Global Views

Weekly commentary on economic and financial market developments

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Global Views **is available on: www.scotiabank.com, Bloomberg at SCOE and Reuters at SM1C**

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Rain Or Shine In Spain?

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

Spain could well dominate **European** and global risks next week. The Spanish cabinet is expected to approve the government's 2013 budget and present it to Parliament on Thursday amid rumours that the ECB-IMF-EC troika is negotiating an aid package to Spain that could come as soon as that same day. What could further play into this is an update to Spain's calendar YTD budget deficit. Up to July, Spain's year-to-date deficit equalled a cumulative €203 billion, or 44% larger than the €141 billion deficit over the same period in 2011. It's likely that deficit pressures are becoming more acute in light of deteriorating growth across the eurozone compounded by pressures to bail-out the regions. Thus, worsening deficit pressures could be the tipping point to encourage Spain to phone a friend. Portugal also releases its year-to-date budget report next week but is less in the limelight than Spain. Moderate European data risk will be focused upon German CPI that is expected to come in soft via a flat m/m print. German business confidence will also be watched for signs that its decline since April to the weakest level since June 2009 may be arrested particularly given improved German investor confidence. Eurozone confidence readings will also play into this debate. A strong suit for Germany has been a steady unemployment rate that sits at a record post-reunification low that is expected to persist into the September print. French consumer spending, Italian retail sales and CPI, and final UK Q2 GDP revisions will round out the hits. Auction risk will be relatively modest and focused upon Italy and Germany.

This will be a big week for **Canadian** markets as we get further readings on how the economy is faring in Q3. If our call for a decline in July's monthly GDP print comes true on Friday, then GDP growth for the quarter as a whole could well come in slightly to either side of no growth over the prior quarter based upon what we know about the Q2 hand-off and assuming flat GDP readings in August and September. If that happens, then growth would seriously under-shoot the BoC's expectation for 2% GDP growth in Q3 which itself had been revised down from an earlier forecast of 2.4%. For the quarter as a whole, the hits the country is taking to manufacturing, international trade and wholesale sales are sizeable enough to put downside risks to such relatively buoyant views. On Tuesday, July retail sales land. They will be used to firm up calls for monthly GDP later in the week so watch for revision risk following the initial consensus GDP call that is available now. Our hunch is that retail sales won't help the cause in that we already know that large hits were taken by auto sales, gasoline prices, and Statistics Canada's survey of large retailers for the same month. A drop in retail sales for the second month in a row, the third month in the past four, and the fourth in the past six months, would be consistent with summertime evidence of a rapid swing toward weakness in Canadian housing markets. All Canadian consumer and housing variables sit at all-time record highs such that as the country reaches points of exhaustion on consumer spending and home buying, a correction is being encouraged through pro-cyclical regulatory policy that has sharply tightened mortgage financing terms over recent years. Before either of these sets of numbers lands, Bank of Canada Governor Mark Carney speaks at a CEOs conference on "Canada In The Pacific Century" thousands of miles away from the Pacific in Ottawa — perhaps to bring the Pacific's agenda closer to federalism's back yard. It will be interesting to see if Carney's sharply critical messages regarding business leadership in Canada that have been focused upon allegedly excessive cash holdings, poor productivity, conservative investment practices and a narrow US-centric focus on global trading opportunities are applied as stridently before this audience, and to what extent his audience reacts differently from more sympathetic audiences such as a recent speech before unionized auto workers. Canada auctions 2s on Wednesday which may be attractively positioned for bets on an extended BoC pause.

If the BoC does not shift its bias next month, then it must more clearly spell out the criteria for doing so. The standard criteria to be judged within the context of the BoC's communicated reaction function appear to be toppling off the list one at a time. Need soft and disappointing growth? Check, particularly given risks that Q3 growth comes in flat given what we know at a very preliminary stage. Is spare capacity closing off? Nope, it's actually widening as growth disappoints and will probably widen further over coming quarters making it unlikely to close the output gap by the end of next year as per BoC expectations. How about undershooting inflation? Check, as elaborated upon above. Geopolitical risks would need to settle down, right? Yes, but the eurozone has enormous ability to blow it yet, the fiscal cliff still looms in the US, Chinese growth worries and their regional spillover effects are intensifying, and then there's the Middle East. Ok, but surely housing has to soften in order to allay BoC and Finance concerns? Check, been to Vancouver or Toronto lately? Coming off structural peaks isn't being helped by pro-cyclical housing finance policy. But wait a minute, the BoC has made it clear it wants much softer growth in household debt! Check!! Alright then, Uncle! For how we think the BoC may shift its bias, see our piece "BoC Implications Stemming From Federal Reserve Policy," in last week's *Global Views*.

