPPI & RMPI** — The industrial products price index increased 0.5% m/m in November, the same as October's increase, while the raw materials index was up 3.5% m/m, following a 2.1% increase the previous month. The indices increased on the strength of petroleum and coal, which was up 3.9% on the month, and primary metals, which were up 0.7%. Higher demand for coal and oil for heating due to cold weather was behind the price increase for petroleum and coal products, while primary metals prices would have been higher than +0.7% m/m if not for slowing demand in Asia for nickel that is used in stainless steel. Also moderating the monthly gain in the IPPI was the motor vehicle industry, which fell 0.4% m/m, the fourth consecutive monthly decline.

### Preview

**Building Permits** (01/10)

**Housing Starts** (01/11)

**New Housing Price Index** (01/12)

**Merchandise Trade Balance** (01/13)

**New Motor Vehicle Sales** (01/14)

While private sector services moved ahead at a healthy pace for the most part last year, manufacturing continued to provide a drag. Although conditions have started to stabilize in the sector, displaced workers are still finding their adjustment to be rather difficult with Ontario's Second Career stating that only 6 out of 10 applicants are finding work. A string of good data from the U.S. indicates that their fortunes may improve, but Canadian plants are still adjusting to a higher dollar while attempting to boost productivity.

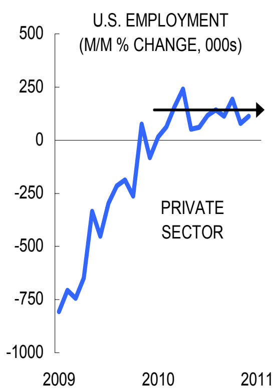
Overall, Canada's performance over the past year has been quite impressive, and 2011 will understandably mark a moderation in pace. However, efforts to improve productivity, diversify markets and to increase workers' skills must continue and when coupled with a brightening outlook for the U.S. economy, will help to slowly chip away at unemployment.■

# United States

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

## No Pluck In U.S. Payrolls

Yet another disappointing payroll release casts a shadow over some of the more upbeat reports of recent weeks, including retail sales and manufacturing activity. Despite mounting evidence that the U.S. economy is regaining some renewed momentum, the report should serve as a reminder that the recovery is not free of significant risk. In this environment, fiscal and monetary policy settings will remain highly accommodative for some time to come.




Confounding a number of earlier upbeat labour market reports (e.g. ADP, Challenger and jobless claims), total employment rose by just 103,000 in December, with a slightly stronger 113,000 increase in private sector payrolls. This brings the total number of new private sector positions created in 2010 to just 1.3 million. While not negligible, these new jobs make only a dent in the over 8 million positions lost in 2008-09, and represent the weakest post-recession recovery of the post-war era.

The details of the report were also discouraging. Aggregate hours worked edged up just 0.1% m/m last month, as did average hourly earnings. The unemployment rate dropped sharply to 9.4%, from 9.8% the prior month, but only because another wave of job seekers abandoned the labour market. The aggregate U.S. labour force participation rate fell to just 64.3% in December, its lowest level in over 25 years.

The trend in hiring is back in the black, but remains weak and essentially directionless (see chart). The lack of hiring despite improved sales and corporate balance sheets suggests a lingering wariness among many businesses regarding the sustainability of the recovery underway. It may also reflect some uncertainty over the broader regulatory/tax framework going forward.

U.S. household spending power is getting a significant boost from declining debt-servicing costs, as Americans pay down debt in an environment of low interest rates. The recent tax-cut package passed by Congress — which included a temporary reduction in employee payroll taxes, the extension of current income tax rates and extended unemployment benefits — is also supportive. However, it is questionable whether the recent pickup in sales can be sustained without a stronger pace of job growth, especially given rising gasoline costs, now topping US$3/gallon. Indeed, one in six Americans remain either unemployed or underemployed. ■

Neil Tisdall (416) 866-6252
neil_tisdall@scotiacapital.com

### Review

**ISM Indices —** Both the ISM manufacturing and non-manufacturing indices increased to finish off 2010, with the manufacturing index up 0.4 points, while non-manufacturing jumped 2.1 points, the strongest result since March of 2010. The headline manufacturing index is now at 57.0, while non-manufacturing is slightly higher at 57.1. New orders and business activity & production were strong positive drivers for the non-manufacturing segment, increasing 5.3 and 6.5 points to 63.0 and 63.5 respectively, well over the 50 mark which denotes expansion. While the important drivers of non-manufacturing are entering into 2011 on a strong note, the same cannot be said for the employment component of the index, which dropped 2.2 points on the month, leaving the index at the near contraction level of 50.5.

