Global Views

Weekly commentary on economic and financial market developments

February 1, 2013

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Carney Testimony And BoE Meeting Could Be The Show-Stealers

- **Please see our full indicator, central bank, auction and event calendars on pp. A3-A8.**

Most eyes will be upon **Europe** next week. The greatest scope for fireworks surrounds the Bank of England. It is unanimously expected to keep its asset purchase target unchanged at £375 billion, and its benchmark policy rate at 0.5% on Thursday. Just hours before, however, BoC Governor and BoE Governor-Designate Mark Carney testifies before the UK Parliament's Treasury Select Committee. The timing is interesting in that Carney's remarks could further deepen the debate over the future course of UK monetary policy. More will develop on this count when the Bank of England's meeting minutes get released on February 20th and hence we will have most colour on the post-Carney dialogue inside the BoE. For more on our thoughts on this please see our paper "Carney's UK Testimony Promises To Be Insightful" published on January 24th which addressed the (low) risk of rejection and flagged key questions he is likely to face and that will be of interest to policy watchers on both sides of the pond. UK data risk will also be in play next week as industrial production is expected to bounce higher at year-end, the trade deficit is expected to narrow, and the pace of contraction in the services PMI is expected to lessen. That will help inform the debate over whether the UK faces the so-called 'triple dip' with a 2013Q1 GDP contraction alongside the monthly GDP estimate from the UK National Institute of Economic & Social Research for January.

The eurozone will also be a focal point. The ECB rate announcement on Thursday and the ensuing press conference hosted by President Mario Draghi will likely carry few new developments. The ECB has already announced that an additional €3.5 billion in LTRO proceeds will be repaid by banks on Wednesday following €137 billion having been repaid this past week out of what will be a remaining total of €348.5 billion. The EU Leaders Summit on Thursday and Friday will be focused upon achieving an EU budget for 2014-20 and the focus upon securing trade pacts with the US, Canada and Japan. Recall that the budget talks collapsed in disarray at a Summit last November.

European data risk will be focused upon Germany. Following sharply disappointing prints for the last round of German factory orders, industrial production and export growth, consensus is mildly optimistic regarding next week's updates on all three counts. If that happens, then it could further reinforce the sharp reversal in German two-year yields since mid-December that has reversed a break-up premium on bunds and restored yields to positive territory. Eurozone retail sales, French trade, an update on France's central government budget balance, Italian industrial production and CPI round out the hits.

Chinese economic data will bookend the week, with the China Federation of Logistics services PMI starting things off over the weekend and then CPI numbers for January on Friday shutting things down (and possibly trade data as well as numbers on monetary aggregates, depending on the final release schedule). The improvement in the tone of Chinese economic data released in November and December 2012 has been a spur for US markets, and the risk trade has been propelled in decent part by the turn in Chinese fundamentals in December following the leadership change. The AUD has been one of the major beneficiaries of the turn in Chinese data, and it will be interesting to note if the RBA will make note of the shift in Chinese economic growth — and what it means for Australia's commodities exporters — when it makes an interest rate announcement on Feb. 5. Australian home price numbers for Q4 2012 as well as trade data for December will be released on the same day, and the RBA should have some insight into the retail sales and employment numbers that will be released mid-week, so the RBA statement will not only incorporate the changing international situation but take account also of a full update on the domestic front. The other major economic data release this week will be Japanese trade figures for January. With Japan's trade deficit hitting record levels in recent months, this is one of the key variables cited to defend the political establishment's yen-bearish bias. It will be interesting to see if the weakening of the yen — which accelerated in December — will start to show in the January trade data. Indonesia will release Q4 GDP numbers on Tuesday.

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Canada heats up toward the end of the week. Following third-tier data like the Ivey PMI and new house prices, the scope for market action might intensify when Canadian Finance Minister James Flaherty speaks on Wednesday about the government's achievements, challenges and its vision for the future on his seventh anniversary as minister of finance. As a share of GDP, Canada's budget deficit is expected to diminish from 1.4% in FY12 to 1% in FY13 and 0.5% in FY14. Deficits are in the process of being reined in from the worst points during the crisis and much earlier than many of the country's developed economy peers. The government has faced the difficulty of steering Canada through enormously challenging global conditions during which most of the problems were external to the country while the domestic economy was buoyed by very strong corporate balance sheets, considerably better government finances than the US, Europe and Japan, strong bank capital and liquidity, and resource riches. The nation may be at a crossroads, however, as signs of moderately healthier global economies now coincide with growing evidence that the country's imbalances in the housing sector and household finances are coming off the boil just as Canada is running record trade deficits. This makes Minister Flaherty's guidance to markets increasingly apropos. The following day, Minister Flaherty's chosen Governor of the Bank of Canada Mark Carney will be testifying before the UK Parliament's Treasury Select Committee and this could include reflections upon his Canadian experiences. The week closes with strong data risk of particular relevance to CAD and the front end of the Canada curve. It's more of the same with the Canadian jobs call that day. Following the creation of 184,000 jobs over the past five months—a pace that would be equivalent to nearly two million US nonfarm payroll jobs having been created over the same period — the consensus is again wary of extending the cycle of strong job gains. We and consensus are flat in our calls, mostly because of a paucity of anything more insightful to point to other than strong base effects and the disconnect between very strong job growth and next to no economic growth that usually does not persist for as long as we've seen. We'll also get an update on the housing debate that day when January's housing starts land. Starts have fallen from a temporary high of 253,000 units at an annualized pace in April of last year to 198k in December. That still leaves us toward the upper end of readings witnessed over the past four years but considerably below the pre-crisis cruising speed from 2003-08. That said, new and existing home and condo sales sharply weakened over the second half of last year and that is likely to continue to weigh upon starts with 1-2 year lags. The decline in the volume of housing permits issued last Fall may portend greater-than-expected softening in housing starts near term. Finally, international merchandise trade also lands on Friday and will inform our fresh thinking on challenges facing Canada's net trade influences upon GDP growth as 2012 came to a close. Canada also auctions $2.7 billion in 3-year notes on Wednesday.

After firing off just about all it had to offer over the past week, **US** markets should be relatively quieter next week. An exception is that fiscal policy will be front and centre on three counts. One is that the Congressional Budget Office releases its semi-annual Budget Outlook that will incorporate the January 1st fiscal cliff agreement. Two is that the US Treasury will release quarterly borrowing estimates on Monday and that could have bearing upon supply perspectives as they relate to Treasuries. Third, Friday is the US Defense Department's deadline to submit spending cut proposals from the Army, Air Force, Marines and Navy in advance of the March 1st sequestration cuts. The scope for headline risk affecting the Treasury market is therefore not insignificant. Data risk will take a back seat with expectations for a decent rise in factory orders following the strong gain in durable goods orders that comprise about half of the report, a resilient ISM services, a slightly narrower trade deficit, and jobless claims that will probably continue to shake off the early-year seasonal distortions. Earnings season marches on with 90 firms on the S&P500 releasing over the course of the week. A few of the household names include Walt Disney, Estee Lauder, Kellogg, Genworth, Time Warner, Visa, and Kraft. Fed speak will bring two Governors forward, but probably not on market sensitive issues. The greater risk likes in a speech by Governor Elizabeth Duke; her topic is community banks, but the fact that she will take audience Q&A is where the risk lies. Governor Jeremy Stein speaks on financial stability on Thursday and will speak from prepared text absent audience Q&A.

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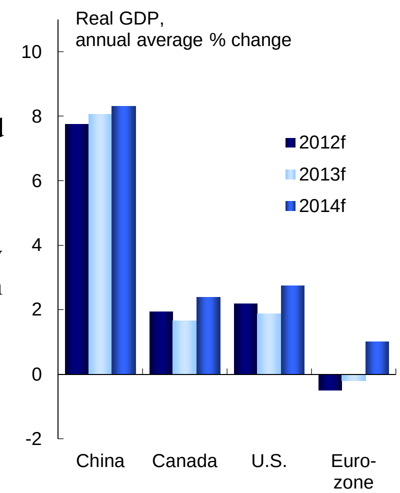
Shifting Expectations

The significant headwinds that helped restrain global growth last year have begun to dissipate. Investors have responded positively, pushing global equity prices up around 5% in January alone, and a cumulative 22% since last summer.

Global Growth



Source: Bloomberg, BEA, Statistics Canada, Eurostat, Scotiabank Economics.

The financial market instability and currency weakness that plagued the euro zone have been significantly reversed alongside the strategic support provided by the European Central Bank and European Union member states, and the initial progress made in redressing the structural budgetary and competitive deficiencies in many of the southern peripheral nations. Sovereign debt borrowing costs have ratcheted down from their punitive high levels for many of the troubled southern peripheral nations, while European banks have begun to repay their short-term central bank loan advances. Even so, the euro zone remains in the grip of recession, with both Germany and, especially, France still having trouble generating sufficient takeoff velocity. The renewed strengthening in the euro will work against a faster revival in exports and corporate revenues.

In China, credit-easing initiatives alongside some additional government support have helped to bolster infrastructure spending, consumer purchases, and housing activity, and have virtually eliminated the risk of a hard landing. The country's new leadership is focusing on domestically-driven demand, abetted by significant national savings and ongoing but very gradual currency appreciation. The recovery should continue to gain momentum, though for China, at a more moderate growth trajectory that will reduce the risk of overheating in the property market. A number of other emerging market economies are introducing additional accommodation aimed at strengthening domestic growth.

The new government in Japan is taking aim at the country's renewed economic slump as the post-reconstruction gains failed to hold. A recently introduced fiscal stimulus package targets public works and tax subsidies to promote investments and jobs, as well as public pensions. The Bank of Japan will further expand its balance sheet and lift its inflation target from 1% to 2%. As a consequence of the aggressive shift in policy, the yen has weakened sharply against most of its regional and international competitors, a key factor that will help revitalize earnings in its sizeable export sector.

Improving sentiment regarding U.S. prospects has been reinforced by Washington's compromise on taxes reached at the turn of the year, and more recently, Congressional leaders who agreed to postpone raising the 'debt ceiling' until May. While U.S. politicians have begun addressing the country's significant fiscal shortcomings, they agreed to raise taxes on the wealthy, and roll back the two-year 2 percentage point reduction in payroll taxes for all Americans. Taking another bite out of U.S. pocketbooks will be higher taxes on dividends and capital gains, in addition to Obamacare's health tax levy. With the increasing likelihood that sequestration will be in play, increased spending restraint is just around the corner.

The combined fiscal drag undoubtedly will leave its mark on the U.S. economy's performance, though there are a number of important sectors that appear to be generating more sustainable momentum. Strengthening employment conditions — a function of revitalized manufacturing and energy production — are unleashing pent-up consumer demand and underpinning a rebound in housing-related activity. Business investment will keep pace, highlighted by the strengthening trend in capital goods orders.

The generally softer turn-of-the-year performances in many countries will limit this year's global output growth to an estimated 3.2%, in line with last year's average of 3.1%. And even with a modest upgrade to our 2014 forecast for U.S. real GDP — now pegged at 2.7% — our estimate for global growth remains at our previous target of 3.8%, though the cyclical recovery remains historically subpar and not fully evident in every country.

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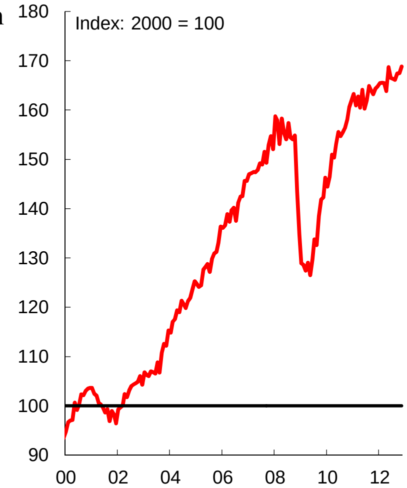
Canada is expected to piggyback on the U.S. revival, with the improving U.S. demand for building materials including forest products, transportation equipment and machinery benefiting domestic producers and exporters because of the large and highly integrated trade ties between the NAFTA zone partners. Business spending, including non-residential construction and infrastructure expansions, along with a number of publicly-funded investment projects, will also help underpin growth.

World Trade Volumes



Source: CPB Netherlands Bureau For Economic Policy Analysis, Scotiabank Economics.

However, after equaling or bettering the U.S. economic performance for ten out of the past thirteen years since 2000, the Canadian economy is set to marginally underperform its neighbour to the south with output growth forecasted to advance 1.7% this year and 2.4% in 2014. Like the U.S., Canada is also feeling the fiscal drag from federal and provincial spending restraint, though the relative impact is less in terms of magnitude and duration. But unlike our U.S. counterparts, the Canadian economy has already benefitted from a lengthy period of ramped-up consumer spending and housing activity.

At the same time, competitiveness issues — both currency and structural — are forcing domestic producers to repeatedly restructure, advance productivity-enhancing spending, and focus on expanding markets in Canada and around the world. Canadian export earnings also are not benefiting from world prices for domestic crude oil and natural gas owing to capacity bottlenecks south of the border, and inadequate export infrastructure capabilities domestically.

Canada's slower, albeit sustainable growth trajectory will help keep a lid on core inflation pressures which have already drifted well below the central bank's 2% target. Overheated housing markets in Vancouver and Toronto are cooling off, and household borrowing and debt accumulation are moderating. Accordingly, the Bank of Canada will likely refrain from raising its overnight rate until early in 2015. Although many fundamental factors are still supportive of a small premium in the Canadian dollar vis-à-vis the U.S. dollar, there are increasing risks to the Canadian currency in the absence of a significant and sustained turnaround in the country's weakened trade performance.

Around the world, most central banks remain committed to keeping borrowing costs at exceptionally low levels for longer. Among the developed nations, most central banks have adopted some form of non-conventional monetary accommodation, Canada and Australia being two notable exceptions. Late last year, the Federal Reserve Board expanded its commitment to buy longer-term Treasuries and mortgage-backed securities, while more recently, the Bank of Japan has also moved to expand its balance sheet. Just this past week India and Colombia were the latest countries to lower their benchmark short-term rates another notch.