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US markets face elevated data risk throughout much of next week and this carries the potential to impact the global market tone through key waves of updates to big ticket orders, consumer spending and housing markets. Expect a large retrenchment in durable goods orders when the August print lands on Thursday, but the key will lie beneath the headline. We already know there was a large plunge in volatile aircraft orders. After 260 planes were ordered from Boeing in July in the wake of major world air shows, only one plane was ordered in August. Thus, while the large gain in aircraft orders in July had propelled durable goods orders higher, the give-back will occur in the August figures. Markets are likely to look past any scream effect stemming from the headline print and have a second thought focused upon core orders excluding the volatile transportation sector (both autos and planes). Consensus is expecting a small gain on this component, but there is often very little to go by in making the call so the tail risk is usually high. A wave of consumer and housing market reports, however, will dominate the week's attention and provide us with a much better understanding of how the household sector is shaping up in Q3. S&P Case-Shiller house prices are expected to rise for the sixth consecutive month. One of the parts to our assessment of the durability of a US housing recovery on pp. 4-7 entails acknowledging that rising home prices have resulted in a deterioration in housing affordability compared to the best point for affordability back in February although affordability remains strong. Weaker affordability combined with potential confidence shocks such as the year-end fiscal 'cliff' effect may at least put temporary downside risks to the durability of a turnaround across an otherwise broad array of housing indicators. Wednesday's new home sales will be watched in this same context. There was a gentle rise in new home sales over the back half of last year that petered out into 2012, but more important is that there is a large and growing disconnect between soaring measures of foot traffic through model homes versus still soft new home sales. This either suggests that pent-up buying lies waiting in the wings once shoppers turn to buyers, or that traipsing through model homes for decoration ideas has returned as a family pastime. Pending home sales for the month of August will further add to this picture, and this has indeed been a bright spot that is translating into gains in completed resale transactions. A strong gain in July's pending sales, however, may pose a high base effect off of which further growth in August may be difficult to achieve. As for the consumer, key will be two measures. One is that the Conference Board's consumer confidence measure trades off competing influences through weak job markets versus stronger stock markets. The other lands on Friday with income and spending figures for August that we think will result in soft income growth, and a firm gain in total consumer spending following the already known gain in retail sales that likely came at the expense of the personal saving rate. No revisions are expected when the final print for Q2 US GDP lands on Thursday. The US auctions 2s, 5s and 7s next week. We are not bearish toward the near-term dynamics in U.S. Treasuries because of continued concerns over global growth and how that may translate into revenue weakness in the stock market, the prospect for yet further quantitative easing from the Federal Reserve, and safe haven seeking into year-end through fiscal 'cliff' dynamics. Fed speak continues at a somewhat less hectic pace next week with dovish San Francisco Fed President John Williams (voting 2012, non-voting non-alternate 2013), dovish Chicago Fed President Charles Evans (non-voting non-alternate 2012, voting 2013) trading comments with hawkish Philadelphia Fed President Charles Plosser (Non-voting non-alternate 2012, alternate 2013).