**Construction Spending —** Spending on construction rose 0.4% m/m in November, the third consecutive monthly increase. This was above consensus estimates of a 0.1% increase, and the important component of residential housing also experienced its third consecutive monthly gain. These two positive factors are moderated by the fact that construction spending is still down 6.0% on a y/y basis, but November's print is nonetheless encouraging.

### Preview

**Wholesale Trade** (01/11)

**Trade Price Indices** (01/12)

**PPI, Trade Balance** (01/13)

**CPI, Retail Sales, Capacity Utilization & Industrial Production, Consumer Sentiment, Business Inventories** (01/14)

# Mexico

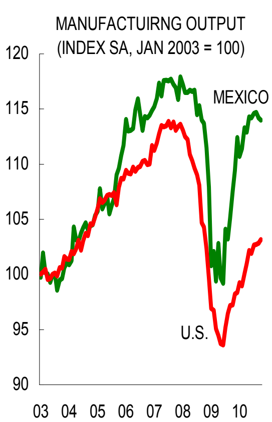
Oscar Sánchez

(416) 862-3174

oscar_sanchez@scotiacapital.com

## Manufacturing Rebound Twice As Dynamic As In U.S.

A favourable outlook for the Mexican industrial sector is being complemented by a pickup in activity within locally-oriented sectors as construction and utilities have entered into an expansionary phase. These developments are further confirmed by solid gains in demand for services, which is increasing at a yearly rate over 5%, underpinned by improving labour market conditions, ample bank credit growth and vast portfolio capital inflows. While we expect Mexico's GDP to expand by 3.5% year-over-year in 2011 following an estimated 5.1% gain in 2010, the risk to our outlook is clearly on the upside.




A manufacturing-led recovery during the second half of 2009 has finally ignited domestic demand activity. While the appearance of this balanced growth picture took longer than originally estimated, it is likely to remain in place through 2011, barring a significant global economic adverse shock.

Factory output pulled the Mexican economy into recession and is leading it out as activity approaches pre-recession peaks. While a close link with the United States is inescapable, the recovery in Mexico's manufacturing output has been almost twice as dynamic, as it stands currently 15% (versus the U.S.'s 8%) over the bottom in June 2009 (see chart).

The Mexican rebound can be adequately characterized by the evolution of durable goods exports, with shipments of automobiles playing a prominent role. The country followed the global inventory replenishment cycle foreign vehicle sales recovered after U.S.-based car companies exited bankruptcy proceedings in the fall of 2009. Investment in machinery and equipment in Mexican manufacturing is in line to reach pre-recession levels in the first half of 2011, on the back of cost competitiveness and favourable access to a rejuvenated U.S. market.

# Developing Americas

**Brazil's Growth To Be Led By Local Demand**

The recovery in Brazil has reached full cycle, with the output gap already in positive territory (as opposed to Mexico where full productive capacity has yet to be regained).

An originally industrial-sector led rebound has pulled unemployment down to historically low levels, with swelling payrolls persistently lifting household demand. Ample financing by private banks is now in full swing as loan loss provisions continue to carve a bottom. Corporate credit still depicts a positive profile in sectors favoured by terms of trade gains or prioritized by the government. Public sector credit will continue to aim at strategic industries as infrastructure is to be revamped in anticipation of the 2014 FIFA World Cup and the 2016 Olympic Games in Rio de Janeiro.

The industrial sector recovery has run its course. An agile post-crisis rebound was backed by accessible credit from state-owned banks, with still-favourable terms of trade continuing to benefit commodity-intensive industries. However, manufacturing activity which is exposed to foreign competition is now suffering the effects of currency strength, as domestic producers are undercut by more affordable imports.

Steady expansions in domestic absorption are running ahead of output and thus being paired with a swelling trade deficit, with net exports subtracting further from GDP growth each subsequent quarter. While the current account deficit has doubled in the past 12 months, it has yet to become a threat as it remains at a manageable 2.5% of GDP.

The recovery in Mexican factory output is also being supported by a decisive move towards alternative markets, a clear example of which is the performance of Mexican automobile exports after the recession.

A persistent diversification drive has resulted in a rising share of Mexican auto sales directed towards South America and Asia, as the relevance of the U.S. market has fallen to below 70%, from 80% in 2008 (exports of Mexican automobiles to the U.S. accounted for 68% of the total through November of 2010). ■