Combined, global monetary authorities are continuing to fund a meaningful tailwind designed to support economic activity through a variety of channels, including borrowing-to-buy, refinancing to bolster cash flows, and a shift into risk assets. There is good reason for their concern. The overriding factor for policymakers is that the simultaneous deleveraging of either the public or private sectors or both could still undermine the historically moderate recoveries underway. Deflationary fears persist, notwithstanding the potential longer-run reflationary bias of unlimited government bond purchases. But there are additional factors that could slow or even derail the recovery around the world. The continuing rise in euro zone unemployment, particularly for youth, threatens to delay any revival in domestic demand, further the exodus of job seekers, and exacerbate social unrest. Consistently underperforming economies are witnessing a widening in income inequality. Heightened geopolitical risks persist in many strategic intersections of the world. The increasing incidence of natural disasters has again focused attention on climate change. And more recently, dramatic currency revaluations that increase the risk of competitive currency adjustments have the potential to undo international efforts to co-ordinate policy and promote economic and financial market stability.

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Easing Tensions And An Improving Growth Outlook Drive A Repricing In FX

A sudden recognition that Europe has made progress together with less fiscal-related tension in the US and ongoing signs of economic recovery in China have contributed to a moderation in risk aversion. A material repricing of assets is taking place as investors regain confidence in the management of the euro zone crisis. Intensified activism by major central banks through large asset-purchase programs in the US and Japan remains a key factor driving capital flows. Emerging-market economies with floating currencies in Asia and the Americas continue to benefit from the ongoing quest for high yield. Currency war rhetoric has increased materially, though there has yet to be a unified voice. Meanwhile, the flight to triple-A rated assets, a key development in 2012, is in the process of being unwound.

The broad based US trade weighted dollar is weakening, even as there is increasing evidence of recovery in US employment and housing and the fiscal pressures have temporarily eased. Please see the ***Global Forecast Update*** for our full economic outlook. An equity rally, rising 10-year UST bond yields and curve steepening imply an improving growth scenario, as the Federal Reserve (Fed) remains committed to injecting of liquidity through a low-interest rate environment and the purchase of US Treasury and mortgage backed securities.

The Canadian dollar (CAD), trading at virtual parity against the USD, has been relatively stable despite the re-pricing dynamics under way and evidence of widening growth differentials between the US and Canada. The CAD remains influenced by the US credit and monetary cycles as well as by the direction of commodity prices (primarily energy). As the Bank of Canada has eased its hawkish stance, the currency recently struggled, but over the long term, Fed policy combined with improving global growth and an ongoing risk rally should support the CAD. Elsewhere in the Americas, other currencies such as the Brazilian real (BRL) and the Mexican peso (MXN) have benefitted from increasing global risk appetite and from forward guidance that the US monetary outlook will remain unchanged for the time being. We are of the view that Mexico offers an attractive investment potential for the coming year now that a new leadership is in place.

The euro (EUR) is experiencing a strong rebound (edging towards the 1.36 mark at the end of January) on the back of improved confidence in the region’s economic recovery prospects and the ongoing commitment of the European Central Bank to purchase sovereign debt assets if needed. We expect the EURUSD rate to close the quarter at 1.34 and regain a defensive tone through the remainder of the year once technical repricing is completed. We are concerned that the market is getting ahead of itself and that a rising EUR will only complicate what is already a challenged European path. Accordingly, we expect EURUSD to fall into year-end, closing at 1.27. The GBP has been subject to negative forces, due to growing uncertainty over the European Union/United Kingdom relationship, general political uncertainty, soft growth, a dovish Bank of England and material GBP selling as last year's triple-A trading dynamics are unwound.

The Japanese yen (JPY) has undergone the most significant re-pricing; against the USD, the JPY has lost 15% since September 2012. The Japanese authorities are committed to using fiscal and monetary tools to stimulate economic activity, proof of which is the ongoing purchase of assets as well as raising the inflation target to 2%. We are of the view that the JPY will maintain a weakening trend (but a more contained year-over-year depreciation of 10%) and close the year at 95 per USD.

The Chinese economy is recovering with manufacturing activity indicators showing signs of gradual improvement; in fact, after growing by 7.9% in 2012, we expect real GDP to expand by 8.1% in 2013. The Chinese renminbi (CNY) is also influenced by the activist stance adopted by other central banks in the region to instill currency-linked competitiveness into their economies. The CNY is consolidating gains achieved over the past three months, before initiating another phase of gradual appreciation: we expect the USDCNY to close the year at 6.10, implying a yearly gain of just 2%. Elsewhere in the developing Asia region, performance presents a mixed outlook. While currencies such as the Thai baht (THB) and the Indian rupee (INR) regained a strengthening bias as intra-regional trade flows improve and the Europe-related concerns subside, others such as the Korean won (KRW) have been subject to policy-related shifts to control speculative capital inflows.

Please see our full Monthly FX Outlook for our views and forecasts.

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Bank Of Canada On Hold Throughout 2013-14

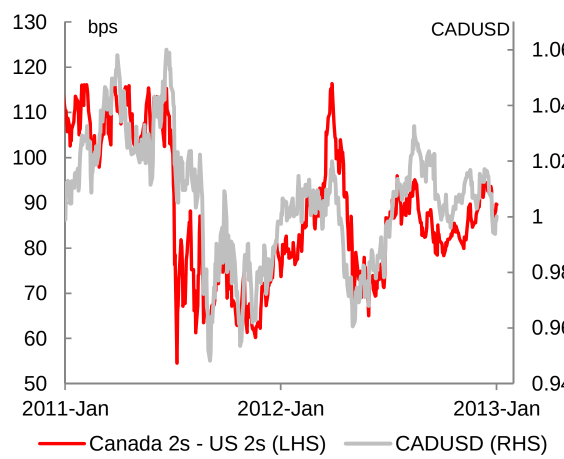
- **We explain a half dozen reasons for our forecast change.**

We have changed our house forecast for the Bank of Canada to show no rate change throughout 2013-14. As such, the overnight rate is forecast to end 2014 at an unchanged 1%. Our prior print forecast was that the BoC would remain on hold until 2014Q1 and so we are therefore now pushing that out by about a full year. While I have long spoken about how the fat tail risks to our print forecast are skewed toward later rather than sooner, this is a pretty sizeable forecast change that merits delving into some of the key reasons.

1. The Fed & CAD

We are forecasting the Fed to begin raising its fed funds target rate by mid-2015 and have greater confidence on the Fed call. It is difficult to expect Fed funds target rate hikes before early 2015 and so timing a BoC hike to occur around the same time seems reasonable. What informs our Fed view? We assume that the Fed will continue its MBS buying through to the end of 2013 and continue Treasury purchases into early 2014. After that point, we assume that Chairman Bernanke's order of operations marked by ceasing asset purchases, continuing with coupon reinvestment but then halting this and shifting toward tightening through a variety of tools including possible increases in the fed funds target will take us well into at least 2014 before the US faces materially higher short-term interest rates. We do not believe that the BoC will be able to significantly widen Canada-US spreads at the front end of the yield curve without imposing a more deleterious overshooting of the currency's rate of exchange against the USD which remains the key cross from the standpoint of the country's trade balance. As evidenced by chart 1, the period in which the BoC has swung from dovish in late summer 2011 to hawkish late last winter and through the summer and now back to dovish has motivated substantial swings in the 2-year Canada-US spread within a roughly 60bps band. This, in turn, has been responsible for driving much of the CADUSD volatility (versus the USDCAD convention to more easily show the correlation on a chart). To widen the Canada-US 2s spread by, say, another 100bps from here could well prompt sharp currency appreciation which we do not believe the economy could handle without encountering further downside risks to both growth and inflation via imported pass-through effects of a stronger Canadian dollar. In short, there are limits to the independence of a central bank in a modestly sized economy that is heavily dependent upon its bilateral trading and capital markets relationship with the United States. Adding to these constraints are a host of domestic economic concerns.

Chart 1 The Fed Constraint

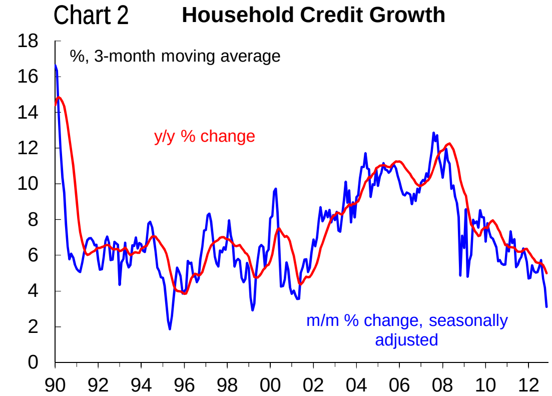


Source: Bloomberg, Scotiabank Economics

2. The Effects Of Macroprudential Rule Tightening

We now feel that we have more evidence that cumulative regulatory tightening of lending conditions since 2008 and up to this past June's further tightening of mortgage rules is sharply cooling credit growth and housing markets. We don't wish to turn this into a housing paper that we have treated with near exhaustion in our slide decks and notes, and instead focus upon the end policy focus of evidence on household sector imbalances and their linkages with household finances. The cumulative, lagged impact of this rule tightening lessens the BoC's focus upon perhaps having to reinforce its effects by raising interest rates. As evidenced by chart 2, Canadian household credit growth is

Chart 2 Household Credit Growth



Source: Bank of Canada, Scotiabank Economics.

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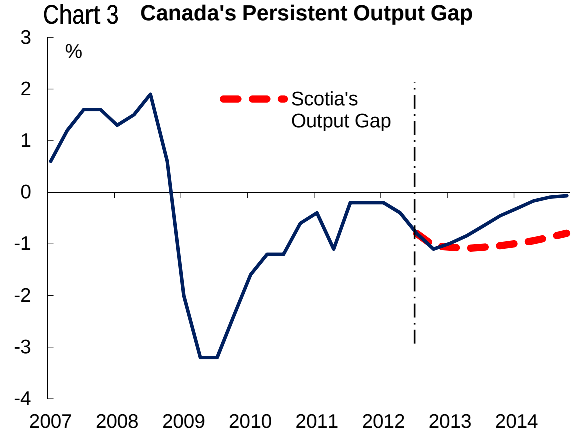
running at its slowest pace since the moribund 1990s. As the lagged effects of rules-based and less transparent forms of regulatory tightening continue to unfold, there may well be additional downsides to credit growth as we have consistently argued.

More recent support for this bias is that the BoC recently shifted its own stance toward forecasting that the household debt-to-income ratio will be flat around current levels over 2013-14. That is a strong signal to markets that the central bank's concerns regarding household imbalances are waning. The BoC now believes that there are "the beginnings of a more constructive evolution of imbalances in the household sector" which in plain English means that debt growth and housing markets are coming off the boil.

3. Spare Capacity To Persist

Chart 3 flags that we are still materially different from the BoC's revised assumptions on spare capacity, and that is one reason why we think the BoC remains a tad on the optimistic side. We have argued since a note last August that the BoC was being too aggressive with respect to the pace at which spare capacity would be closed. The chart shows that the BoC now sees spare capacity closing off toward the end of 2014 and therefore just pushed out its prior view that this would occur by the end of this year. Using the BoC's potential GDP growth assumptions (i.e., the economy's "speed limit") but replacing their actual GDP growth forecast with Scotiabank's forecast, results in the red dashed line for our view on what happens to the output gap.

Chart 3 **Canada's Persistent Output Gap**



Source: Bank of Canada, Statistics Canada, Scotiabank Economics

Recall that being above the horizontal line signals excess aggregate demand that may be inflationary and below it signals excess aggregate supply in the economy that may be disinflationary — importantly with all else equal on limitations to this framework of thinking. We see spare capacity persisting into 2015 at a minimum and therefore do not anticipate that the BoC's malleable 1-3% inflation target band within a flexible framework will be significantly challenged.

Even if the output gap were to close by the end of 2014 as the BoC forecasts, that does not mean that an outbreak of inflation risk lies around the corner in such a manner that would require policy tightening beforehand. One reason for this is that we don't know what the BoC is assuming on 2015 growth relative to the economy's non-inflationary speed limit since it has yet to publish 2015 forecasts. The BoC is simply too smart to go out that far. Nor do we have tremendous confidence in timing the potential inflation response should the economy happen to trip into spare excess demand and not be pre-empted by monetary tightening.

The reason for this difference of opinion on when spare capacity closes relates to different growth assumptions. The BoC is repeating its established tendency to push out bullish optimism after downgrading near-term growth. The Fed has generally taken a similar approach over the years. The BoC may turn out to be right going forward, but our forecast differences are material when compounded over the quarters. In 2013Q3 and Q4, the BoC thinks the Canadian economy can return to nearly 3% GDP growth versus our view that is in the low 2% range and which is comparable to the economy's speed limit such that we don't build more spare capacity but we don't close it either. Material forecast differences persist into 2014, and it may be prudent to play it safer yet on housing risks and what we have flagged in the past on risks to Canadian exports.

4. Inflation Could Easily Keep On Undershooting

Canada is seriously undershooting the BoC's inflation target with headline CPI currently tracking 0.8% y/y. In the process, the BoC's inflation targeting apparatus is suggestive of an asymmetric approach to returning

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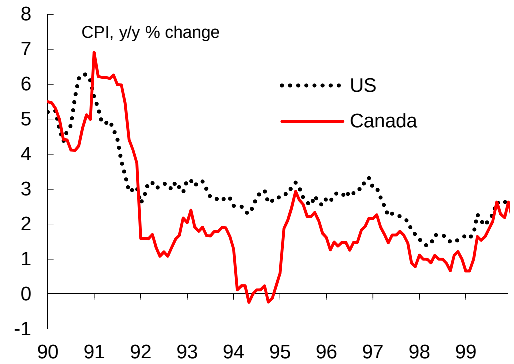
headline inflation back to its trend line; the BoC might be expected to adopt an easing bias when falling so short of its inflation target. The household imbalances perspective is one reason why the BoC has not embraced an easing bias; indeed, this is supported by BoC references to maintaining tighter monetary policy than would otherwise be warranted through a strict, mechanistic focus upon its inflation target precisely because it has been so focused upon engineering a hopefully soft landing in the household sector. As we have previously noted, however, the BoC is shifting away from this line of reasoning.