Asian markets will put Japan's troubled economy into the spotlight and may therefore result in thank you cards coming from Europe. Each of jobs, household spending, retail sales, CPI, industrial production and housing starts will be updated for the Japanese economy. The fact that the country's economy is troubled is an understatement. Retail sales have been falling, deflation has reared its ugly face again and is expected to persist into the September readings, and factory output has been in a free-fall over recent months. This was supposed to be a better year for sustained gains in the economy in the wake of last year's devastating earthquake and tsunami but two forces are pummeling growth. One is economic weakness in China and turbulent political relations with that country. The other is an elevated yen that shook off an additional ¥10 trillion in monetary easing by the Bank of Japan to push higher yet. A driving force behind the yen is that domestic deflationary pressures have widened the real rate gap compared to other countries that are experiencing soft inflation. Yen strength is seriously eroding the competitiveness of Japan's domestic production and exports. Further to this issue will be minutes to the Bank of Japan's meeting on August 8th-9th at which the additional stimulus was unexpectedly announced. They will be parsed for evidence on why the additional bond buying was delayed until into next year, and for further colour on what motivated the announcement other than obvious points like weakness spilling over from China, yen strength, and political pressures. China releases the final print on the private sector version of its manufacturing PMI in the wake of the continued deterioration in the preliminary 'flash' reading that was released this past week. Finally, the spillover effects of weakness in China's economy will also be examined in the form of trade figures for Hong Kong, the Philippines, Thailand and New Zealand plus industrial production in South Korea.

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Is US Housing Really On The Mend?

- **We survey the evidence and conclude that cautious optimism is warranted, but it could easily be short-lived should the fiscal cliff or global developments derail confidence again.**

One of the top US macro themes governing the outlook for the United States is whether the housing sector is finally on the mend. In addressing this question, we review the mixed evidence across a variety of indicators and conclude that while there is limited cause for encouragement, frail job markets and the looming fiscal 'cliff' could make this just another head fake.

Unambiguously Better Readings...

The first batch of indicators we'll explore capture unambiguously better readings on the health of US housing markets than anything we've seen since the crisis began to unfold.

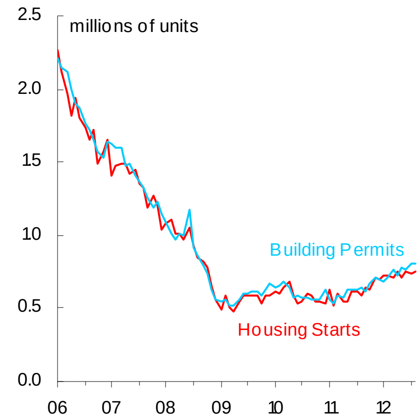
Chart 1 shows that the level of home building activity has steadily trended higher and currently sits at its most elevated reading since 2008 as building permits point to further strength ahead. Construction is still a fraction of what it once was, but the trend is right and it is contributing toward muted improvement in the economy by virtue of decent trend gains albeit off a low base.

Chart 2 backs this up. There is room for adding to the new housing stock by virtue of the leanest inventory of unsold new homes ever with records stretching back to the 1960s. We'll come back to the resale inventory picture.

What is also encouraging is that new home sales (thick line) have trended mildly higher to the best reading since the Spring of 2010 (chart 3). What is puzzling, however, is the extreme disconnect between new home sales and the National Association of Homebuilders' measure of prospective buyers that captures foot traffic through model homes that is also shown on the same chart. Normally the two series are reasonably well connected, but this time around, foot traffic is far stronger. This could be because foot traffic is an index reading based upon qualitative answers to the question of whether traffic is better, the same or lower. Thus, it is not a volume measure like new home sales. So, there can be better traffic through model homes, but still just a trickle of the past. Another possibility is that new home sales may rise as foot traffic translates into sales. A third possibility is clearly just that foot traffic represents window shoppers with no intention to buy.

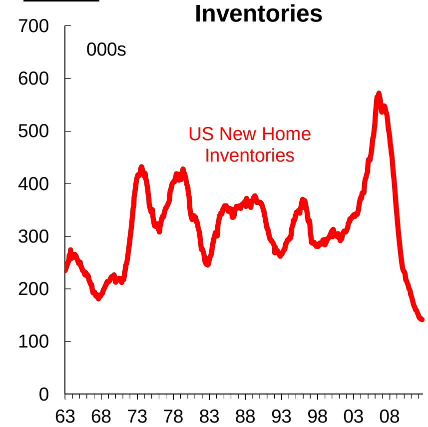
Chart 4 also shows that markets have not been as positive toward homebuilder prospects as they are now since before the crisis hit. The homebuilder equity sub-index on the S&P500 is at its highest level in about five years. This will not just reflect housing market prospects, however, since equity valuations will also reflect factors such as capital structure shifts and changes in discount rates that are partly attributable to policy developments.