# Europe & Asia / Oceania

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

## Euro Zone Economy Continues To Move Ahead Despite Sovereign Credit Concerns

The underlying momentum of the euro zone economy remains broadly positive despite the ongoing sovereign credit turmoil. We estimate that regional real GDP growth reached 1.9% in 2010. The industrial sector continues to perform strongly, with the December print for the regional purchasing managers' index for the manufacturing industry revised upwards, indicating faster-than-estimated output increases, while regional industrial order books point towards maintained momentum. European Commission surveys on economic and industrial confidence show further improvements in business sentiment in December; meanwhile, however, a dip in consumer confidence reflects concerns regarding the sovereign credit crisis surrounding Ireland and some other peripheral economies. Indeed, a decline in retail sales (-0.8% m/m) in November confirms that consumers remain cautious. Divergences in member countries' economic performance continue to widen, with Germany remaining the region's star-performer. While German industrial production dipped in November (-0.7% m/m), the country's factory orders jumped 5.2% m/m in the same month, suggesting that the economy will continue to record solid growth in the coming months. As 2011 will bring intensified fiscal consolidation efforts in many parts of the euro zone, and as export sector performance will be adversely impacted by slower momentum in the euro zone's trading partners' economies, the regional real GDP growth will likely slow to 1.4% this year.

Regional inflationary pressures intensified in December with the consumer price index increasing by 2.2% y/y according to a "flash estimate", a pace which exceeds the European Central Bank's (ECB) inflation target of "below, but close to, 2%". Regardless, monetary conditions in the euro zone will likely remain accommodative for an extensive period of time. We expect the ECB to leave the benchmark interest rate on hold at 1.0% following the Governing Council meeting on January 13th. In fact, monetary conditions will likely remain unchanged until the final quarter of 2011, when a cautious process of monetary normalization begins. ■

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

## China: Costs To Remain Elevated But Inflation Could Peak Soon

The People's Bank of China (PBoC) decided on a second 25 basis point (bps) increase in the benchmark interest rate over Christmas, as yearly inflation continued to climb, to 5.1% in November.

Double-digit food costs have been the main driver of the recent upsurge in the annual inflation rate, with base effects playing a relevant role given last year's food deflation.

While costs are likely to remain elevated in coming months within a context of solid economic momentum, annual inflation could peak soon on the back of dissipating base effects. Although producer price gains also accelerated in November, they remain below mid-2010 peaks. Rising price pressures have yet to disseminate to the rest of the economy as non-food price gains remain below 2%, having reached 1.9% y/y in November.

As part of the recognition by Chinese authorities of the higher inflationary environment, the PBoC has raised its yearly inflation objective to 4% from 3% in 2010 (CPI data for December are to be published on January 19th).

We expect the PBoC to persist in its monetary normalization drive, as interest rate increases pick up pace in 2011 after the 50 bp rise of 2010. With exports still expanding at over 30% y/y, and given strong momentum in local retail sales, authorities' confidence on the country's economic performance should also lead to further CNY appreciation.

The Chinese yuan (CNY) will accelerate its strengthening bias in 2011 as part of a concerted policy to keep inflation in check. We expect the CNY to close at 6.1 per U.S. dollar in 2011 and 5.8 in 2012.

## Industry & Commodity

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

### Global Sales To Rev Up To Record Highs In 2011

The cyclical recovery in global auto sales that began in the spring of 2009 accelerated over the past year, and will likely lift volumes to record highs in 2011. The emerging markets of China, India and Russia will continue to lead the way, but the U.S. market is also expected to post its second consecutive double-digit increase in the coming year — a development that has not occurred since the early 1980s.

The recovery in global car sales has shifted gears and will increasingly be driven by improving labour markets. This represents a healthy transition from the massive and synchronized monetary and fiscal stimulus that was required to get the industry, and the global economy, back on a positive growth trajectory. The pace of job creation — and not the level of unemployment — is the key driver of global car sales, and the ongoing improvement should enable the United States and the euro zone to climb out of their deep hole. The auto industry is also getting a helping hand from increased auto lending across the globe — especially in emerging nations, where loan growth is approaching 40% year-over-year. However, loan growth will moderate in 2011, as central banks in emerging nations tighten monetary policy more aggressively to dampen inflation pressures.

Improving global job growth — currently at about 2% year-over-year, the strongest pace since late 2007 — leaves potential new vehicle buyers better equipped to deal with ongoing concerns about the sluggish pace of the U.S. economic recovery, as well as with persistent sovereign debt problems emanating from Western Europe. Job creation is being led by growth of 4% year-over-year in the BRIC nations. However, prospects have even improved in Western Europe, with fourth-quarter euro-zone employment likely climbing above a year earlier for the first time since mid-2008.

China became the largest auto market in 2009, surpassing sales in the United States. Purchases soared an additional 30% over the past year leading the global auto recovery. In 2011, new car sales in China and the other BRIC nations will surpass the combined volumes of Western Europe and Japan, and account for roughly 30% of global car sales.

