Global Views

Weekly commentary on economic and financial market developments

July 20, 2012

2-11 Economics

12-14 Emerging Markets Strategy

A1-A10 Forecasts & Data

Derek Holt (416) 863-7707
derek.holt@scotiabank.com

Four Top Global Market Risks Next Week

- **Please see our full indicator, central bank, auction and event calendars on pp. A3-A10.**

The top four risks to watch next week by way of factors that could impact the global market tone include Q2 US GDP on Friday, Chinese and European manufacturing data, fiscal progress reports out of beleaguered Greece and Portugal, and a continuation of the US Q2 earnings season.

At the top of the list of factors that could influence the global market tone is **US** GDP growth for Q2. That's because this will significantly factor into Federal Reserve policy expectations particularly insofar as the prospects for QE3 are concerned. Consensus now sits at 1.4% q/q annualized growth in Q2 and Scotia is slightly higher at 1.6%. The distribution of viewpoints is fairly wide, from a low of 0.8% to a high estimate of 1.9% and a standard deviation of 0.3%. A one-handled Q2 growth figure would be a fairly damning indictment of the sustainability of the US recovery in the wake of tepid 1.9% growth in Q1 over the prior quarter, especially considering that growth was so narrowly based. Take autos out of the Q1 growth picture and the economy entirely stalled out at sub-1% growth and Q2 might offer a similar picture. Given a Congressional mandate to focus upon domestic full employment and price stability, the Fed is obligated to heavily weight its policy considerations to the sharp souring of the US economy in a manner that is likely skewed toward further balance sheet expansion such that we continue to believe that QE3 odds are elevated around a September timeline.

A continuation of the **Q2 US earnings parade** will witness no fewer than 1,101 earnings reports affecting all major US stock market indexes. It starts off slowly on Monday with only 86 earnings releases, but builds to a crescendo by Thursday when 369 companies release. Equities were rallying on the earnings 'beat' ratio thus far until the wheels fell off by the end of the week under renewed concerns over Spanish government finances including a plea for regional aid from within the country, but our article on pages 7-9 addresses reasons to be cautious toward what this beat ratio really means. How earnings estimates are being beaten is a warning sign, and why analysts have been steadily beaten in their earnings estimates for a dozen years is explored.

Other US releases may get additional market attention next week including new home sales on Wednesday that despite disappointing resale figures are expected to more closely mirror recent upsides to new housing starts. Durable goods orders on Thursday may carry last-minute revision risk to our Q2 GDP call for the next day, but the effects are likely to be minor in anticipation of a soft print. Jobless claims on Thursday will be scrutinized for further evidence of whether recent auto sector distortions that have been marked by fewer and shorter seasonal shutdowns for retooling are shaking out of the recently volatile data in favour of cleaner impressions of the health of US job markets. Pending home sales in June likely flattened out after a sharp rise the month before. The Richmond Fed's manufacturing gauge could shed further insight into the lead-up toward an ISM manufacturing call as the regional reports come in generally unfavourably thus far. Lastly, the US auctions 2s, 5s and 7s next week.

Asian markets will really only be in a position to affect the global market tone insofar as fresh Chinese manufacturing data is concerned — barring the ever-present risk of fresh comments by Chinese officials (and global policymakers for that matter). The private sector 'flash' manufacturing purchasing managers' index is on tap for the start of the week. It has signaled a contracting manufacturing sector throughout the year in considerable contrast to the state's manufacturing PMI partly due to the private sector version's greater emphasis upon smaller businesses in coastal regions that are more export-oriented and thus more likely to be suffering from weakness in Europe and the US. Australia releases Q2 CPI figures that are expected to cool in yearly terms. General awareness of the contents to this Tuesday release could make a speech on Monday by RBA Governor Glenn Stevens worth reading as it is his first speech in several weeks and could well contain useful cash target rate guidance after the RBA halted its easing cycle at the July 3rd meeting. The RBNZ, Bank of Thailand and Bankgko Sentral ng Pilipinas are all expected to keep rates on hold next week. Japanese data is expected to bring forward soft figures for retail sales and inflation.

Derek Holt (416) 863-7707
derek.holt@scotiabank.com

… continued from previous page

Europe could impact the global market tone in two major ways, but with a number of other important regional influences that could sway domestic markets. First is that purchasing managers' reports for the manufacturing sectors of Germany and France are likely to remain in contraction territory when they land on Tuesday. That same day, ECB/IMF inspectors enter Greece in order to commence evaluation of the country's progress toward fiscal reforms. The day before, Portugal releases its year-to-date budget report. With Portuguese 10 year notes yielding a whopping 10.5%, markets will be watching for success or failure in putting the country's finances on an eventually sounder path. The UK economy is almost universally expected to remain in recession when Q2 GDP figures land on Wednesday next week and thus commence the European GDP reporting cycle over coming weeks. This would be the third consecutive contraction in UK GDP, as all but six out of 36 forecasters expect a negative print. European auction risk should be fairly light and only focused upon a 30 year German note. It should likely go without saying that markets are demanding inadequate compensation for inflation and term structure risk via only about a 2% yield, let alone more fundamental risks facing the outlook for the eurozone with several scenarios being blatantly unkind to the outlook for the German economy and German government finances. German business confidence on Wednesday and state level CPI on Friday round out the eurozone market risks.

Canadian markets will be relatively quiet by way of domestic developments next week, and will otherwise follow the broad global tone. There could be one exception. Canada releases retail sales for the month of May on Tuesday. We're expecting a solid gain in headline sales given a rise in auto sales and strength at large retailers, but this would only largely negate the contraction in sales that occurred over the prior month if it comes true. Retail sales are also important because they are the last major indicator we'll be using to round out our May GDP call in advance of the following week's release. Canada also releases the Teranet repeat-sales indicator for house prices on Wednesday, and the country auctions 10s on Wednesday.

Derek Holt (416) 863-7707
derek.holt@scotiabank.com
Dov Zigler (416) 862-3080
dov.zigler@scotiabank.com

Key Risks To The Bank of Canada's MPR Views

- **We offer three major risks to the views presented by the Bank of Canada in its latest forecast update.**

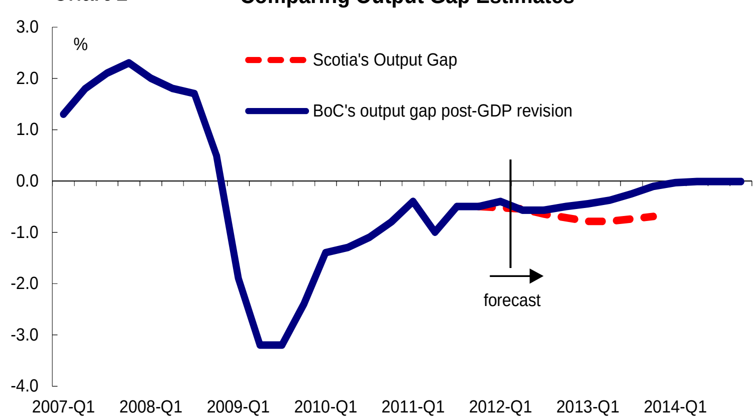
The Bank of Canada's latest Monetary Policy Report and the ensuing press conference by Governor Carney provided important details in an as-usual useful write-up and set of comments explaining the BoC's reaction function to back up its briefer policy statement, but there are a number of areas where we would flag some differences of opinion that have us thinking that the risk remains pointed in the direction of downside risks to the BoC's forward-looking views. They are focused upon risks to the BoC's views on the output gap, household credit growth, and the outlook for consumer spending and the saving rate. While differences of opinion abound with respect to the nature and composition of risks facing global growth and financial markets, we've focused upon risks to their domestic story. Since the BoC has backed away from much of the hawkish slant in the April MPR we are providing a more detailed (and longer) than usual interpretation of its refreshed views after thoroughly reading the report and watching the press conference.

1. BoC May Be Underestimating Future Slack In The Canadian Economy

One difference of opinion concerns the output gap. The BoC's revised view is shown in the accompanying chart. The BoC doesn't actually publish its output gap forecast but we've pieced it together into 2014 using their published potential and actual GDP growth forecasts. The blue solid line is the BoC's output gap which now closes by the end of 2013 which is somewhat in contrast to the BoC's more vague guidance in its policy statement that the gap would close over 2013H2. That might be quibbling over a few tenths, but if the gap closes by the end of the year then let's be clear in stating as much. Our guidance remains that Canada still faces net slack by the end of 2013 and into 2014 so we would continue to shave the risks in the direction of the BoC underestimating the sustainability of disinflationary spare capacity in the Canadian economy over its forecast horizon. Either we are too low in our growth forecast, or the BoC is too high – time will tell.

Why we differ on the output gap has everything to do with actual GDP growth forecasts, since we're using the same potential GDP growth assumptions as the BoC. With the BoC's downward forecast revisions they are now bang in line with the Scotia Economics forecast for Canadian GDP growth in 2012H1 (BoC 1.9% and 1.8%, Scotia 1.9% and 1.9% in Q1 and Q2 respectively). Then we part company. The BoC has a stronger second half 2012 rebound and a stronger 2013 growth forecast than we have. In fact, there is about a half percentage point difference with the BoC being higher in each of 2012Q3 through to 2013Q1 and then a 0.3-0.4 point gap for the rest of 2013. I'm not sure that we get the BoC's assumed pick up in growth over 2012H2 into next year when European risks are still very much alive and the US enters its peak fiscal crunch — concerns that the CBO and Fed Chairman Ben Bernanke pose as recession risks. I'm also not sure of the BoC's assumed acceleration when Canadian housing and consumption could well both face downside risks stemming from operating at all-time highs for virtually every variable while regulatory policy continues its pro-cyclical bias by potentially having eased too much in the good times around 2006-07 and tightening too much at recent and current structural peaks for housing and the consumer. It's entirely possible that the BoC's pushed-out optimistic bias comes true after having been disappointed with this forecast approach over 2012H1, but I'm skeptical.