Chart 1 **More Building!**



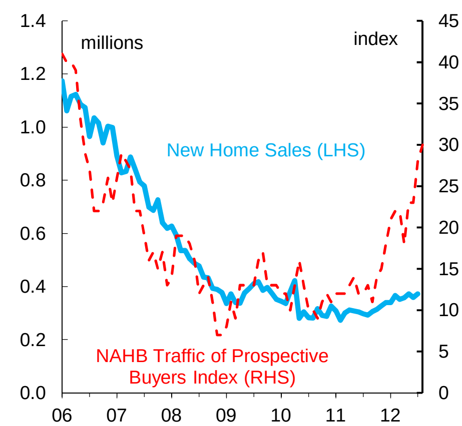
Source: U.S. Census Bureau, Scotia Economics.

Chart 2 **Record Low For New Home Inventories**



Source: Bloomberg, U.S. Census Bureau, Scotia Economics.

Chart 3
More Shoppers Than Buyers



Source: U.S. Bureau of the Census, NAHB, Scotia Economics.

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...Accompanied By More Ambiguous Indicators

The next batch of readings have posted improvements, but fall into the category of having seen it before as opposed to the prior section that focused upon consistently improving trends.

Charts 5-6 show that pending home sales and existing home sales have markedly improved since the lows set in 2010. Recall that pending home sales are transactions that are mostly 30-60 days away from closing off all of the paperwork and showing up in a completed resale transaction. The two often have a lagged relationship, with the risk that separations can occur due to turmoil that may cause contract cancellations for one reason or another. We are cautious toward both of these indicators, however, because we've seen evidence of strength in the past such as in 2009 and early 2010.

The composition of resales is also encouraging. Distressed sales are a falling share of total purchases as a somewhat more normalized type of sale re-enters the market. Distressed sales accounted for about 22% of total sales in the latest report for August, and this is down from the 30% range late last year and into early this year. This is because of fewer foreclosure sales and fewer short sales.

In chart 7, we show that the recent pick-up in house prices as measured by the S&P Case-Shiller metric which focuses on repeat-sales can by no means be called a secular break-out. In fact, it's the fourth upward trend we've witnessed since the US recession — and while we work on the fourth, it bears noting that three of the four prior cases proved to be head fakes.

There Are Still Important Pressure Points

There is a third category of readings that we end upon because they counsel a bit more caution.

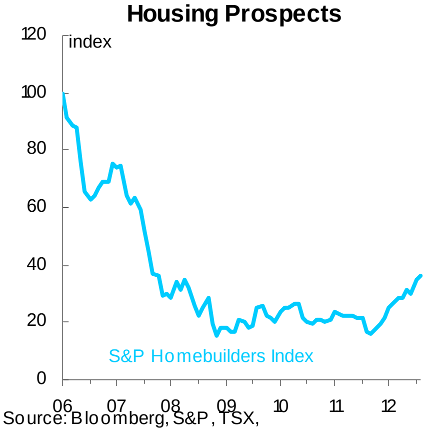
A) Affordability — Good, But Falling

One is that housing affordability had reached its best point on record by February of this year at which point house prices had bottomed. Since then, rising house prices and disappointing growth in jobs and incomes combined to drive affordability weaker (chart 8). Affordability has now deteriorated to levels that are more in keeping with the average of the late 2010 onward period. In the context of very weak job growth and still rising house prices, it is possible that this deterioration in affordability will spark a softening in housing demand going forward. In other words, house prices may have run ahead of the capacity of job and income growth to fund purchases.

Then again, perhaps accelerated job growth is not needed in order to sustain housing strengths. Eventually it would be, but for an interim period it is reasonable to think that pent-up demand from postponed purchases by employed individuals could be released and thus drive sustained housing strength until enough momentum has gathered to spill over into lagged job gains via multiplier effects upon the rest of the economy.