Sales growth in China will moderate to about 15% over the coming year, held back by the expiry of government tax incentives, and a sharp reduction in licence plate issuance by the city of Beijing as it attempts to tackle vehicle congestion. However, purchases will be underpinned by per capita income growth in excess of 9%, as well as by favourable demographics. Per capita income in China is currently US$4,200 — in the 'sweet spot' for auto industry growth. Historically, vehicle sales have experienced the fastest growth, when per capita income is in the US$4,000-US$6,000 range. ■

#### U.S. Auto Sales Heat Up, Canadian Volumes Cool

Passenger vehicle sales in Canada weakened in December, largely due to a sharp fall-off at a major automaker. We estimate that sales fell to an annualized 1.50 million units — the lowest level since the emergence of the European sovereign debt crisis in the spring, and prior to the sharp escalation in incentives.

Higher gasoline prices also held back purchases, with light truck volumes posting the smallest year-over-year increase since November 2009. In particular, SUV sales moderated to only a 4% y/y gain from nearly a 30% jump during the previous eleven months. Gains in pickup truck volumes also moderated to 8% in December, from 23% through November. Despite last month's slowdown, light trucks continued to outperform and outsold cars last year for the first time. We expect light trucks to continue to dominate the market, but the strength will increasingly shift to fuel-efficient crossover utility vehicles (CUVs) from pickup trucks.

U.S. passenger vehicle sales ended the year on a high note, climbing to a stronger-than-expected 12.5 million units in December — the highest level since the 'cash-for-clunkers' in August 2009. This marks the fourth consecutive month that U.S. volumes have surpassed an annualized 12.0 million units, and leaves automakers optimistic that the market will continue to strengthen.

Retail volumes climbed above an annualized 11.0 million units in December, as households are increasingly displacing fleet purchases as the main source of strength for the U.S. auto industry. Retail volumes have posted double-digit year-over-year increases over the past four consecutive months — a sharp improvement from a 5% slide through August, and a clear indication that households are feeling more comfortable in undertaking big-ticket purchases.

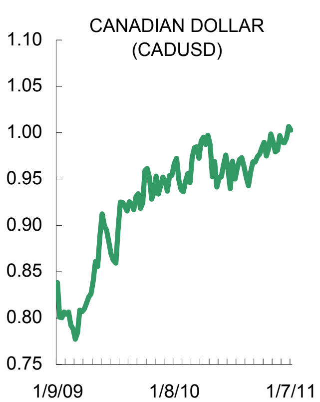
As in Canada, light trucks now dominate the U.S. auto market, capturing 51.2% of overall sales. In particular, sales of CUVs totaled 2.8 million units in 2010, overtaking mid-size cars (2.4 million) — the traditional leading segment in the United States.

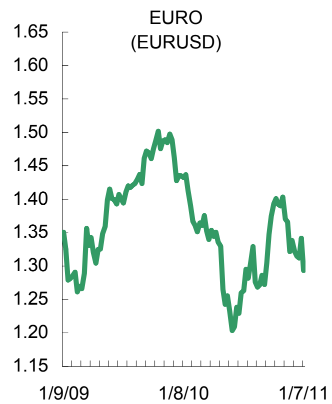
# Market Metrics

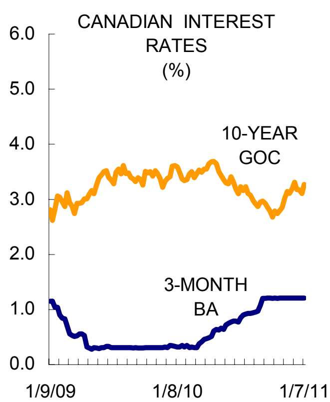
Nathan Joshua
(416) 866-5338
nathan_joshua@scotiacapital.com

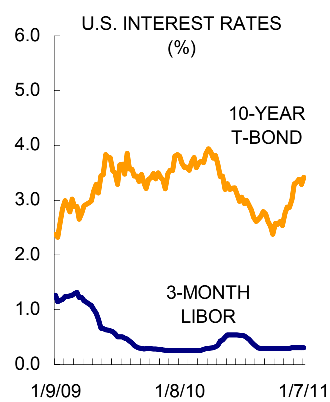
Neil Tisdall
(416) 866-6252
neil_tisdall@scotiacapital.com

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

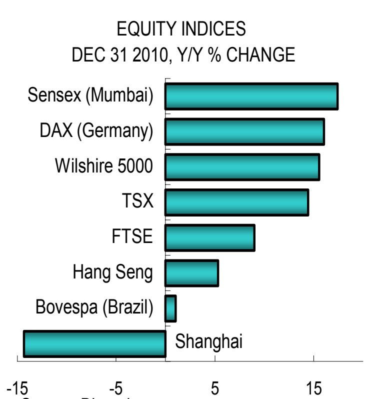


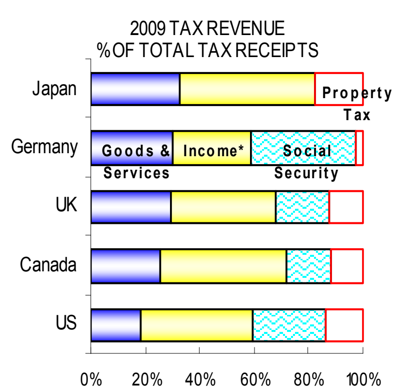




Fiscal Charts




Source: Bloomberg




* Incudes profits and capital gains. Source: OECD.