Chart 1 **Comparing Output Gap Estimates**



Source: Bank of Canada, Statistics Canada, Scotia Economics

Derek Holt (416) 863-7707
derek.holt@scotiabank.com

Dov Zigler (416) 862-3080
dov.zigler@scotiabank.com

… continued from previous page

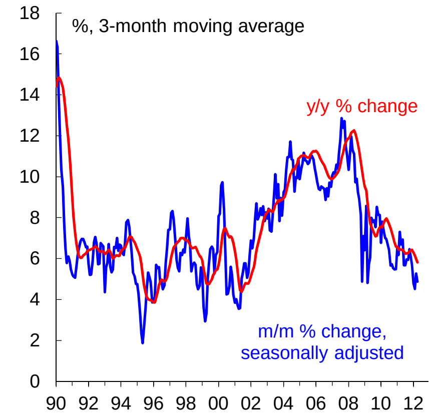
2. BoC May Be Too Sanguine Toward Slowing Growth In Household Debt

One other difference of opinion is with respect to the comments on Canadian credit growth. The BoC states on page 19 of the full report that "Despite the deterioration in global financial conditions, the supply and price of credit for businesses and households in Canada remain very stimulative…" I'm not sure that's a totally fair assessment. The second chart shows y/y growth in total household credit which is running at a modest 5% y/y and markedly slower than the 12% pre-crisis range. In fact, household credit is rising at the slowest pace in over a decade (indeed, back to the moribund 1990s levels of growth and it continues to trend lower). Mortgage balance growth in the third chart has slowed to about half the pre-crisis pace and is only relatively resilient over the past couple of years as households have substituted away from other consumer lending products while they engage in term structure extension in an environment marked by a very flat yield curve (one of the bright things households are doing to manage rate risk and cash flows). Note the fourth chart that demonstrates that growth in consumer credit ex-mortgages has slowed to virtually nothing especially once inflation is removed; indeed, it's at the lowest end of the range experienced over the past quarter century. That's not at all very stimulative in my opinion and signals a disturbing loss of momentum that is backed up by very soft consumer spending into 2012. Thus, when the BoC says that "household credit growth has slowed somewhat" in chart 19 on page 21, I think that's an understatement. Note that their chart makes this point by omitting the pre-2008 credit growth trend — which we have not — and which was a sustainably much stronger environment for household debt growth than the 2008-onward environment. The BoC does then eventually acknowledge that this slowdown follows "an extended period of rapid growth in household credit"

The BoC argues that because housing indicators have been strong through 2012 then household debt growth may re-accelerate when lag effects flow through into the credit data. There are two counter-arguments here. One is that not all of the strength in housing has been through domestic mortgages as opposed to, say, foreign flows into the investor-dominated Toronto and Vancouver condo markets so not all of this strength particularly on the multiples side will necessarily flow through to mortgages. We also know that private equity pools have been driving a considerable portion of the investor segment and sometimes operating through leverage by playing modest downpayments and thus high gearing ratios between the opening of condo sales offices and when the units are complete and ready for resale. More importantly, if household credit growth does accelerate in the near-term, then time could well fix that if housing activity has simply been brought forward at the expense of 2012H2 into 2013 especially after considering the impact of repeated rounds of tightened mortgage financing rules and a broad tightening of regulatory policy toward capital, liquidity, and lending standards in Canada.

Chart 2

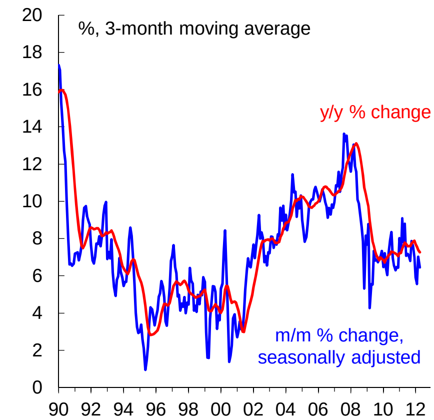
Household Credit Growth



Source: Bank of Canada, Scotia Economics.

Chart 3

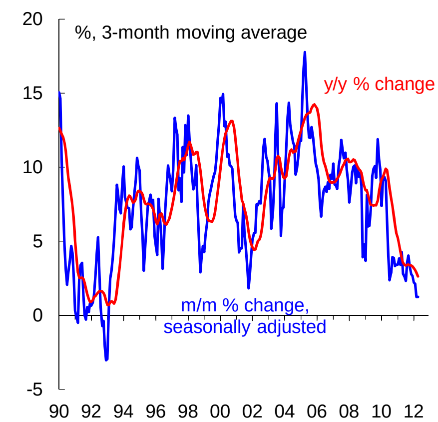
Residential Mortgage Growth



Source: Bank of Canada, Scotia Economics.

Chart 4

Consumer Loan Growth



Source: Bank of Canada, Scotia Economics.

Derek Holt (416) 863-7707
derek.holt@scotiabank.com

Dov Zigler (416) 862-3080
dov.zigler@scotiabank.com

… continued from previous page

3. Risks To Consumer Spending Coming Off Of A Boom

One area where the BoC's consumption growth forecasts may be at risk lies in the assumption that the personal saving rate remains at the depths at which it has sat since about the middle of the last decade on through into 2015 (see chart 27 in the MPR). The risk here is that operating at leveraged peaks across virtually everything in the household sector could mean a renewed focus upon repairing the personal saving rate going forward which would come at the expense of growth in consumer spending and housing. The BoC is assuming that consumer spending accounts for about half of overall GDP growth throughout the 2012-14 forecast horizon.

I continue to think that the main point to the BoC repeating its upward rate guidance (with plenty of cover in the language) is to fight the market bias in favour of a rate cut more so than to actually signal that it will raise rates. There isn't much to its current projections that would support any rate hike bias this year or well into next. The BoC's bias is to raise rates when it can while signalling no desire to cut barring an extreme global liquidity and funding crisis. That said, I don't think the BoC will have a favourable global and domestic backdrop for hiking until into 2013H2 at the earliest and quite possibly not at all within its 2012-14 forecast horizon. The very material risk is that Canada comes off leveraged peaks and faces a prolonged period of softer growth than the BoC is anticipating.

Derek Holt (416) 863-7707
derek.holt@scotiabank.com

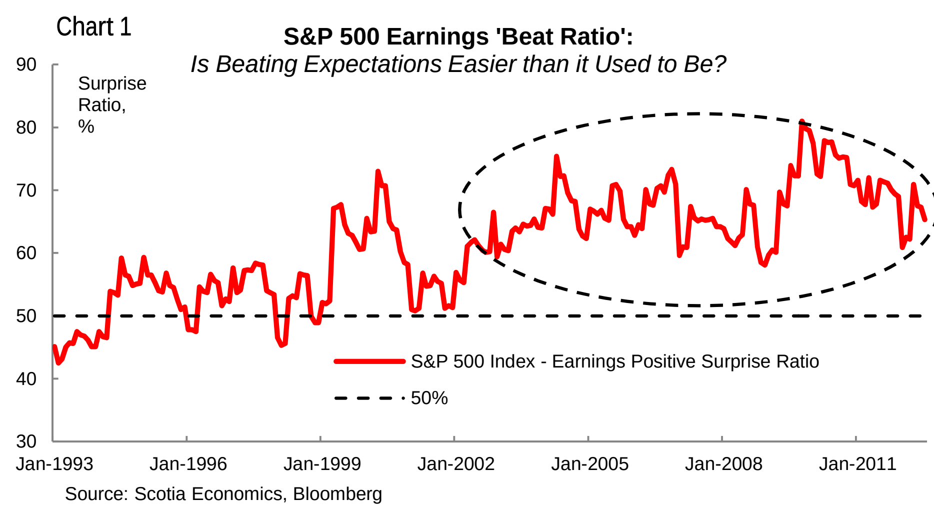
Dov Zigler (416) 862-3080
dov.zigler@scotiabank.com

The Earnings 'Beat Ratio' May Signal Weak-Form Market Inefficiency

- **In a marked departure from the 1990s, equity analysts have been consistently beaten by actual earnings releases over the past dozen years. Our focus is upon why — with a bias toward the unintended consequences of Sarbanes Oxley — and how to trade it. We also point out that how earnings are currently beating analyst expectations may not be sustainable.**

As of the morning of July 20th, out of 118 companies that Bloomberg has down in their tracking of the current US Q2 earnings season for 500 companies on the S&P500, 86 have beaten analyst earnings expectations (73%) while 29 have fallen short and 3 have been in line with expectations. This net out-performance compared to analyst expectations is nothing new—which may come as a surprise to many given the extent to which the beat ratio is widely cited as a measure of earnings season strength or weakness. It didn't always work that way. Indeed, the arrival of steady earnings outperformance of analyst expectations may have given rise to a renewed form of market inefficiency when judging the one-day price response to what have become persistent upward surprises on earnings. Regulatory changes may have played a part in this outcome.

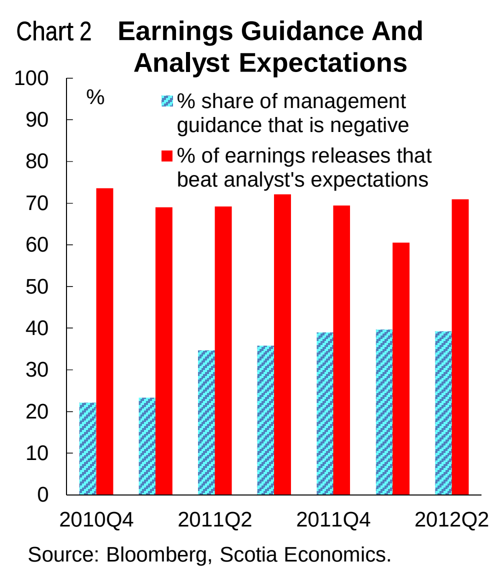
The Persistence of Outperforming Analysts' Earnings Expectations



The earnings beat ratio has been almost always over 60% and has strayed as high as about 80% in figures back to 2000. The one exception was when the earnings beat ratio was only just over 50% in 2001 during the dot bomb period and during which analysts came under pressure for inflated tech earnings estimates. Markets pay a lot of attention to the beat ratio when in fact it's apparently not difficult whatsoever for companies to consistently beat the analysts. This wasn't always the case, and why things changed is an interesting point of uncertainty.

In the 1990s the beat ratio was within a tighter 45-55% range which is closer to the fair coin toss that it probably should be. It's only over the past decade that the earnings cycle has consistently beaten analyst expectations (Chart 1) There are at least four possible theories that we offer for why this might be the case.

One common theory is that perhaps the earnings cycle has become manipulated by management guidance to analysts whereby guidance comes in lower just before earnings season, leading analysts to become more cautious through downward revisions, only for management to release earnings that surprise higher and take their share price higher with the report in the immediate aftermath. This is difficult to prove. Consider Chart 2 which would



Derek Holt (416) 863-7707
derek.holt@scotiabank.com

Dov Zigler (416) 862-3080
dov.zigler@scotiabank.com

… continued from previous page

tend to refute this theory. The beat ratio has been consistently high recently even as the net percentage of company earnings guidance that has been negative has not been a majority and exhibited more volatility than the beat ratio itself. For example, in 2010Q4 it was still the case that a vast majority of analyst earnings expectations were beaten (over 70%) despite the fact that only 21% of the 151 companies on the S&P500 that provided some earnings guidance warned of earnings disappointments. Unfortunately we can only get management guidance changes for the broad index off Bloomberg since 2010Q4.