Chart 4

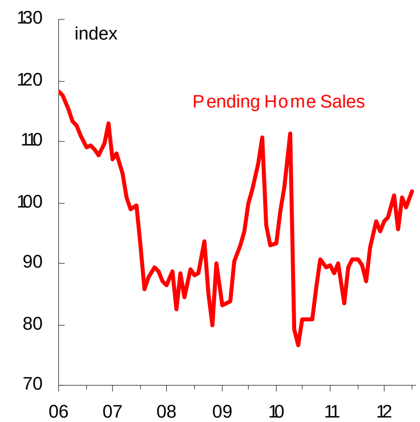
Markets More Optimistic Toward Housing Prospects



Source: Bloomberg, S&P, TSX, Scotia Economics.

Chart 5

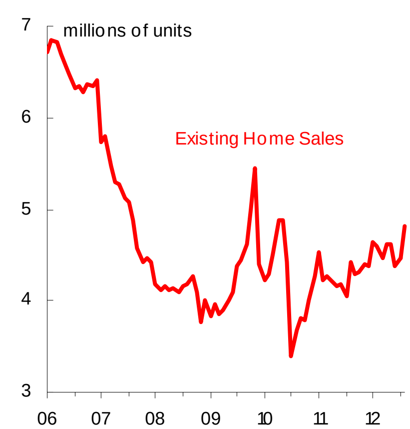
A Leading Indicator...



Source: NAR, Scotia Economics.

Chart 6

... For An Accelerating Resale Market



Source: NAR, Scotia Economics.

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Another complicating factor is the role of price expectations. Should employed prospective buyers believe that prices have bottomed and will continue to trend higher, then this could have them believing that affordability will further deteriorate. The motivation could well turn out to be supportive of additional buying activity. This therefore leads into a discussion on confidence on two counts.

B) Large And Rising Shadow Inventory

The first confidence factor concerns the outlook for prices. As chart 9 demonstrates, the stock of vacant primary-occupancy homes held off-market continues to rise. This is a key component to measuring shadow inventories. The normal pre-crisis run rate for this measure was around the 2.6-2.8 million range and we're now pushing toward 4 million. This extra roughly 1¼ million vacant homes mostly represents foreclosed homes that lenders are keeping off the market. To this is added vacant non-primary occupancy homes like seasonal residences. The normal run rate on that was around 3 million prior to the crisis, and now stands at about 3.7 million. This extra 700,000 should be added to the extra 1¼ million vacant primary homes held off-market for a grand total of about two million vacant residences being held off-market. Of course, there are also homes that are going through foreclosure that may not yet be vacant, and homes that have not yet started foreclosure proceedings but that might should lenders have more confidence toward the prices they may fetch upon resale. Added to this is the possibility of pent-up demand for foreclosures by banks that have been increasingly reticent to do so either because of regulatory pressure or because they fear being stuck with an asset they can't sell and that might diminish in value if left vacant.

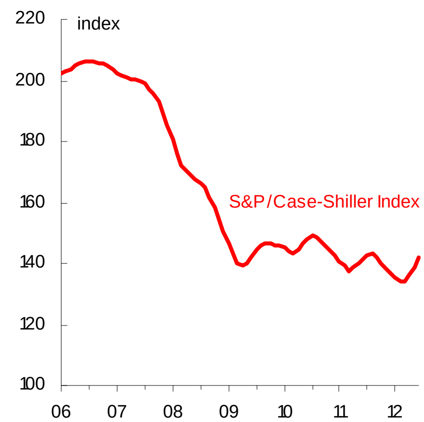
This leads to our concern about the sustainability of house price gains in a general equilibrium sense. As housing recovers — if it has legs — there will be pressure upon lenders to shed their inventory of empty homes. Add to this the likelihood that more people who have not been foreclosed upon may well list their homes if they think they have finally clawed back losses. These two forces could bring idled supply back into the market just as demand improves. How this happens only time will tell, but it bears mentioning that the supply side will adjust alongside the demand side in such a manner as to constrain any tendency toward a strong trend improvement in house prices for some time yet. If it happens, then the supply side is likely to respond and thus cap the gains.