**Markets** — The S&P 500 started 2011 on a strong note, hitting an over 2-year high at 1276.56 on Wednesday. Unemployment claims falling below 400,000 for the first time since 2008 and stronger expectations for employment growth in 2011 along with increasing oil prices are helping the equities index. A weaker-than-expected employment report in the U.S., where 103,000 jobs were gained as opposed to expectations of 150,000, pared the index slightly at week's end. Canadian markets didn't fare as well as their U.S. counterparts to begin the year, as the S&P TSX composite dropped to a two-week low on Friday, partially due to a selloff in gold that has dropped prices to their lowest level since mid-December.

*Note: Latest observation taken at time of writing.*

**Fiscal Policy** — As **Japan's** growth slows in 2011 and its general government gross debt continues to climb beyond 200% of GDP, Prime Minister Kan has presented his priorities for 2011. A more "open" Japan reflects his determination to enter free trade agreements, notably the Trans-Pacific Partnership. A related goal is reform of Japan's agriculture sector. Given Japan's older population, Kan urges non-partisan discussion on funding solutions for Japan's expanding social security burden, including tax reform, led by a hike in the 5.0% consumption tax. The latter proposal by Kan proved controversial during last summer's elections and the opposition majority in the upper house remains a complicating factor for the government. The draft *Budget* for FY2011, beginning April 1, maintains Kan's pledge to hold new bond issuance at or below the FY2010 level.

**Europe's** heavier reliance on consumption taxes is rising with Value Added Tax (VAT) rate hikes a favoured deficit-reduction strategy and rates in a number of countries now at or above 20%. While consumption taxes typically create less economic drag than other levies such as income taxes, steep increases, such as the U.K.'s hike in its VAT rate from 17½% to 20% this week, are expected to impact consumer spending. In **Canada**, Nova Scotia's increase in its portion of the HST and Quebec's QST hikes are taking advantage of the tax room vacated by Ottawa's two percentage point reduction in its GST rate since July 2006. To support competitiveness, Canadian governments are proceeding with scheduled corporate income tax (CIT) cuts, with Ottawa, for example, trimming its general CIT rate from 18% to 16.5% on January 1, en route to 15% in January 2012.

# Economic Tables

| Canada | 2009 | 10Q2 | 10Q3 | Latest | |
|---|---|---|---|---|---|
| Real GDP (annual rates) | -2.5 | 2.3 | 1.0 | | |
| Current Acc. Bal. (C$B, ar) | -43.5 | -51.9 | -70.1 | | |
| Merch. Trade Bal. (C$B, ar) | -4.6 | -9.4 | -27.5 | -20.5 | (Oct) |
| Industrial Production | -9.4 | 6.2 | 7.9 | 6.2 | (Oct) |
| Housing Starts (000s) | 149 | 199 | 191 | 188 | (Nov) |
| Employment | -1.6 | 1.8 | 2.1 | 2.1 | (Dec) |
| Unemployment Rate (%) | 8.3 | 8.0 | 8.0 | 7.6 | (Dec) |
| Retail Sales | -2.9 | 4.9 | 3.5 | 3.3 | (Oct) |
| Auto Sales (000s) | 1459 | 1518 | 1608 | 1601 | (Oct) |
| CPI | 0.3 | 1.4 | 1.8 | 2.0 | (Nov) |
| IPPI | -3.5 | 0.7 | 1.0 | 2.1 | (Nov) |
| Pre-tax Corp. Profits | -32.3 | 26.3 | 16.0 | | |

| United States | 2009 | 10Q2 | 10Q3 | Latest | |
|---|---|---|---|---|---|
| Real GDP (annual rates) | -2.6 | 1.7 | 2.6 | | |
| Current Acc. Bal. (US$B, ar) | -378 | -493 | -509 | | |
| Merch. Trade Bal. (US$B, ar) | -507 | -678 | -685 | -617 | (Oct) |
| Industrial Production | -9.3 | 7.8 | 6.8 | 5.3 | (Nov) |
| Housing Starts (millions) | 0.55 | 0.60 | 0.59 | 0.56 | (Nov) |
| Employment | -4.3 | -0.5 | 0.2 | 0.8 | (Dec) |
| Unemployment Rate (%) | 9.3 | 9.6 | 9.6 | 9.4 | (Dec) |
| Retail Sales | -7.1 | 7.5 | 6.1 | 8.1 | (Nov) |
| Auto Sales (millions) | 10.4 | 11.3 | 11.6 | 12.5 | (Dec) |
| CPI | -0.4 | 1.8 | 1.2 | 1.1 | (Nov) |
| PPI | -2.6 | 4.4 | 3.8 | 3.5 | (Nov) |
| Pre-tax Corp. Profits | -1.2 | 46.7 | 34.8 | | |

