

Global Views

Weekly commentary on economic and financial market developments

August 19, 2011

Economics >	Corporate Bond Research	Emerging Markets Strategy >	Equity Strategy >	Fixed Income Research	Fixed Income Strategy >	Foreign Exchange Strategy
Economic Statistics >	Financial Statistics >	Forecasts >	Contact Us >			

2-13 Economics

- 2 • Jackson Hole A Key End To An Active Week Karen Cordes Woods & Derek Holt
- 3-5 • Half-Empty Or Half-Full? Aron Gampel & Carlos Gomes
- 6-7 • On The Effects Of Current Financial Market Stress On Asian Growth Oscar Sánchez
- 8-9 • Core Europe — Regional Economic Outlook Pablo Bréard & Tuuli McCully
- 10 • An Update On The U.S. Housing Market Gorica Djerić
- 11 • Slowing Economic Expansion Adds To Health Reform Pressures Gaelan MacKenzie & Mary Webb
- 12-13 • Sweden's Experience Is One Reason To Tread Carefully Toward A Tobin Tax Karen Cordes Woods & Derek Holt

14-15 Emerging Markets Strategy

- Distortions In The Mexican Global Curve Joe Kogan

16-17 Equity Strategy

- Q2/11 Earnings Scorecard — Another Beat Hugo Ste-Marie

18-19 Fixed Income Strategy

- Eurozone: Getting Sentimental Alan Clarke

A1-A12 Forecasts & Data

- Key Data Preview A1-A2
- Key Indicators A3-A6
- Global Auctions Calendar A7
- Events Calendar A8
- Global Central Bank Watch A9
- Forecasts A10
- Latest Economic Statistics A11
- Latest Financial Statistics A12

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

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

Jackson Hole A Key End To An Active Week

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

Fed Chairman Ben Bernanke's speech at the annual **Jackson Hole** symposium in Wyoming on Friday may turn out to be the show-stopper of the week. The downdraft in global indicators and markets heightens expectations, but we doubt the Fed is about to pull the trigger on QE3 or other key policy options. Last year's speech is of course the one where he teed up expectations for QE2 and delivered the goods in the November FOMC statement. This year is unlikely to repeat at least as yet. Bernanke will repeat that the Fed still has options, will elaborate upon downward revisions to growth as has become the norm at this time of year, and will say that the Fed is ready to act when needed, but probably won't give an aggressive nod toward action just yet. For one, while growth is stumbling as it was last summer, inflation is mixed. The one-year TIPS breakeven has risen significantly off the recent floor, but it mixes inflation expectations with changes in a safe haven liquidity premium that has driven variable wedges between nominal Treasuries and real return bonds and that has dirtied its usefulness as an inflation signal. Ten year TIPS breakevens are signaling materially higher inflation expectations than last summer's depths which may give cause for Bernanke to point to soft but reasonably well behaved long-run inflation expectations. Actual inflation is another matter, as we're awaiting the turning point away from higher readings over the past year. That stands in sharp contrast to last summer's inflation depths in which it took several months of very soft inflation data to motivate the Fed into action. At current yields, most of anything the Fed is likely to do may be largely priced in, suggesting a richly valued curve perhaps set up for disappointment should Bernanke wish to purge the "Bernanke put" moniker (i.e., rescuing the risk trade upon each stumble as plagued his predecessor). Indeed, I've grown much more disenchanted toward the virtues of QE over time. As a solid supporter — and having forecast — QE1, it stood to reason that this was a perfectly sensible act driven by a central bank leaning its balance sheet into a private market failure characterized by the vaporization of liquidity and a panoply of relative pricing anomalies. QE2 was not about such policy goals and was instead justified ex-post by raising inflation expectations to avert deflation and boosting stock prices to grease the recovery wheels. If one accepts that QE2 played such a powerful role in isolation of other forces like earnings and weak base effects off of which to post higher inflation going forward, then it likely did more harm than good in my opinion, boosting commodity prices to the detriment of the US consumer and raising the all-important thirty year fixed mortgage rate priced off 10s and swapped out. Both consequences contributed toward weakness in consumer spending and housing markets this year. In a broader sense, rate caps, extending the asset profile of the Fed's balance sheet, or more outright purchases of Treasuries, agencies or MBS would not likely be sustainably fruitful to markets or the economy. Households will not borrow at any price in the US economy. But most disconcerting of all is that logic toward influencing the curve is malleable according to where the curve sits at the point of judgment: anchoring long-term yields at low levels is supposed to stimulate risk seeking away from low-yielding Treasuries, yet preserving a steep yield curve to recapitalize US banks and encourage term lending has been another goal to yield curve management. In that regard, policy is sucking and blowing simultaneously, as both policy outcomes cannot be achieved at the same time. The policy quandary is the pursuit of a zero sum yield curve game; hence Plosser's "frustrated" Fed.

US data will be light, including key releases like an expected gain in durable goods orders (Wed), downward revisions to Q2 GDP (Friday) and timely regional surveys from the Chicago and Richmond Fed. **Europe** will be a hotbed of activity. Headline risk could flow randomly as usual, or from Angela Merkel's scheduled weekend TV interview and/or a debate on the euro crisis within her CDP and CSU coalition partners. Auctions in Belgium, Spain and Italy will test market appetite in the wake of the disappointing Merkel-Sarkozy meeting. Data risk will be focused upon manufacturing PMIs on Tuesday, German readings on investor and business confidence and retail sales, Q2 UK GDP and a UK services index, and EC new industrial orders.

Retail sales will be the only marquee release of the week in **Canada** next week. We doubt any surprises will materialize from two BoC speeches, so consumer spending will be the only made-in-Canada market risk.

Asian markets will be relatively quiet with one key exception. The advance, or 'flash' estimate of the HSBC manufacturing PMI caught markets off guard when it signaled a contraction in China's manufacturing sector in the July reading, so the August reading will be feared to put in a repeat performance next week.

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

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

Half-Empty Or Half-Full?

- **Take your pick — some indicators are pointing to recession, but others are not.**

With the global economy losing considerable momentum, financial markets are pricing in a greater chance that it will tilt back into recession, and probably soon. The growing pessimism over the outlook is reflected in the sharp losses on global bourses, the slide in U.S. government bond yields back to recession lows, the record-setting spike in the price of gold, as well as the increased day-to-day volatility.

The uncertainty reflects a number of compounding factors. In the United States, slower-than-expected economic activity will add to already bloated federal deficit and debt levels. Unrelenting sovereign debt strains and intensifying banking sector problems in the euro zone are exposing the limits to co-ordinated relief. On both sides of the Atlantic, there are concerns that engorged central bank balance sheets, and in some cases, the upward trend in core inflation, may preclude any additional stimulative efforts at a time when fiscal consolidation begins to bite. There is residual concern that the faster-growing emerging nations may be increasingly susceptible to the efforts that have been made to cap domestic credit and inflation pressures, in addition to reduced export demand. And because of the close trade and capital ties between nations, even countries that are in comparatively better economic and fiscal shape, like Canada, tend to be swamped by the spillover.

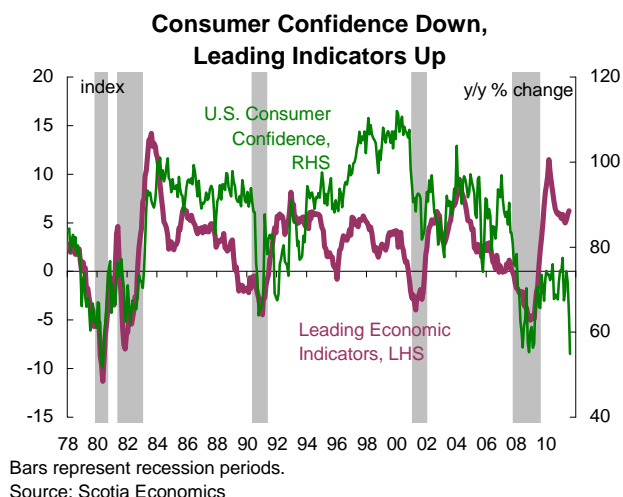
Some, but not all indicators are reflecting the change in expectations.

Confidence is being beaten down. The University of Michigan’s consumer confidence index for August plunged to its lowest level in three decades, dragged sharply lower by the compounding effect of the more downbeat economic performances and renewed turmoil in financial markets. Unquestionably, no confidence could quickly morph into no spending and no growth.

Nevertheless, U.S. leading indicators advanced 5.4% in the second quarter from a year earlier, with the July result increasing further as well. Historically, leading indicators turn negative an average of two quarters prior to the peak in the economic cycle, and over the past 40 years, no recessions have occurred with the index still posting a positive performance. Coincident indicators, such as industrial production, are heading up, not down, as the impact of the Japanese supply chain disruptions on manufacturing dissipate.

Significant stock market corrections can be a precursor to recessions. There have been six recessions since the early 1970s, with declines in the bellwether S&P500 index averaging a hefty 33%.

Even so, the frequency of fairly large stock market retreats that are not accompanied by an



S&P 500 Market Corrections During Bull & Bear Markets

Bull/Expansion			Bear/Recession	
Date	# of corrections	% change	Date	% change
May 70-Jan 73	1	-14	Nov 73-Mar 75	-42
Oct 74-Feb 80	3	-15	Jan 80-Jul 80	-17
			Jan 81-Nov 82	-25
Aug 82-Jul 90	3	-18	Jul 90-Mar 91	-19
Oct 90-Mar 00	2	-15	Mar 01-Nov 01	-37
Oct 02-Oct 07	1	-14	Dec 07-Jun 09	-56
Mar 09	1	-16		
average		-15		-33
			Apr 11-Aug 11	-16

Source: Scotia Economics

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

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

... continued from previous page

economic downturn is relatively high. For example, there have been six bull markets over the past forty years that have witnessed the S&P500 increase by an average of 110%. During these market expansions, the S&P500 stock index has witnessed 11 selloffs in excess of 10%, with an average decline of 15%. The current slump in the S&P500 index has reached 16% — a performance that is still in line with periodic corrections in a longer-term bull market.

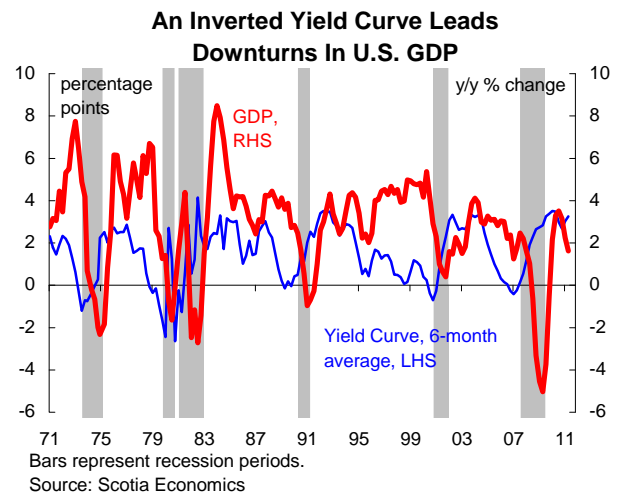
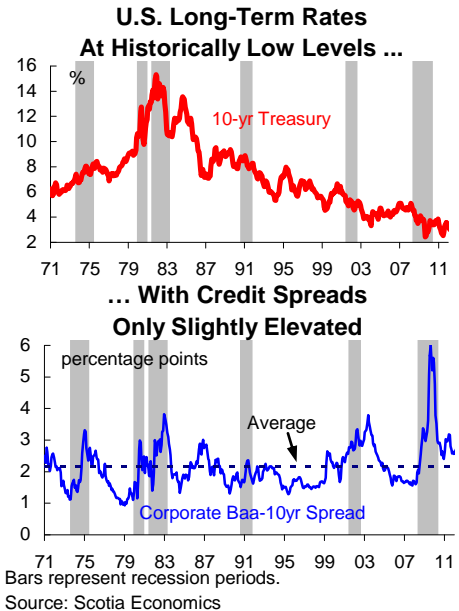
‘Safe-haven’ flows have favoured U.S. government bills and bonds and buoyed the U.S. dollar, despite S&P’s recent downgrade of America’s sovereign credit rating. The U.S. 10-year T-bond yield has plunged from a high of 3.73% in early February to the most recent level around 2.10% — tracking the 2-4% range that has existed since late-2007, and essentially matching the recession low. Moving below the 2% threshold — and establishing a new cycle low yield for this bellwether bond — could well signal much tougher times ahead, particularly if it was accompanied by a further widening in credit spreads for prime corporate borrowers.

However, with long-term interest rates declining faster than short-term rates, the U.S. yield curve (the yield difference between a U.S. 10-year T-bond and a 3 mo. T-bill) has flattened from a peak slope of 350 bp in mid-February to just over 200 bp today. Yet the yield curve remains quite positively-sloped compared with the 160 bp average recorded since 1971. Positively-sloped yield curves are associated with economic expansions, either fast or slow, reflecting generally accommodative and pro-growth monetary and banking sector conditions. Every U.S. recession has been preceded by the yield curve inverting with short-term rates higher than long-term rates, with the inversion normally occurring four quarters prior to the peak in the economic cycle.

Financial stress has clearly intensified. One indicator, the VIX, estimates the implied volatility in the S&P500 stock index. This indicator hit 48 on August 8th and has dropped modestly to around 40 during the subsequent days of ongoing market agitation. This level, though, is still double the 40-year average of 20. From a historical perspective, the VIX has peaked at around 48 in each of the past six periods of financial stress that did not precede a recession, while peaking at around 80 in November 2008 at the height of the global credit meltdown and economic slide into recession.

Another financial stress indicator, the TED spread (the yield difference between Libor and a 3 mo. T-bill), appears much less stressed. It has declined to around 25 bp, a level that is well below the average of about 70 bp since 1971. Moreover, this metric typically widens as the U.S. economy approaches a cyclical peak, and has averaged 130 bp during the six recessions in the past forty years. Despite the slowing in growth, debt-burdened governments on both sides of the Atlantic, renewed concerns over European banks, and slumping stock markets, the TED spread has not jumped to danger-like financial stress levels.