A second theory, however, simply posits that earnings are more ineptly forecast by the more recent crop of equity analysts given the industry boom over the past decade, and/or that they may wish to manufacture 'beats' . This too is difficult to prove by way of getting at clear measures of analyst competence.

A third technology-related argument would be that as Bloomberg and Reuters have made it easier to follow analyst predictions, analysts have been compelled to temper their expectations — or confront a checkered record available to the entire capital markets universe. Greater transparency therefore does not necessarily beget better outcomes. The same is true of attempts to publish economists' monthly indicator calls and their accuracy which is bound to lead to even more hugging of consensus estimates — or to cease contributing to published consensus estimates.

A fourth theory is that legislation and regulatory changes aimed at the financial community have had unintended consequences by way of making analysts more risk averse (and hence persistently cautious) in their earnings calls. To this latter point, in the wake of the tech earnings bubble, Title V of the Sarbanes Oxley Act (2002) succeeded in giving analysts more independence with respect to their evaluations of companies, allowing them to lower their average expectations for earnings without incurring the wrath of equity desks at investment banks. This response to the tech bubble nevertheless came after a decade long experience whereby one could not say that analysts were clearly biased one way or the other given a nearly-even beat ratio throughout the 1990s. Regardless, this legislation was supposed to make analysts correct more often. Sarbanes Oxley separated compensation of analysts from the opinions of non-research personnel and similarly protected analysts from retaliation by angry bankers and traders for releasing critical analyst reports. In concert with this, the analyst community probably policed itself somewhat in order to restore credibility to its research reports following the euphoria and outsized earnings expectations of the late 1990s. Did it work? The evidence on how the 1990s on balance had a roughly even beat ratio that then gave way to a persistently positive beat ratio almost exactly around the period of the fresh legislation would suggest that an unintended consequence to Sarbanes Oxley may have been to deliver overall cautious earnings forecasts by analysts that were easily beaten by actual earnings. Again, however, proving this beyond dispute is difficult, but of the theories we've presented, it may well hold the most promise. The effects might also be reinforced by an overall very different regulatory climate that has included prosecution of analysts in such a manner as to reinforce risk-averse behaviour.

Regardless of the reason why analysts are now consistently beaten in their earnings projections, this might, in turn, suggest that a tactical investment strategy would be to wait until analysts are done with their earnings revisions just prior to each new earnings season and then buy equities right at the start of the earnings season. A caution in this regard is that while we're aware that the one-day price response to earnings hits and misses has recently been clear, the robustness of the relationship over time after controlling for many other possible influences upon one-day after price changes is an area requiring further empirical research.

The fact that analysts are repeatedly fooled higher, for one reason or another, and that there may be a persistent positive price response following an upward surprise may, in other words, be an example of weak-form market inefficiency in an efficient markets hypothesis sense whereby a persistent technical pattern like this should be eventually caught on to and arbitraged away.

Derek Holt (416) 863-7707
derek.holt@scotiabank.com

Dov Zigler (416) 862-3080
dov.zigler@scotiabank.com

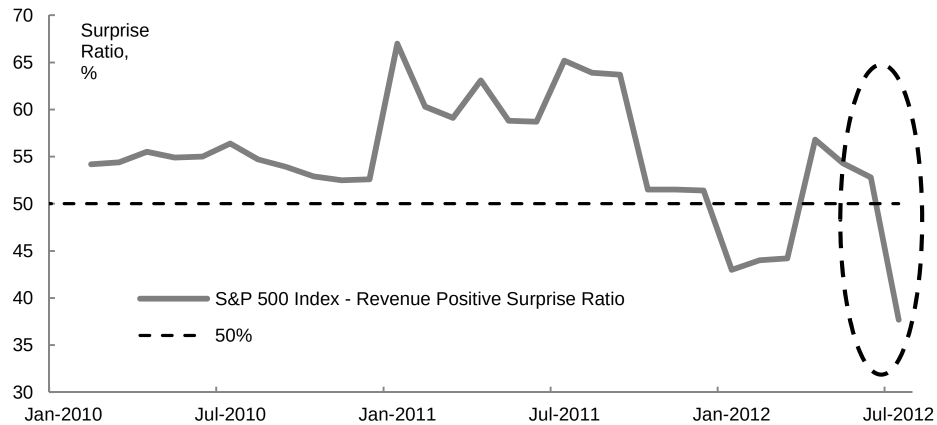
… continued from previous page

How Earnings Are Now Surprising Higher Questions Sustainability

As a second and separate issue, how companies are beating expectations in the current earnings season also matters, since it questions the sustainability of the earnings upsides into a softening US and global economy.

Most companies have beaten analyst earnings expectations thus far, but have missed analyst revenue expectations with only 50 beating revenue targets (or 42%), and 68 missing. Thus, beating on earnings and missing on revenues points to operating leverage as the factor that has helped boost earnings through expense control which has been a common occurrence through the crisis period we've remained stuck in since 2008. That is confirmed by a number of the cutback announcements of late, and in trend weakness in initial jobless claims. The key is therefore whether companies can continue to prop up earnings through operating leverage gains that are long in the tooth, or whether equities will pay a rising price by way of softening revenues reflecting a soft economic growth picture.

Chart 3 **S&P 500: Revenue Surprises are Harder to Come By**



Source: Scotia Economics, Bloomberg

The current quarter's earnings season is a stand-out compared to the recent past in this regard. As Chart 3 demonstrates, there are far fewer companies currently beating revenue targets than in the recent past even while the number of companies that are beating analysts' earnings expectations is in line with recent history. We can only get the 'revenue beat' share back to then on Bloomberg.

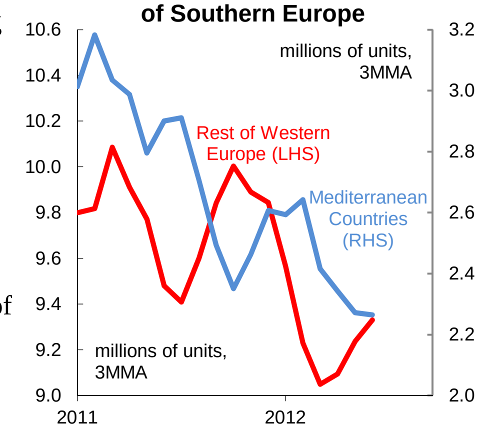
Carlos Gomes (416) 866-4735
carlos.gomes@scotiabank.com

The Ups & Downs Of The Western European Auto Market

- **Activity improves outside of southern Europe, but continues to deteriorate in the Mediterranean nations.**

The downturn in car sales across Western Europe moderated in June, with the decline easing to 1.7% y/y from an 8% slump during the previous five months. In fact, on a seasonally adjusted basis, volumes have actually edged up for two consecutive months, climbing to an annualized 11.7 million units in June from a low of 11.5 million in April and an average of 11.6 million between January and May. This improvement provides some hope that conditions may be beginning to stabilize in some countries. However, it also highlights the growing differential between the debt-ridden nations of southern Europe, where austerity continues to erode economic activity and consumer confidence, and the rest of the continent, which may be starting to experience some improvement.

Car Sales Improve Outside of Southern Europe



Source: Scotia Economics.

Car sales and in the Mediterranean nations — Portugal, Spain, Italy and Greece — slumped 22% below a year earlier in June. This represents a further deterioration from an 18% y/y slide during the previous five months, and reduced the annualized sales pace in these nations to only 2.1 million units last month, down from 2.8 million last year and a pre-recession peak of 4.6 million in 2007. Further deterioration is expected, especially since unemployment continues to increase, and Spain recently announced additional austerity measures, including a further three percentage point increase in its value-added sales tax effective September 1st.

In contrast, car sales in the rest of Western Europe advanced year-over-year for the first time since last October, led by double-digit increases in the Netherlands, Switzerland and Luxembourg. The improvement in the Netherlands is likely temporary, as it reflects the pulling forward of sales prior to the expiry of subsidies on low-emission cars on July 1st. However, the 3% y/y increase in Germany — the region's largest auto market — is more encouraging as it was driven by strengthening household incomes. Disposable income growth in Germany picked up to 3.5% y/y in the first quarter — the strongest pace since 2008, and well ahead of the 2% decade-average prior to the global economic downturn. The improvement in income growth reflects a strengthening labour market which has trimmed unemployment in Germany to a low of 5.6% — half the level prevailing in the entire euro zone.

Sales also steadied in France last month, with solid gains by Renault, VW and Japanese automakers offsetting ongoing weakness at PSA Peugeot Citroen. In particular, Renault's volumes were buoyed by a 44% y/y surge in purchases of its low-cost Dacia brand, while the gain by Japanese automakers reflects low sales a year ago when volumes were undercut by a lack of product in the aftermath of the earthquake in Japan.

The improvement is even more pronounced in the U.K., with volumes advancing year-over-year for the fourth consecutive month. In June, the sales gain in the U.K. was driven by a 10% y/y rebound in household purchases — a segment that typically accounts for 40% of overall car market. As is the case in several nations outside of southern Europe, the labour market has been gaining momentum over the past year, and U.K. employment is currently at the highest level since late 2008.