| Mexico | | | | | |
|---|---|---|---|---|---|
| Real GDP | -6.1 | 7.6 | 5.3 | | |
| Current Acc. Bal. (US$B, ar) | -6.2 | -2.5 | -7.4 | | |
| Merch. Trade Bal. (US$B, ar) | -4.6 | -0.2 | -9.2 | -1.2 | (Nov) |
| Industrial Production | -7.4 | 7.9 | 6.3 | 3.7 | (Oct) |
| CPI | 5.3 | 4.0 | 3.7 | 4.4 | (Dec) |

| Brazil | | | | | |
|---|---|---|---|---|---|
| Real GDP | -0.6 | 8.5 | 5.9 | | |
| Current Acc. Bal. (US$B, ar) | -24.3 | -46.7 | -45.2 | | |
| Merch. Trade Bal. (US$B, ar) | 25.3 | 28.0 | 19.4 | 64.4 | (Dec) |
| Industrial Production | -7.2 | 14.2 | 8.1 | 4.1 | (Nov) |
| CPI | 5.2 | 5.5 | 5.0 | 6.6 | (Dec) |

| Argentina | | | | | |
|---|---|---|---|---|---|
| Real GDP | 0.9 | 11.8 | 8.6 | | |
| Current Acc. Bal. (US$B, ar) | 11.0 | 12.8 | 3.6 | | |
| Merch. Trade Bal. (US$B, ar) | 16.9 | 21.4 | 12.0 | 4.7 | (Nov) |
| Industrial Production | 0.1 | 10.1 | 9.3 | 12.8 | (Nov) |
| CPI | -26.9 | 93.3 | 89.8 | 11.0 | (Nov) |

| Italy | | | | | |
|---|---|---|---|---|---|
| Real GDP | -5.1 | 1.3 | 1.1 | | |
| Current Acc. Bal. (US$B, ar) | -0.07 | -0.08 | -0.07 | -0.04 | (Oct) |
| Merch. Trade Bal. (US$B, ar) | -8.0 | -32.1 | -22.9 | -33.5 | (Oct) |
| Industrial Production | -18.2 | 7.8 | 6.3 | 3.3 | (Oct) |
| CPI | 0.8 | 1.5 | 1.6 | 1.8 | (Nov) |

| Germany | | | | | |
|---|---|---|---|---|---|
| Real GDP | -4.7 | 3.9 | 3.9 | | |
| Current Acc. Bal. (US$B, ar) | 168.9 | 132.0 | 148.1 | 196.9 | (Nov) |
| Merch. Trade Bal. (US$B, ar) | 193.4 | 179.3 | 205.9 | 193.3 | (Nov) |
| Industrial Production | -15.5 | 12.2 | 10.2 | 11.1 | (Nov) |
| Unemployment Rate (%) | 8.2 | 7.7 | 7.6 | 7.5 | (Dec) |
| CPI | 0.3 | 1.1 | 1.2 | 1.7 | (Dec) |

| France | | | | | |
|---|---|---|---|---|---|
| Real GDP | -2.8 | 1.8 | 2.0 | | |
| Current Acc. Bal. (US$B, ar) | -52.2 | -58.3 | -45.4 | -75.3 | (Oct) |
| Merch. Trade Bal. (US$B, ar) | -31.4 | -42.3 | -40.0 | -34.0 | (Nov) |
| Industrial Production | -13.5 | 7.3 | 5.3 | 4.5 | (Oct) |
| Unemployment Rate (%) | 9.5 | 9.8 | 9.7 | 9.8 | (Nov) |
| CPI | 0.1 | 1.6 | 1.5 | 1.6 | (Nov) |

| Euro Zone | | | | | |
|---|---|---|---|---|---|
| Real GDP | -4.0 | 1.9 | 1.9 | | |
| Current Acc. Bal. (US$B, ar) | -69.2 | -118 | -81 | -38 | (Oct) |
| Merch. Trade Bal. (US$B, ar) | 54.7 | 19.8 | 36.1 | 111.2 | (Oct) |
| Industrial Production | -14.8 | 8.9 | 7.0 | 6.9 | (Oct) |
| Unemployment Rate (%) | 9.4 | 9.9 | 9.9 | 10.0 | (Nov) |
| CPI | 0.3 | 1.5 | 1.7 | 1.9 | (Nov) |