Chart 4 **Back To The 1990s?**



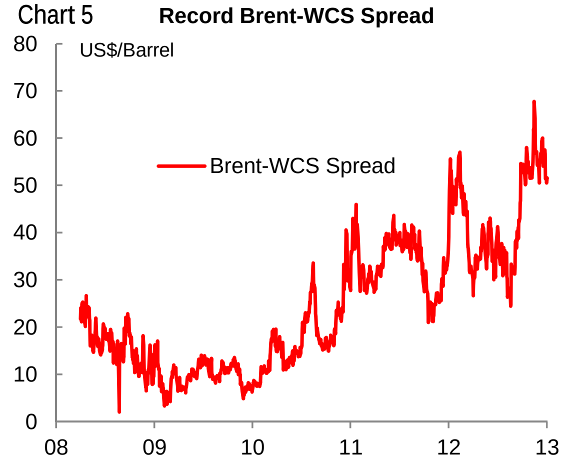
Source: Statistics Canada, BLS, Scotiabank Economics.

Regardless, we are left with the reality of having to forecast inflation in Canada relative to the US. Key here is that we think there are parallels between today's conditions and the 1990s. Canadian and US GDP growth are strongly correlated over long periods of time, but there have been instructive periods of relevance to monetary policy when the economies are off-cycle to one another and particularly in the household sector. During the 1990s, the move away from the structural highs that existed at the end of the 1980s and early 1990s across multiple household sector measures meant less pricing power for Canadian businesses serving the business-to-consumer segments. Canadian inflation consistently under-shot US inflation as chart 4 depicts. A repeat of that is entirely possible, and so I'm not sure we buy the BoC's base case projection for headline inflation to neatly shoot back to its 2% target by 2014H2. A stronger argument would posit that the two countries' household sectors have never been as off-cycle relative to one another as is the case today.

5. Canada's Oil Price Discount

Another reason to think that Canada's output gap might persist for longer than previously anticipated is the unwelcome weakness in the crude oil producing sector with an emphasis on heavy oil. The most recent Bank of Canada statement flagged a "record discount on Canadian heavy crude" which it attributed in part to "temporary disruptions" and in part to "persistent transportation bottlenecks." While the former will pass, the latter are likely to exacerbate the issue as output of Canadian and U.S. crude — which both travel on North America's integrated pipeline network — is set to increase significantly in 2013 by most estimates. The result is a material risk that bottlenecks might keep the spread between Canadian heavy crude and world prices above their normal level (see chart). Should the price gap persevere, will it begin to deter capital spending and other investment in the sector over the next two years? It's hard to say with any certainty; however, the Bank of Canada is hinting here at another downside risk to its projections, and one which has the potential to weigh on capital investment moving forward.

Chart 5 **Record Brent-WCS Spread**



Source: Bloomberg, Scotiabank Economics

6. Uncertainty During A Leadership Transition

Throughout this framework is the added uncertainty imposed by the pending leadership transition at the Bank of Canada in the wake of Governor Mark Carney's announced departure. We assume policy continuity, but a risk is slanted toward a transition that could afford the opportunity for a new Governor to guide markets with his or her own bias in consultation with the Governing Council.

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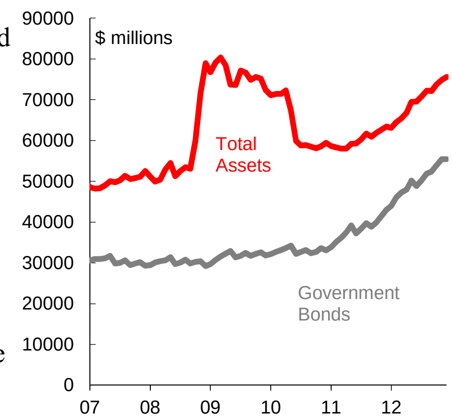
Why The Bank of Canada's Balance Sheet Is Expanding So Rapidly

- **The Federal Government's Prudential Liquidity Management Plan is the culprit, as opposed to any policy easing by the Bank of Canada.**

A rapidly growing Bank of Canada (BoC) balance sheet has been drawing attention for some time, but it is important to understand why this is occurring in the context of fresh questions that we have been receiving from clients. An expanding BoC balance sheet does not connote policy easing by 'stealth' tactics curiously unbeknownst to market watchers and economists. Instead, there is an alternative explanation.

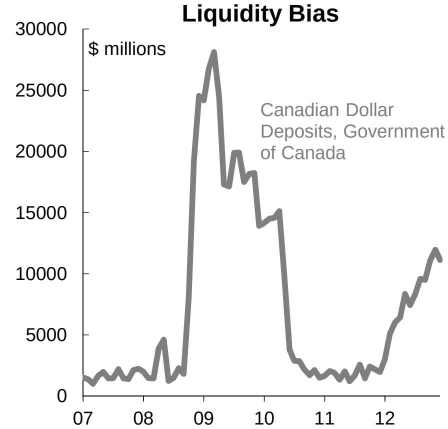
As demonstrated in the first chart, the BoC's assets have indeed risen from $63.4 billion to $77.7 billion over the past year. A central bank, however, expands its balance sheet for reasons that are not always related to quantitative easing (QE). In this case, what has happened is that the federal government has increased its deposits at the BoC about five-fold from December 2011 to December 2012, or by about $9.8 billion (chart 2). The BoC has taken that rise in liabilities and invested it in direct and guaranteed GoC securities to make the balance sheet, well, balance (see the bonds line in chart 1). The BoC is performing such actions within the confines of its duties as banker to the government.

BoC's Asset Expansion…



Source: Bank of Canada, Scotiabank Economics.

…Is Driven By The GoC's Liquidity Bias



Source: Bank of Canada, Scotiabank Economics.

This naturally begs the next question: why are the GoC's deposits held at the BoC rising so rapidly? The BoC has repeatedly explained over the past year that this is due to the Government of Canada's Prudential Liquidity Management Plan. Under this plan, the GoC has stated the desire to increase its liquidity in the event that a financial market disruption imperils access to markets. This program was announced in Annex 2 of the 2011 Federal Budget when the GoC proposed increasing its holdings of liquid financial assets by $35 billion split between deposits (about $25 billion) and FX reserves in the Foreign Exchange Fund Account (about $10 billion) in order to cover at least one month of net cash requirements.

Even in the absence of the Prudential Liquidity Management Plan, the BoC would have to serve as bank to the government in such a manner as to always expose BoC balance sheet movements to changes in cash management at the GoC. The more formal explanation is that the BoC manages funds of the Receiver General which serves the function of collecting and disseminating almost all of the funds in and out of the federal government. As the BoC's web site explains, "The Bank ensures that these accounts have enough cash to meet daily requirements and invests any surpluses in term deposits."

Thus, taking from one part of the financial system to invest in another makes the actions sterilized and hence not QE. Central Banks do not only expand their balance sheets when they engage in QE. They also do it as normal functioning to raise narrow money along with nominal GDP growth. There is nothing to be implied regarding any mysterious QE practices the BoC has been pursuing. Indeed, the entire BoC balance sheet is only $77.7 billion at the end of Dec/12 of which $56B is in bonds. That's pretty small stuff in aggregate and relative to the size of the Canadian economy. Canadian markets benefitted indirectly from the Fed's QE initiatives, but the BoC has never pursued quantitative easing. That was also true back in the 1990s when Canada was in a situation similar to the US and Europe today, and as such enormous credit goes to the BoC for having resisted the money printing bandwagon over the 1990s onward over the 1990s onward.

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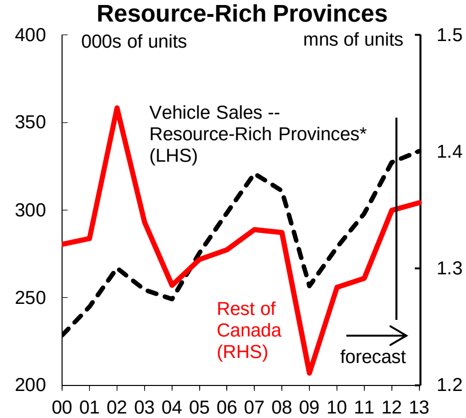
Near-Record Canadian Auto Sales In 2013

- **Resource-rich provinces will continue to drive gains.**

Canadian auto sales climbed 6% last year, and will likely edge up further in 2013, advancing to 1.69 million units — the second-highest level on record. The resource-rich provinces of Alberta, Saskatchewan and Newfoundland & Labrador will continue to lead gains. Purchases in these provinces set record highs in 2012, climbing above the 2007 peak. Volumes in other regions are back to the average of the previous expansion, but even with a moderate improvement in the coming year, will still remain 6% below the previous peak.

Record Sales In Resource-Rich Provinces



* Alberta, Saskatchewan, Newfoundland & Labrador. Source: Scotiabank Economics.

Labour markets, demographic trends and development activity are strongest in Western Canada, while a ramp-up of several projects on the east coast will support regional gains. Commodity prices have rebounded since last summer, and will be underpinned over the coming year by the recent pick-up of economic growth in China and improving global financial market conditions. Global equity markets have advanced by more than 20% since mid-2012, including 5% in January — the best performance in two decades.

Alberta will be the auto industry's growth leader in 2013. Vehicle sales in Alberta climbed to 239,000 units last year — the second-highest on record. We expect volumes to advance to 244,000 units in 2013, approaching the 2007 peak of 249,000 cars and light trucks. Sales will be bolstered by a buoyant labour market, record population inflows and a continuing, albeit single-digit increase in energy sector investments. Unemployment in Alberta has dropped to only 4.5% — the lowest level in Canada and nearly 3 percentage points below the national average. Meanwhile, population growth accelerated to 2.5% last year — nearly triple the advance in the rest of Canada. Alberta's driving-age population is increasing at even a faster pace. Despite these positive developments, the improvement in vehicle sales will be held back by weak pricing for Alberta's oil exports. The export price for Canadian heavy crude has fallen to a substantial discount from international benchmark prices due to export pipeline constraints. This widening discount prompted the Alberta premier to warn last week of a $6 bn revenue shortfall for the 2013-14 fiscal year.

Vehicle sales in Saskatchewan climbed to a record-high 55,000 units in 2012, buoyed by a solid gain in farm incomes and ongoing expansion of the mineral sector. An increase in purchases to 56,000 units is projected for 2013, bolstered by the government of Saskatchewan's commitment to spent at least $2.5 bn on infrastructure over the next several years and the scheduled start-up of the Cigar Lake uranium mine in late 2013. Newfoundland & Labrador also reported record car and light truck sales in 2012, with volumes jumping to 33,000 units — 29% above the 2001-08 average. Purchases will be boosted this year by a rebound in offshore oil production and increased iron ore output.

Outside of the resource-rich jurisdictions, British Columbia and Ontario are expected to be the next best performers over the coming year. Vehicle sales in British Columbia will be supported by rising exports to Asia — the destination for more than 40% of the province's international shipments — and the ongoing revival in the U.S. housing market. In Ontario, purchases will be underpinned by improvement in industrial activity — led by an auto industry revival. The auto sector led the growth in manufacturing employment across Ontario last year, advancing by 5% — the strongest increase since the turn of the millennium. Further gains are scheduled for 2013, as vehicle production strengthens to 2.6 million units — the highest level since 2005. Auto industry employment in Ontario is currently 96,000, nearly 8,000 above the cycle-trough in late 2009.

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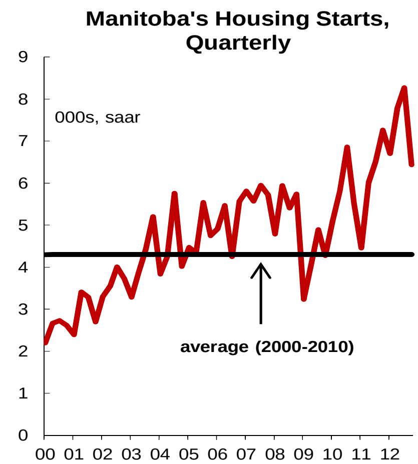
Manitoba Keeps Moving

- **Manitoba's economy advances with support from manufacturing, agriculture and construction.**

Manitoba's economic output is forecast to increase by 1.7% in 2013 and 2.2% in 2014, at about the national average. In 2012, the province's diversified economy was supported by robust residential and non-residential construction, modest consumer spending gains and a recovery in agricultural production. Going forward, strengthening manufacturing and export activity along with increasing global growth should help to offset a slower pace of homebuilding and ongoing public sector restraint.

For Manitoba, ongoing net migration to other provinces has been mitigated by an inflow of international immigrants, resulting in moderate population growth of about 1.2% annually. This continued population growth has helped to drive housing starts and large-ticket item sales, including building supplies, furniture and new autos, that led a 2% advance in retail sales in the first eleven months of last year.



Source: CMHC, Scotiabank Economics.

While effectively unchanged in 2012, Manitoba's home sales have remained near record levels, even as national sales have edged downwards. The historically high level of activity resulted in average house prices increasing by 5% last year. Strong sales and record high prices have supported residential construction, with housing starts up 25% on a seasonally adjusted basis in 2012. The level of annual housing starts should remain firm, but some moderation in housing activity is expected through 2014.

Business investment has been a key driver for the province. Manitoba's real non-residential construction growth exceeded 9% in 2012, second only to Saskatchewan. Manitoba's non-residential construction strength should persist as the province posted the highest provincial rate of non-residential building permit growth in the first eleven months of 2012. This construction will be directed towards office, retail and transportation and warehousing. Ongoing mining developments are adding to investment and offsetting production losses from mine closures.

Manufacturing shipments increased a modest 2.4% in the first eleven months of 2012. However, a sizeable decline in food manufacturing shipments obscured a double-digit increase in shipments of machinery, wood products and transportation equipment, including buses and jets. Expect the rate of manufacturing shipment growth to pick up this year, supported by the ongoing U.S. economic recovery.

The province's small oil sector has continued to develop — year-to-date production increased 24% as of last September — while natural gas production declined in the face of low prevailing prices. Manitoba's electricity sales declined some 4% in the first eleven months of 2012. Electricity export revenue, in particular, was hurt by increased competition from U.S., natural-gas-fired, electricity generators. Meanwhile, the province added to its hydroelectric capacity with the opening of the Wuskwatim power station last year.