Erika Cain (416) 866-4205
erika.cain@scotiabank.com

Mary Webb (416) 866-4202
mary.webb@scotiabank.com

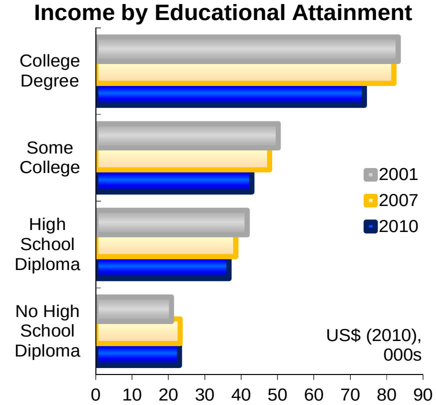
U.S. Families' Financial Repair

- **The *Survey of Consumer Finances* offers insights into consumers' subsequent caution.**

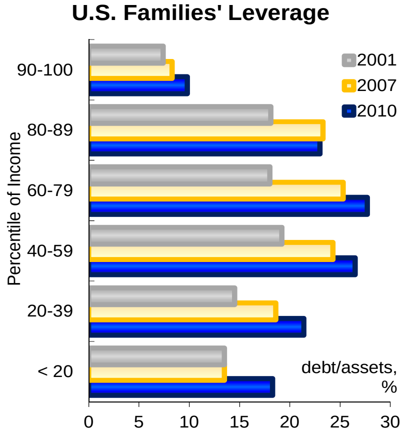
As fiscal repair discussions heat up again in the United States with sequestration and the expiry of major tax relief currently scheduled for January 2013, the steep decline of almost 39% reported recently for the median real value of U.S. family net worth from 2007 to 2010 underlines the importance of a longer-term plan for federal deficit reduction and the reinforcement of major entitlement programs. The U.S. Federal Reserve's *Survey of Consumer Finances* for 2010[1] published in June emphasizes the breadth of the recent correction in real family incomes and net worth. The fall in the median value of real family pre-tax income from 2007 to 2010 was 7.7%, and was most pronounced for families with incomes falling between the 40th and 79th percentiles, headed by individuals up to 54 years old, and by individuals with college degrees or some college *(top right chart).*

The steep decline in families' real net worth from 2007 to 2010 was primarily driven by declining asset values — the plunge in home prices and to a lesser extent capital losses (including unrealized) on financial assets such as equities. Excluding primary residences and the related mortgage debt, the drop in the median value of families' real net worth was 29½% from 2007 to 2010. By region, the most dramatic fall in median real family net worth was the 55.3% drop in the Western States reflecting their deep housing value correction. Over the three years to 2010, the larger decline in median net worth in metropolitan areas erased most of the widening gap versus non-metropolitan areas that had occurred from 1998 to 2007. The overall level of debt owed by families was almost unchanged from 2007 to 2010. For families with home-secured debt, median home equity fell 42.3% from 2007 to 2010. Families' leverage increased from 14.8% to 16.4% from 2007 to 2010 mirroring the fall in asset values. In 2010, the absolute level of leverage remained highest for middle-income households, but the sharpest three-year rise in leverage was among families in the lowest income quintile from 13.5% to 18.3% *(bottom left chart)*. With respect to financial assets, the median real value of families' savings in retirement accounts declined by 6.6% over the three years to 2010. However, these accounts continued to climb as a share of families' total financial assets to 38% in 2010 *(bottom middle chart)*, nearly double the 1989 share. Not surprisingly, the percentage of families reporting saving out of current income in 2010 edged lower from 2007 (*bottom right chart*). After liquidity, retirement was the second most important motivation for saving, though financial market volatility and low interest rates since 2010 have complicated retirement saving.

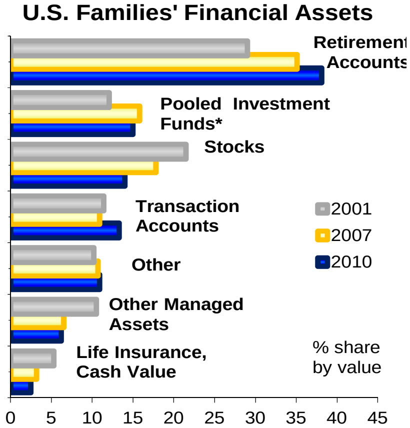
U.S. Real Median Pre-Tax Family Income by Educational Attainment



U.S. Families' Leverage

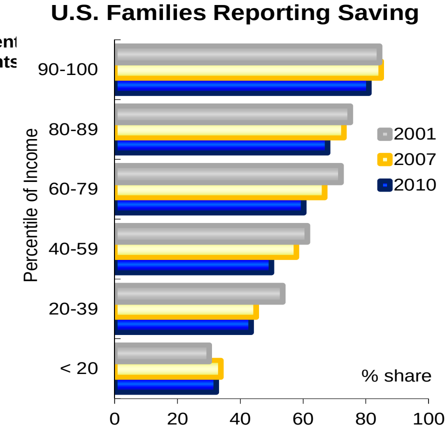


U.S. Families' Financial Assets



* Excludes money market funds.

U.S. Families Reporting Saving



Source for all charts: U.S. Federal Reserve, *Survey of Consumer Finances,* June 2012.

[1] Interviews for the triennial *Survey of Consumer Finances* are primarily conducted from May to December in the target years.

Joe Kogan (212) 225-6541
joe.kogan@scotiabank.com

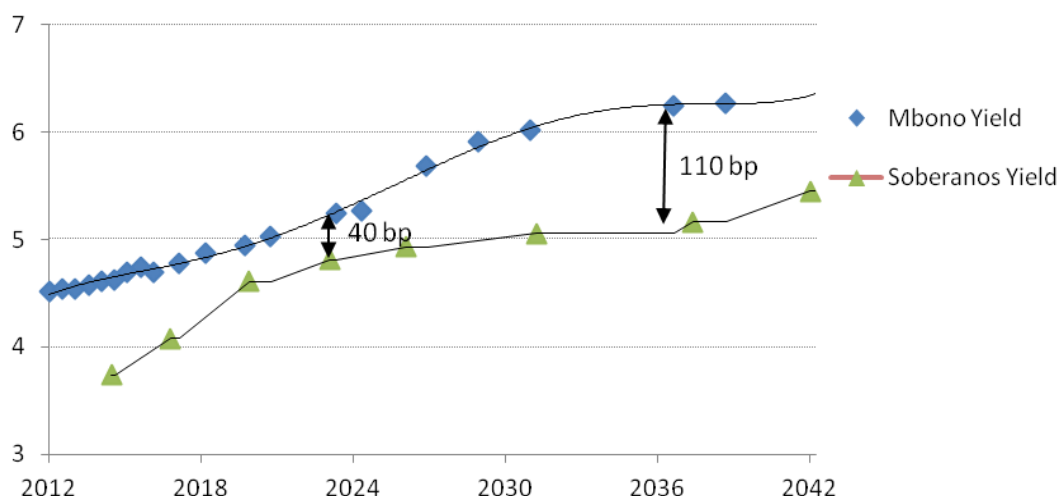
Relative Value In Peru And Mexico Local Bonds

The following article was published on July 16, 2012.

While 10Y local currency yields between Peru and Mexico have converged, 30Y yields between these countries have not. We argue that increased foreign participation in these markets should eliminate the large difference in the slopes of the curves over time.

Peru and Mexico are the two countries in Latin America where foreign participation in local currency bonds is greatest, with low transaction costs allowing steady increases in the role of foreigners that now exceeds 50% of the amount outstanding of nominal bonds. In examining the effects of the recent rally on curve shape, we noticed that Peru and Mexico local yields have almost converged in the 10Y segment but not in the 30Y part of the curve, as shown in Figure 1.

Figure 1. Mexico (Mbonos) vs. Peru (Soberanos) local currency bond curves



Source: Bloomberg, Scotiabank GBM. As of close on July 13, 2012.

We think that difference is explained by the fact that foreign investors in both countries have focused on the short and middle parts of the curves, while leaving the back end for local pension funds. For example, ownership data for the end of June show non-residents owning over 70% of Mbono 20s, 21s and 24s, as well as Soberano 20s. The fact that the long-end in both of these countries does not have a common set of investors—Mexican pension funds in one and Peruvian pension funds in the other—has delayed convergence in this part of the curve.

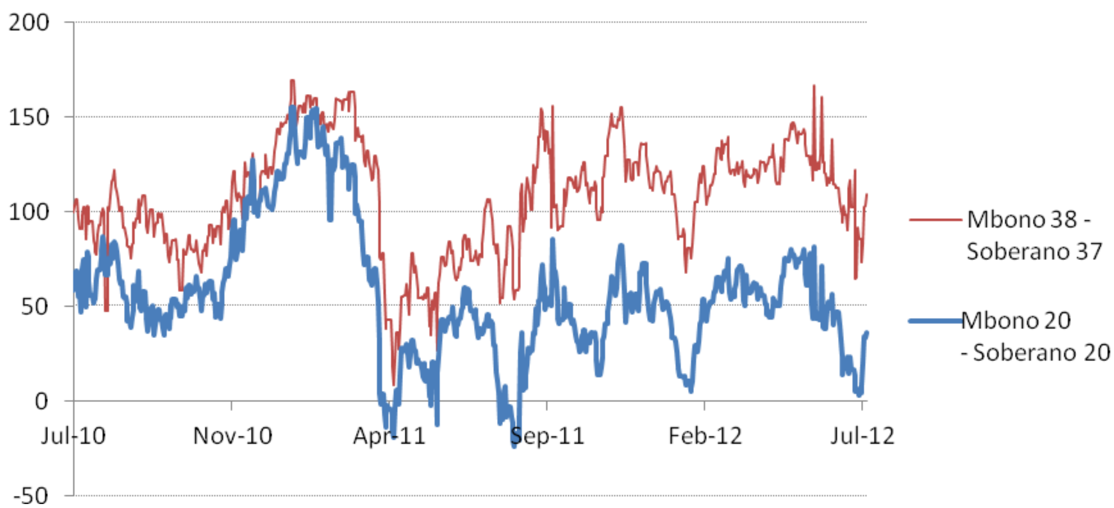
We saw a similar phenomenon about six years ago during the rally in hard currency bonds. Foreign investors became more comfortable with emerging market risk, leading them to move out along the curve. The spread curve flattening that followed was not evenly distributed at first, with some countries flattening more than others. For example, Colombia’s dollar curve remained steep while other Latin American peers flattened. That effect was usually attributed to the role of local pension funds. Regulations which penalized funds for significantly underperforming their peers ensured that pension funds did not deviate from each other, making it difficult for any one fund to switch from the middle of the curve to the long-end, even as it was clear that the long end was the more appropriate investment for pensioners. Nevertheless, as US-based investors

Joe Kogan (212) 225-6541
joe.kogan@scotiabank.com

… continued from previous page

gradually increased their exposure to Latin American hard currency bonds, they picked the points on each country's curve that was most attractive while maintaining a certain duration exposure overall. The relative importance of local pension funds diminished, and as a result, slopes in Colombia converged to those of other Latin American countries.

Figure 2. Yield differential between Mexico and Peru at middle and long ends



Source: Bloomberg, Scotiabank GBM. As of close on July 13, 2012.

The fact that over the past year Mexico and Peru 10Y local rates have converged to the same levels, as shown in Figure 2, suggests that markets view risks related to inflation and monetary policy as similar. Why should 30Y rates differ so much between Mexico and Peru? The evolution of hard currency emerging market curves suggests that convergence in slopes could occur in local currency instruments as well.