| United Kingdom | | | | | |
|---|---|---|---|---|---|
| Real GDP | -4.9 | 1.6 | 2.7 | | |
| Current Acc. Bal. (US$B, ar) | -37.1 | -28.3 | -63.9 | | |
| Merch. Trade Bal. (US$B, ar) | -128.7 | -135.3 | -159.6 | -162.3 | (Oct) |
| Industrial Production | -10.1 | 1.5 | 3.2 | 3.3 | (Oct) |
| Unemployment Rate (%) | 7.6 | 7.8 | 7.8 | 7.9 | (Sep) |
| CPI | 2.2 | 3.4 | 3.1 | 3.2 | (Nov) |

| Japan | | | | | |
|---|---|---|---|---|---|
| Real GDP | -6.3 | 3.5 | 5.0 | | |
| Current Acc. Bal. (US$B, ar) | 141.8 | 156.9 | 221.5 | 210.5 | (Oct) |
| Merch. Trade Bal. (US$B, ar) | 29.1 | 59.9 | 84.6 | 62.0 | (Nov) |
| Industrial Production | -21.8 | 21.1 | 12.9 | 4.2 | (Nov) |
| Unemployment Rate (%) | 5.1 | 5.2 | 5.1 | 5.1 | (Nov) |
| CPI | -1.4 | -0.9 | -0.8 | 0.1 | (Nov) |

| Australia | | | | | |
|---|---|---|---|---|---|
| Real GDP | 1.3 | 3.1 | 2.7 | | |
| Current Acc. Bal. (US$B, ar) | -41.4 | -12.3 | -33.5 | | |
| Merch. Trade Bal. (US$B, ar) | -3.2 | 31.9 | 27.1 | 31.0 | (Oct) |
| Industrial Production | -1.6 | 6.9 | 5.0 | | |
| Unemployment Rate (%) | 5.6 | 5.2 | 5.2 | 5.2 | (Nov) |
| CPI | 1.8 | 3.1 | 2.8 | | |

| China | | | | | |
|---|---|---|---|---|---|
| Real GDP | 9.1 | 10.3 | 9.6 | | |
| Current Acc. Bal. (US$B, ar) | 297.1 | | | | |
| Merch. Trade Bal. (US$B, ar) | 195.7 | 164.3 | 261.4 | 274.7 | (Nov) |
| Industrial Production | 18.5 | 13.7 | 13.3 | 13.3 | (Nov) |
| CPI | 1.6 | 1.5 | 1.5 | 1.9 | (Nov) |

| South Korea | | | | | |
|---|---|---|---|---|---|
| Real GDP | 0.2 | 7.2 | 4.4 | | |
| Current Acc. Bal. (US$B, ar) | 32.8 | 34.3 | 37.6 | 23.2 | (Nov) |
| Merch. Trade Bal. (US$B, ar) | 40.4 | 58.0 | 45.7 | 44.9 | (Dec) |
| Industrial Production | -1.3 | 19.5 | 14.1 | 9.0 | (Nov) |
| CPI | 2.8 | 2.6 | 2.9 | 3.5 | (Dec) |