Crop farmers increased the total area seeded in 2012, as the province recovered from excessive moisture levels in 2010 and 2011. Yields were also generally higher, resulting in a year-over-year jump in production that exceeded 75% for wheat, soybeans, corn, and barley. Increased production, and supportive prices, did not generate higher crop receipts in the first three quarters of 2012, as crop farmers rebuilt their inventories. Over the same time period, livestock sale revenue advanced by 4%, but hog producers were hurt by softening hog, and higher feed, prices.

Manitoba is less dependent on the U.S. as an export destination than many provinces. In 2011, about 60% of Manitoba's exports were directed to the U.S., while China, Hong Kong, Japan, South Korea and Taiwan received another 18% of the province's exports. In the first eleven months of 2012, Manitoba's export receipts declined by 4%, hampered by a 17% decline in export receipts from East Asia, reflected in most categories other than oilseeds. Meanwhile, the ongoing U.S. economic recovery boosted the value of exports that it received from Manitoba by 5%. In 2013, expect exports from Manitoba to increase supported by the U.S. economic recovery and more rapid economic growth in China.

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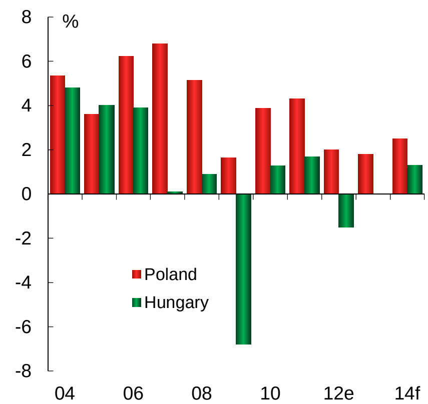
Poland And Hungary — Two Divergent Stories Of Emerging Europe

- **The two emerging European economies offer substantially different outlooks, with Poland set to outperform Hungary on economic, fiscal and foreign-exchange fronts.**

Both Poland and Hungary have recently engaged in financial assistance negotiations with the International Monetary Fund (IMF). However, a number of key factors differentiate the two nations, with Poland currently offering a more stable and promising outlook. Each nation joined the European Union (EU) in 2004, enjoying strong growth rates in the years surrounding accession. Poland's growth averaged 4.1% in 2000-07 while Hungary's measured 3.6% (versus an average of 2.7% for the EU and 2.2% for the euro area over the same period). Highly exposed to external financial uncertainties, including shifts in global risk aversion and portfolio flows (given large external financing needs), as well as the recession in the euro area (56% of both countries' exports went to the euro zone in 2011), both economies saw growth fall sharply in 2012.

Despite a drastic deceleration in the pace of growth over the course of 2012 (to 0.7% y/y in the fourth quarter from 4.6% in the same period a year prior) and a gradual rise in the unemployment rate (to 10.6% as of December), Poland's real GDP continues to expand. The resilience of the Polish economy has been demonstrated previously; the nation was the only in the EU to avoid a recession during the global crisis in 2008-09. The average growth rate may dip slightly lower in 2013 (following a disappointing 2% advance in 2012), but the large domestic base and stable policy framework should permit a return to an upward trajectory in 2014, reaching 3% and above from 2015 on. In view of potential external shocks — with deep and relatively developed local banking and capital markets, Poland is particularly vulnerable to sudden swings in investor sentiment — the Polish authorities have sought a new two-year Flexible Credit Line (FCL) arrangement with the IMF, worth US$34 billion. The request was approved in mid-January, with the authorities agreeing that it is intended as a precautionary buffer, not a loan.

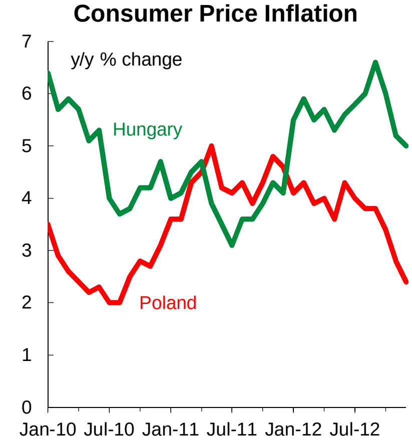
Real GDP Growth



Source: IMF, Scotiabank Economics.

Hungary, on the other hand, has seen output contract on a yearly basis since 2012 Q1, resulting in an estimated 1½% decline for the year overall. This will likely be followed by a flat or slightly negative performance this year, and a resumption of slow growth thereafter (the IMF foresees yearly advances under 2% for the next five years). Counter-cyclical fiscal policy is weighing on growth, as the government remains bent on achieving fiscal deficit targets of below 3% of GDP in order to exit the EU's punitive Excessive Deficit Procedure and ensure continued access to EU funds. The unconventional measures introduced to this end (including taxes on the banking and energy sectors) have dampened business confidence and investment. The IMF has likened the situation to a negative feedback loop. Unpredictable government interference in the economy (with the aim of supporting households in the downturn) has undermined private sector activity, leading to lower investment and growth, and high public debt (78% of GDP). Discussions between the Hungarian authorities and the IMF for a financial assistance package — initiated over a year ago — have been put on hold, likely due to disagreements on several policy fronts.

Consumer Price Inflation



Source: Bloomberg.

Inflation in Poland rose in the years following the crisis, but has trended lower since mid-2011 (2.4% y/y as of December) thanks to a credible inflation-targeting regime and flexible exchange rate. The pace of price gains is expected to remain within safe distance of the central bank's 2.5% target over the forecast horizon. Meanwhile, Hungary's inflation rate has averaged 5% y/y since 2005 (5.6% in 2012), well above the 3% target in place since then. The independence of the Hungarian central bank has been called into question, with concerns related to the influence

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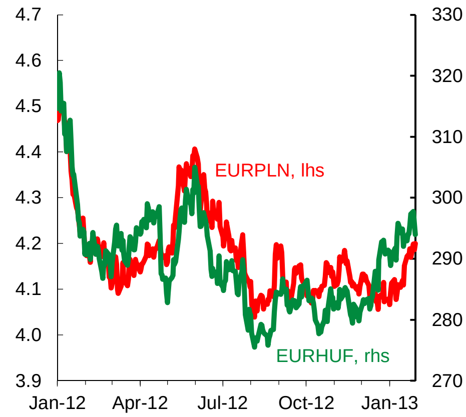
of the ruling Fidesz administration on the bank's Monetary Council. In fact, András Simor, the outgoing governor and strident advocate of price stability (he has consistently voted against interest rate cuts), will be replaced by a government appointee in March, who will likely support further monetary easing to boost the faltering economy, keeping inflation elevated over the coming year.

Both the Polish zloty (PLN) and Hungarian forint (HUF) experienced considerable appreciation through most of 2012 (being the top two emerging-market currency performers versus both the euro and the US dollar). Each currency peaked late in the year and has since followed a weakening trend, despite the recent relaxation in global risk aversion and monetary stimuli from major advanced-economy central banks which has flooded many emerging markets with yield-seeking flows. The PLN's deprecation since December has been driven by a series of rate cuts by the central bank, combined with increasing evidence of economic deterioration. With the pace of monetary easing likely to slow and further, though gradual, expected improvement in euro area financial and economic conditions, we do not foresee any significant additional weakening in the zloty. A strong economic and policy foundation, credible public finance profile and full investment-grade credit rating status (with a "stable" outlook from each of the major rating agencies) support an underlying trend of appreciation for the PLN over the forecast horizon. We expect year-end EURPLN rates of around 4.02 and 3.92 in 2013 and 2014, respectively.

Currency Performance



Source: Bloomberg.

The forint should also see a positive correction from its current level with the anticipated improvement in the external risk environment later in the year, though domestic factors could offset this to some extent. Unorthodox and unpredictable policy-making, which have already caused Hungary to lose it's investment-grade status, could lead to additional downgrades, a further erosion in growth, persistent inflationary pressures and, in turn, continued currency weakness. We anticipate year-end EURHUF levels at 288 and 283 in 2013 and 2014, marked by periodic bouts of volatility.

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BoE Inflation Report Preview

BoE Inflation Projection Pushed Higher Again…

Next week's February MPC decision will be made against a backdrop of updated macroeconomic projections as part of the quarterly *Inflation Report* process. The themes are becoming rather too familiar; the growth outlook has deteriorated since last time and the inflation outlook is likely to have been pushed higher.

Table 1 shows that since the November *Inflation Report*, four of the key influences on the inflation outlook argue for raising the Bank's medium term projection, while one argues for lower inflation. More specifically, oil prices have risen, the effective GBP is weaker, the near term inflation readings have been higher than envisaged 3 months ago and equities have powered ahead. The flipside is that the Bank's GDP projection is likely to be nudged lower – but that has hardly been a drag on inflation over the last few years.

Table 1: Key Influences on MPC Medium Term Inflation Projection

		Nov	Now	% Chg	Impact on BoE Inflation Projection
Oil*	Spot (USD)	109	114	4.6	0.12
	Spot (GBP)	68.2	72.4	6.2	
GBP*	Effective GBP	83.2	81.6	-1.9	0.20
Near quarter inflation fcast**		2.58	2.83	0.25	0.1
GDP forecast	2013	1.25	1.00	-0.25	-0.1
	2014	2.03	1.90	-0.13	
FTSE All-Share*		3046	3240	6.4	+
Market rate expectations					
					0.30

* 15 working day average ** average of first two quarters of profile

Presentationally, this could be uncomfortable for the BoE Governor. Firstly, we have lost count of the number of times that the Bank's projections have been revised in this way. The Bank keeps making the same mistake — aiming too low on inflation. Secondly, with the BoE's medium term inflation projection likely to be above the 2% target, traditionally that would have pointed to fairly imminent tightening in monetary policy. Clearly with the economy at risk of slipping back into recession, the last thing the economy needs right now is a rate hike. So we doubt that this is even a consideration for the MPC.

Perhaps this is why the Governor has changed his tune of late with regards to adjusting the BoE's mandate. It would be unwise to abandon a medium term inflation objective having won a hard fought battle with inflation expectations. However, at times such as this, it might be desirable to extend the horizon over which the Bank aims to get inflation back into line with target — in order to avoid choking off the recovery. In other words, the Bank could argue that although it projects inflation to be above 2% y/y after 2 years, it is likely to reassure us that the pace of inflation will slow to 2% or below on a 3-4 year horizon — which justifies maintaining a loose stance for monetary policy.

Implicitly, the BoE has been doing this for years and likely to continue to do so at this meeting. However a revised mandate would make this strategy a little more formal. A subtle difference this time around is that in the past, the Bank has been able to loosen policy because its medium term projection for inflation was below target. This *Inflation Report* is likely to be the first time that the Bank will have a medium term inflation projection above the 2% target — making continued policy easing a harder sell.

At the very least, we would expect this to lay to rest residual expectations of a BoE rate cut. It also reduces the likelihood of an expansion in QE any time soon.

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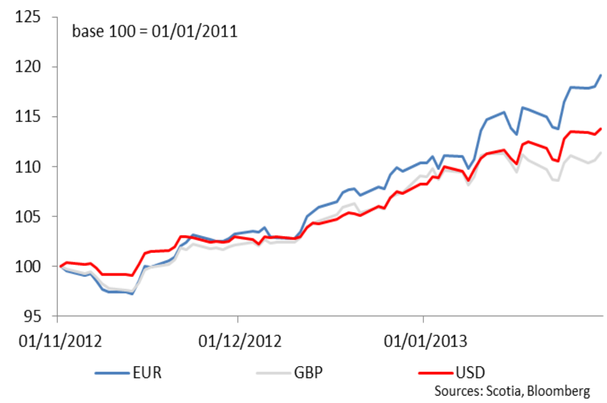
Is The Euro Too Strong Already?

- Talks about the risk of a currency war have restarted since Japanese Prime Minister Abe declared war on deflation, pushing on both the fiscal and monetary stimulus. As a result, the yen has depreciated sharply in recent weeks. While all major currencies have adjusted, it is once again the euro (which is seen as the least capable of defending itself) which adjusted the most. Since the beginning of November, the euro has appreciated against the yen by close to 20%, vs. 14% for the US dollar against the yen and 11% for the sterling. This move pushed Jean Claude Junker to indicate that the euro is overvalued while Bundesbank President Weidmann worried about central banks' independence, being forced by governments to loosen monetary policy by lowering their currencies. While the ECB is usually not very talkative about the euro, it is likely to be one of the main topics at next week's ECB meeting.

Chart 1 : Yen vs; EUR, USD & GBP



- There is no doubt that swings in the euro could have significant consequences on macroeconomic developments in the area. ECB working papers indicate that a 10% rise in the euro nominal effective exchange rate (the euro vs. all currencies on a trade-weighted basis) could cut growth by one full percentage point over a one-year horizon, and by close to 1.5% after two years. Over the past three months, this euro nominal effective exchange rate has appreciated by close to 5% which, in theory, creates a significant downside risk, especially at a time when growth expectations for the EMU this year are around or even below zero. So, at a time when the latest business confidence surveys are sending encouraging signals, there are already worries that this euro re-strengthening could jeopardize the current gradual recovery process.

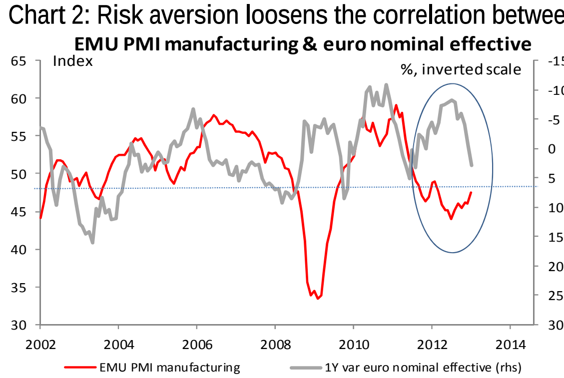
Table 1: Impact of a 10% rise in the euro nominal effective exchange rate

	Q1	Q4	Q8
GDP	-0.2	-1.1	-1.4
HICP	-0.3	-0.7	-1.4

source: ECB working paper

- Nonetheless, looking to a simple correlation between business sentiment and the euro movements, the correlation has not always been stable, especially over the recent period when euro weakness failed to support business sentiment. It is true that the implementation of fiscal austerity plans across a number of EMU countries could have erased any positive impact from this weakness. However, the currency's softness also had a lot to do with rising risk aversion regarding the euro area itself as seen through the strong correlation between the euro and the changes in the 10Y nominal yield spread between Italian and German bonds. So, the recent strengthening of the euro against all currencies is not necessary unwelcome as it also reflects the positive developments in the euro crisis and its capacity to provide a more stable macroeconomic environment for both businesses and households.