An important theoretical point here is that there is no reason for rates to converge in the short term, since the countries may be subject to different monetary policy dynamics and inflation dynamics. For example, Peru currently has a lower overnight rate and a lower inflation target than Mexico. Instead, we would expect some congruence in forward rates. That is, if Mexico and Peru had the same 5Y5Y forward rates, we would expect them to also have the same 5Y15Y forward rates. Nevertheless, the steepness in the front-end of the Soberano curve ensures that the effect is actually even more pronounced when we look at forward rates rather than yields. We would not take this forward analysis too far, since the Soberano curve is artificially steep thanks to foreign investors taking advantage of forward arbitrage opportunities using short-dated Soberanos and FX hedges; that technical features means that short-end bonds do not reflect expectations of monetary policy. Similarly, one could argue that the fact that Soberanos generally have lower coupons than Mbonos should cause a different curve shape. Yet, since curves are upwards sloping and Peru bonds have longer duration, the back end of Peru's curve should have a higher yield than Mexico's rather than a lower one.

Another relevant consideration is the role of US Treasuries. Since the US is more integrated economically with Mexico than with Peru, one could argue that steepness of the US Treasury curve mattes more for Mexico than for Peru. We have argued in the past ("Is Mexico temporarily the 51st state?" December 14, 2010), that despite the strong link in economic output, the correlation in monetary variables like inflation is

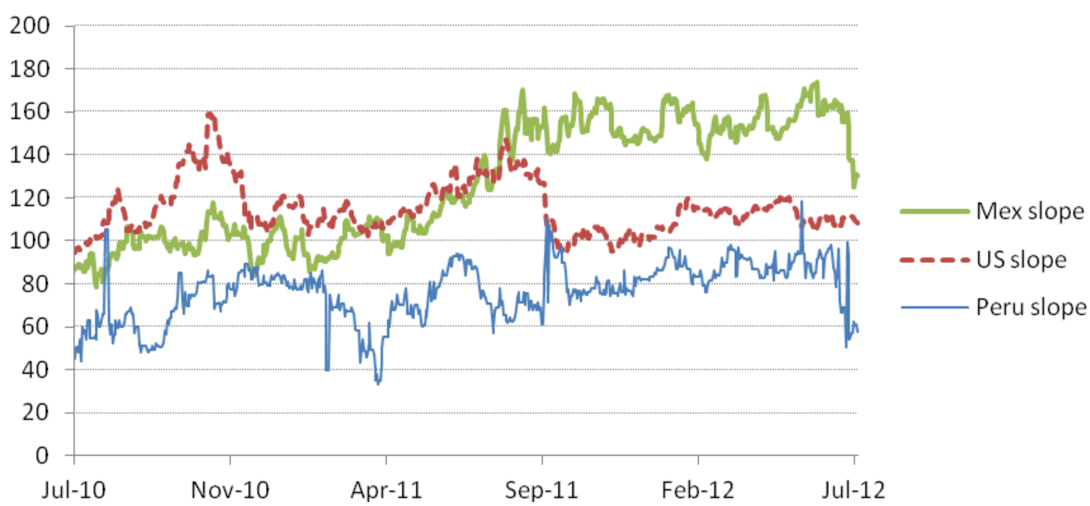
Joe Kogan (212) 225-6541
joe.kogan@scotiabank.com

… continued from previous page

lower than many observers would expect. In addition, Figure 3 shows that, while the slope of the Mexican curve used to be lower than that of the US, it is now higher. Of course the US curve slope was affected by Operation Twist, and it is difficult to know where the curve would be otherwise. Nevertheless, we can see that the slope of the Mexican curve is higher than it was in 2010 even as Mexican 10Y yields are 2% lower. That is perhaps the most surprising aspect of the recent rally, as we would have expected curve slope to decrease in proportion to the level of yields.

Based on this expectation of a convergence in slopes, we would position in the long end of the Mbono curve and the middle of Soberano curve. Some observers believe that the rally in both countries is overdone (see our article "Mysteries of the Mbono rally" from Friday), and for this reason we are not recommending increasing exposure overall right now, but rather merely reallocating across curves. We recognize that the long end of Peru and Mexico may have different betas to global market factors, but the rapidly changing investor base makes this effect hard to estimate and it is probably the Mexican peso that is most sensitive to global factors anyway.

Figure 3. Slopes in Mexico, US and Peru



Source: Bloomberg, Scotiabank GBM. Slopes are Mbono '38 – '20, Soberano '37-'20. As of close on July 13, 2012.

Derek Holt (416) 863-7707
derek.holt@scotiabank.com

Dov Zigler (416) 862-3080
dov.zigler@scotiabank.com

Key Data Preview

CANADA

Retail sales for May are the only major data release in Canada next week (July 24). Scotia expects that retail sales will pick up rather nicely, growing at a 0.6% m/m clip after a soft -0.5% m/m number in April. Our forecast is driven by expectations for higher new car sales, which picked up measurably according to Statscan, as well as a gangbusters reading on the Monthly Survey of Large Retailers, up 6.6% m/m in seasonally adjusted terms. Gasoline prices are a major mitigating factor, as the average price at the pump fell by 2.7% during May according to Bloomberg data. This should provide a drag on the overall number as sales at gasoline stations represent 12.6% of total retail sales albeit based upon more than just gasoline. Our greatest word of caution comes by way of the survey itself, which can move around very rapidly and includes a great many data points that are simply not visible in the wider economy until the retail sales survey itself is released.

UNITED STATES

A first look at **US GDP** for Q2 2012 (July 27) will be by far the most import data release next week. Recall that the initial breaking point for equities during the summer of 2011 — before the US debt ceiling, Chinese slow-down, and EU sovereign plunge took over — was when weak US Q2 GDP numbers were released in late July along with revisions to prior years that showed a longer and deeper recession than previously thought. Scotia is anticipating a GDP print of 1.6% q/q SAAR. The outlook for US GDP deteriorated during the quarter as a result of three factors: a) retrenching consumers as job and income growth disappoint and the focus returns to rebuilding the saving rate, b) a surprising deterioration in the trade balance even as the US's energy production profile improved and prices of the crude products that the US imports fell, and c) a slowdown in investment by US firms who perhaps over-invested during the initial post-2008 recovery years and are now confronting an uncertain global economic environment four years after the crisis reached what was probably its apex. Data from all three of those sectors of the economy were weak in Q2, with growth in consumption of goods going negative in nominal terms – although it seems as if the inflation-adjusted 'real consumption' numbers should show growth. That brings us to one of the two positives this quarter. Falling inflation at least somewhat mitigates the drop-off in activity, and price growth should detract less from GDP in Q2 than it did in Q1 after CPI only increased by 0.18% q/q and PPI fell, registering a -0.8% q/q print. The second positive factor was the ongoing rebound in the housing economy, which remains depressed, but less so than at any time since 2008. The scaling up of the housing economy – albeit to levels that are still the lowest on record prior to 2008 – is a plus that we would point to as likely to make a healthy contribution to GDP, although not enough to make up for weak investment, weak trade, and most of all weak consumption of goods. The risk here is that the low consumption numbers and weak investment will undo all of this and nudge GDP lower. Another risk is that last quarter's gangbusters auto production will result in ballooning inventory numbers in Q2.

US durable goods orders and capital goods shipments for June (July 26) have the ability to cause revisions to US GDP forecasts one day prior to the release of GDP, however, our view is that a flat to moderately negative print on capital goods shipments should leave the overall investment numbers fairly flat with risks that capital goods orders might rise somewhat in light of the strong May +0.7% m/m core durable orders number. In terms of our forecast for durable goods orders, weakness in the ISM new orders for June point to a lower general trajectory (new orders fell from a reading of 60.1 on the index in May to 47.8 in June). While a rise in orders at Boeing from 8 to 24 ought to contribute somewhat on the margin, the reality is that +16 orders will not be enough to swing the number one way or the other. That leaves autos as the 'x-factor', and our view is that between a higher base and strong output from previous months, output of cars should level off. That leaves us anticipating a flat print on headline orders with a decrease by 0.3% on core.

Daniela Blancas (416) 862-3908
daniela.blancas@scotiabank.com

Pablo Bréard (416) 862-3876
pablo.breard@scotiabank.com

Sarah Howcroft (416) 863-2859
sarah.howcroft@scotiabank.com

… continued from previous page

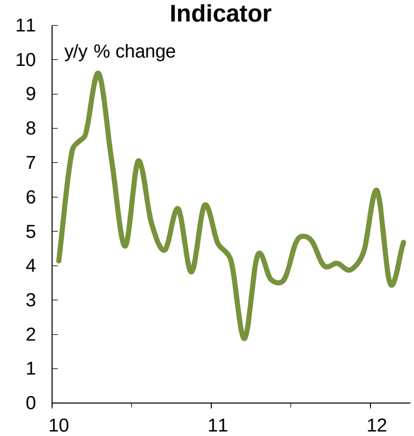
EUROPE

One of the highlights on next week's European data calendar is the advance estimate of second-quarter GDP in the UK. The UK has been in recession since the end of 2011, with output falling 0.4% q/q in the fourth quarter and 0.3% in the first quarter of this year. We estimate that the economy contracted another 0.1% on a quarterly basis in the April-June period, underscoring that the risks to this forecast are weighted to the downside. Several factors held back output in the quarter, including the extra bank holiday in June for the Queen's Diamond Jubilee, unusually poor weather, and the lagged effects from higher energy prices. The purchasing managers' indexes deteriorated considerably in the period, while retail sales remained stagnant. For the year as a whole, we expect growth of no more than 0.2% (underpinned by a rebound in consumer spending during the London Olympics), down from 0.7% in 2011. In this weak economic context, and with inflation surprising on the low side for three consecutive months — the headline rate eased from 3.5% y/y in March to 2.4% in June — the Bank of England (BoE) will have a strong case to further enhance their quantitative easing (QE) program, which was most recently boosted by GBP 50 billion at the bank's July meeting.

LATIN AMERICA

Mexico's economic growth remains on track, notwithstanding the deterioration in the international environment. Industrial production continues to grow at an annual rate close to 3.0%, while retail sales jumped to 5.2% y/y in May. The second quarter seems to have been a strong period for the Mexican economy. The global economic activity indicator (IGAE) for May, which is a proxy of monthly GDP, will be released on July 25th. In April, the indicator expanded by 4.7% y/y, the second biggest increase in the year so far, with the agricultural sector expanding by 8.5% y/y, the service sector by 5.4% and industrial activity by 3.6%. We expect the IGAE to expand at a more moderate pace in May of around 3.6% y/y.