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

# Financial Tables

## Interest Rates (%, end of period)

| Canada | 10Q3 | 10Q4 | Dec/31 | Jan/07* | United States | 10Q3 | 10Q4 | Dec/31 | Jan/07* |
|---|---|---|---|---|---|---|---|---|---|
| BoC Overnight Rate | 1.00 | 1.00 | 1.00 | 1.00 | Fed Funds Target Rate | 0.25 | 0.25 | 0.25 | 0.25 |
| 3-mo. T-bill | 1.01 | 1.05 | 1.05 | 1.05 | 3-mo. T-bill | 0.15 | 0.12 | 0.12 | 0.13 |
| 10-yr Gov't Bond | 2.76 | 3.12 | 3.16 | 3.19 | 10-yr Gov't Bond | 2.51 | 3.29 | 3.29 | 3.34 |
| 30-yr Gov't Bond | 3.36 | 3.53 | 3.55 | 3.62 | 30-yr Gov't Bond | 3.68 | 4.33 | 4.33 | 4.50 |
| Prime | 3.00 | 3.00 | 3.00 | 3.00 | Prime | 3.25 | 3.25 | 3.25 | 3.25 |
| FX Reserves (US$B) | 59.4 | | 58.1 | (Nov) | FX Reserves (US$B) | 122.1 | | 119.2 | (Nov) |
| **Germany** | | | | | **France** | | | | |
| 3-mo. Interbank | 0.86 | 0.96 | 0.96 | 0.81 | 3-mo. T-bill | 0.51 | 0.40 | 0.41 | 0.42 |
| 10-yr Gov't Bond | 2.28 | 2.96 | 2.96 | 2.87 | 10-yr Gov't Bond | 2.66 | 3.36 | 3.36 | 3.32 |
| FX Reserves (US$B) | 62.4 | | 61.3 | (Nov) | FX Reserves (US$B) | 52.2 | | 52.9 | (Nov) |
| **Euro-Zone** | | | | | **United Kingdom** | | | | |
| Refinancing Rate | 1.00 | 1.00 | 1.00 | 1.00 | Repo Rate | 0.50 | 0.50 | 0.50 | 0.50 |
| Overnight Rate | 0.88 | 0.82 | 0.39 | 0.38 | 3-mo. T-bill | 4.85 | 4.85 | 4.85 | 4.85 |
| FX Reserves (US$B) | 300.1 | | 296.1 | (Nov) | 10-yr Gov't Bond | 2.95 | 3.40 | 3.47 | 3.51 |
| | | | | | FX Reserves (US$B) | 67.2 | | 65.1 | (Nov) |
| **Japan** | | | | | **Australia** | | | | |
| Discount Rate | 0.30 | 0.30 | 0.30 | 0.30 | Cash Rate | 4.50 | 4.50 | 4.75 | 4.75 |
| 3-mo. Libor | 0.15 | 0.13 | 0.13 | 0.12 | 10-yr Gov't Bond | 4.96 | 5.55 | 5.62 | 5.62 |
| 10-yr Gov't Bond | 0.94 | 1.13 | 1.17 | 1.21 | FX Reserves (US$B) | 38.1 | | 38.3 | (Nov) |
| FX Reserves (US$B) | 1077.4 | | 1067.0 | (Nov) | | | | | |

## Exchange Rates (end of period)

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| USDCAD | 1.03 | 1.00 | 1.00 | 0.99 | ¥/US$ | 83.52 | 81.16 | 81.16 | 83.07 |
| CADUSD | 0.97 | 1.00 | 1.00 | 1.01 | US¢/Australian$ | 96.71 | 102.33 | 102.33 | 99.50 |
| GBPUSD | 1.572 | 1.561 | 1.561 | 1.555 | Chinese Yuan/US$ | 6.69 | 6.59 | 6.59 | 6.63 |
| EURUSD | 1.363 | 1.339 | 1.339 | 1.293 | South Korean Won/US$ | 1138 | 1125 | 1125 | 1121 |
| JPYEUR | 0.88 | 0.92 | 0.92 | 0.93 | Mexican Peso/US$ | 12.593 | 12.360 | 12.360 | 12.240 |
| USDCHF | 0.98 | 0.93 | 0.93 | 0.97 | Brazilian Real/US$ | 1.688 | 1.660 | 1.660 | 1.687 |

## Equity Markets (index, end of period)

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| United States (DJIA) | 10788 | 11578 | 11578 | 11654 | U.K. (FT100) | 5549 | 5900 | 5971 | 5984 |
| United States (S&P500) | 1141 | 1258 | 1258 | 1268 | Germany (Dax) | 6229 | 6914 | 6914 | 6951 |
| Canada (S&P/TSX) | 12369 | 13443 | 13434 | 13283 | France (CAC40) | 3715 | 3805 | 3805 | 3867 |
| Mexico (Bolsa) | 33330 | 38551 | 38551 | 38514 | Japan (Nikkei) | 9369 | 10229 | 10345 | 10541 |
| Brazil (Bovespa) | 69430 | 69305 | 69305 | 70178 | Hong Kong (Hang Seng) | 22358 | 23035 | 23035 | 23687 |
| Italy (BCI) | 1033 | 1048 | 1048 | 1072 | South Korea (Composite) | 1873 | 2051 | 2051 | 2086 |

## Commodity Prices (end of period)

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Pulp (US$/tonne) | 990 | 970 | 970 | 970 | Copper (US$/lb) | 3.65 | 4.42 | 4.42 | 4.26 |
| Newsprint (US$/tonne) | 638 | 640 | 640 | 640 | Zinc (US$/lb) | 0.99 | 1.10 | 1.10 | 1.09 |
| Lumber (US$/mfbm) | 236 | 308 | 308 | 321 | Gold (US$/oz) | 1307.00 | 1405.50 | 1405.50 | 1367.00 |
| WTI Oil (US$/bbl) | 79.97 | 91.38 | 91.38 | 88.83 | Silver (US$/oz) | 22.07 | 30.63 | 30.63 | 28.39 |
| Natural Gas (US$/mmbtu) | 3.87 | 4.41 | 4.41 | 4.35 | CRB (index) | 286.86 | 332.80 | 332.80 | 325.38 |

** Note: Latest observation taken at time of writing. + Last week's price.*