Chart 2: Risk aversion loosens the correlation between EUR & business sentiment



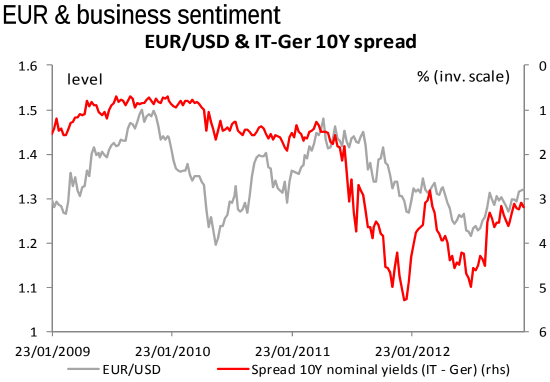


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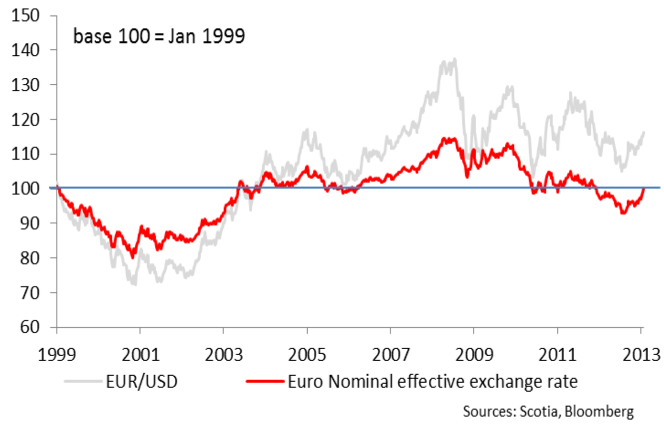
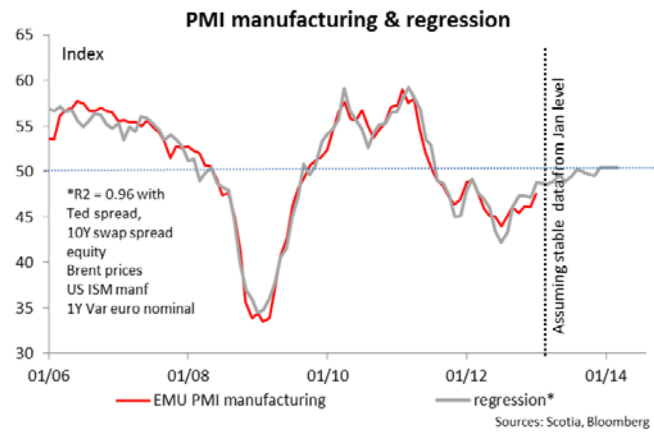
Chart 3: Searching for a "fair value" point



- Also, taking a long-term perspective, it is worth remembering that in the first month of its introduction back in 1999, the euro traded between 1.15 and 1.18 vs. the US dollar. At that time, this was seen by the ECB itself as around "fair value" from an economic point of view. At around 1.35 currently, it therefore seems legitimate, as suggested by Mr Junker's comment, to question the "overvaluation" of the euro. However, one should note that the aggressive monetary policy of the Fed has also helped to significantly debase the US dollar over the past few years. So, using a sole US dollar benchmark to assess the "overvaluation" of the euro could be a bit misleading. In nominal effective terms, the recent appreciation of the euro has actually just put it back around its introduction level, which, as mentioned above, was seen ten years ago as "fair value".

Chart 4: EMU manufacturing PMI - bias still on the upside!



- At this stage, examining the various factors impacting business sentiment in the EMU area, it does not seems that the recent appreciation of the euro has already put at risk the scenario of a gradual recovery in the region. The impact of easing financial conditions and stronger global demand, seen through rises in the US ISM and Chinese PMI for example, appears in our view to be strong enough to offset the theoretical negative impact of the uptrend in the euro, and points to further gradual gains in the EMU PMI manufacturing index, for example.
- However, we would agree that further appreciation of the euro from this point would be unwelcome as, so far, the recovery process remains slow and fragile, given that easing financial conditions have yet to feed into strengthening domestic demand. Indeed, loans to households and businesses have remained downbeat, with the yoy trend in December at respectively 0.2% and -3.8%. Also, while a strong early repayment of the LTRO was a good signal regarding the capacity of the financial sector to return to more normal financing conditions, it also indicates that there is little expectation of a significant improvement in loan activity in the near term. It is therefore crucial at this stage, when the constraints on domestic demand remain high, to avoid an additional strengthening of the euro which could jeopardize any stimulus coming from the external side.
- In that sense, the management of ECB monetary policy will remain important and that is why comments from the ECB president next week are worth listening to. On a long-term basis, the dynamic of the euro is linked to the monetary stance. This is evident, for example, when looking at the correlation between the trend in the EUR/USD and the spread between the 3-month euribor and 3-month US Libor. This is also the case when looking over recent years to the relationship between the EUR/USD and changes in the balance sheets of the ECB vs. the Fed. In that sense, the early repayment of the LTRO represented in markets' thinking a kind of gradual exit strategy from the ECB's unconventional monetary policy measures, and thus contributed to the recent strengthening of the euro.

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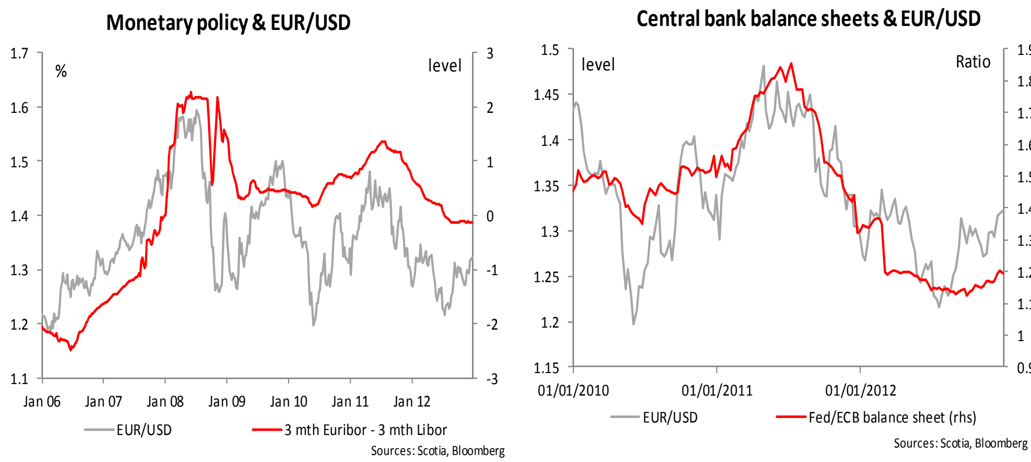
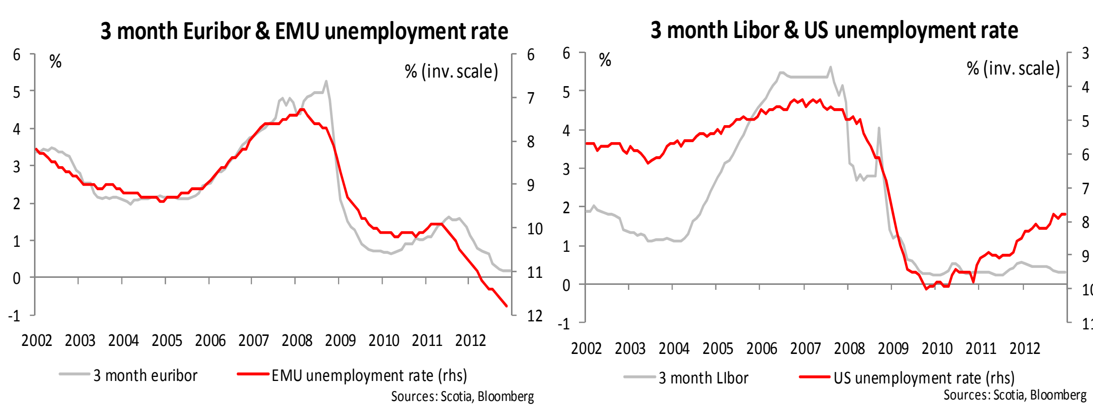
Chart 5: The management of monetary policy remains the long-term driver



- Our scenario is that this re-strengthening of the euro, especially against the US dollar, will be capped and will not put the recovery process at risk. Indeed, beyond the short-term impact of LTRO repayments in the first months of this year, the management of monetary policy by the ECB will remain dovish for a prolonged period. Also, additional QE from the Fed looks unlikely in view of improving growth in the US. Looking to the diverging trend in the labour markets between the EMU and the US, which appears in the past to have been one of the key indicators driving monetary policy, talks of an exit strategy are likely to come quicker in the US than in the EMU.

Chart 6: Talks of exit strategy to come back earlier in the US than the EMU



- However, the first months of this year will need to be managed carefully. Indeed, early repayment of the LTRO (with the possibility of LTRO2 repayment as early as February 27) is seen as de facto a tightening (or less accommodative stance) in monetary policy, pushing the euro higher. So, it will be all the more crucial for the President Draghi to make clear the ongoing and prolonged accommodative stance of the ECB's monetary policy in order to cap any further strengthening of the euro during this period.

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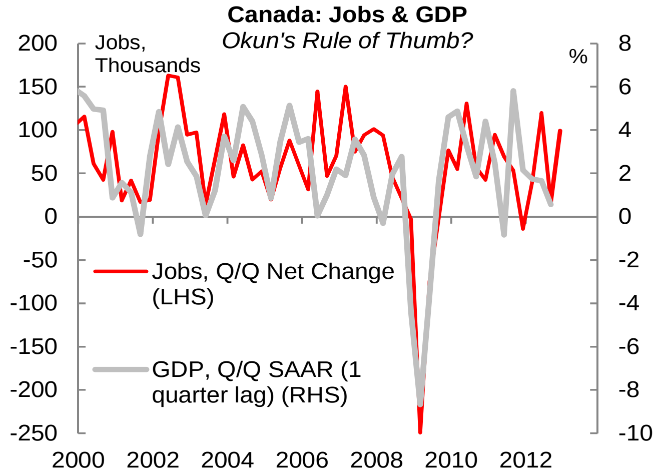
Key Data Preview

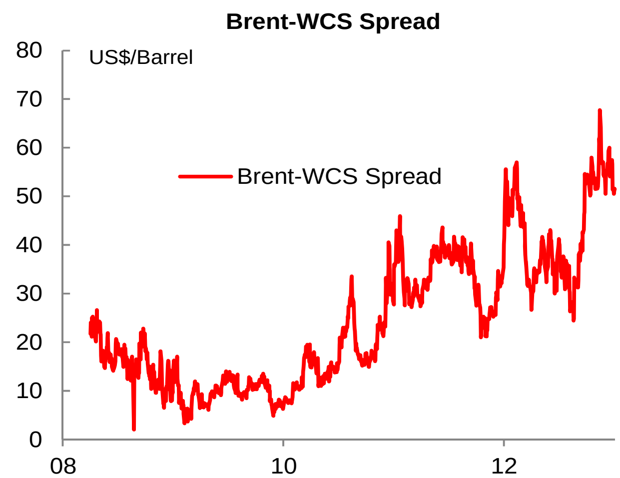
CANADA

Scotiabank is looking for a flat **jobs** print for January (Feb. 8) that will push the unemployment rate up 10bps to 7.2%. While Canadian economic growth looks to have been at best sluggish during Q4 2012, jobs numbers picked up considerably, with the economy adding 88k jobs during November and December. The pace of job gains was less dramatic if viewed on a half-year basis (the economy averaged 26k jobs per month during the back half of 2012, slightly higher than the recovery-phase average of 22k jobs per month) and even on a quarterly basis (Q4 2012 jobs averaged 33k/month, weighed down by a gain of only 11k in October). Nonetheless, a repeat performance of the gains seen over the final two months of 2012 seems improbable in light of the muted underlying economic growth (see chart).



Source: Statistics Canada, Scotiabank Economics

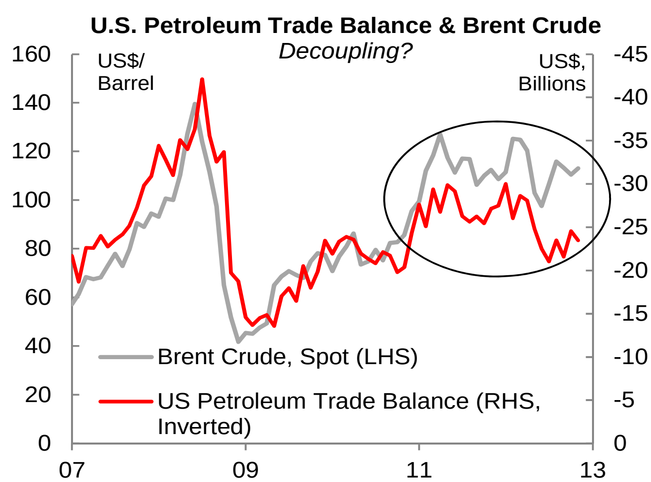
Trade deficits have been a major issue in Canada through 2012, with record monthly deficits being incurred and weakness in key export sectors. Scotiabank is expecting December's trade figures (Feb. 8) to reflect those trends, and we're forecasting a trade deficit of -C$1.7bn. Key issues include a disturbing combination whereby the world price of crude oil that Canada imports increased (Brent crude was up slightly on the month) while the Western Canada Select crude price (in which a sizable portion of Canadian exports are denominated) fell 4.2% on average. (That trend picked up more momentum in Dec. but was still present in Nov. — see chart). Some of this could be mitigated as idle supply comes back online, and a stronger CAD should cushion nominal import prices.