Is recession inevitable? A renewed downturn could materialize if the fiscal taps are turned too tight,



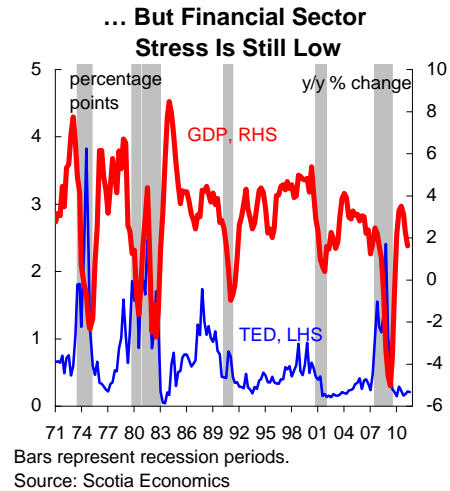
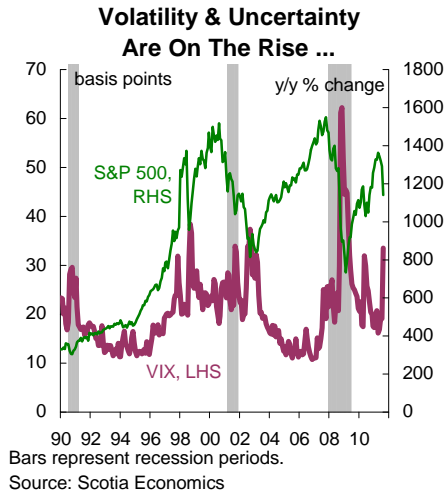
Aron Gampel (416) 866-6259
aron_gampel@scotiacapital.com

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

... continued from previous page

especially in those developed countries/regions where growth is already sub-par; if the global flow of credit is disrupted by a renewed squeeze on liquidity in the banking sector; if there was a significant supply shock, sharply higher oil prices for example, that would tax over-burdened households; if monetary policy was forced to tighten prematurely to combat eroding inflation expectations and weaker currencies; if businesses collectively retrench and pare back employment and investments to protect their bottom line; or if the credit restraint measures implemented in the emerging economies unexpectedly shifts them out of overdrive and into low gear or even reverse.

Renewed recession is possible, but not probable. More likely, the global economy is adjusting to a lower growth trajectory that is prone to periods of little or no activity. Ultra-low interest rates, low inventories, cash-rich businesses in many countries, and continuing gains in emerging economies are likely to underpin the global economy's forward momentum.



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

On The Effects Of Current Financial Market Stress On Asian Growth

- **No derailment of the Asian expansionary machine is envisaged; on the contrary, recent shocks support for the most part the region's prevalence in the global growth picture.**

Asian economies will not entirely avoid the effects of rich country growth succumbing to financial market fears. However, the impact of global uncertainty on regional growth will vary according to the size of the local market relative to the export sector's contribution to GDP growth.

In general, the economies that are less open to trade with the rest of the world (China, India, Indonesia) will be less affected, while the more commercially active (S. Korea, Taiwan, Thailand) are likely to suffer a bigger blow. However, the right measure of vulnerability is not simply the share of exports on a country's GDP, but how much of foreign sales go to North-Atlantic countries, the source of the uncertainty and whose demand is most at risk. Thus, for instance, notwithstanding Japan's openness to trade, it's vulnerability to a shock emanating from the US and Western Europe has been greatly diminished as the country focuses on Asian markets, with China standing now as its main trading partner. This is a general regional trend that intensified after the global recession of 2008.

The previous argument stands squarely on the reason why current market risk will not derail Asian growth leadership. Contrary to generalized perceptions, Asia's economic engine does not rely mainly on exports, but also on consumer spending momentum across the region. Excluding Japan, the six largest economies in the region averaged consumer spending gains of 4.8% y/y in the first quarter of 2011 (and an estimated 1.1% q/q non-annualized advance based on latest figures that include the second quarter for some countries). Yearly retail sales growth remain on solid footing with double digit expansions in China and Indonesia, with India on an upward trend. Even countries that have experienced recent slowdowns in household spending, like South Korea and Taiwan, are still recording firm 5-7% y/y advances. With the exception of China, consumption represents between 50-60% of GDP in Asia's seven largest economies (Japan, China, India, S. Korea, Indonesia, Taiwan and Thailand). With consumer spending in the region having rebounded completely since the global recession, the outlook remains positive, underpinned by firm income growth amid a stable job market.

Asia's GDP growth relies mainly on manufacturing production. The question that arises then is whether Asian industrial output will fall if North-Atlantic growth stalls. The answer is most likely no, as long as consumer spending remains robust. But there are elements of the issue that are worth investigating further given the recent global turn of events, as they shed light in the growth outlook. As illustrated by the following table, industrial production in Asia's largest economies is undergoing a mid-cycle deceleration after a strong recovery from the global recession. Accordingly, most countries have gone from double-digit gains in yearly output growth to single-digit advances during the second quarter of 2011. Clearly, Japan and Thailand stand out as performance remains conditioned by the effects of the Japanese earthquake/tsunami earlier in the year. However, latest figures in both countries have taken activity almost back to pre-shock levels, a point not captured by the year-on-year growth figures presented here.

INDUSTRIAL OUTPUT							
	Japan	China	India	S. Korea	Indonesia	Taiwan	Thailand
1Q10	27.8	16.5	13.9	26.6	4.4	49.3	31.1
2Q10	20.6	16	9.7	18.8	7.3	29.9	17.9
3Q10	13.3	13.5	6.9	12.9	4.3	18.9	9.9
4Q10	6.9	13.3	8.6	9.9	4.7	17.6	2.8
1Q11	-2.4	14.4	7.9	11.3	4.8	15.1	-1.9
2Q11	-6.9	13.9	6.8	6.6	2.1	6.1	-2.8

Ordered according to IMF PPP based GDP ranking. Numbers are quarterly averages of monthly y/y % changes.

Source: Scotia Economics.

... continued from previous page

Interestingly, momentum within China remains not only strong but actually building as growth in the first half of 2011 has been greater on average than in the second half of 2010. But, in general, we can assert that as countries' industrial sectors shake-off the effects of the adverse Japanese shock, activity is transitioning towards more sustainable growth rates supported by long-term structural drivers. Thus, barring a dislocation of global financial markets, Asian industrial output is expected to avoid an outright downturn and experience a mid-cycle deceleration similar to that witnessed during the first half of last year.

During the first half of 2011, manufacturing performance in Asia has been conditioned not only by the adverse natural shocks suffered throughout the region, but also by swings in global commodity prices, which affected both input costs and credit affordability as inflation spiked. Corporate profits were constrained by these factors, with the outlook conditioned on further cost increases. At the current juncture, however, this element has been considerably curtailed on the back of the downward correction in commodity prices. This bodes well for future profits and in general for manufacturing performance overall. Of course, projected demand conditions have also become more subdued, which brings the argument back to a given country's demand exposure to the US and Europe.

Inflation seems to be peaking in Asia, having been led to this point by up-trending food and fuel costs. The recent fall in commodity prices is thus a favourable development because it further strengthens the outlook for household consumption and widens credit accessibility as central banks consider switching towards less stringent monetary policy stances, at least in the short-run. Nevertheless, monetary authorities will need to keep watching for domestically generated price pressures given relative tightness in local labour markets.

Finally, even for those countries more exposed to North-Atlantic demand for exports, recent exchange rate weakness vis-à-vis the US dollar bodes well for local manufacturing sectors as it provides a much needed competitiveness boost after the persistent appreciation of the past twelve months. This brings to the fore the issue of the acceleration of Chinese yuan (CNY) strengthening, which provokes a clear exchange rate adjustment in favour of those countries that serve the vast mainland market as their currencies have weakened against the CNY.

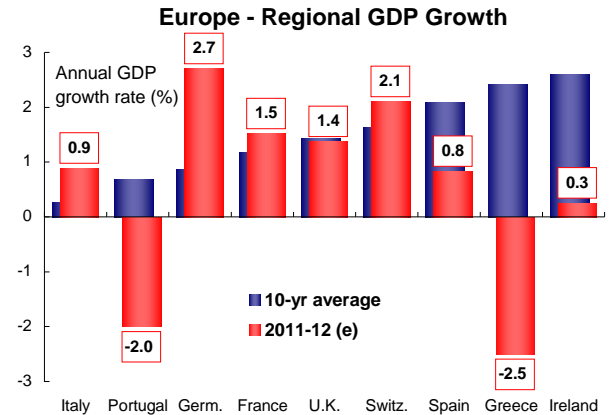
Pablo Bréard (416) 862-3876
pablo_breard@scotiacapital.com

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

Core Europe — Regional Economic Outlook

Softening & Divergent Growth Dynamics Amongst European Economies

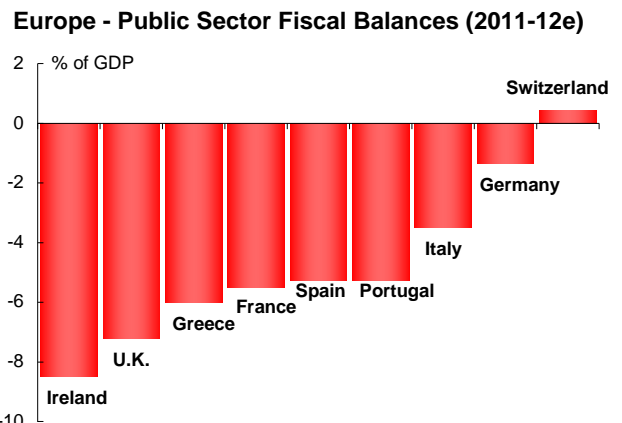
The outlook for European economic activity remains fragile at best, fuelling uncertainties regarding the policy framework needed to place the region back onto a sustainable growth path. The structural fiscal adjustment underway in many of the euro zone countries is expected to further dampen economic growth through 2013. Accordingly, the region will continue to present an inconsistent growth pattern, despite structural links between the core European economies. Regardless of subdued performance in the second quarter of 2011, Germany will likely continue to exhibit the most robust economic environment, while France and Italy are facing the need for additional fiscal restraint. Beyond the monetary union, Switzerland continues to offer remarkable resilience to multiple shocks originated in both advanced and developing economies; indeed, the Swiss economy is positioned to expand by around 2% through 2012. Finally, the British economy continues to struggle to regain a sustainable growth path due to persistent weakness in its financial services industry, meagre employment creation, a fragile real estate market and fiscal restraint.



Source: IMF, Scotia Economics.

Regional Fiscal Sustainability Prompts Drastic Deficit-Reduction

Market pressures and large refinancing needs continue to weigh heavily on the regional fiscal outlook, despite some progress in repairing government finances. Securing sovereign debt sustainability has become the most pressing issue in order to restore confidence within the euro zone. Yet, the achievement of fiscal sustainability extends well beyond maintaining (or regaining) access to global sources of finance, due to the structural roots of the long-standing fiscal imbalances. The need to accelerate the process of fiscal consolidation constrains the region’s economic outlook unless implemented alongside credible growth policies. The deficit reduction initiatives may entail a major structural shift away from overly generous welfare economics models that are not sustainable over time. In addition, reducing high unemployment is critical to containing increasing social unrest.



Source: IMF, Scotia Economics.

Uneven Monetary Policy Direction Amidst Heightened Market Turmoil

In Europe, uneven policy shifts are materializing depending on individual country conditions. Sensitive to the developments of price pressures within the euro zone, the European Central Bank (ECB) initiated the process of interest rate normalization four months ago. The main refinancing rate has been raised by a cumulative 50 basis points to 1.50% following two years of stable conditions. Nevertheless, on the back of uncertain global economic growth prospects and an improving inflation outlook, the ECB will likely refrain from further monetary tightening through 2012. In the United Kingdom, the Bank of England (BoE) shows no indication that a change in its current accommodative stance is imminent, despite persistently elevated inflation. The BoE’s official repo rate has remained unchanged at 0.50% since March 2009.

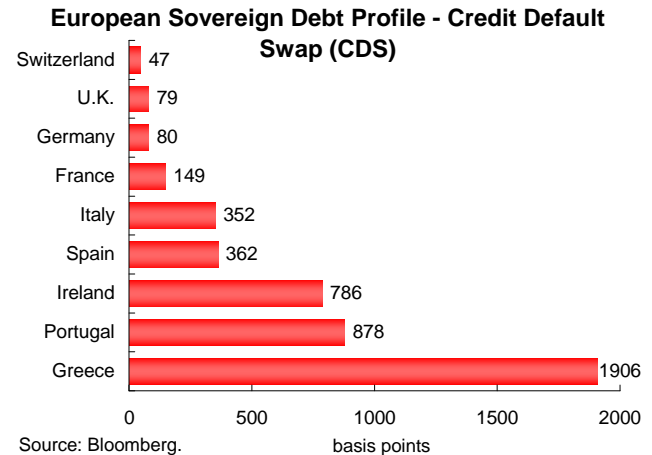
Pablo Bréard (416) 862-3876
pablo_breard@scotiacapital.com

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

... continued from previous page

Rigorous Investor Scrutiny Of Multifaceted Government Intervention

Government intervention is increasing in Europe. The ECB has activated an emergency bond-purchase programme to protect Spain and Italy as the confidence crisis spreads throughout the region. If the sovereign debt distress continues to intensify, Spain and/or Italy could become candidates for receiving financial assistance from the European Union and the International Monetary Fund. The Swiss National Bank has clearly stressed its willingness to limit the Swiss franc's (CHF) strength vis-à-vis the euro (EUR). The BoE may consider extending its debt-purchase initiatives if economic conditions continue to deteriorate. While European policymakers' intensified market interventions show that they remain committed to the European project, further efforts will be required to assure market participants' heightened anxiety. A cohesive approach towards stepped-up government intervention and fiscal co-operation will mark a fundamental shift in the role that the state plays in Europe in the years ahead.