Mexican Economic Activity Indicator



Source: Thomson Reuters

ASIA

The Chinese economy is decelerating as shown by the authorities' concerns with respect to a flagging property market and the implied bias towards a more competitive exchange rate (read, a weaker renminbi versus the US dollar). The flash Manufacturing PMI will provide an advanced gauge of the degree of the activity decline under way. There is a growing consensus that the Chinese authorities (in a political transition year) are implying that a massive 2009-style fiscal stimulus package is not in the making. In turn, further monetary easing (lower reserve requirements and interest rate cuts) will be complemented by an acceleration of capital expenditures for infrastructure development (airports, roads) projects. Nevertheless, the government will remain sensitive to developments in the property market.

Key Indicators for the week of July 23 - 27

North America

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	07/24	08:30	Retail Sales (m/m)	May	0.6	0.5	-0.5
CA	07/24	08:30	Retail Sales ex. Autos (m/m)	May	0.3	0.1	-0.3
MX	07/24	09:00	Bi-Weekly Core CPI (% change)	Jul 15	--	0.1	0.1
MX	07/24	09:00	Bi-Weekly CPI (% change)	Jul 15	0.33	0.3	0.3
US	07/24	10:00	Richmond Fed Manufacturing Index	Jul	-2.0	0.0	-3.0
US	07/25	07:00	MBA Mortgage Applications (w/w)	JUL 20	--	--	16.9
CA	07/25	09:00	Teranet HPI (y/y)	Jun	--	--	5.8
MX	07/25	09:00	Global Economic Indicator IGAE (y/y)	May	3.6	4.2	4.7
US	07/25	10:00	New Home Sales (000s a.r.)	Jun	368	370	369
US	07/26	08:30	Continuing Claims (000s)	JUL 14	3300	3300	3314
US	07/26	08:30	Initial Jobless Claims (000s)	JUL 21	385	380	386
US	07/26	08:30	Durable Goods Orders (m/m)	Jun	0.0	0.4	1.3
US	07/26	08:30	Durable Goods Orders ex. Trans. (m/m)	Jun	-0.3	0.0	0.7
MX	07/26	09:00	Trade Balance (US$ mn)	Jun P	--	-222.5	362.7
US	07/26	10:00	Pending Home Sales (m/m)	Jun	0.0	0.9	5.9
US	07/27	08:30	GDP (q/q a.r.)	2Q A	1.6	1.4	1.9
US	07/27	08:30	GDP Deflator (q/q a.r.)	2Q A	--	1.6	2.0
US	07/27	09:55	U. of Michigan Consumer Sentiment	Jul F	72	72.5	72.0

Europe

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
EC	07/23	10:00	Consumer Confidence	Jul A	--	-20.0	-19.8
FR	07/24	03:00	Manufacturing PMI	Jul P	45.0	45.5	45.2
FR	07/24	03:00	Services PMI	Jul P	47.5	47.5	47.9
GE	07/24	03:30	Manufacturing PMI	Jul A	45.2	45.1	45.0
GE	07/24	03:30	Services PMI	Jul A	50.2	50.0	49.9
HU	07/24	08:00	**Base Rate (%)**	Jul 24	**7.00**	**7.00**	**7.00**
GE	07/25	04:00	IFO Business Climate Survey	Jul	104.1	104.5	105.3
GE	07/25	04:00	IFO Current Assessment Survey	Jul	113.0	113.0	113.9
GE	07/25	04:00	IFO Expectations Survey	Jul	96.0	96.8	97.3
UK	07/25	04:30	GDP (q/q)	2Q A	-0.1	-0.2	-0.3
UK	07/25	04:30	Index of Services (m/m)	May	--	0.2	0.0
SP	07/27	03:00	Unemployment Rate (%)	2Q	--	24.6	24.4
GE	07/27	08:00	CPI (m/m)	Jul P	0.4	0.4	-0.1
GE	07/27	08:00	CPI (y/y)	Jul P	1.7	1.7	1.7
GE	07/27	08:00	CPI - EU Harmonized (m/m)	Jul P	0.4	0.4	-0.2
GE	07/27	08:00	CPI - EU Harmonized (y/y)	Jul P	1.9	1.9	2.0

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

Key Indicators for the week of July 23 - 27

Asia Pacific

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CH	07/22	07:59	HSBC Flash China Manufacturing PMI	Jul	--	--	48.1
HK	07/24	04:30	Exports (y/y)	Jun	--	1.8	5.2
HK	07/24	04:30	Imports (y/y)	Jun	--	1.5	4.6
HK	07/24	04:30	Trade Balance (HK$ bn)	Jun	--	-39.8	-35.6
VN	07/24	06:59	Exports (y/y)	Jul	--	--	22.2
VN	07/24	06:59	Imports (y/y)	Jul	--	--	6.9
JN	07/24	19:50	Merchnds Trade Balance Total (JPY bns)	Jun	--	-140.0	-910.4
JN	07/24	19:50	Adjusted Merchnds Trade Bal. (JPY bns)	Jun	--	-397.8	-657.2
JN	07/24	19:50	Merchnds Trade Exports (y/y)	Jun	--	-3.0	10.0
JN	07/24	19:50	Merchnds Trade Imports (y/y)	Jun	--	1.1	9.3
PH	07/24	21:00	Imports (y/y)	May	--	--	-13.7
PH	07/24	21:00	Trade Balance (US$ mn)	May	--	--	-135.0
AU	07/24	21:30	Consumer Prices (q/q)	2Q	--	0.6	0.1
AU	07/24	21:30	Consumer Prices (y/y)	2Q	--	1.3	1.6
TH	07/25	03:30	**BoT Repo Rate (%)**	Jul 25	**3.00**	**3.00**	**3.00**
NZ	07/25	17:00	**RBNZ Official Cash Rate (%)**	Jul 26	**2.50**	--	**2.50**
PH	07/26	04:00	**Overnight Borrowing Rate (%)**	Jul 26	--	**4.00**	**4.00**
JN	07/26	19:30	National CPI (y/y)	Jun	--	0.0	0.2
JN	07/26	19:30	Tokyo CPI (y/y)	Jul	--	-0.7	-0.6
JN	07/26	19:50	Large Retailers' Sales (y/y)	Jun	--	-1.6	-0.8
JN	07/26	19:50	Retail Trade (m/m)	Jun	--	0.2	0.7
JN	07/26	19:50	Retail Trade (y/y)	Jun	--	1.1	3.6
CH	07/26	21:30	Industrial Profits YTD (y/y)	Jun	--	--	-2.4

Latin America

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
BZ	07/24	09:30	Current Account (US$ mn)	Jun	--	-4050.0	-3467.8
BZ	07/26	08:00	Unemployment Rate (%)	Jun	--	5.6	5.8
CO	07/27	06:59	**Overnight Lending Rate (%)**	Jul 27	**5.25**	**5.25**	**5.25**

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

Global Auctions for the week of July 23 - 27

North America

Country	Date	Time	Event
US	07/23	11:00	U.S. Fed to Purchase USD4.25-5.00 Bln Notes
US	07/23	11:30	U.S. to Sell 3-Month Bills
US	07/23	11:30	U.S. to Sell 6-Month Bills
US	07/24	11:00	U.S. Fed to Purchase USD1.50-2.00 Bln Notes
US	07/24	11:30	U.S. to Sell 52-Week Bills
US	07/24	11:30	U.S. to Sell 4-Week Bills
US	07/24	13:00	U.S. to Sell 2-Year Notes
US	07/25	11:00	U.S. Fed to Purchase USD4.50-5.50 Bln Notes
CA	07/25	12:00	Canada to Sell 10-Year Notes
US	07/25	13:00	U.S. to Sell 5-Year Notes
US	07/26	11:00	U.S. Fed to Purchase USD1.50-2.00 Bln Notes
US	07/26	13:00	U.S. to Sell 7-Year Notes
US	07/27	11:00	U.S. Fed to Sell USD7.00-8.00 Bln Notes

Europe

Country	Date	Time	Event
GE	07/23	05:30	Germany to Sell EU3 Bln 12-Mth Bills
FR	07/23	09:00	France to Sell Bills
SP	07/24	04:30	Spain to Sell 3-Month and 6-Month Bills
SZ	07/24	05:30	Switzerland to Sell 3-Month Bills
GE	07/25	05:30	Germany to Sell Add'l EU3 Bln 30-Year Notes
IT	07/26	05:00	Italy to Sell Zero coupon/BTP
IT	07/27	05:00	Italy to Sell Bills
UK	07/27	06:10	U.K. to Sell Bills

Asia Pacific

Country	Date	Time	Event
CH	07/22	23:00	China Muni to Sell CNY23.1 Bln 3-Year Bonds
JN	07/22	23:35	Japan to Sell 2-Month Bills
JN	07/24	04:00	Japan Auction for Enhanced-Liquidity
CH	07/24	23:00	China to Sell 3-Year Bonds
JN	07/25	23:35	Japan to Sell 3-Month Bills
JN	07/25	23:45	Japan to Sell 20-Year Bonds
NZ	07/26	22:30	New Zealand Plans to Sell Bonds
CH	07/26	23:00	China to Sell 6-Month Bill

Latin America

Country	Date	Time	Event
BZ	07/24	11:00	Brazil to Sell I/L Bonds due 8/15/2016
BZ	07/24	11:00	Brazil to Sell I/L Bonds due 8/15/2018
BZ	07/24	11:00	Brazil to Sell I/L Bonds due 8/15/2022
BZ	07/26	10:00	Brazil to Sell Bills due 4/1/2013
BZ	07/26	10:00	Brazil to Sell Bills due 7/1/2014
BZ	07/26	10:00	Brazil to Sell Bills due 1/1/2016

Source: Bloomberg, Scotia Economics.