Source: Bloomberg, Scotiabank Economics

UNITED STATES

Scotiabank is looking for the U.S. **trade** deficit (Feb. 8) to narrow a touch to -US$47bn when December numbers are released on February 8th. Our forecast is premised on a few key assumptions: a) strong capital goods and automotive shipments ought to translate into exports, b) the drop-off in food exports will reverse itself, and c) the crude oil balance will continue to show improvement. The U.S. crude oil balance has been performing fairly strongly in light of the elevated Brent crude prices seen over the past number of years (see chart). As U.S. crude oil production surged into year-end, U.S. crude import costs have tended to lag hikes in Brent. We're expecting more of the same, and will be interested to see if net U.S. crude oil import costs stay flat in light of the increasing availability of domestic oil for substitution — and the lower price of Canadian crude exports described above.



Source: Bloomberg, Scotiabank Economics

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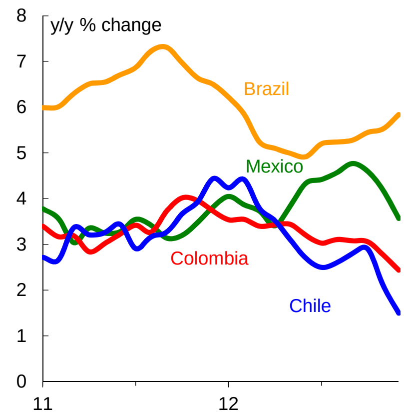
EUROPE

We expect next week's hard data in Germany to look positive. Beyond the sharp monthly volatility in manufacturing orders in the October/November period, the trend is gradually improving. Furthermore, we suspect that part of the -1.8% m/m fall seen in November could have been linked to the impact of Hurricane Sandy in the US. Indeed, details of the reports showed in particular a -4.1% m/m fall in foreign orders. So, with the December data showing a re-strengthening in activity in the US through a rise in the ISM index in particular, we would look for some bounce-back in the German foreign orders figure. Also encouraging was the rise for the second month in a row in domestic orders. Mirroring the rise in the order assessment component of the latest Ifo survey, we look for German manufacturing orders to show a 1.5% m/m rise in December. German industrial production (IP) increased 0.2% m/m in November. However, this rise came after very sharp falls in the previous two months. Compared to the encouraging trend seen in German manufacturing orders, German IP appears to have remained subdued. So, there is still some more room for catch-up in December. Improving business sentiment and a turnaround in the job market — with the number of unemployed once again moving down since December — point to this direction, and we therefore look for a +0.8% m/m gain.

LATIN AMERICA

Inflation in Latin America



Source: Bloomberg.

January's inflation reports for the four major economies in Latin America will be released next week. Although inflationary pressures are re-emerging in Brazil, consumer price gains in Mexico, Chile and Colombia decelerated by the end of last year. After an aggressive monetary easing cycle in Brazil and despite a mild economic recovery, headline inflation has accelerated significantly in recent months, reaching 5.8% y/y in December. We anticipate that this trend will continue in the coming months, putting more pressure on monetary authorities. With economic activity slowing in Colombia, inflation fell below the 3% y/y mark in December (the mid-point of the central bank's tolerance range), the lowest level since October 2010. Chile maintains the lowest inflation rate among its regional peers, declining surprisingly to 1.5% y/y in December. We anticipate that in both Chile and Colombia inflation could rebound slightly during the first half of the year, remaining within the respective authority's tolerance range. In Mexico, after six months above the central bank's range, headline inflation decelerated significantly from 4.2% y/y in November to 3.6% in December. We expect this performance to continue in the coming months, giving the central bank more room to adjust its policy rhetoric.

ASIA

China will release January consumer and producer price inflation data on February 8th. We assess that while prices continue to increase on a month-to-month basis driven by food costs, annual consumer price inflation will record a temporary dip to 2.1% y/y from 2.5% in December, reflecting a high base in the year before. Inflation in China will likely accelerate moderately over the next two years on the back of an improving overall economic outlook, reaching 3.3% y/y by the end of 2013 and around 4% by end-2014. Nevertheless, persistent deflationary pressures further up the distribution chain alleviate any concerns regarding significant upside pressures on prices. Indeed, producer prices declined 1.9% y/y in December, and only a slightly smaller drop of 1.5% y/y is estimated to have taken place in January.

Indonesian Q4 2012 real GDP will be released on February 5th. We estimate that the economy maintained its third-quarter momentum, and expanded by 6.2% y/y, taking the overall economic growth rate in 2012 to 6.3%. Falling unemployment, rising real wages, and improving consumer confidence will likely remain supportive of household consumption in Indonesia, with solid private investment also underpinning domestic demand strength. We expect the nation's output to grow by 6⅓% this year, followed by a 6½% gain in 2014.

Key Indicators for the week of February 4 - 8

North America

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	02/04	10:00	Factory Orders (m/m)	Dec	2.3	2.2	0.0
US	02/05	10:00	IBD/TIPP Economic Optimism Index	Feb	--	46.0	46.5
US	02/05	10:00	ISM Non-Manufacturing Composite	Jan	55.0	55.0	55.7
US	02/06	07:00	MBA Mortgage Applications (w/w)	FEB 1	--	--	-8.1
CA	02/07	08:30	Building Permits (m/m)	Dec	--	2.5	-17.9
CA	02/07	08:30	New Housing Price Index (m/m)	Dec	--	0.1	0.1
US	02/07	08:30	Initial Jobless Claims (000s)	FEB 2	365	360	368
US	02/07	08:30	Continuing Claims (000s)	JAN 26	3200	3187	3197
US	02/07	08:30	Productivity (q/q a.r.)	4Q P	--	-1.0	2.9
US	02/07	08:30	Unit Labor Costs (q/q a.r.)	4Q P	--	2.9	-1.9
MX	02/07	09:00	Consumer Prices (m/m)	Jan	0.4	0.3	0.2
MX	02/07	09:00	Consumer Prices (y/y)	Jan	3.2	3.1	3.6
MX	02/07	09:00	Consumer Prices Core (m/m)	Jan	--	0.3	0.1
MX	02/07	09:00	Consumer Prices Core (y/y)	Jan	2.7	--	--
US	02/07	15:00	Consumer Credit ($ bn m/m)	Dec	15.0	14.5	16.0
CA	02/08	08:15	Housing Starts (000s a.r.)	Jan	190.0	193.5	198.0
CA	02/08	08:30	Employment (000s m/m)	Jan	0.0	4.0	31.2
CA	02/08	08:30	Merchandise Trade Balance (C$ bn)	Dec	-1.7	-1.5	-2.0
CA	02/08	08:30	Unemployment Rate (%)	Jan	7.2	7.2	7.1
US	02/08	08:30	Trade Balance ($ bn)	Dec	-47.0	-46.0	-48.7
US	02/08	10:00	Wholesale Inventories (m/m)	Dec	--	0.4	0.6

Europe

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
UK	02/04	04:30	PMI Construction	Jan	--	49.2	48.7
EC	02/04	05:00	PPI (m/m)	Dec	--	-0.2	-0.2
UK	02/04	07:59	Halifax House Price (3 month, y/y)	Jan	--	1.6	-0.3
IT	02/05	03:45	Services PMI	Jan	--	45.8	45.6
FR	02/05	03:50	Services PMI	Jan F	43.6	43.6	43.6
GE	02/05	03:55	Services PMI	Jan F	55.3	55.3	55.3
EC	02/05	04:00	Composite PMI	Jan F	48.2	48.2	48.2
EC	02/05	04:00	Services PMI	Jan F	48.3	48.3	48.3
UK	02/05	04:30	Official Reserves (£ bn)	Jan	--	--	-350.0
UK	02/05	04:30	Services PMI	Jan	52.0	49.5	48.9
EC	02/05	05:00	Retail Trade (m/m)	Dec	--	-0.5	0.1
IT	02/05	05:00	CPI (y/y)	Jan P	--	2.2	2.3
IT	02/05	05:00	CPI - EU Harmonized (m/m)	Jan P	-1.7	-1.8	0.3
IT	02/05	05:00	CPI - EU Harmonized (y/y)	Jan P	2.7	2.6	2.6
GE	02/06	06:00	Factory Orders (m/m)	Dec	1.5	0.7	-1.8
FR	02/07	02:45	Trade Balance (€ mn)	Dec	--	-4200.0	-4334.0
SP	02/07	03:00	Industrial Output NSA (y/y)	Dec	--	--	-7.3
UK	02/07	04:30	Industrial Production (m/m)	Dec	1.1	0.9	0.3
UK	02/07	04:30	Manufacturing Production (m/m)	Dec	0.0	0.8	-0.3
UK	02/07	04:30	Visible Trade Balance (£ mn)	Dec	--	-8900.0	-9164.0
GE	02/07	06:00	Industrial Production (m/m)	Dec	0.8	0.2	0.2
UK	02/07	07:00	BoE Asset Purchase Target (£ bn)	Feb	375	375	375
UK	02/07	07:00	**BoE Policy Announcement (%)**	Feb 7	**0.50**	**0.50**	**0.50**
EC	02/07	07:45	**ECB Announces Interest Rates (%)**	Feb 7	**0.75**	**0.75**	**0.75**
GE	02/08	02:00	Current Account (€ bn)	Dec	--	17.5	15.3
GE	02/08	02:00	Trade Balance (€ bn)	Dec	--	15.0	17.0
FR	02/08	02:45	Central Government Balance (€ bn)	Dec	--	--	-103.4
IT	02/08	04:00	Industrial Production (y/y)	Dec	--	-6.6	-7.6

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

Key Indicators for the week of February 4 - 8

Asia Pacific

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CH	02/02	20:00	Non-manufacturing PMI	Jan	56.5	--	56.1
JN	02/03	18:50	Monetary Base (y/y)	Jan	--	--	11.8
AU	02/03	19:30	Building Approvals (m/m)	Dec	--	1.0	2.9
AU	02/03	19:30	ANZ Job Advertisements (m/m)	Jan	--	--	-3.8
SI	02/04	08:30	Purchasing Managers Index	Jan	--	48.8	48.6
AU	02/04	19:30	House Price Index (q/q)	4Q	--	0.3	0.3
AU	02/04	19:30	House Price Index (y/y)	4Q	--	0.9	0.3
AU	02/04	19:30	Trade Balance (AUD mn)	Dec	--	-800.0	-2637.0
TA	02/04	19:30	CPI (y/y)	Jan	1.3	1.4	1.6
PH	02/04	20:00	CPI (y/y)	Jan	--	3.1	2.9
PH	02/04	20:00	Core CPI (y/y)	Jan	--	--	3.3
PH	02/04	20:00	GDP (m/m)	Jan	--	0.6	-0.1
CH	02/04	20:45	HSBC Services PMI	Jan	--	--	51.7
HK	02/04	21:30	Purchasing Managers Index	Jan	--	--	51.7
AU	02/04	22:30	RBA Cash Target Rate (%)	Feb 5	3.0	3.0	3.0
ID	02/05	02:00	Annual GDP (y/y)	2012	6.3	6.3	6.5
ID	02/05	02:00	Real GDP (q/q)	4Q	--	-1.2	3.2
ID	02/05	02:00	Real GDP (y/y)	4Q	6.2	6.2	6.2
AU	02/05	19:30	Retail Sales (m/m)	Dec	--	0.3	-0.1
NZ	02/06	16:45	Unemployment Rate (%)	4Q	--	7.1	7.3
NZ	02/06	16:45	Employment Change (y/y)	4Q	--	0.2	0.0
JN	02/06	18:50	Machine Orders (m/m)	Dec	--	-0.9	3.9
AU	02/06	19:30	Employment (000s)	Jan	--	6.0	-5.5
AU	02/06	19:30	Unemployment Rate (%)	Jan	5.4	5.5	5.4
TH	02/06	22:30	Consumer Confidence Economic	Jan	--	--	70.6
JN	02/07	00:00	Coincident Index CI	Dec P	--	92.6	90.2
JN	02/07	00:00	Leading Index CI	Dec P	--	93.6	92.1
JN	02/07	00:00	New Composite Leading Economic Index	Dec P	--	93.6	92.1
IN	02/07	00:30	Annual GDP Govt. Estimate (y/y)	1Q A	--	5.5	6.2
AU	02/07	00:30	Foreign Reserves (AUD bn)	Jan	--	--	47.3
TA	02/07	03:00	Exports (y/y)	Jan	--	23.4	9.0
TA	02/07	03:00	Imports (y/y)	Jan	--	9.3	1.6
TA	02/07	03:00	Trade Balance (US$ bn)	Jan	--	3.7	4.1
SI	02/07	04:00	Foreign Reserves (US$ mn)	Jan	--	--	259307.1
JN	02/07	18:50	Bank Lending (y/y)	Jan	--	--	1.2
JN	02/07	18:50	Current Account (¥ bn)	Dec	--	-141.1	-222.4
JN	02/07	18:50	Trade Balance - BOP Basis (¥ bn)	Dec	--	-560.3	-847.5
MA	02/07	23:01	Industrial Production (y/y)	Dec	--	6.8	7.5
MA	02/07	23:01	Exports (y/y)	Dec	--	2.6	3.3
MA	02/07	23:01	Imports (y/y)	Dec	--	1.5	4.3
MA	02/07	23:01	Trade Balance (MYR bn)	Dec	--	9.1	9.3
JN	02/08	00:00	Eco Watchers Survey (current)	Jan	--	48.0	45.8
JN	02/08	00:00	Eco Watchers Survey (outlook)	Jan	--	--	51.0
CH	02/08	00:30	CPI (y/y)	Jan	2.1	2.1	2.5
CH	02/08	00:30	PPI (y/y)	Jan	-1.5	-1.6	-1.9
MA	02/08	04:00	Foreign Reserves (US$ bn)	Jan 31	--	--	140.0
CH	02/08	06:59	New Yuan Loans (bn)	Jan	--	1000.0	454.3
CH	02/08	06:59	Exports (y/y)	Jan	--	17.1	14.1
CH	02/08	06:59	Imports (y/y)	Jan	--	23.5	6.0
CH	02/08	06:59	Trade Balance (USD bn)	Jan	--	24.2	31.6