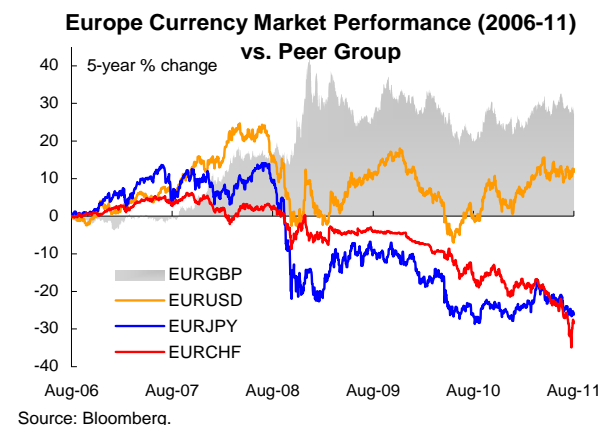


Eroding Creditworthiness Triggers Ratings Downgrade Momentum

International credit ratings are rapidly catching up with deteriorating sovereign debt profiles as discounted by market metrics. The fundamentally justified US credit rating downgrade has fuelled expectations for further downward rating revisions in other major economies. Following the relentless wave of rating downgrade activity in peripheral European countries including Greece, Ireland, Portugal and Spain, Italy seems to be next on the list for a rating downgrade (both Moody's and Standard & Poor's have recently assigned a "negative" outlook on Italian ratings). While significant fiscal challenges linger, the three largest European economies retain a stable outlook on their triple-A rating status.

Single Currency And Financial Sector Subject To Firm Systemic Tests

The EUR is experiencing divergent trading dynamics with major currency peers. When measured against the US dollar and the British pound, the EUR demonstrates a remarkable resilience to the recent wave of financial market volatility caused by global economic deceleration concerns, and corrective forces in global commodity and equity securities markets. However, it has steadily weakened against the Japanese yen and the CHF, two of the world's perceived safe-haven assets. A bearish view on the US dollar may prolong EUR attractiveness in the near term, although fragile growth and fiscal prospects will weigh on the single currency in 2012. The CHF has emerged as a clearly defined "shadow currency", providing global market participants with a European alternative. Despite the prospect of potentially disorderly currency adjustments in global markets, we continue to believe that the single currency regime will remain unchanged in Europe. Beyond volatile currency market gyrations, Europe is being subject to stringent scrutiny of the key countries' financial sectors. Bank exposure to distressed sovereign debt assets has placed European banks on the global radar screen again.



For more detailed information regarding the economic outlook of the core economies in Europe, please refer to the *Europe - Regional Economic Outlook* report, published on August 19, 2011, at www.scotiabank.com/economics.

Gorica Djerić (416) 866-4212
gorica_djeric@scotiacapital.com

An Update On The U.S. Housing Market

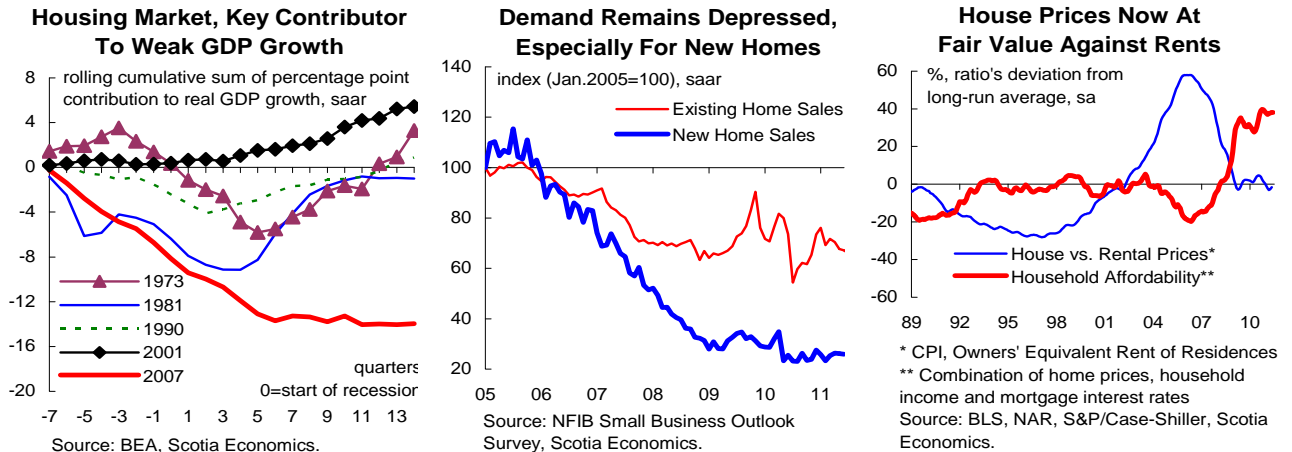
- **Despite some stabilization, the outlook for the U.S. housing market remains problematic.**

This week was marked with a string of U.S. housing data releases, which reaffirmed that the housing market continues to struggle and any recovery is still weak and inconsistent.

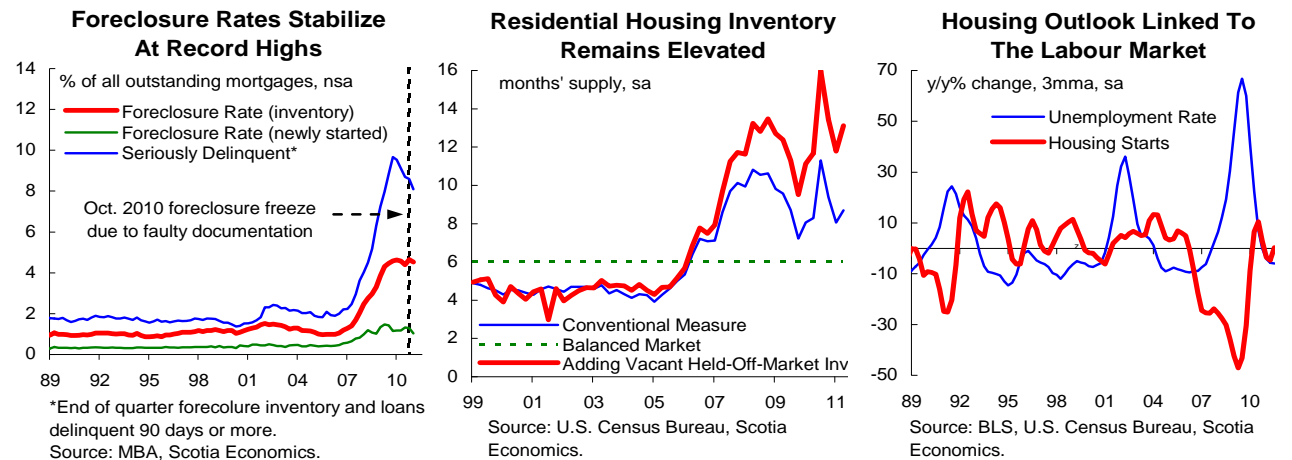
Accounting for about 5-6% of GDP, the housing market has traditionally contributed on average 0.2 percentage points quarterly to real GDP. However, during this downturn, it has taken a big bite out of the economy, posting 22 straight quarters of decline and cumulatively erasing nearly 14 percentage points from GDP growth, record figures on both counts (see chart 1). Sales, especially of new residential properties, continue to bounce along the floor (see chart 2). While existing home sales have fared relatively better, much of the support is coming from all-cash and distressed-property purchases. Higher investor demand does not mean a stronger housing market, particularly as the number of first-time buyers has been eroding since the expiry of the first-time homebuyers tax credit in mid-2010. Those with financial ability are snapping up deeply-discounted foreclosure and short-sales properties, further depressing home prices. Prices now appear to be fairly valued against the cost of rent (see chart 3). However, they are significantly undervalued when looking at household affordability, which was at its third-highest level in June.

The outlook for the housing market remains uncertain, hobbled by a lack of consumer confidence, a stubbornly high unemployment rate, a lack of equity in real estate, stricter mortgage standards, competition from distressed properties (see chart 4), a high supply of homes — on and off the market (see chart 5) — and the uncertainty surrounding government stimulus programs. Its future is strongly linked to the prospects for the labour market (see chart 6), but even should hiring activity pick up it could take some time for the single-family housing market to make major strides toward long-run levels, and provide a positive contribution to economic activity.

Charts 1, 2, 3



Charts 4, 5, 6



Gaelan MacKenzie (416) 607-0058
gaelan_mackenzie@scotiacapital.com

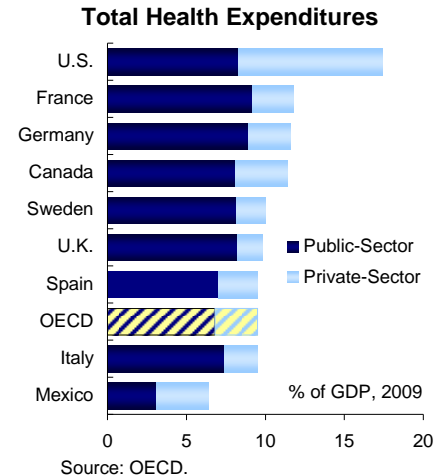
Mary Webb (416) 866-4202
mary_webb@scotiacapital.com

Slowing Economic Expansion Adds to Health Reform Pressures

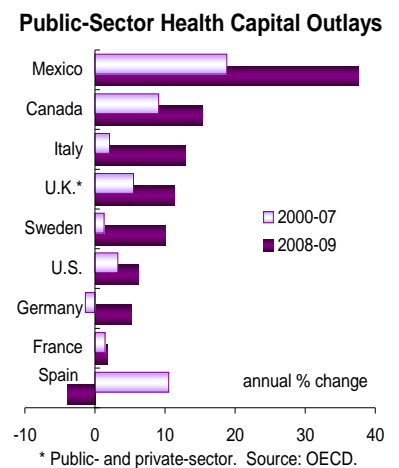
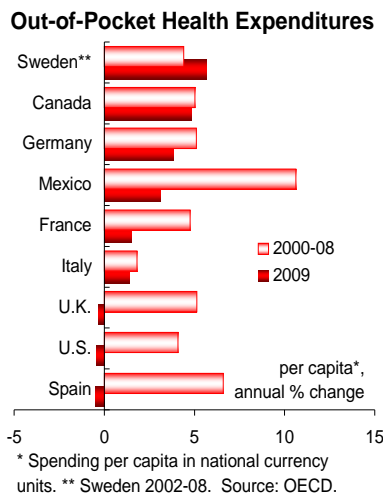
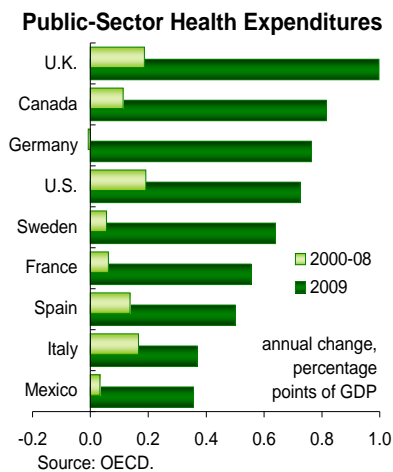
- For many developed nations, lowering public-sector health spending relative to GDP in the near term will be further complicated by moderating economic growth.

As fiscal repair is complicated in a number of developed nations by the near-term outlook for softer economic growth, the impact of a more fragile economic expansion in the critical area of health policy reform also should be recognized. The recession weathered in 2009 contributed to the sharp jump in total health expenditures as a share of GDP across the OECD from 8.8% in 2008 to 9.5% in 2009, the latest year for OECD health statistics. This jump is in part due to the 2.3% decline in OECD nominal GDP in 2009, as well as the continuing upward trend in OECD total health outlays, with a 3.5% per capita increase in 2009, following a 3.8% hike in 2008. The U.S. stands out with its public- and private-sector health expenditures a hefty 17.4% of GDP in 2009 (*top chart*), a worrisome level given the health spending pressures anticipated with its baby boom generation’s retirement from 2011 to 2029. Also notable is that 11 other OECD nations estimate that their health spending accounted for a 10%-12% share of their GDP in 2009, including Canada with an 11.4% share.

While the rise in OECD private-sector health spending per capita (including private insurance) rose 2.7% in 2009, after a 1.9% increase in 2008, growth is much steeper for public-sector per capita health expenditures at 4.8% and 4.1% for 2008 and 2009, respectively. The *bottom left chart* illustrates the sharp jump in public-sector health spending relative to GDP across key nations. Indeed, among many developed nations, health spending in 2009 was broadly considered an automatic macroeconomic stabilizer, with public-sector health care assistance available if private-sector health provision receded through events such as escalating unemployment. The recession’s squeeze on personal incomes dampened growth in individuals’ out-of-pocket health outlays in 2009 (*bottom middle chart*). Health capital outlays, however, picked up in 2008 and 2009 (*bottom right chart*), often as part of fiscal stimulus initiatives, but this increase in capital, though often an overdue priority, still elevates subsequent operating and maintenance costs.



A resumption of positive GDP growth in 2010 across the OECD — though the OECD’s estimated 3.6% gain falls short of the 2004-07 average increase of 6.3% — should help to dampen the rise in public-sector health spending versus GDP. Stabilizing this ratio in 2011, or even 2012, will be tough, however, as GDP growth forecasts moderate. The weak recovery complicates substantial health restraint efforts, such as raising co-payments, but it is focusing efforts on streamlining administration to better focus spending on front-line patient care.