Events for the week of July 23 - 27

North America

Country	Date	Time	Event
US	07/23	19:00	Fed's Raskin Speaks on Community Banking in Boulder, Colorado
CA	JUL 23-25		Australia-Canada Economic Forum in Toronto
US	07/24	08:45	Fed's Bernanke Speaks on Early Childhood Ed. in Cincinnati
US	07/25	09:30	Secretary Geithner Testifies to House Committee
US	07/26	10:00	Geithner Testifies Before Senate Banking Committee on FSOC Report
US	07/26	12:15	Treasury's Miller Speaks in Washington

Europe

Country	Date	Time	Event
EC	07/23	03:30	EU Foreign Ministers Meet in Brussels
EC	07/23	10:30	EU Foreign Ministers Meet `Eastern Partnership' Officials
PO	07/23	14:00	Portugal Year-to-Date Budget Report
EC	07/24	04:00	EU General Affairs Ministers Meet in Brussels
EC	07/24	18:00	ECB Publishes Bank Lending Survey
EC	07/24		EU's Schmid Meets Iran's Bagheri in Istanbul
GR	07/24		ECB and IMF Inspectors Meet in Greece to Evaluate Progress
EC	07/25		EU Commission Holds Last Pre-Vacation Meeting

Asia Pacific

Country	Date	Time	Event
AU	07/23	23:05	RBA's Stevens Gives Speech to Anika Foundation in Sydney
JN	07/24	21:30	BOJ Deputy Governor Yamaguchi Speech and Press Conference
CH	JUL 24-26		WTO's General Council Meets
TH	07/25	03:30	**BoT Repo Rate (%)**
NZ	07/25	17:00	**Reserve Bank of New Zealand Reviews Official Interest Rate**
JN	07/25	20:10	BOJ Governor Shirakawa Speech to Futures Industry Association
PH	07/26	04:00	**Overnight Borrowing Rate (%)**

Latin America

Country	Date	Time	Event
CL	07/25	08:30	Central Bank's Traders Survey
CO	07/27		**Overnight Lending Rate**

Source: Bloomberg, Scotia 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	September 5, 2012	1.00	--
Federal Reserve – Federal Funds Target Rate	0.25	August 1, 2012	0.25	0.25
Banco de México – Overnight Rate	4.50	September 7, 2012	4.50	--

BoC: The BoC measurably decreased its forecasts for the Canadian economy in its MPR released July 18. It now sees the output gap closing in H2 2013, sees inflation remaining below 2% through mid-2013, and expects GDP to come in at 2.1% over the course of 2012 (down from a 2.4% forecast in the April MPR). The lower forecasts add to our view that the BoC will be on hold at least through mid-2013 and possibly longer in light of the wider output gap forecast. Fed: Chairman Bernanke's testimony before US Congress emphasized his view that should further policy action be forthcoming from the Fed it would probably involve the use of the Fed's balance sheet. Economic data released recently including weak retail sales and a rebound in initial jobless claims add to the view that the economy is deteriorating. Q2 2012 GDP, which will be released on July 27, will be key.
Banxico: Banco de Mexico left the reference rate unchanged at 4.50% at its latest monetary policy announcement. Banxico highlighted in the statement that Mexican economic conditions remain solid, despite the fact that the international economic environment has turned less positive. Regarding recent inflationary pressures, the monetary authorities stated that upside factors are expected to be temporary and that non-tradable goods inflation remains well anchored.

Europe

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
European Central Bank – Refinancing Rate	0.75	August 2, 2012	0.75	--
Bank of England – Bank Rate	0.50	August 2, 2012	0.50	0.50
Swiss National Bank – Libor Target Rate	0.00	September 13, 2012	0.00	--
Central Bank of Russia – Refinancing Rate	8.00	August 10, 2012	8.00	--
Hungarian National Bank – Base Rate	7.00	July 24, 2012	7.00	7.00
Central Bank of the Republic of Turkey – 1 Wk Repo Rate	5.75	August 16, 2012	5.75	--
Sweden Riksbank – Repo Rate	1.50	September 6, 2012	1.50	--
Norges Bank – Deposit Rate	1.50	August 29, 2012	1.50	--

We do not expect the Hungarian National Bank to adjust monetary policy at the next rate-setting meeting on July 24th. Inflation picked up in June, rising to 5.6% y/y from 5.3%, on strong wage growth and the lagged effects of high energy prices and currency depreciation. The forint was relatively stable between 285 and 290 per euro over the last month as Hungarian credit default swaps continued to move lower (currently around 482 basis points). We do foresee some policy easing over the coming months, given the nation's very weak economic outlook (we anticipate a GDP contraction of near 1% in 2012) and the currently high level of interest rates (at 7%, the policy rate is among the highest in Europe). Ideally, the central bank would like to see an agreement between the government and the EU/IMF on a credit line before moving on interest rates.

Asia Pacific

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Bank of Japan – Target Rate	0.10	August 9, 2012	0.10	--
Reserve Bank of Australia – Cash Target Rate	3.50	August 7, 2012	3.50	3.50
Reserve Bank of New Zealand – Cash Rate	2.50	July 25, 2012	2.50	--
People's Bank of China – Lending Rate	6.00	TBA	--	--
Reserve Bank of India – Repo Rate	8.00	July 31, 2012	7.75	--
Bank of Korea – Bank Rate	3.00	August 8, 2012	3.25	--
Bank of Thailand – Repo Rate	3.00	July 25, 2012	3.00	3.00
Bank Indonesia – Reference Interest Rate	5.75	August 9, 2012	5.75	--

We expect the Bank of Thailand to keep its reference discount rate unchanged at 3% on July 25th. The monetary authorities have joined forces with the government to reinforce a stimulus-driven policy; however, the strong recovery currently in place may raise policymakers' eyebrows as demand-side inflationary pressures develop during the second half of the year. The growth outlook continues to improve and inflationary expectations are receding; in fact, the central bank now expects the headline rate to close the year at 3.3%. Also, the government has recently revised its 2012 growth projection upwards to 6.2% based upon supporting data provided by strengthening export and manufacturing activity.

Latin America

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Banco Central do Brasil – Selic Rate	8.00	August 29, 2012	8.00	--
Banco Central de Chile – Overnight Rate	5.00	August 16, 2012	5.00	--
Banco de la República de Colombia – Lending Rate	5.25	July 27, 2012	5.25	5.25
Banco Central de Reserva del Perú – Reference Rate	4.25	August 9, 2012	4.25	--

We expect the central bank of Colombia to leave its monetary policy rate unchanged at 5.25% at the next meeting scheduled for July 27th. Recent data suggest that Colombian economic activity is moderating, with industrial production contracting for the third consecutive month in May and retail sales recovering slowly from its retrenchment a month ago. Authorities have also highlighted that the economy is decelerating; however, we continue to expect a solid economic performance in the second half of the year.

Africa

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
South African Reserve Bank – Repo Rate	5.00	September 20, 2012	5.00	--

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

Forecasts as at July 6, 2012*	2000-10	2011	2012f	2013f	2000-10	2011	2012f	2013f
Output and Inflation (annual % change)		Real GDP				Consumer Prices[2]		
World[1]	3.7	4.0	3.1	3.6				
Canada	2.2	2.4	2.0	1.9	2.1	2.9	2.0	2.0
United States	1.8	1.7	2.0	2.1	2.5	3.1	2.0	2.0
Mexico	2.1	4.2	3.7	3.6	4.9	3.8	3.9	4.1
United Kingdom	2.0	0.7	0.2	1.5	2.1	4.2	2.2	3.0
Euro Zone	1.4	1.5	-0.7	0.5	2.1	2.7	1.6	1.9
Japan	0.9	-0.7	2.3	1.5	-0.3	-0.2	0.1	0.3
Australia	3.1	2.1	3.1	3.3	3.1	3.1	2.5	2.8
China	9.4	9.3	7.8	8.4	2.3	4.1	4.0	4.4
India	7.6	10.0	6.0	6.5	6.4	7.7	6.5	6.8
South Korea	4.6	3.6	3.4	4.2	3.1	4.8	3.3	3.0
Thailand	4.4	5.7	5.0	4.5	2.7	3.5	3.0	2.8
Brazil	3.7	2.7	2.4	4.0	6.6	6.5	5.0	5.5
Chile	4.6	6.1	5.1	5.6	3.4	4.4	3.2	3.1
Peru	5.5	7.0	6.3	6.2	2.4	4.7	3.0	3.0

Central Bank Rates (%, end of period)	12Q1	12Q2f	12Q3f	12Q4f	13Q1f	13Q2f	13Q3f	13Q4f
Bank of Canada	1.00	1.00	1.00	1.00	1.00	1.00	1.25	1.50
Federal Reserve	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
European Central Bank	1.00	1.00	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	3.75	3.50	3.25	3.00	3.00	3.00	3.25	3.50
Exchange Rates (end of period)								
Canadian Dollar (USDCAD)	1.00	1.02	1.02	0.99	0.98	0.97	0.97	0.97
Canadian Dollar (CADUSD)	1.00	0.98	0.98	1.01	1.02	1.03	1.03	1.03
Euro (EURUSD)	1.33	1.27	1.23	1.23	1.22	1.22	1.21	1.21
Sterling (GBPUSD)	1.60	1.57	1.59	1.60	1.62	1.63	1.64	1.64
Yen (USDJPY)	83	80	81	83	84	85	86	87
Australian Dollar (AUDUSD)	1.03	1.02	0.99	1.02	1.04	1.04	1.05	1.05
Chinese Yuan (USDCNY)	6.3	6.4	6.3	6.3	6.3	6.2	6.2	6.1
Mexican Peso (USDMXN)	12.8	13.4	13.3	13.1	13.2	13.1	13.1	13.3
Brazilian Real (USDBRL)	1.83	2.01	1.96	1.95	1.92	1.87	1.88	1.90

Commodities (annual average)	2000-10	2011	2012f	2013f
WTI Oil (US$/bbl)	54	95	90	95
Brent Oil (US$/bbl)	52	111	104	104
Nymex Natural Gas (US$/mmbtu)	5.81	4.03	2.75	3.00
Copper (US$/lb)	1.93	4.00	3.65	3.45
Zinc (US$/lb)	0.75	0.99	0.89	1.02
Nickel (US$/lb)	7.36	10.38	8.00	7.80
Gold, London PM Fix (US$/oz)	586	1,569	1,665	1,650
Pulp (US$/tonne)	694	977	880	955
Newsprint (US$/tonne)	575	640	640	670
Lumber (US$/mfbm)	273	255	280	310