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

Key Indicators for the week of February 4 - 8

Latin America

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CL	02/05	06:30	Economic Activity Index SA (m/m)	Dec	--	0.6	1.3
CL	02/05	06:30	Economic Activity Index NSA (y/y)	Dec	--	3.7	5.5
CO	02/05	19:00	Consumer Price Index (m/m)	Jan	--	0.5	0.1
CO	02/05	19:00	Consumer Price Index (y/y)	Jan	--	2.2	2.4
BZ	02/07	06:00	IBGE Inflation IPCA (m/m)	Jan	--	0.9	0.8
BZ	02/07	06:00	IBGE Inflation IPCA (y/y)	Jan	--	6.1	5.8
PE	02/07	18:00	**Reference Rate (%)**	**Feb**	**4.25**	**4.25**	**4.25**
CL	02/08	06:00	CPI (m/m)	Jan	--	0.1	0.0
CL	02/08	06:00	CPI (y/y)	Jan	--	1.5	1.5

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

Global Auctions for the week of February 4 - 8

North America

Country	Date	Time	Event
US	02/04	11:30	U.S. to Sell USD32 Bln 3-Month Bills
US	02/04	11:30	U.S. to Sell USD28 Bln 6-Month Bills
US	02/05	11:30	U.S. to Sell USD25 Bln 52-Week Bills
CA	02/06	12:00	Canada to Sell 3 Year Notes

Europe

Country	Date	Time	Event
NE	02/04	05:30	Netherlands to Sell Up to EUR3 Bln 82-Day Bills
NE	02/04	05:30	Netherlands to Sell Up to EUR2 Bln 175-Day Bills
FR	02/04	08:50	France to Sell Bills
DE	02/05	04:30	Denmark to Sell Bonds
AS	02/05	05:00	Austria to Sell 3.4% 2022 Bonds
AS	02/05	05:00	Austria to Sell 1.95% 2019 Bonds
UK	02/05	05:30	U.K. to Sell GBP1.1 Bln 0.125% I/L 2024 Bonds
SZ	02/05	05:30	Switzerland to Sell 3-Month Bills
BE	02/05	05:30	Belgium to Sell Bills
SW	02/06	05:03	Sweden to Sell SEK3.5 Bln 4.5% 2015 Bonds
GE	02/06	05:30	Germany to Sell Add'l EU4 Bln 5-Year Notes
SP	02/07	04:30	Spain to Sell Bonds
FR	02/07	04:50	France to Sell Bonds
BE	02/08	06:00	Belgium to Sell Bonds
UK	02/08	06:10	UK to Sell Bills

Asia Pacific

Country	Date	Time	Event
JN	02/04	22:45	Japan to Sell 10-Year Bonds
JN	02/05	22:35	Japan to Sell 6-Month Bills
NZ	02/06	20:05	New Zealand Plans to Sell NZD200 Mln Inflation Bonds Due 2025
JN	02/06	22:35	Japan to Sell 3-Month Bills
JN	02/08	03:00	Japan Auction for Enhanced-Liquidity

Source: Bloomberg, Scotiabank Economics.

Events for the week of February 4 - 8

North America

Country	Date	Time	Event
US	02/04	15:00	U.S. Treasury Issues Quarterly Borrowing Estimates
US	02/06	09:00	U.S. Treasury Makes Quarterly Refunding Announcement
CA	02/06	11:45	Canadian Finance Minister Flaherty Speaks on Government Plans
UK	02/07	04:45	BOE Governor-Designate Carney Questioned by Lawmakers
US	02/07	09:30	Fed's Stein Speaks on Household Balance Sheets in St. Louis

Europe

Country	Date	Time	Event
EC	02/04	02:30	Ireland's Kenny Meets EU's Barroso, Van Rompuy in Brussels
EC	02/04	04:00	EU General Affairs Ministers Hold Meeting in Brussels
GE	02/04	10:00	Merkel Meets Spanish Prime Minister Rajoy in Berlin
IT	02/04		Italian Court Holds Final Berlusconi Hearing
SZ	02/05	07:30	SNB's Fritz Zurbruegg Speaks at Conference in Zurich
GE	02/05	12:00	Merkel to Speak at CDU Event in Bremen
PO	02/05	12:00	Portugal's Gaspar to Attend Event in Lisbon
EC	02/05		EU Hosts Ministerial Meeting on Support of Mali
EC	02/06	04:00	ECB Releases Bank Lending Survey
EC	02/06	07:00	ESM's Strauch Speaks at Madariaga Think Tank
EC	02/06	10:30	Luxembourg's Juncker Meets Poland's Tusk in Luxembourg
UK	02/07	04:45	BOE Governor-Designate Carney Questioned by Lawmakers
UK	02/07	07:00	Bank of England Monetary Policy Committee Decision
UK	02/07	07:00	**BOE ANNOUNCES RATES**
UK	02/07	07:00	BOE Asset Purchase Target
EC	02/07	07:45	**ECB Announces Interest Rates**
EC	02/07	07:45	ECB Deposit Facility Rate
EC	02/07	08:30	ECB'S Draghi Holds Press Conference After Rate Decision
EC	02/07	10:30	IMFS-ECB Symposium with Coeure, Honohon, Lautenschlaeger, ect.
EC	07-08 FEB		EU Leaders Hold Summit in Brussels

Asia Pacific

Country	Date	Time	Event
NZ	02/03	20:00	Treasury Publishes Monthly Economic Indicators
AU	02/04	22:30	**RBA CASH TARGET**
FR	04-05 FEB		French Prime Minister Ayrault Visits Thailand
JN	02/05	20:30	Bank Of Japan Board Member Sato Speaks in Gunma
NZ	02/05		Markets, Banks, Government Offices Closed for Waitangi Day
HK	05-06 FEB		Hong Kong Legislative Council Meeting
IN	02/06	07:00	India Finance Minister Chidambaram Delivers lecture
PK	07-08 FEB		**Benchmark Interest Rate**

Latin America

Country	Date	Time	Event
PE	02/07	18:00	**Reference Rate**

Source: Bloomberg, Scotiabank Economics.

Global Central Bank Watch

North America

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Bank of Canada – Overnight Target Rate	1.00	March 6, 2013	1.00	--
Federal Reserve – Federal Funds Target Rate	0.25	March 20, 2013	0.25	--
Banco de México – Overnight Rate	4.50	March 8, 2013	4.50	--

BoC: Scotiabank expects the Bank of Canada to be on hold throughout our full forecast horizon spanning 2013 and 2014. The BoC's current guidance sees the economy returning to full capacity in H2 2014 and therefore implies that interest rate hikes are unlikely to be required until at least that point. We expect weaker economic outcomes than the BoC, more persistent softness in CPI, and finally, we think that loose monetary policy on a global basis will condition the BoC's flexibility. Fed: We expect the Fed to continue with its current pace of asset purchases (US$85/bn per month) through 2013, and think that Minneapolis Fed President Kocherlakota's argument that FOMC policy needs to lag economic improvements will have more traction than St. Louis Fed President Bullard's view that recent upward revisions to nonfarm payrolls justify a slight reduction in the pace of asset purchases.

Europe

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
European Central Bank – Refinancing Rate	0.75	February 7, 2013	0.75	0.75
Bank of England – Bank Rate	0.50	February 7, 2013	0.50	0.50
Swiss National Bank – Libor Target Rate	0.00	March 14, 2013	0.00	--
Central Bank of Russia – Refinancing Rate	8.25	February 15, 2013	8.25	--
Hungarian National Bank – Base Rate	5.50	February 26, 2013	5.50	--
Central Bank of the Republic of Turkey – 1 Wk Repo Rate	5.50	February 19, 2013	5.50	--
Sweden Riksbank – Repo Rate	1.00	February 13, 2013	1.00	--
Norges Bank – Deposit Rate	1.50	March 14, 2013	1.50	--

The European Central Bank will maintain a cautious stance at next week's policy-setting meeting. While no policy changes are anticipated, President Draghi will likely lean on the dovish side, aiming to preclude further euro appreciation amid early signs of a financial market stabilization and recovery (in confidence, not yet in real economic activity). The January flash CPI estimate showed inflation falling to 2.0% y/y from 2.2%. The Bank of England is also expected to leave monetary conditions unchanged next week. The impact of a worse-than-expected GDP result in the fourth quarter (-0.3% q/q) will likely be offset by sticky inflation concerns (unchanged at 2.7% y/y in December), a relatively robust labour market and improving global financial conditions, allowing the bank more time to assess the impact of previous policy actions.

Asia Pacific

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Bank of Japan – Target Rate	0.10	February 14, 2013	0.10	--
Reserve Bank of Australia – Cash Target Rate	3.00	February 4, 2013	3.00	3.00
Reserve Bank of New Zealand – Cash Rate	2.50	March 13, 2013	2.50	--
People's Bank of China – Lending Rate	6.00	TBA	--	--
Reserve Bank of India – Repo Rate	7.75	March 19, 2013	7.75	--
Bank of Korea – Bank Rate	2.75	February 13, 2013	2.75	--
Bank of Thailand – Repo Rate	2.75	February 20, 2013	2.75	--
Bank Indonesia – Reference Interest Rate	5.75	February 12, 2013	5.75	5.75

We expect the Reserve Bank of Australia to maintain monetary conditions unchanged following the February 4th policy meeting, with the benchmark Cash Target Rate remaining at 3.0%. With the key rate being the highest among major advanced economies, monetary policy space continues to represent a tool for Australian authorities to address any potential economic shocks. Nevertheless, in our view, the easing cycle has now reached its bottom, as inflation will likely continue to climb gradually higher in the near future from the end-2012 level of 2.2% y/y.

Latin America

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Banco Central do Brasil – Selic Rate	7.25	March 6, 2013	7.25	--
Banco Central de Chile – Overnight Rate	5.00	February 14, 2013	5.00	5.00
Banco de la República de Colombia – Lending Rate	4.00	February 22, 2013	4.00	--
Banco Central de Reserva del Perú – Reference Rate	4.25	February 7, 2013	4.25	4.25

We do not anticipate any changes to the monetary policy rate in Peru as inflation reached its lowest level since the beginning of 2011 in December and economic activity remains solid. The reference rate currently stands at 4.25%, where it has been since May 2011; however, the central bank has raised on many occasions the reserve requirements in US dollars in order to mitigate the effect of external flows and the appreciation of the currency.

Africa

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
South African Reserve Bank – Repo Rate	5.00	March 20, 2013	5.00	--

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

Forecasts as at January 31, 2013*	2000-11	2012e	2013f	2014f	2000-11	2012e	2013f	2014f
Output and Inflation (annual % change)		Real GDP				Consumer Prices[2]		
World[1]	3.7	3.1	3.2	3.8				
Canada	2.2	1.9	1.7	2.4	2.1	1.5	1.3	2.0
United States	1.8	2.2	1.9	2.7	2.5	2.1	2.0	2.1
Mexico	2.2	4.0	3.6	3.9	4.8	3.6	3.8	3.8
United Kingdom	1.9	0.0	0.9	1.4	2.3	2.7	2.8	2.4
Euro Zone	1.4	-0.5	-0.2	1.0	2.1	2.2	1.9	1.7
Japan	0.8	1.9	0.8	1.2	-0.3	-0.1	0.3	0.6
Australia	3.0	3.5	2.6	3.1	3.1	2.2	2.8	3.0
China	9.4	7.8	8.1	8.3	2.4	2.5	3.3	3.9
India	7.3	5.5	6.0	6.5	6.6	7.2	7.0	6.1
South Korea	4.5	2.0	2.8	3.5	3.2	1.4	2.7	3.0
Thailand	4.0	5.5	4.0	4.2	2.7	3.6	3.1	3.3
Brazil	3.6	1.0	3.3	4.0	6.6	5.8	5.8	5.5
Chile	4.8	5.6	5.0	5.5	3.5	1.5	3.1	3.3
Peru	5.6	6.3	6.0	5.5	2.6	2.6	3.0	3.0

Central Bank Rates (%, end of period)	12Q4	13Q1f	13Q2f	13Q3f	13Q4f	14Q1f	14Q2f	14Q3f
Bank of Canada	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Federal Reserve	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
European Central Bank	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Bank of England	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Swiss National Bank	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bank of Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Reserve Bank of Australia	3.00	3.00	3.00	3.00	3.25	3.25	3.50	3.50
Exchange Rates (end of period)								
Canadian Dollar (USDCAD)	0.99	0.98	0.97	0.97	0.96	0.96	0.96	0.97
Canadian Dollar (CADUSD)	1.01	1.02	1.03	1.03	1.04	1.04	1.04	1.03
Euro (EURUSD)	1.32	1.34	1.30	1.28	1.27	1.26	1.26	1.25
Sterling (GBPUSD)	1.63	1.59	1.61	1.63	1.64	1.65	1.65	1.66
Yen (USDJPY)	87	92	93	94	95	95	96	97
Australian Dollar (AUDUSD)	1.04	1.05	1.06	1.07	1.08	1.08	1.09	1.09
Chinese Yuan (USDCNY)	6.2	6.2	6.2	6.2	6.1	6.1	6.1	6.1
Mexican Peso (USDMXN)	12.9	12.8	12.6	12.6	12.8	12.9	12.7	12.8
Brazilian Real (USDBRL)	2.05	1.96	1.98	2.01	2.00	2.00	1.98	1.98

Commodities (annual average)	2000-11	2012	2013f	2014f
WTI Oil (US$/bbl)	57	94	94	96
Brent Oil (US$/bbl)	58	112	112	112
Nymex Natural Gas (US$/mmbtu)	5.67	2.83	3.75	4.00
Copper (US$/lb)	2.10	3.61	3.50	3.30
Zinc (US$/lb)	0.77	0.88	1.00	1.15
Nickel (US$/lb)	7.62	7.95	8.25	8.50
Gold, London PM Fix (US$/oz)	668	1,669	1,725	1,700
Pulp (US$/tonne)	718	872	875	950
Newsprint (US$/tonne)	581	640	630	660
Lumber (US$/mfbm)	272	298	360	398

[1] World GDP for 2000-11 are IMF PPP estimates; 2012-14f are Scotiabank Economics' estimates based on a 2011 PPP-weighted sample of 38 countries.
[2] CPI for Canada and the United States are annual averages. For other countries, CPI are year-end rates.

* See Scotiabank Economics 'Global Forecast Update' (http://www.gbm.scotiabank.com/English/bns_econ/forecast.pdf) for additional forecasts & commentary.