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

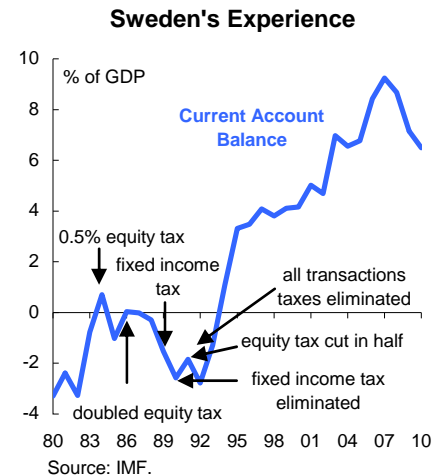
Derek Holt (416) 863-7707
derek_holt@scotiacapital.com

Sweden's Experience Is One Reason To Tread Carefully Toward A Tobin Tax

- The Merkel-Sarkozy proposal is fraught with risk.

The past week's Merkel-Sarkozy tête-à-tête generally failed to impress, but one particularly bad idea stood out via dredging up a Tobin tax on financial transactions as recommended by the European Commission in July. The global experience is limited in this regard, but one country in particular provides a useful example.

Sweden is the usual example offered of a country that imposed such taxes in the 1980s partly to fund socialist ambitions and ward off volatile capital flows, and then lived to regret it. Of note is that Sweden now opposes a European move toward a tax on financial transactions perhaps based upon its experience. I found this accounting by Marion Wrobel — who has since moved on to a senior role with the Canadian Bankers' Association — to be useful (link: <http://dsp-psd.tpsgc.gc.ca/Collection-R/LoPBdP/BP/bp419-e.htm>). A 0.5% tax on the purchase or sale of an equity security was imposed by Sweden in January 1984, doubled in July 1986, and then accompanied by a 0.002% tax on money markets and a 0.003% tax on fixed income instruments with maturities of 5 years and over in January 1989. The revenues were a big disappointment to say the least as volumes were killed off. In the first week following implementation, bond trading volumes plummeted by 85%, and both futures and options markets were entirely killed off — both following a significant equity market correction after the first round of equity taxes were introduced.



All of these taxes were eliminated over April 1990 through to the end of 1991 when Sweden entered a banking crisis and Scandinavian economies lost a good portion of their export markets following the collapse of the Soviet Union. Now Europe — faced with the risk of a banking crisis — is considering financial transaction taxes. Sweden faced a current account deficit back then that needed capital inflows to finance it — much like the broad euro zone today — but such a tax was ultimately counter-productive in this regard by way of the hot money flows (see chart). Following the elimination of the taxes and Sweden's move toward greater openness to foreign markets, and once its banking crisis had subsided, Sweden set out along a productive path of rising current account surpluses.

More generally, there are many problems with such taxes:

- Some assert that contrary to the policy aim of reducing volatility, the outcome is more likely to be enhanced volatility at lower volumes of business which Europe doesn't need.
- With such lower volumes go added liquidity risk premiums and hence higher borrowing costs which Europe also doesn't need.
- With lower volumes go impaired bank funding costs, lower bank revenues and potentially intensified systemic risk. Isn't Europe already facing deep structural challenges in this regard?
- The argument that only a few major centres that dominate world trading need to implement such a tax is folly on two counts. For one, Europe doesn't have them all and getting the others (NY, Tokyo etc) to go along is highly unlikely. For another, Canada offers an example of how one financial centre's trading dominance (Montreal) can largely migrate elsewhere (Toronto) when circumstances warrant such that one cannot take for granted the role of a current major financial centre. There's a nice atoll somewhere in the Pacific waiting for a hedge fund to be set up should the rest of the world embrace the idea. With Ireland's

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

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

... continued from previous page

finance minister declaring that all EU-27 members would have to implement such a tax — and not just France and Germany — a big thank you card signed by thousands on Wall Street and Bay Street would be sent abroad in appreciation of the diversion of trading revenues from abroad.

- There are also implementation challenges. What's a prop spec trade versus something that's vital to day-to-day-business? How do you uncover spec activities inter-mingled with the rest of business lines or do you just uniformly apply the tax and harshly impact the whole system? What would markets and economies really look like if not for the perfectly legitimate role of speculative price discovery such as what ended the illusion of the Asian miracle a decade and a half ago? You might not like some forms of speculation, but the power to choose between legitimate versus undesired forms is dangerously wielded by policy markets under a Tobin tax and who is the arbiter of worthy speculation versus unworthy?
- What of the panoply of financial instruments that have emerged since Tobin first proposed his 'small tax' on currency transactions decades ago in that how do you capture offshore markets and complicated derivatives with flow charts that only a relative handful of market specialists can ever really understand?

On balance, taxing financial transactions in tumultuous times is misinterpreting causes and symptoms. Europe would do better to make solid progress toward addressing the core problem of fragmented capital markets with room for fiscal policy divergence albeit within narrower differences than at present.

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

Distortions In The Mexican Global Curve

The following article was published on August 17, 2011.

The Mexico 2019s closed last week at a yield approximately equivalent to that of US Treasuries, and many other high-coupon bonds in Mexico are trading at a premium as well. We discuss the reasons for this pattern and what may happen going forwards.

For those who think that technical factors don't matter, one has only to glance at the Mexican curve to know that something is wrong (Figure 1). Last Friday, the old Mexico 19s closed at a negative spread to Libor. While that bond seems to have the largest distortion relative to the curve, other older Mexican global bonds have also been behaving strangely (Figure 2). In particular, Mexico 26s are trading at a premium of around 100bp even though they used to trade flat to Mexico 31s. Mexico 16s and 22s have been trading at a premium of about 25bp over the last month even though they normally trade in line with the curve. Theoretically, these high-coupon bonds should actually trade at higher rather than lower relative spreads, since recovery rates are usually a fixed percentage of par and higher-priced bonds therefore recover less in a default in percentage terms.

The effect does not seem to be merely a preference among emerging market investors for high-coupon bonds, an effect we have seen in the past attributed to Asia-based investors buying Latin American assets. For example, the Brazil 12.75% 2020 bonds actually widened relative to the Brazil 19s this year, while the spread differential on the Colombia 11 ³/₄ 2020s has not moved significantly. Instead, it seems to be a Mexico-specific effect.

A distinguishing feature of the older bonds is that they are reportedly not-taxable for the income taxes of some local Mexican investors; those tax rates can be 30% to 35% for Mexican retail investors. Such tax breaks could indeed lead to a large premium, but the history of the spread premium on those bonds suggests that local investors have not traditionally been the marginal investors driving secondary-market prices. Alternatively, if it is not taxes, then we could be seeing the purchase of certain bonds in anticipation of a liability management exercise or the cornering of the market for a particular series of bonds by a few investors.

We certainly have seen significant liability management by the government in previous years on

Figure 1:
Mexico Global USD Curve – Z-spread

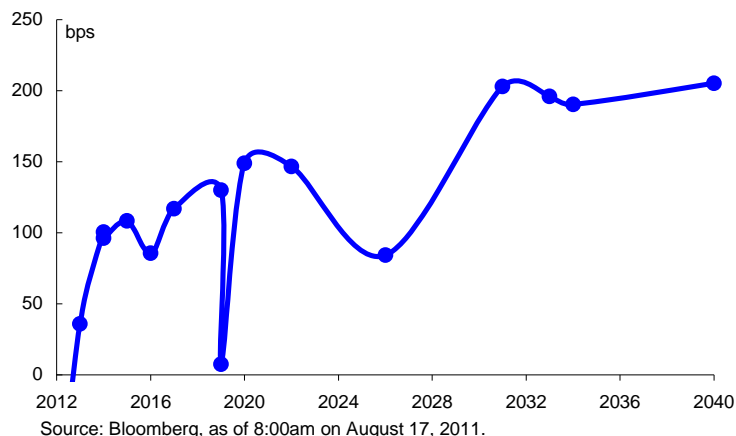
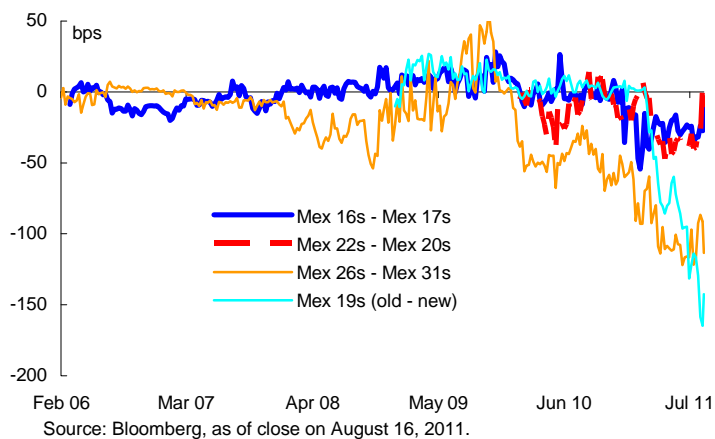


Figure 2:
Differential between old and new bonds



... continued from previous page

these bonds, though a variety of mechanisms, including swap offers, debt exchange warrants, and secondary market purchases. For example, in March of 2008, the government bought back \$714mn in bonds across the curve over a period of several weeks in order to take advantage of market volatility. The government is usually opportunistic in their buybacks, however; it tries to repurchase bonds at near market levels and has shown a willingness to choose from a variety of bonds on the curve. Thus, based on previous patterns, it seems unlikely that the government would pay a \$12 premium relative to the curve to repurchase the 2019s. One could argue that removing these tax-exempt bonds from the market would force investors into taxable securities, generating additional revenue for the government later to compensate for the premium today. Nevertheless, there are other bonds the government could target which also have tax advantages, and a buyback could well take bonds out of the hands of foreign investors who are not paying taxes anyway.

We are more surprised by the yield compression in 19s than the 26s. The 26s have only 339mn outstanding, and a quarterly turnover ratio (quarter trading volume to amount outstanding) of 0.3; thus it may not take much to move the prices on those bonds. In contrast, in the first quarter of this year, the 19s were the fourth most traded Mexican bond in absolute terms, and had the second highest turnover ratio of 1.7. EMTA has not yet released data for the second quarter, and it will be interesting to see what has happened to volumes in more recent months. With repo levels on the bonds at around negative 200bp, it seems whoever is buying the bonds is not lending them out. We therefore imagine trading volumes are falling.

The situation is reminiscent of the experience with Argentine Discounts back in 2007, where the bonds also became unavailable on the repo market as the price rallied. We saw the effect in the yield differential between Argentine law and NY law bonds—two instruments which were identical in all terms except court venue. This differential widened from 30bp to 100bp due to what was widely believed to be purchases of the NY law instruments by a single investor. When that investor was suddenly forced by external events to reduce his position, the differential dropped to negative 200bp within several months before eventually normalizing.

Why is someone bidding up the price of these bonds? Is it to anticipate a government buyback, to create a long-term position for tax benefits, or to benefit from the short-term appreciation? We note that this instrument does not have the “make-whole” option found in many newer Mexican bonds. If the government were to decide, for whatever reason, that it needs to redeem this bond, its only route would be through secondary market purchases; theoretically, there is no limit on how high the price can go. Nevertheless, we see no reason why the government would want this bond in particular. An explanation we cannot rule out is that some large institution has a sudden need for the tax breaks offered and intends to hold the bonds to maturity. Nevertheless, there are higher coupon bonds with the same tax benefits, and this explanation is not consistent with what we are seeing in the repo market. The recent price movements are consistent with a large investor cornering the market in order to benefit from the price appreciation. We don't know how long it would take, but we think in this case the rally in the bond must ultimately reverse. Except for the tax benefits, we are not sure why anyone would want to hold a BBB bond with the same yield as US Treasuries. On net, and to the extent that market liquidity allows, we think investors who still have a long position in the 19s should use the recent rally as an opportunity to reduce exposure.

Hugo Ste-Marie (514) 287-4992
hugo_ste-marie@scotiacapital.com

Q2/11 Earnings Scorecard — Another Beat

The U.S. Q2 earnings season is almost over, and once again S&P 500 companies delivered better than expected financial results with actual earnings exceeding consensus forecasts by almost 4%. A combination of rising top-line growth and improving profit margins helped explain the strong earnings season. S&P 500 Q2 EPS is coming in at US\$24.90 per share according to S&P, suggesting a record EPS run-rate of almost US\$100. S&P 500 Q2 EPS has improved 10.3% sequentially (Q2 vs. Q1) and 19% on a year-over-year basis. Profit margins have continued to expand in Q2, reaching their highest level on record at 9.5%. Margins stood at 9.0% in Q1 and 8.7% in Q4. The top line improved as well with S&P 500 revenues expanding 11% over the same quarter last year. On a sector basis, cyclicals continue to dominate with Industrials, Energy, and Discretionary posting the strongest sequential earnings improvement. More defensive sectors are lagging with Utilities and Telecom earnings contracting 9% and 7%, respectively (see Exhibit 1).

	Beat Ratio	Q2/11 EPS		
		\$	QOQ	YOY
S&P 500	71%	24.90	10%	19%
Industrials	74%	5.53	21%	20%
Energy	71%	12.98	20%	40%
Discretionary	82%	5.36	15%	16%
Materials	53%	5.44	10%	57%
Staples	66%	5.39	10%	12%
Technology	79%	7.75	8%	27%
Health Care	76%	8.27	7%	14%
Financials	73%	3.97	6%	4%
Telecom	25%	1.78	-7%	-10%
Utilities	52%	2.87	-9%	8%

Source: Scotia Capital, S&P

In Canada, the Q2 earnings season is relatively positive as well with earnings coming in 1% ahead of Bay Street expectations. TSX Q2 EPS currently stands at \$229 compared to consensus of \$226 at the end of June. In terms of earnings growth, TSX Q2 EPS is up 11% sequentially and a 48% YOY. However, the strong year-over-year improvement is mainly due to a strong base effect in light of write-downs in the Insurance sector last year. TSX revenues are up only marginally (+3% YOY) due to weak top line growth in the insurance sector. Cyclical sectors are delivering much stronger earnings improvement than defensive sectors on a sequential and year-over-year basis (see Exhibit 2). Despite strong commodity prices, gold and mining companies have not been able to meet consensus forecasts mainly due to soaring input costs and operational issues. Banks will start reporting only next week with BMO kicking it off on August 23.