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

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

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

Canada	2011	11Q4	12Q1	Latest	
Real GDP (annual rates)	2.4	1.9	1.9		
Current Acc. Bal. (C$B, ar)	-48.4	-38.7	-41.1		
Merch. Trade Bal. (C$B, ar)	2.3	14.9	8.9	-9.5	(May)
Industrial Production	3.5	3.0	1.1	1.4	(Apr)
Housing Starts (000s)	193	199	206	223	(Jun)
Employment	1.6	1.2	0.9	1.0	(Jun)
Unemployment Rate (%)	7.5	7.5	7.4	7.2	(Jun)
Retail Sales	4.1	4.2	4.3	3.4	(Apr)
Auto Sales (000s)	1588	1603	1701	1719	(May)
CPI	2.9	2.7	2.3	1.5	(Jun)
IPPI	4.6	3.9	1.7	-6.3	(May)
Pre-tax Corp. Profits	15.4	13.7	5.4		
Mexico					
Real GDP	3.9	3.9	4.6		
Current Acc. Bal. (US$B, ar)	-9.0	-7.5	-0.2		
Merch. Trade Bal. (US$B, ar)	-1.5	-2.9	7.1	4.4	(May)
Industrial Production	4.0	3.5	4.4	7.4	(May)
CPI	3.4	3.5	3.9	4.3	(Jun)
Chile					
Real GDP	6.0	4.5	5.6		
Current Acc. Bal. (US$B, ar)	0.0	-5.1	-1.4		
Merch. Trade Bal. (US$B, ar)	10.0	9.4	11.1	12.4	(Jun)
Industrial Production	6.9	2.1	3.9	2.8	(May)
CPI	3.3	4.0	4.1	2.6	(Jun)
Germany					
Real GDP	3.1	2.0	1.2		
Current Acc. Bal. (US$B, ar)	202.6	254.4	215.8	137.6	(May)
Merch. Trade Bal. (US$B, ar)	216.2	224.1	223.3	235.1	(May)
Industrial Production	8.0	3.4	1.0	8.0	(May)
Unemployment Rate (%)	7.1	6.9	6.8	6.8	(Jun)
CPI	2.3	2.3	2.2	1.7	(Jun)
Euro Zone					
Real GDP	1.5	0.7	-0.1		
Current Acc. Bal. (US$B, ar)	-3	188	-32	-39	(May)
Merch. Trade Bal. (US$B, ar)	6.9	78.5	28.0	95.9	(May)
Industrial Production	3.6	-0.1	-1.5	1.1	(May)
Unemployment Rate (%)	10.1	10.5	10.8	11.0	(May)
CPI	2.7	2.9	2.7	2.4	(Jun)
Japan					
Real GDP	-0.7	-0.5	2.7		
Current Acc. Bal. (US$B, ar)	119.2	48.0	101.1	32.4	(May)
Merch. Trade Bal. (US$B, ar)	-33.4	-75.3	-73.5	-98.9	(May)
Industrial Production	-2.3	0.0	2.7	-2.2	(May)
Unemployment Rate (%)	4.6	4.5	4.5	4.4	(May)
CPI	-0.3	-0.3	0.3	0.0	(May)
China					
Real GDP	10.4	8.9	8.1		
Current Acc. Bal. (US$B, ar)	201.7				
Merch. Trade Bal. (US$B, ar)	155.0	193.0	3.0	380.7	(Jun)
Industrial Production	12.8	12.8	9.3	9.5	(Jun)
CPI	4.1	4.1	3.6	2.2	(Jun)

United States	2011	11Q4	12Q1	Latest	
Real GDP (annual rates)	1.7	3.0	1.9		
Current Acc. Bal. (US$B, ar)	-466	-475	-549		
Merch. Trade Bal. (US$B, ar)	-738	-757	-778	-762	(May)
Industrial Production	4.1	4.0	4.0	4.8	(Jun)
Housing Starts (millions)	0.61	0.68	0.71	0.76	(Jun)
Employment	1.1	1.3	1.6	1.3	(Jun)
Unemployment Rate (%)	9.0	8.7	8.3	8.2	(Jun)
Retail Sales	8.2	7.5	6.4	3.5	(Jun)
Auto Sales (millions)	12.7	13.4	14.5	14.0	(Jun)
CPI	3.2	3.3	2.8	1.7	(Jun)
PPI	6.0	5.4	3.4	0.7	(Jun)
Pre-tax Corp. Profits	4.2	9.3	13.9		
Brazil					
Real GDP	2.5	1.2	0.6		
Current Acc. Bal. (US$B, ar)	-52.5	-63.2	-48.3		
Merch. Trade Bal. (US$B, ar)	29.8	27.0	9.8	9.7	(Jun)
Industrial Production	0.4	-1.8	-3.5	-3.4	(May)
CPI	6.8	6.7		6.6	(Jan)
Italy					
Real GDP	0.5	-0.5	-1.4		
Current Acc. Bal. (US$B, ar)	-0.07	-0.03	-0.07	-0.02	(May)
Merch. Trade Bal. (US$B, ar)	-34.2	-8.3	-17.5	15.5	(May)
Industrial Production	0.3	-3.1	-5.3	-5.8	(May)
CPI	2.8	3.3	3.4	3.3	(Jun)
France					
Real GDP	1.7	1.2	0.3		
Current Acc. Bal. (US$B, ar)	-54.5	-43.9	-50.6	-113.2	(May)
Merch. Trade Bal. (US$B, ar)	-51.1	-46.2	-53.0	-50.0	(May)
Industrial Production	2.4	0.3	-1.5	0.4	(May)
Unemployment Rate (%)	9.7	9.8	10.0	10.1	(May)
CPI	2.1	2.4	2.3	1.9	(Jun)
United Kingdom					
Real GDP	0.8	0.6	-0.2		
Current Acc. Bal. (US$B, ar)	-46.5	-40.7	-76.4		
Merch. Trade Bal. (US$B, ar)	-160.9	-155.6	-157.5	-159.7	(May)
Industrial Production	-0.7	-2.7	-3.1	-1.9	(May)
Unemployment Rate (%)	8.1	8.4	8.2	8.1	(Apr)
CPI	4.5	4.7	3.5	2.4	(Jun)
Australia					
Real GDP	2.1	2.5	4.3		
Current Acc. Bal. (US$B, ar)	-33.1	-39.4	-66.0		
Merch. Trade Bal. (US$B, ar)	35.7	28.9	1.9	27.2	(May)
Industrial Production	-1.1	1.3	4.7		
Unemployment Rate (%)	5.1	5.2	5.2	5.2	(Jun)
CPI	3.4	3.1	1.6		
South Korea					
Real GDP	3.6	3.3	2.8		
Current Acc. Bal. (US$B, ar)	26.5	46.0	10.2	43.3	(May)
Merch. Trade Bal. (US$B, ar)	30.8	36.6	5.8	58.9	(Jun)
Industrial Production	6.9	5.2	2.9	7.8	(May)
CPI	4.0	4.0	3.0	2.2	(Jun)

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

Source: Bloomberg, Scotia Economics.

Interest Rates (%, end of period)

Canada	12Q1	12Q2	Jul/13	Jul/20*
BoC Overnight Rate	1.00	1.00	1.00	1.00
3-mo. T-bill	0.91	0.88	0.87	0.91
10-yr Gov't Bond	2.11	1.74	1.64	1.62
30-yr Gov't Bond	2.66	2.33	2.25	2.24
Prime	3.00	3.00	3.00	3.00
FX Reserves (US$B)	69.2		68.5	(May)
Germany				
3-mo. Interbank	0.71	0.53	0.28	0.21
10-yr Gov't Bond	1.79	1.58	1.26	1.17
FX Reserves (US$B)	67.9		68.3	(May)
Euro Zone				
Refinancing Rate	1.00	1.00	0.75	0.75
Overnight Rate	0.39	0.38	0.12	0.12
FX Reserves (US$B)	319.9		322.6	(May)
Japan				
Discount Rate	0.30	0.30	0.30	0.30
3-mo. Libor	0.13	0.13	0.13	0.13
10-yr Gov't Bond	0.99	0.84	0.78	0.74
FX Reserves (US$B)	1247.8		1239.4	(May)

United States	12Q1	12Q2	Jul/13	Jul/20*
Fed Funds Target Rate	0.25	0.25	0.25	0.25
3-mo. T-bill	0.07	0.08	0.08	0.09
10-yr Gov't Bond	2.21	1.64	1.49	1.46
30-yr Gov't Bond	3.34	2.75	2.57	2.54
Prime	3.25	3.25	3.25	3.25
FX Reserves (US$B)	138.0		137.8	(May)
France				
3-mo. T-bill	0.07	0.04	-0.01	-0.02
10-yr Gov't Bond	2.89	2.69	2.23	2.07
FX Reserves (US$B)	49.2		49.6	(May)
United Kingdom				
Repo Rate	0.50	0.50	0.50	0.50
3-mo. T-bill	0.37	0.37	0.36	0.35
10-yr Gov't Bond	2.20	1.73	1.55	1.48
FX Reserves (US$B)	82.4		84.6	(May)
Australia				
Cash Rate	4.25	3.50	3.50	3.50
10-yr Gov't Bond	3.98	3.04	2.89	2.93
FX Reserves (US$B)	47.7		47.8	(May)

Exchange Rates (end of period)

	12Q1	12Q2	Jul/13	Jul/20*
USDCAD	1.00	1.02	1.01	1.01
CADUSD	1.00	0.98	0.99	0.99
GBPUSD	1.601	1.571	1.558	1.563
EURUSD	1.334	1.267	1.225	1.217
JPYEUR	0.90	0.99	1.03	1.05
USDCHF	0.90	0.95	0.98	0.99
¥/US$	82.87	79.79	79.18	78.50
US¢/Australian$	1.03	1.02	1.02	1.04
Chinese Yuan/US$	6.30	6.35	6.38	6.37
South Korean Won/US$	1133	1145	1150	1141
Mexican Peso/US$	12.811	13.361	13.290	13.294
Brazilian Real/US$	1.827	2.009	2.037	2.024

Equity Markets (index, end of period)

	12Q1	12Q2	Jul/13	Jul/20*
United States (DJIA)	13212	12880	12777	12848
United States (S&P500)	1408	1362	1357	1368
Canada (S&P/TSX)	12392	11597	11515	11602
Mexico (IPC)	39521	40200	40498	40772
Brazil (Bovespa)	64511	54355	54331	54650
Italy (BCI)	859	761	746	748
U.K. (FT100)	5768	5571	5666	5656
Germany (Dax)	6947	6416	6557	6635
France (CAC40)	3424	3197	3181	3194
Japan (Nikkei)	10084	9007	8724	8670
Hong Kong (Hang Seng)	20556	19441	19093	19641
South Korea (Composite)	2014	1854	1813	1823

Commodity Prices (end of period)

	12Q1	12Q2	Jul/13	Jul/20*
Pulp (US$/tonne)	870	900	900	900
Newsprint (US$/tonne)	640	640	640	640
Lumber (US$/mfbm)	279	283	294	295
WTI Oil (US$/bbl)	103.02	84.96	87.10	91.23
Natural Gas (US$/mmbtu)	2.13	2.82	2.87	3.00
Copper (US$/lb)	3.85	3.45	3.49	3.46
Zinc (US$/lb)	0.91	0.84	0.85	0.84
Gold (US$/oz)	1662.50	1598.50	1595.50	1576.25
Silver (US$/oz)	32.43	27.08	27.48	27.07
CRB (index)	308.46	284.19	293.96	303.46

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

Emerging Markets Strategy

www.gbm.scotiabank.com

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

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

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

Scotia Economics

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

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