North America

Canada	2011	12Q2	12Q3	Latest	
Real GDP (annual rates)	2.6	1.7	0.6		
Current Acc. Bal. (C$B, ar)	-52.3	-73.5	-75.6		
Merch. Trade Bal. (C$B, ar)	0.9	-14.4	-20.6	-23.5	(Nov)
Industrial Production	3.8	2.8	0.0	0.6	(Nov)
Housing Starts (000s)	193	231	222	198	(Dec)
Employment	1.6	1.2	1.0	1.8	(Dec)
Unemployment Rate (%)	7.5	7.3	7.3	7.1	(Dec)
Retail Sales	4.1	2.6	2.5	1.4	(Nov)
Auto Sales (000s)	1589	1671	1663	1725	(Nov)
CPI	2.9	1.6	1.2	0.8	(Dec)
IPPI	4.6	0.7	0.0	-0.2	(Dec)
Pre-tax Corp. Profits	15.2	0.9	-2.3		

United States	2011	12Q2	12Q3	Latest	
Real GDP (annual rates)	1.8	1.3	3.1	-0.1	(Q4-A)
Current Acc. Bal. (US$B, ar)	-466	-472	-430		
Merch. Trade Bal. (US$B, ar)	-738	-743	-696	-789	(Nov)
Industrial Production	4.1	4.9	3.4	1.8	(Dec)
Housing Starts (millions)	0.61	0.74	0.77	0.95	(Dec)
Employment	1.2	1.6	1.7	1.6	(Jan)
Unemployment Rate (%)	8.9	8.2	8.0	7.9	(Jan)
Retail Sales	8.3	4.3	4.6	4.4	(Dec)
Auto Sales (millions)	12.7	14.1	14.5	15.3	(Dec)
CPI	3.2	1.9	1.7	1.7	(Dec)
PPI	6.0	1.1	1.5	1.3	(Dec)
Pre-tax Corp. Profits	2.1	14.6	19.3		

Mexico					
Real GDP	3.9	4.4	3.3		
Current Acc. Bal. (US$B, ar)	-9.2	3.6	-14.6		
Merch. Trade Bal. (US$B, ar)	-1.5	6.1	-4.7	11.5	(Dec)
Industrial Production	4.0	4.1	3.6	2.8	(Nov)
CPI	3.4	3.9	4.6	3.6	(Dec)

Europe

Euro Zone	2011	12Q2	12Q3	Latest	
Real GDP	1.5	-0.5	-0.6		
Current Acc. Bal. (US$B, ar)	17	77	205	305	(Nov)
Merch. Trade Bal. (US$B, ar)	12.8	129.1	152.9	250.6	(Nov)
Industrial Production	3.4	-2.2	-2.4	-4.1	(Nov)
Unemployment Rate (%)	10.1	11.2	11.4	11.7	(Dec)
CPI	2.7	2.5	2.5	2.2	(Dec)

Germany	2011	12Q2	12Q3	Latest	
Real GDP	3.1	1.0	0.9		
Current Acc. Bal. (US$B, ar)	203.6	192.1	208.7	235.5	(Nov)
Merch. Trade Bal. (US$B, ar)	217.1	248.2	257.9	233.1	(Nov)
Industrial Production	8.0	-0.2	-1.1	0.6	(Nov)
Unemployment Rate (%)	7.1	6.8	6.8	6.8	(Jan)
CPI	2.3	1.9	1.9	1.7	(Jan)

France					
Real GDP	1.7	0.1	0.0		
Current Acc. Bal. (US$B, ar)	-54.5	-90.2	-40.0	-65.6	(Nov)
Merch. Trade Bal. (US$B, ar)	-53.5	-57.6	-48.0	-40.5	(Nov)
Industrial Production	1.7	-1.9	-2.1	-3.9	(Nov)
Unemployment Rate (%)	9.6	10.2	10.3	10.6	(Dec)
CPI	2.1	2.0	2.0	1.3	(Dec)

United Kingdom					
Real GDP	0.9	-0.3	0.0		
Current Acc. Bal. (US$B, ar)	-32.7	-106.3	-100.9		
Merch. Trade Bal. (US$B, ar)	-160.7	-176.7	-162.1	-175.6	(Nov)
Industrial Production	-0.7	-2.7	-1.8	-5.4	(Nov)
Unemployment Rate (%)	8.1	8.1	7.8	7.7	(Oct)
CPI	4.5	2.7	2.4	2.7	(Dec)

Italy					
Real GDP	0.6	-2.3	-2.4		
Current Acc. Bal. (US$B, ar)	-67.4	-3.6	4.3	10.5	(Nov)
Merch. Trade Bal. (US$B, ar)	-35.5	17.0	23.0	36.4	(Nov)
Industrial Production	0.2	-7.5	-6.4	-9.9	(Nov)
CPI	2.8	3.3	3.2	2.4	(Dec)

Russia					
Real GDP	4.3	4.0	2.9		
Current Acc. Bal. (US$B, ar)	98.8	21.2	6.7		
Merch. Trade Bal. (US$B, ar)	16.5	16.6	12.8	15.4	(Nov)
Industrial Production	4.8	2.3	2.5	1.4	(Dec)
CPI	8.4	3.8	6.0	6.6	(Dec)

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

Source: Bloomberg, Global Insight, Scotiabank Economics.

Asia Pacific

Australia	2011	12Q2	12Q3	Latest	
Real GDP	2.4	3.8	3.1		
Current Acc. Bal. (US$B, ar)	-33.9	-34.5	-66.1		
Merch. Trade Bal. (US$B, ar)	35.7	27.5	2.2	-31.7	(Nov)
Industrial Production	-0.8	2.7	4.3		
Unemployment Rate (%)	5.1	5.1	5.3	5.4	(Dec)
CPI	3.3	1.2	2.0		

Japan	2011	12Q2	12Q3	Latest	
Real GDP	-0.5	4.0	0.5		
Current Acc. Bal. (US$B, ar)	119.2	56.8	82.4	-33.0	(Nov)
Merch. Trade Bal. (US$B, ar)	-33.7	-64.2	-97.3	-114.9	(Dec)
Industrial Production	-2.3	5.1	-4.6	-6.4	(Dec)
Unemployment Rate (%)	4.6	4.4	4.2	4.2	(Dec)
CPI	-0.3	0.2	-0.4	-0.1	(Dec)

South Korea	2011	12Q2	12Q3	Latest	
Real GDP	3.6	2.3	1.5		
Current Acc. Bal. (US$B, ar)	26.1	44.8	58.2	27.0	(Dec)
Merch. Trade Bal. (US$B, ar)	30.8	38.9	30.1	10.5	(Jan)
Industrial Production	6.9	2.4	-0.1	5.1	(Dec)
CPI	4.0	2.4	1.6	1.5	(Jan)

China	2011	12Q2	12Q3	Latest	
Real GDP	10.4	7.6	7.4		
Current Acc. Bal. (US$B, ar)	201.7				
Merch. Trade Bal. (US$B, ar)	155.0	273.3	316.7	379.4	(Dec)
Industrial Production	12.8	9.5	9.2	10.3	(Dec)
CPI	4.1	2.2	1.9	2.5	(Dec)

Thailand	2011	12Q2	12Q3	Latest	
Real GDP	0.1	4.4	3.0		
Current Acc. Bal. (US$B, ar)	5.9	-2.3	2.7		
Merch. Trade Bal. (US$B, ar)	1.4	0.5	1.7	0.3	(Dec)
Industrial Production	-9.3	-1.7	-10.9	24.1	(Dec)
CPI	3.8	2.5	2.9	-7.7	(Jan)

India	2011	12Q2	12Q3	Latest	
Real GDP	7.5	5.5	5.3		
Current Acc. Bal. (US$B, ar)	-62.5	-16.4	-22.3		
Merch. Trade Bal. (US$B, ar)	-13.5	-13.7	-16.9	-17.7	(Dec)
Industrial Production	4.8	-0.3	0.4	-0.1	(Nov)
WPI	9.5	7.5	7.9	7.2	(Dec)

Indonesia	2011	12Q2	12Q3	Latest	
Real GDP	6.5	6.4	6.2		
Current Acc. Bal. (US$B, ar)	1.7	-7.7	-5.3		
Merch. Trade Bal. (US$B, ar)	2.2	-0.8	0.2	-0.2	(Dec)
Industrial Production	4.1	2.2	2.9	8.9	(Oct)
CPI	5.4	4.5	4.5	4.6	(Jan)

Latin America

Brazil	2011	12Q2	12Q3	Latest	
Real GDP	2.5	0.4	0.8		
Current Acc. Bal. (US$B, ar)	-52.5	-52.7	-35.6		
Merch. Trade Bal. (US$B, ar)	29.8	18.5	34.6	27.0	(Dec)
Industrial Production	0.4	-4.4	-2.3	-2.1	(Dec)
CPI	6.6	5.0	5.2	5.8	(Dec)

Chile	2011	12Q2	12Q3	Latest	
Real GDP	6.0	5.7	5.7		
Current Acc. Bal. (US$B, ar)	-0.3	-7.0	-19.1		
Merch. Trade Bal. (US$B, ar)	10.0	6.7	-7.1	18.1	(Dec)
Industrial Production	6.9	4.1	1.5	-2.5	(Dec)
CPI	3.3	3.1	2.6	1.5	(Dec)

Peru	2011	12Q2	12Q3	Latest	
Real GDP	6.9	6.3	6.5		
Current Acc. Bal. (US$B, ar)	-3.3	-1.9	-2.8		
Merch. Trade Bal. (US$B, ar)	0.9	0.2	0.3	0.2	(Nov)
Unemployment Rate (%)	7.7	7.2	6.5	5.6	(Dec)
CPI	3.4	4.1	3.5	2.9	(Jan)

Colombia	2011	12Q2	12Q3	Latest	
Real GDP	5.9	4.9	2.1		
Current Acc. Bal. (US$B, ar)	-10.0	-3.3	-3.6		
Merch. Trade Bal. (US$B, ar)	0.4	0.2	0.0	-0.2	(Nov)
Industrial Production	4.8	0.2	-0.4	1.1	(Oct)
CPI	3.4	3.4	3.1	2.4	(Dec)

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

Source: Bloomberg, Global Insight, Scotiabank Economics.

Interest Rates (%, end of period)

Canada	12Q3	12Q4	Jan/25	Feb/01*	United States	12Q3	12Q4	Jan/25	Feb/01*
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	0.98	0.93	0.91	0.93	3-mo. T-bill	0.09	0.04	0.07	0.06
10-yr Gov't Bond	1.73	1.80	1.95	1.99	10-yr Gov't Bond	1.63	1.76	1.95	1.96
30-yr Gov't Bond	2.32	2.37	2.54	2.58	30-yr Gov't Bond	2.82	2.95	3.13	3.17
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US$B)	67.9	68.4	68.4	(Dec)	FX Reserves (US$B)	142.0	139.1	139.1	(Dec)
Germany					**France**				
3-mo. Interbank	0.11	0.10	0.10	0.14	3-mo. T-bill	0.00	-0.01	0.00	0.02
10-yr Gov't Bond	1.44	1.32	1.64	1.67	10-yr Gov't Bond	2.18	2.00	2.22	2.24
FX Reserves (US$B)	68.5	67.4	67.4	(Dec)	FX Reserves (US$B)	50.9	54.2	54.2	(Dec)
Euro Zone					**United Kingdom**				
Refinancing Rate	0.75	0.75	0.75	0.75	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	0.11	0.13	0.07	0.08	3-mo. T-bill	0.35	0.36	0.38	0.38
FX Reserves (US$B)	332.8	332.4	332.4	(Dec)	10-yr Gov't Bond	1.73	1.83	2.06	2.09
					FX Reserves (US$B)	87.9	88.6	88.6	(Dec)
Japan					**Australia**				
Discount Rate	0.30	0.30	0.30	0.30	Cash Rate	3.50	3.00	3.00	3.00
3-mo. Libor	0.13	0.11	0.10	0.10	10-yr Gov't Bond	2.99	3.27	3.32	3.52
10-yr Gov't Bond	0.78	0.79	0.72	0.77	FX Reserves (US$B)	42.4	44.9	44.9	(Dec)
FX Reserves (US$B)	1233.3	1227.2	1227.2	(Dec)					

Exchange Rates (end of period)

USDCAD	0.98	0.99	1.01	1.00	¥/US$	77.94	86.75	90.91	92.51
CADUSD	1.02	1.01	0.99	1.00	US¢/Australian$	1.04	1.04	1.04	1.04
GBPUSD	1.617	1.625	1.580	1.575	Chinese Yuan/US$	6.29	6.23	6.22	6.23
EURUSD	1.286	1.319	1.346	1.370	South Korean Won/US$	1113	1064	1077	1094
JPYEUR	1.00	0.87	0.82	0.79	Mexican Peso/US$	12.859	12.854	12.707	12.633
USDCHF	0.94	0.92	0.93	0.90	Brazilian Real/US$	2.028	2.052	2.031	1.982

Equity Markets (index, end of period)

United States (DJIA)	13437	13104	13896	13995	U.K. (FT100)	5742	5898	6284	6346
United States (S&P500)	1441	1426	1503	1510	Germany (Dax)	7216	7612	7858	7830
Canada (S&P/TSX)	12317	12434	12817	12767	France (CAC40)	3355	3641	3778	3774
Mexico (IPC)	40867	43706	45576	45571	Japan (Nikkei)	8870	10395	10927	11191
Brazil (Bovespa)	59176	60952	61170	60160	Hong Kong (Hang Seng)	20840	22657	23580	23722
Italy (BCI)	825	873	947	921	South Korea (Composite)	1996	1997	1947	1958

Commodity Prices (end of period)

Pulp (US$/tonne)	830	870	870	870	Copper (US$/lb)	3.75	3.59	3.66	3.70
Newsprint (US$/tonne)	640	640	640	640	Zinc (US$/lb)	0.95	0.92	0.94	0.97
Lumber (US$/mfbm)	300	388	370	362	Gold (US$/oz)	1776.00	1657.50	1660.00	1669.00
WTI Oil (US$/bbl)	92.19	91.82	95.88	97.78	Silver (US$/oz)	34.65	29.95	31.56	31.43
Natural Gas (US$/mmbtu)	3.32	3.35	3.44	3.33	CRB (index)	309.30	295.01	299.31	305.44

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

Fixed Income Strategy (London)

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Fixed Income Strategy (Paris)

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