	Beat Ratio	Q2/11 EPS			
		\$	Beat/Miss* (%)	QOQ	YOY
S&P/TSX	49%	229	1%	11%	48%
Energy	59%	43.33	9%	17%	41%
Materials	32%	63.42	-1%	40%	59%
Divers. M/Mining	21%	155.70	-34%	33%	17%
Gold	32%	44.17	-2%	15%	65%
Fertilizers	75%	137.40	16%	67%	59%
Industrials	44%	20.23	1%	28%	8%
Discretionary	44%	19.35	-12%	27%	7%
Staples	63%	33.83	2%	50%	7%
Health Care	67%	9.42	3%	16%	120%
Financials	48%	34.05	0%	-4%	103%
Banks	50%	43.65	0%	3%	22%
Insurance	63%	18.68	0%	-3%	n/a
Technology	60%	5.15	1%	-20%	-2%
Telecom	80%	19.47	4%	15%	6%
Utilities	50%	16.67	-4%	-57%	-12%

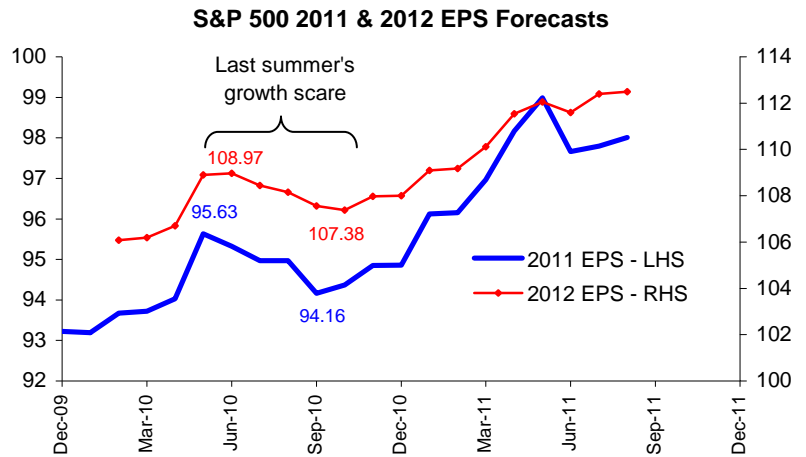
*Relative to end of June consensus figures.

Source: Scotia Capital estimates, Thomson Financial, Bloomberg

... continued from previous page

With global economic growth decelerating, investors are worrying that Wall and Bay Street will have to review their EPS forecasts lower over the coming months. Although earnings forecasts are likely to come down, it may take a few more weeks before recent events are being factored in. So far, earnings revisions have been mixed in August. S&P 500 2011 and 2012 consensus figures have been ratcheted up 0.2% to US\$98.01 and 0.1% to US\$112.49, respectively. U.S. earnings have been spared from negative revisions in August, but EPS forecasts for the TSX and MSCI AC World indices have been reduced by about 2%.

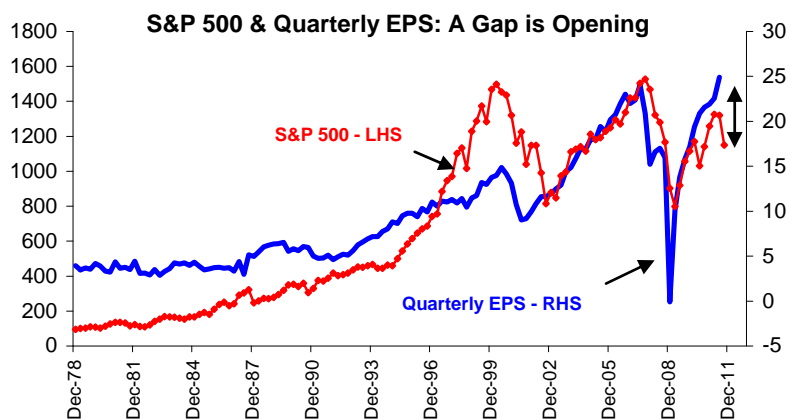
Exhibit 3



Looking back to last summer, the global growth score also had negative impacts on S&P 500 earnings. As illustrated in Exhibit 3, S&P 500 2011 EPS forecasts were revised 1.5% lower between May and September with consensus declining from US\$95.63 to US\$94.16. Hence, negative revisions could accelerate over the coming weeks. However, sentiment is currently a bigger issue than earnings as investors appear to be pricing dire scenarios. The S&P 500 is currently trading at 10.5x forward earnings and 12.5x trailing earnings. Assuming a 20% correction in profits to US\$80, the S&P 500 P/E would be trading at 14.3x. In Q1/09, the S&P 500 troughed with P/E's of 15.7x (trailing) and 10.5x (forward).

Although negative revisions could hurt equity sentiment further in the near term, the current downtrend in equities is at odds with the upward trend in earnings. The S&P 500 has historically tracked quarterly EPS relatively closely. Some divergences have occurred from time to time, but they have been relatively modest and short-lived, especially when earnings are rising. The current gap between the S&P 500 and quarterly earnings is just getting bigger by the day (see Exhibit 4). Either equities resume their upward trend to catch up with rising earnings, or earnings would have to decline precipitously.

Exhibit 4



Source: Scotia Capital

Eurozone: Getting Sentimental

- **We expect the recent financial market turmoil to bear down heavily on next week's key eurozone business survey indicators. In turn, this highlights that GDP growth could slow even further following the disappointing pace recorded during Q2.**

Financial market turmoil likely to damage business sentiment

Having rumbled away for over a year, the jitters in the peripheral eurozone public finances reached a crescendo in early-August. Concerns about the solvency of Italy, Spain and even France contributed to pushing the Dax and CAC indices down by over 20% from their late-July peaks. Similarly, widespread risk aversion and flight to quality trades pushed yields on 10-year US government bonds down by around 80bp over the same period — despite the US being downgraded by S&P.

While markets have calmed a little over the last week, we expect the after-effects of the market turmoil to begin to be felt more heavily in upcoming business survey indicators due to be released over the next week or so.

ZEW provides early clues but...

Thus far, the most evident signs of follow-through from the eurozone crisis into economic data has been in the German ZEW survey. However, this is a survey of analyst opinion rather than hard business activity. While this means the survey may be early to react to new developments, it is prone to sharp gyrations that don't always translate into corresponding swings in the hard economic data such as GDP.

While the survey has begun to weaken in recent months, we expect the abrupt shift in market sentiment to push the survey down by close to 10 points in August. The extent of the fall could be even bigger than that. In the recent past this survey has fallen by as much as 20 points in a month.

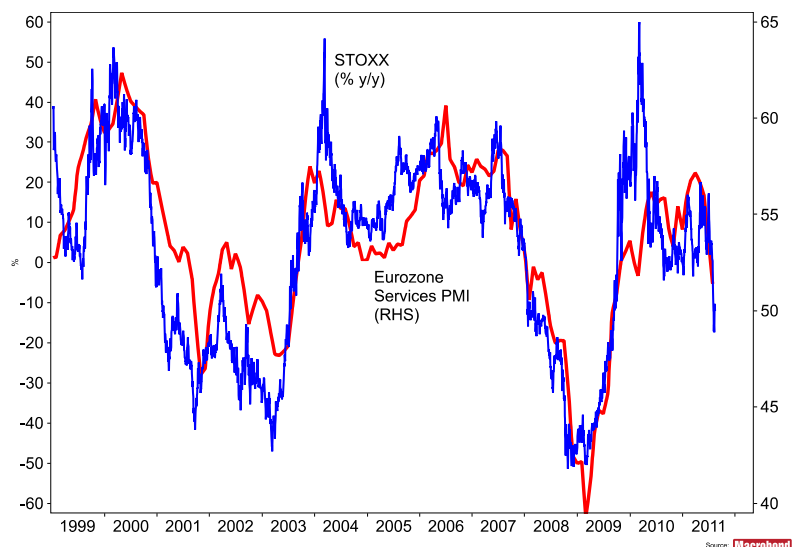
Poor service

The services sector PMIs will provide the best clues on how much impact financial market turmoil is likely to have on GDP growth. Chart 1 shows the relationship between equity prices and the PMI services. On a month-to-month basis, the relationship does not help a huge amount. However, when there have been months that have experienced significant falls (or for that matter rises) it has typically been a reliable guide to the likely outcome of the next PMI services reading. In turn, this relationship suggests that next week's services sector PMI readings could be down by around 2 points (which would push the series down below 50).

Similarly, while it is not such a tight relationship, the plunge in US government bond yields reinforces this signal. Why should either of these relationships help? To a large extent, the services PMI is driven by sentiment. If there has been a bloodbath in the equity market or tidal wave of risk aversion in the bond market, then there is likely to be at least some impact on sentiment in the business world.

The composite of the two eurozone PMI surveys is already pointing to near zero GDP growth (Chart 2 on the following page). If the fall in the surveys that we expect next week materialises then it will point to a serious risk of a negative print for GDP during Q3.

Chart 1: Eurozone PMI Services vs Equities



Source: Bank of England

Alan Clarke (44 207) 826-5986
alan_clarke@scotiacapital.com

... continued from previous page

Furthermore, the PMI surveys have typically provided a guide to the likely future path of the ECB policy rate (Chart 3). If the composite of the two surveys is above 51, then the ECB is more likely to hike the refi rate — below that level and a cut is more likely. Depending on the ECB's tolerance threshold, further downside in the PMIs in the coming months could make an interest rate cut increasingly likely.

Ifo — topping out

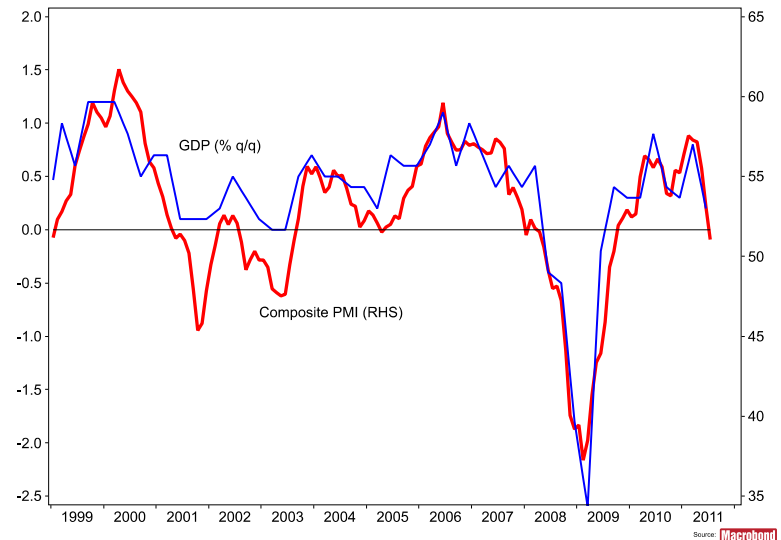
Last but not least we also expect next week's German ifo to post a further decline. The headline index began to fall last month, but still remains not far off February's highest reading for at least 15 years. The main reason for the buoyancy of the Ifo has been the lagging current conditions component. That is not unusual — it tends to peak around 6 months after the expectations component. Given the weakening in industrial production, GDP and other the lead of the expectations component, we expect current conditions to catch down in August. We expect a 2-point fall in this survey.

UK — Survey Data Likely to Fuel QE Speculation

We will have to wait a further week before we get the first clues about the likely impact of the financial market turmoil on UK activity. This week's BoE minutes and comments from comments from MPC member David Miles highlighted that if downside risks to the Bank's economic projections crystallised, then another round of quantitative easing was possible. Given our view that the PMI surveys will fall by at least 2 points, we expect Q3 GDP growth to significantly undershoot the Bank's latest growth projection. In other words, we fully expect the downside risks to the Bank's projections to crystallise.

We believe that the speculation of another round of BoE asset purchases will build. The key sticking point is that CPI inflation is likely to exceed 5% y/y in the coming months. This is already factored into the Bank's projections, so it shouldn't represent an obstacle. However, convincing the wider public that printing more money to prevent inflation undershooting the 2% target, when the latest inflation print is above 5% y/y is going to be hard to sell. It is likely to become less of an obstruction by February, at which stage inflation should have shown clear signs of slowing. The bottom line is we believe the chances of another round of BoE QE is around 45% at this stage.

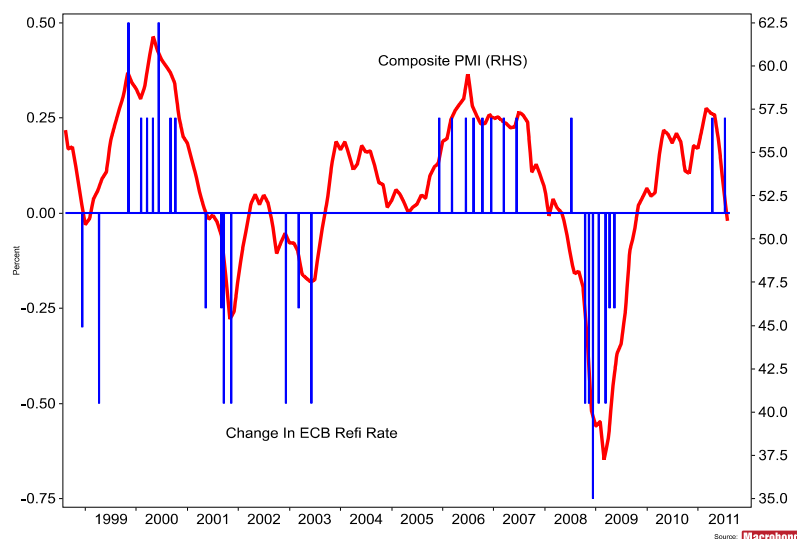
Chart 2: Composite Eurozone PMI vs GDP



Source: Bank of England

That is not unusual — it tends to peak around 6 months after the expectations component. Given the weakening in industrial production, GDP and other the lead of the expectations component, we expect current conditions to catch down in August. We expect a 2-point fall in this survey.

Chart 3: Composite Eurozone PMI vs GDP



Source: Bank of England

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

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

Key Data Preview

CANADA

Canadian retail sales (Tuesday) have decelerated quite substantially since reaching a cycle peak of 9.6% y/y in March 2010. A run-up in both gasoline and food prices has been a large factor behind the deteriorating consumption picture amid sluggish wage growth and increased employment uncertainty. Indeed, over the past six months, price-adjusted retail sales have declined almost 2% as demand for discretionary goods fell to the wayside as the price of staple goods pushed higher. While retail sales may rebound in June, much of the strength will likely come from the auto sector after Statistics Canada's new motor vehicles sales report posted a strong 10.8% m/m increase in the total number of vehicles sold during the month. This does not take into account any changes in prices, however, with increased discounting likely behind much of this strength. Nonetheless, balancing these two factors out, we should still witness a decent increase in total auto sales in June which will help to boost headline retail sales. Excluding autos, however, the picture is a little more gloomy. For one, while a decline in gasoline prices should provide consumers with some relief at the pump, gas prices remain quite elevated so that relief will be minimal. In addition, a decline in gas prices in June could result in a decline in gasoline station sales which account for almost 13% of overall retail sales, especially after a +1% gain in this component in May. Second, most of Western Canada faced cool, soggy weather in June that likely kept foot traffic down. Third, wages continued to deteriorate in June alongside a pullback in aggregate hours worked which likely left many consumers focusing their spending on essential goods. Fourth, Statistics Canada reported a decline in both headline and core CPI on a month-over-month basis, suggesting that discounting was wider spread than just the auto sector. This factor, however, could impact sales in two ways. On the one hand, weaker prices could reduce overall sales should discounting not result in an increase in volumes. On the other hand, weaker prices could have enticed shoppers back to the malls, providing a lift to overall sales through increased volumes. Thus, it is the price-adjusted sales figures that will be most important within this report, not only to distinguish between price and volume effects but also to get an idea of how consumer spending will impact real GDP in June and Q2 as a whole.

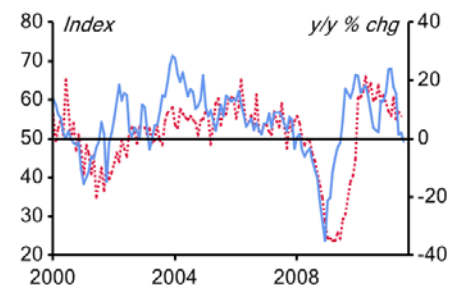
UNITED STATES

New home sales (Tuesday), durable goods orders (Wednesday) and Q2 GDP revisions (Friday) are the only major economic releases out in the U.S. next week. On the housing front, there is no shift in trend expected for **new home sales** as demand remains non-existent and any marginal increase in buying interest continues to be focused upon existing home sales. As such, we don't expect the July new home sales report to have much impact on markets. Durable goods orders and Q2 GDP revisions could, however, cause a shift in market sentiment should we witness a large swing in either direction.

A large increase in aircraft orders should provide a strong boost to **headline durable goods orders** in July, especially after a double digit decline in June. Vehicle orders should also rebound following the Japanese disasters which created very thin supply during the high demand summer market. Excluding transportation, however, the picture will likely be much weaker. The ISM manufacturing new orders index, a decent leading indicator, has been declining since February 2001 but actually fell below the expansion/contraction line in July for the first time since June 2009, suggesting that durable goods orders will also start to turn negative over the next few months on a year-over-year basis. With ISM manufacturing new export orders actually up on the month and still expanding, supported by the weak US dollar, domestic weakness will likely be behind the decline in durable orders in July although we are unable to get the breakdown between foreign and domestic demand within this report. Nonetheless, this would suggest that we could witness a decline in business investment in July, the first decline in four months, which would not be encouraging for Q3 growth, as businesses remained concerned over the U.S. debt ceiling debate, Europe's deteriorating fiscal situation and a slowing global economy.

Q2 GDP growth will likely be revised down next Friday when the second GDP report is released after both trade and personal consumption came in weaker than expected last week, along with business inventories.

Weak Manufacturing Demand to Lead Durable Goods Orders Down Further



..... US Durable goods orders (R)
 — ISM Mfg: New orders

Source: US Census Bureau, ISM, Scotia Capital Economics

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

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

... continued from previous page

EUROPE

Final estimates for Spanish output growth in the second quarter of the year will be released on August 26th. According to preliminary data, the country's real GDP grew by 0.2% q/q (non-annualized) in the April-March period, outperforming the euro zone's powerhouses of Germany and France. Economic activity was supported by net exports while domestic demand remained weak. The €1.1 trillion Spanish economy will continue to recover very gradually. We estimate that output will expand by a modest 0.8% in 2011 and by 1.0% in 2012. Grim employment conditions are prohibiting a robust recovery in household spending; Spain's 21% unemployment rate is the highest in the euro zone. Government spending continues to be constrained by fiscal consolidation efforts, while gross investment will remain a drag on growth this year as large inventories of unsold homes (a result of the real estate collapse) hold down the construction sector. Meanwhile, the export sector will continue to provide a boost to economic activity.



LATIN AMERICA

Brazil's economy has been trending down in the latest months on the back of a sluggish expansion of the manufacturing sector adversely affected by the strength of the real. We expect the unemployment rate to have remained steady at 6.2% in June, paraphrasing the contraction in economic activity observed during the month (the seasonally adjusted monthly activity index contracted for the first time in at least two years). While Brazil's economic expansion remains underpinned by favourable terms of trade trends, with local activity also expanding solidly, manufacturing exports have been in retrenchment for months. We continue to expect Brazil to expand at a 4% y/y rate in 2011, accelerating to a 4.5% y/y rate in 2012.



ASIA

Thailand's GDP will continue to advance at a solid pace in the second quarter. We expect a 1% q/q quarterly gain to come on the back of consumer and investment spending momentum, with net exports displaying a solid rebound during June after contracting due to the adverse effects of the Japanese earthquake/tsunami. While Thailand will not be immune to the effect of slower growth in the US and Europe, exports to the North Atlantic region represent only 20% of the total. A downward shift in global costs of fuel and food will bode well as inflationary trends start to display stabilization. The combination of these factors have led us to bring down slightly our estimate for GDP growth for Thailand to 4.6% y/y for 2011. The introduction of pro-growth policies of the newly elected administration of Ms. Yingluck Shinawatra will derive in growth accelerating to 5% y/y in 2012.



Key Indicators for the week of August 22 - 26

North America								
Country	Date	Time	Event	Period	BNS	Consensus	Latest	
US	08/22	08:30	Chicago Fed Nat Activity Index	JUL	--	-0.5	-0.5	
MX	08/22	09:00	Retail Sales (INEGI) (YoY)	JUN	--	--	1.0	
CA	08/23	08:30	Retail Sales (MoM)	JUN	0.5	0.7	0.1	
CA	08/23	08:30	Retail Sales Less Autos (MoM)	JUN	-0.2	0.3	0.5	
MX	08/23	10:00	Central Bank Announces International Reserves for Previous Week					
US	08/23	10:00	Richmond Fed Manufacturing Index	AUG	--	-5.0	-1.0	
US	08/23	10:00	New Home Sales (000s)	JUL	310	315	312	
US	08/23	10:00	New Home Sales (MoM)	JUL	-0.5	1.0	-1.0	
US	08/24	07:00	MBA Mortgage Applications (WoW)	19-Aug	--	--	4.1	
US	08/24	08:30	Durable Goods Orders (MoM)	JUL	2.0	2.3	-1.9	
US	08/24	08:30	Durables Ex Transportation (MoM)	JUL	-0.5	-0.5	0.4	
US	08/24	08:30	Cap Goods Orders Nondef Ex Air (MoM)	JUL	--	-1.8	0.4	
MX	08/24	09:00	Bi-Weekly CPI (% change)	15-Aug	--	--	0.1	
MX	08/24	09:00	Bi-Weekly Core CPI (% change)	15-Aug	--	--	0.0	
MX	08/24	09:00	Trade Balance (US\$ mns)	JUL P	--	--	107.9	
US	08/24	10:00	House Price Purchase Index (QoQ)	2Q	--	-0.5	-2.5	
US	08/24	10:00	House Price Index (MoM)	JUN	--	0.1	0.4	
US	08/25	08:30	Initial Jobless Claims (000s)	19-Aug	400	405	408	
US	08/25	08:30	Continuing Claims (000s)	13-Aug	3700	3700	3702	
MX	08/25	09:00	GDP Current \$ (YoY)	2Q	--	--	9.6	
MX	08/25	09:00	Unemployment Rate	JUL	--	--	5.4	
MX	08/25	10:00	Current Account Balance (US\$ mns)	2Q	--	--	-1376	
US	08/26	08:30	GDP (QoQ SAAR)	2Q S	1.0	1.1	1.3	
US	08/26	08:30	Personal Consumption (QoQ SAAR)	2Q S	--	0.2	0.1	
US	08/26	08:30	GDP Price Index (QoQ SAAR)	2Q S	--	2.3	2.3	
US	08/26	08:30	Core PCE (QoQ SAAR)	2Q S	--	2.1	2.1	
US	08/26	09:55	U. of Michigan Confidence	AUG F	--	55.8	54.9	
MX	08/26	10:00	Overnight Rate	26-Aug	4.50	--	4.50	

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Key Indicators for the week of August 22 - 26

Europe								
Country	Date	Time	Event	Period	BNS	Consensus	Latest	
FR	08/23	03:00	PMI Manufacturing	AUG P	50.0	49.7	50.5	
FR	08/23	03:00	PMI Services	AUG P	52.0	53.5	54.2	
GE	08/23	03:30	PMI Manufacturing	AUG A	51.0	50.6	52.0	
GE	08/23	03:30	PMI Services	AUG A	51.0	52.0	52.9	
EC	08/23	04:00	PMI Composite	AUG A	49.2	50.0	51.1	
EC	08/23	04:00	PMI Manufacturing	AUG A	49.5	49.5	50.4	
EC	08/23	04:00	PMI Services	AUG A	49.0	50.9	51.6	
UK	08/23	04:30	BBA Loans for House Purchase	JUL	--	31750.0	31747	
GE	08/23	05:00	ZEW Survey (Current Situation)	AUG	80.0	85.0	90.6	
GE	08/23	05:00	ZEW Survey (Econ. Sentiment)	AUG	-22.0	-26.0	-15.1	
EC	08/23	05:00	ZEW Survey (Econ. Sentiment)	AUG	--	--	-7.0	
EC	08/23	10:00	Euro-Zone Consumer Confidence	AUG A	--	-12.4	-11.2	
GE	08/24	04:00	IFO - Business Climate	AUG	111.0	111.0	112.9	
GE	08/24	04:00	IFO - Current Assessment	AUG	119.0	119.8	121.4	
GE	08/24	04:00	IFO - Expectations	AUG	103.0	102.8	105.0	
NO	08/24	04:00	Unemployment Rate (AKU)	JUN	--	3.3	3.3	
EC	08/24	05:00	Industrial New Orders SA (MoM)	JUN	--	0.4	3.6	
UK	08/24	19:01	Nationwide Consumer Confidence	JUL	45.0	45.0	51.0	
GE	08/25	02:00	GfK Consumer Confidence Survey	SEP	5.2	5.1	5.4	
FR	08/25	12:00	Jobseekers- Net Change (000s)	JUL	--	0.0	33.6	
FR	08/25	12:00	Total Jobseekers (000s)	JUL	--	2720.4	2720.4	
GE	08/25	00:00	Import Price Index (MoM)	JUL	--	0.3	-0.6	
UK	AUG 25-31		Nat'wide House prices sa (MoM)	AUG	0.0	--	0.2	
SP	08/26	03:00	GDP (Constant SA) (QoQ)	2Q F	0.2	0.2	0.2	
UK	08/26	04:30	GDP (QoQ)	2Q P	0.2	0.2	0.2	
UK	08/26	04:30	Index of Services (MoM)	JUN	-0.1	-0.1	1.6	
UK	08/26	04:30	Index of Services (3mth/3mth)	JUN	0.5	0.5	1.2	
UK	08/26	04:30	Total Business Investment (QoQ)	2Q P	--	--	-3.2	
GE	08/26	00:00	Retail Sales (MoM)	JUL	--	--	4.5	

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Key Indicators for the week of August 22 - 26

Asia Pacific								
Country	Date	Time	Event	Period	BNS	Consensus	Latest	
TH	08/21	22:30	Gross Domestic Product SA (QoQ)	2Q	1.0	0.6	2.0	
CH	AUG 21-25		HSBC Flash China Manufacturing PMI	AUG	--	--	48.9	
TH	AUG 21-25		Customs Exports (YoY)	JUL	35.7	33.0	16.8	
TH	AUG 21-25		Customs Imports (YoY)	JUL	22.8	21.6	26.1	
TH	AUG 21-25		Customs Trade Balance (US\$ mns)	JUL	860.0	475.5	1268.3	
JN	08/22	01:00	Supermarket Sales (YoY)	JUL	--	--	0.1	
JN	08/22	03:00	Convenience Store Sales (YoY)	JUL	--	--	9.0	
HK	08/22	04:30	CPI - Composite Index (YoY)	JUL	--	8.2	5.6	
NZ	08/22	23:00	RBNZ 2yr Inflation Expectation (%)	3Q	--	--	3.0	
JN	08/23	02:00	Machine Tool Orders (YoY)	JUL F	--	--	34.6	
NZ	08/23	18:45	Trade Balance (NZ\$ mns)	JUL	--	-100.0	230.0	
NZ	08/23	18:45	Exports (NZ\$ bns)	JUL	--	3.9	4.0	
NZ	08/23	18:45	Imports (NZ\$ bns)	JUL	--	3.9	3.7	
AU	08/23	20:00	Conference Board Leading Index	JUN	--	--	-0.1	
TH	08/24	03:30	Benchmark Interest Rate	24-Aug	3.25	3.50	3.25	
NZ	08/24	18:45	Retail Sales Ex Inflation (QoQ)	2Q	--	--	0.9	
AU	08/24	21:00	CBAHIA House Affordability	2Q	--	--	55.7	
PH	08/24	21:00	Total Monthly Imports (US\$ mns)	JUN	--	--	4888.3	
PH	08/24	21:00	Trade Balance (US\$ mns)	JUN	--	--	-780.0	
CH	AUG 24-28		Leading Index	JUL	--	--	101.8	
HK	08/25	04:30	Exports (YoY)	JUL	--	14.2	9.2	
HK	08/25	04:30	Imports (YoY)	JUL	--	16.0	11.5	
HK	08/25	04:30	Trade Balance (HK\$ bns)	JUL	--	-40.8	-40.3	
JN	08/25	19:30	Tokyo CPI (YoY)	AUG	--	-0.2	0.5	
JN	08/25	19:30	Tokyo CPI Ex Food, Energy (YoY)	AUG	--	-0.6	0.3	
JN	08/25	19:30	Natl CPI (YoY)	JUL	--	0.0	-0.4	
JN	08/25	19:30	Natl CPI Ex Food, Energy (YoY)	JUL	--	-0.6	-0.8	
CH	08/25	21:35	MNI August Business Condition Survey					
CH	08/26	22:00	Industrial Profits YTD (YoY)	JUL	--	--	28.7	

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Key Indicators for the week of August 22 - 26

Latin America								
Country	Date	Time	Event	Period	BNS	Consensus	Latest	
BZ	08/22	07:00	FGV Preview Inflation IGP-M (% change)	19-Aug	--	--	0.2	
BZ	08/22	07:30	Central Bank Weekly Economists Survey					
BZ	08/22	10:00	Trade Balance (FOB) - Weekly (US\$ mns)	21-Aug	--	--	366	
AR	08/22		Consumer Confidence	AUG	--	--	58.1	
BZ	08/23	07:00	FGV CPI IPC-S (% change)	19-Aug	--	--	0.2	
BZ	08/23	09:30	Current Account - Monthly (US\$ mns)	JUL	--	--	-3300.1	
BZ	08/23	09:30	Foreign Investment (US\$ mns)	JUL	--	--	5467.0	
AR	08/23	15:00	Trade Balance (US\$ mns)	JUL	--	809.0	1019.0	
AR	08/23	15:00	Unemployment Rate Total	2Q	--	--	7.4	
BZ	08/24	09:30	Total Outstanding Loans (BRL bns)	JUL	--	--	1834	
BZ	08/24	09:30	Outstanding Loans (MoM)	JUL	--	--	1.6	
BZ	08/24	09:30	Private Banks Lending (BRL bns)	JUL	--	--	1062	
BZ	08/24	11:30	Central Bank Posts Currency Flows' Data for Previous Week					
BZ	08/25	04:00	FIPE CPI - Weekly (% change)	23-Aug	--	--	0.4	
BZ	08/25	07:00	FGV Consumer Confidence	AUG	--	--	124.4	
BZ	08/25	08:00	Unemployment Rate	JUL	6.2	6.1	6.2	
BZ	08/25		Central Government Budget (BRL bns)	JUL	--	--	10.5	
BZ	08/26	07:00	FGV Construction Costs (MoM)	AUG	--	--	0.6	
BZ	08/26	09:30	Net Debt % of GDP	JUL	--	--	39.7	
BZ	08/26	09:30	Nominal Budget Balance (BRL bns)	JUL	--	--	-5.6	
BZ	08/26	09:30	Primary Budget Balance (BRL bns)	JUL	--	--	13.4	
AR	08/26	15:00	Shop Center Sales (YoY)	JUL	--	--	19.9	

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

Global Auctions for the week of August 22 - 26

North America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
US	08/22	11:00	U.S. Fed to Purchase USD0.5-1 Bln Notes/Bonds
US	08/22	11:30	U.S. to Sell 3-Month Bills
US	08/22	11:30	U.S. to Sell 6-Month Bills
US	08/23	11:30	U.S. to Sell 4-Week Bills
US	08/23	11:30	U.S. to Sell 52-Week Bills
US	08/23	13:00	U.S. to Sell 2-Year Notes
US	08/24	13:00	U.S. to Sell 5-Year Notes
US	08/25	11:00	U.S. Fed to Purchase USD0.25-0.50 Bln TIPS
US	08/25	13:00	U.S. to Sell 7-Year Notes

Europe

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
NO	08/22	05:00	Norway to sell Bills
BE	08/22	05:30	Belgium to Sell 4% 2014 Bonds
FR	08/22	09:00	France to Sell Bills
EC	08/22	09:30	ECB Announces Bond Purchases
SP	08/23	04:30	Spain to Sell 3M and 8M Bills
SZ	08/23	05:30	Switzerland to Sell 6-Month Bills
UK	08/23	05:30	U.K. to Sell GBP1 Bln 1.875% I/L 2022 Bonds
EC	08/23	07:00	ECB Announces Allotment in 7-Day Term Deposits
GE	08/24	05:15	Germany to Sell EU6 Bln 10-Year Notes
RU	08/24	06:00	Russia to Sell Up to RUB25 Bln OFZ Notes
IT	08/26	05:00	Italy to Sell Bills & Zero Coupon Notes
UK	08/26	06:10	U.K. to Sell Bills

Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
AU	08/22	21:00	Australia to Sell Treasury Indexed Bonds
JN	08/23	04:00	Japan Auction for Enhanced-Liquidity
CH	08/23	23:00	China to Sell 7 Year Bond
JN	08/23	23:35	Japan to Sell 3-Month Bills
JN	08/24	23:45	Japan to Sell 20-Year Bond

Source: Bloomberg, Scotia Economics.

Events for the week of August 22 - 26

North America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
US	08/23		Greenspan Speaks at Washington Convention Center
CA	08/23	12:45	Bank of Canada's Boivin Speaks at CAFE Conference in Kingston
CA	08/24	00:05	Bank of Canada 's Macklem Speaks in Mumbai, India
US	08/26	10:00	Bernanke Gives Speech at Jackson Hole, Wyoming
MX	08/26	10:00	Overnight Rate

Europe

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
GE	AUG 20-21		Schaeuble Hosts Two Day Open Day of Finance Ministry
GE	08/21	13:10	Chancellor Angela Merkel Gives Interview to ZDF Television
PO	08/22	14:00	Portugal Year-to-Date Budget Report
GE	08/23		German Christian Union Lawmakers Discuss Euro Debt Crisis
GE	08/24	11:00	Merkel Attends State Election Campaign Event in Stralsund
EC	08/26	12:25	ECB's Trichet Speaking at Jackson Hole Conference

Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
AU	08/23	00:00	Speech by RBA Deputy Governor Ric Battellino in Sydney
TH	08/24	03:30	Benchmark Interest Rate
AU	08/25	19:30	RBA's Stevens Testifies to House Panel in Melbourne

Source: Bloomberg, Scotia Economics.

Global Central Bank Watch

North America

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Bank of Canada – Overnight Target Rate	1.00	September 7, 2011	1.00	--
Federal Reserve – Federal Funds Target Rate	0.25	September 20, 2011	0.25	--
Banco de México – Overnight Rate	4.50	August 26, 2011	4.50	--

A slew of disappointing data releases this week, especially an unexpected double-digit decline in the Philly Fed index, raised the risk of a US recession, especially as Europe continues to face a debt crisis. This tees up next Friday's Jackson Hole speech by Fed Chairman Bernanke as key to the Fed's current position on future monetary policy options. In Canada, much weaker US economic data, a decline in price-adjusted Canadian manufacturing shipments in June and a tame inflation report this week all put growth well below the BoC's July forecast for 1.5% q/q annualized growth in Q2 with BoC Governor Carney himself admitting that Canada will likely witness "minimal to slightly negative growth in the second quarter."

Banco de Mexico will continue to keep interest rates on hold within the context of an economy that continues to portray very favourable indicators in latest readings as core inflation increased slightly in July, remaining well within the central bank's comfort range. On the other hand, Mexico's GDP growth accelerated in the second quarter reporting a 1.1% q/q seasonally adjusted gain; doubling the 0.52% advance of the first three months of 2011.

Europe

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

In light of concerns related to the recent moderation in global economic momentum and the ongoing debt crisis in Europe, no changes are expected at the rate-setting meetings of either the Hungarian or Turkish central banks on August 23rd. Pressure is off the Russian central bank ahead of its September 1st meeting as inflation eases on the back of lower food prices, and uncertainty increases with respect to global growth.

Asia Pacific

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Bank of Japan – Target Rate	0.10	September 7, 2011	0.10	--
Reserve Bank of Australia – Cash Target Rate	4.75	September 6, 2011	4.75	4.75
Reserve Bank of New Zealand – Cash Rate	2.50	September 14, 2011	2.50	2.50
People's Bank of China – Lending Rate	6.56	TBA	--	--
Reserve Bank of India – Repo Rate	8.00	TBA	8.00	--
Hong Kong Monetary Authority – Base Rate	0.50	TBA	0.50	--
Central Bank of China Taiwan – Discount Rate	1.88	September 30, 2011	--	--
Bank Negara Malaysia – Overnight Policy Rate	3.00	September 8, 2011	3.00	--
Bank of Korea – Bank Rate	3.25	September 7, 2011	3.25	--
Bank of Thailand – Repo Rate	3.25	August 24, 2011	3.25	3.50
Bank Indonesia – Reference Interest Rate	6.75	September 8, 2011	6.75	--
Central Bank of the Philippines – Overnight Policy Rate	4.50	September 8, 2011	4.50	--

Under normal conditions the Bank of Thailand would follow up with another monetary tightening move after its upcoming meeting next week. We believe current global financial uncertainty will prevent that. Moreover, Thai baht relative strength within the Asian currency space is already providing enough stringency in a context where food and fuel costs continue to carry most of the inflationary weight. Thus, notwithstanding the rise in core inflation in the last reading, we expect the repo rate to remain constant at 3.25% after next week's monetary decision.

Latin America

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Banco Central do Brasil – Selic Rate	12.50	August 31, 2011	12.50	--
Banco Central de Chile – Overnight Rate	5.25	September 15, 2011	5.25	--
Banco de la República de Colombia – Lending Rate	4.50	August 19, 2011	4.50	--
Banco Central de Reserva del Perú – Reference Rate	4.25	September 8, 2011	4.25	--

Africa

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

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

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

¹ World GDP for 2000-09 are IMF estimates; 2010-12f are Scotia Economics' estimates based on a 2009 PPP-weighted sample of 34 countries.

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

Canada	2010	10Q4	11Q1	Latest	United States	2010	10Q4	11Q1	Latest
Real GDP (annual rates)	3.2	3.1	3.9		Real GDP (annual rates)	3.0	2.3	0.4	1.3 (Q2-A)
Current Acc. Bal. (C\$B, ar)	-50.9	-41.1	-35.7		Current Acc. Bal. (US\$B, ar)	-471	-449	-477	
Merch. Trade Bal. (C\$B, ar)	-9.0	1.5	7.4	-18.7 (Jun)	Merch. Trade Bal. (US\$B, ar)	-646	-637	-730	-811 (Jun)
Industrial Production	4.6	6.0	5.3	8.0 (May)	Industrial Production	5.3	6.2	5.3	3.9 (Jul)
Housing Starts (000s)	192	179	178	205 (Jul)	Housing Starts (millions)	0.58	0.54	0.58	0.60 (Jul)
Employment	1.4	1.7	1.9	1.5 (Jul)	Employment	-0.8	0.5	0.9	1.0 (Jul)
Unemployment Rate (%)	8.0	7.7	7.8	7.2 (Jul)	Unemployment Rate (%)	9.6	9.6	8.9	9.1 (Jul)
Retail Sales	5.5	5.3	2.5	8.2 (May)	Retail Sales	6.8	8.1	8.6	8.9 (Jul)
Auto Sales (000s)	1560	1553	1573	1659 (Apr)	Auto Sales (millions)	11.6	12.3	13.0	12.2 (Jul)
CPI	1.8	2.3	2.6	2.7 (Jul)	CPI	1.6	1.3	2.1	3.6 (Jul)
IPPI	1.0	2.6	4.0	-5.2 (Jun)	PPI	4.2	3.8	4.9	7.2 (Jul)
Pre-tax Corp. Profits	21.2	19.1	13.4		Pre-tax Corp. Profits	25.0	1.1	2.8	
Mexico					Brazil				
Real GDP	5.4	4.4	4.6		Real GDP	6.7	4.2	3.8	
Current Acc. Bal. (US\$B, ar)	-5.7	-13.9	-5.4		Current Acc. Bal. (US\$B, ar)	-47.4	-48.0	-58.3	
Merch. Trade Bal. (US\$B, ar)	-3.0	-4.2	7.6	1.3 (Jun)	Merch. Trade Bal. (US\$B, ar)	20.2	29.9	12.6	37.6 (Jul)
Industrial Production	6.0	4.8	5.2	3.7 (Jun)	Industrial Production	10.5	3.6	2.5	0.7 (Jun)
CPI	4.2	4.2	3.5	3.5 (Jul)	CPI	5.1	6.1	6.8	6.8 (Jul)
Chile					Italy				
Real GDP	5.2	5.8	10.0		Real GDP	1.2	1.5	1.0	
Current Acc. Bal. (US\$B, ar)	3.1	4.9	0.7		Current Acc. Bal. (US\$B, ar)	-0.07	-0.07	-0.12	-0.07 (Jun)
Merch. Trade Bal. (US\$B, ar)	11.6	17.7	16.5	14.6 (Jul)	Merch. Trade Bal. (US\$B, ar)	-39.1	-46.3	-77.2	-31.6 (Jun)
Industrial Production	0.5	2.7	11.7	4.0 (Jun)	Industrial Production	6.5	5.3	2.3	0.3 (Jun)
CPI	1.4	2.5	2.9	2.9 (Jul)	CPI	1.6	1.8	2.3	2.7 (Jul)
Germany					France				
Real GDP	3.6	3.8	4.6		Real GDP	1.4	1.4	2.1	
Current Acc. Bal. (US\$B, ar)	187.6	251.7	194.8	205.8 (Jun)	Current Acc. Bal. (US\$B, ar)	-44.5	-86.6	-59.7	-97.3 (Jun)
Merch. Trade Bal. (US\$B, ar)	201.5	219.8	209.3	198.2 (Jun)	Merch. Trade Bal. (US\$B, ar)	-39.5	-39.7	-54.5	-46.7 (Jun)
Industrial Production	10.1	11.7	12.8	6.6 (Jun)	Industrial Production	5.1	4.7	4.8	2.3 (Jun)
Unemployment Rate (%)	7.7	7.4	7.3	7.0 (Jul)	Unemployment Rate (%)	9.8	9.7	9.7	9.7 (Jun)
CPI	1.1	1.5	2.1	2.4 (Jul)	CPI	1.5	1.6	1.8	1.9 (Jul)
Euro Zone					United Kingdom				
Real GDP	1.7	1.9	2.4		Real GDP	1.4	1.5	1.6	
Current Acc. Bal. (US\$B, ar)	-77	-41	-169	-57 (Jun)	Current Acc. Bal. (US\$B, ar)	-71.6	-72.2	-74.0	
Merch. Trade Bal. (US\$B, ar)	32.0	53.2	-68.5	16.0 (Jun)	Merch. Trade Bal. (US\$B, ar)	-153.0	-171.9	-142.4	-172.6 (Jun)
Industrial Production	7.4	8.1	6.5	3.0 (Jun)	Industrial Production	2.1	3.3	2.0	-0.3 (Jun)
Unemployment Rate (%)	10.1	10.0	9.9	9.9 (Jun)	Unemployment Rate (%)	7.9	7.9	7.7	7.9 (May)
CPI	1.6	2.0	2.5	2.5 (Jul)	CPI	3.3	3.4	4.1	4.5 (Jul)
Japan					Australia				
Real GDP	4.0	2.5	-0.7		Real GDP	2.7	2.7	1.0	
Current Acc. Bal. (US\$B, ar)	195.9	176.8	193.9	78.5 (Jun)	Current Acc. Bal. (US\$B, ar)	-31.8	-37.4	-37.9	
Merch. Trade Bal. (US\$B, ar)	74.8	60.7	32.0	-19.7 (Jul)	Merch. Trade Bal. (US\$B, ar)	19.3	26.1	21.9	39.6 (Jun)
Industrial Production	16.6	6.8	-2.5	-1.8 (Jun)	Industrial Production	4.3	0.0	-5.4	
Unemployment Rate (%)	5.1	5.0	4.7	4.6 (Jun)	Unemployment Rate (%)	5.2	5.2	5.0	5.1 (Jul)
CPI	-0.7	-0.3	-0.5	-0.4 (Jun)	CPI	2.8	2.7	3.3	
China					South Korea				
Real GDP	10.3	9.8	9.7		Real GDP	6.2	4.7	4.2	
Current Acc. Bal. (US\$B, ar)	305.4				Current Acc. Bal. (US\$B, ar)	28.2	36.6	10.4	35.9 (Jun)
Merch. Trade Bal. (US\$B, ar)	181.5	246.8	-6.8	377.8 (Jul)	Merch. Trade Bal. (US\$B, ar)	41.2	52.1	29.3	75.8 (Jul)
Industrial Production	13.5	13.5	14.8	14.0 (Jul)	Industrial Production	16.6	9.9	11.2	6.1 (Jun)
CPI	4.6	4.6	5.4	6.4 (Jun)	CPI	3.0	3.6	4.5	4.7 (Jul)

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

Source: Bloomberg, Scotia Economics.

Interest Rates (% , end of period)

	11Q1	11Q2	Aug/12	Aug/19*		11Q1	11Q2	Aug/12	Aug/19*
Canada					United States				
BoC Overnight Rate	1.00	1.00	1.00	1.00	Fed Funds Target Rate	0.25	0.25	0.25	0.25
3-mo. T-bill	0.95	0.90	0.84	0.85	3-mo. T-bill	0.09	0.01	0.01	0.00
10-yr Gov't Bond	3.35	3.11	2.46	2.33	10-yr Gov't Bond	3.47	3.16	2.25	2.10
30-yr Gov't Bond	3.76	3.55	3.09	2.96	30-yr Gov't Bond	4.51	4.37	3.73	3.41
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US\$B)	60.4	62.3	62.3	(Jun)	FX Reserves (US\$B)	128.3	136.6	136.6	(Jun)
Germany					France				
3-mo. Interbank	1.26	1.51	1.49	1.50	3-mo. T-bill	0.80	1.18	0.72	0.68
10-yr Gov't Bond	3.35	3.03	2.33	2.12	10-yr Gov't Bond	3.71	3.41	2.98	2.77
FX Reserves (US\$B)	64.8	66.0	66.0	(Jun)	FX Reserves (US\$B)	61.0	60.3	60.3	(Jun)
Euro-Zone					United Kingdom				
Refinancing Rate	1.00	1.25	1.50	1.50	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	0.90	1.72	0.90	0.88	3-mo. T-bill	4.85	4.85	4.85	4.85
FX Reserves (US\$B)	319.9	317.2	317.2	(Jun)	10-yr Gov't Bond	3.69	3.38	2.53	2.40
Japan					FX Reserves (US\$B)	75.3	79.7	79.7	(Jun)
Discount Rate	0.30	0.30	0.30	0.30	Australia				
3-mo. Libor	0.14	0.13	0.13	0.13	Cash Rate	4.75	4.75	4.75	4.75
10-yr Gov't Bond	1.26	1.14	1.05	0.99	10-yr Gov't Bond	5.49	5.21	4.43	4.23
FX Reserves (US\$B)	1080.6	1100.8	1100.8	(Jun)	FX Reserves (US\$B)	33.3	40.3	40.3	(Jun)

Exchange Rates (end of period)

USDCAD	0.97	0.96	0.99	0.98	¥/US\$	83.13	80.56	76.71	76.19
CADUSD	1.03	1.04	1.01	1.02	US¢/Australian\$	103.29	107.22	103.55	104.60
GBPUSD	1.603	1.605	1.628	1.661	Chinese Yuan/US\$	6.55	6.46	6.39	6.39
EURUSD	1.416	1.450	1.425	1.443	South Korean Won/US\$	1097	1068	1080	1088
JPYEUR	0.85	0.86	0.92	0.91	Mexican Peso/US\$	11.905	11.714	12.309	12.230
USDCHF	0.92	0.84	0.78	0.78	Brazilian Real/US\$	1.632	1.563	1.612	1.595

Equity Markets (index, end of period)

United States (DJIA)	12320	12414	11269	11021	U.K. (FT100)	5909	5946	5320	5092
United States (S&P500)	1326	1321	1179	1147	Germany (Dax)	7041	7376	5998	5576
Canada (S&P/TSX)	14116	13301	12542	12228	France (CAC40)	3989	3982	3214	3073
Mexico (Bolsa)	37441	36558	33362	33309	Japan (Nikkei)	9755	9816	8964	8719
Brazil (Bovespa)	68587	62404	53473	53228	Hong Kong (Hang Seng)	23528	22398	19620	19400
Italy (BCI)	1120	1039	795	814	South Korea (Composite)	2107	2101	1817	1745

Commodity Prices (end of period)

Pulp (US\$/tonne)	990	1035	1020	1020	Copper (US\$/lb)	4.26	4.22	4.01	3.98
Newsprint (US\$/tonne)	640	640	640	640	Zinc (US\$/lb)	1.05	1.05	0.98	0.98
Lumber (US\$/mfbm)	290	237	230	225	Gold (US\$/oz)	1439.00	1505.50	1736.00	1848.00
WTI Oil (US\$/bbl)	106.72	95.42	85.38	83.30	Silver (US\$/oz)	37.87	35.02	38.29	41.98
Natural Gas (US\$/mmbtu)	4.39	4.37	4.06	3.95	CRB (index)	359.43	338.05	326.53	330.05

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

This publication has been prepared for Institutional Investors by Fixed Income Strategists of Scotia Capital (USA) Inc. ("Scotia Capital"). Fixed Income Strategists are employees of Scotia Capital's Fixed Income Credit Sales & Trading Desk and support the trading desk through the preparation of market commentary, including specific trading ideas, and other materials, both written and verbal, which may or may not be made publicly available, and which may or may not be made publicly available at the same time it is made available to the Fixed Income Credit Sales & Trading Desk. Fixed Income Strategists are not research analysts, and this report was not reviewed by the Research Departments of Scotia Capital. Fixed Income Strategist publications are not research reports and the views expressed by Fixed Income Strategists in this and other reports may differ from the views expressed by other departments, including the Research Department, of Scotia Capital. The securities laws and regulations, and the policies of Scotia Capital that are applicable to Research Analysts may not be applicable to Fixed Income Strategists.

This publication is provided to you for informational purposes only. Prices shown in this publication are indicative and Scotia Capital is not offering to buy or sell, or soliciting offers to buy or sell any financial instrument. Scotia Capital may engage in transactions in a manner inconsistent with the views discussed herein. Scotia Capital may have positions, or be in the process of acquiring or disposing of positions, referred to in this publication. Other than the disclosures related to Scotia Capital, the information contained in this publication has been obtained from sources that Scotia Capital knows to be reliable, however we do not represent or warrant that such information is accurate and complete. The views expressed herein are the views of the Fixed Income Strategists of Scotia Capital and are subject to change, and Scotia Capital has no obligation to update its opinions or information in this publication. Scotia Capital and any of its officers, directors and employees, including any persons involved in the preparation or issuance of this document, may from time to time act as managers, co-managers or underwriters of a public offering or act as principals or agents, deal in, own or act as market-makers or advisors, brokers or commercial and/or investment bankers in relation to the securities or related derivatives which are the subject of this publication.

Neither Scotia Capital nor any of its officers, directors, partners, or employees accepts any liability for any direct or consequential loss arising from this publication or its contents. The securities discussed in this publication may not be suitable for all investors. Scotia Capital recommends that investors independently evaluate each issuer and security discussed in this publication, and consult with any advisors they deem necessary prior to making any investment.

This report has been prepared on behalf of Scotia Capital and is not for the use of private individuals. The Scotia Capital trademark is used in association with the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and some of its subsidiaries, including Scotia Capital Inc., Scotia Capital (USA) Inc., Scotiabank Europe plc; Scotia Capital (Europe) Limited; Scotiabank (Ireland) Limited – all members of the Scotiabank Group and authorized users of the mark. The Bank of Nova Scotia, a Canadian chartered bank, is incorporated in Canada with limited liability. The Bank of Nova Scotia, Scotiabank Europe plc, Scotia Capital (Europe) Limited and Scotia Capital Inc. are each authorized and regulated by the Financial Services Authority (FSA) in the U.K.

Opinions, estimates and projections contained herein are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither the Bank of Nova Scotia, its affiliates, employees or agents accepts any liability whatsoever for any loss arising from the use of this report or its contents. The Bank of Nova Scotia, its affiliates, employees or agents may hold a position in the products contained herein. This report is not a direct offer financial promotion, and is not to be construed as, an offer to sell or solicitation of an offer to buy any products whatsoever.

This market commentary is regarded as a marketing communication. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This report has been prepared by SCOTIA CAPITAL INC. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Scotia Capital Inc., nor its affiliates accept liability whatsoever for any loss arising from any use of this report or its contents. This report is not, and is not to be construed as, an offer to sell or solicitation of an offer to buy any securities and/or commodity futures contracts. Scotia Capital Inc., its affiliates and/or their respective officers, directors or employees may from time to time acquire, hold or sell securities and/or commodities and/or commodity futures contracts mentioned herein as principal or agent. This report may not be reproduced in whole or in part, or referred to in any manner whatsoever, nor may the information, opinions, and conclusions contained in it be referred to without in each case the prior express consent of Scotia Capital. SCI is authorized and regulated by The Financial Services Authority. U.S. residents: Scotia Capital (USA) Inc., a wholly owned subsidiary of Scotia Capital Inc., accepts responsibility for the contents herein, subject to the terms and limitations set out above. Any U.S. person wishing further information or to effect transactions in any security discussed herein should contact Scotia Capital (USA) Inc. at 212-225-6500.

Each research analyst named in this report or any subsection of this report certifies that (1) the views expressed in this report in connection with securities or issuers that he or she analyzes accurately reflect his or her personal views; and (2) no part of his or her compensation was, is, or will be directly or indirectly, related to the specific recommendations or views expressed by him or her in this report.

The Research Analyst's compensation is based on various performance and market criteria and is charged as an expense to certain departments of Scotia Capital Inc., including investment banking.

Scotia Capital Inc. and/or its affiliates: expects to receive or intends to seek compensation for investment banking services from issuers covered in this report within the next three months; and has or seeks a business relationship with the issuers referred to herein which involves providing services, other than securities underwriting or advisory services, for which compensation is or may be received. These may include services relating to lending, cash management, foreign exchange, securities trading, derivatives, structured finance or precious metals.

For Scotia Capital Research Analyst standards and disclosure policies, please visit www.scotiacapital.com/disclosures

Scotia Economics

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

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