C) Not Showing Up In Mortgage Debt Growth

Finally, consider the implications for lenders. As yet, mortgage purchase applications and mortgage debt are not picking up in any material sense (chart 10). Indeed, the Fed's flow of funds

Chart 7

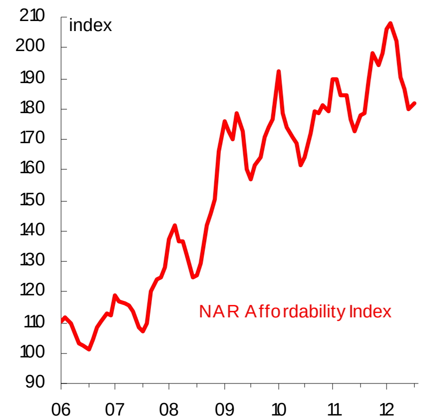
For Real, Or Just Another False Start?



Source: Bloomberg, Scotia Economics.

Chart 8

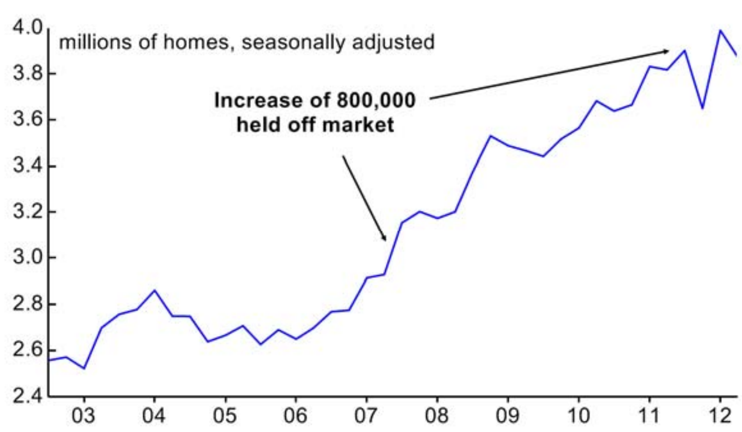
Affordability Past Its Prime



Source: NAR, Bloomberg, Scotia Economics.

Chart 9

Vacant Primary-occupancy Homes Held Off-market



Note: Primary occupancy homes, excluding seasonal & occasional use.
Source: U.S. Census Bureau.

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report just noted that mortgage debt outstanding fell by 2.1% q/q in 2012Q2 and this continued the long string of crisis-era negatives.

Conclusion

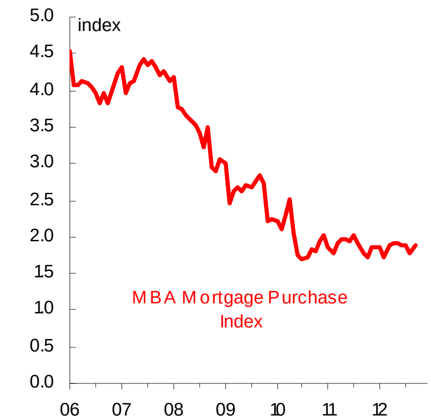
In our opinion, an overall take on US housing market developments cannot be expressed stronger than to point to cautious market optimism. Market timers should be more careful than buy-and-hold patient money. The structural and more recent cyclical improvements across a broad array of indicators is encouraging, and lean new home inventories are an important offset to still-high shadow resale inventories. All of this must be expressed in the context of sound demographic supports as the kids of the aging baby boomers gradually begin moving into the owned accommodation housing segment. Born roughly since the late 1970s, the oldest among them are pushing into their early 30s while the full generation covers roughly a two-decade cohort skewed toward younger than this leading edge. On the assumption that the parents will eventually wish their kids well (a push effect) and that a longer-run recovery will support their kids to become heads of their own households (a pull effect), the structural demand drivers should be supportive. When coupled with still-excellent housing affordability in a long-run historical sense, the conditions are ripe for a turnaround in US housing markets.

You may recall that we mentioned there were two confidence factors to consider. What will determine the outcome to the US housing story is exactly what has scuttled hopes several times in the recovery period already: confidence and jobs. Pent-up demand will only be released should fiscal 'cliff' turmoil not derail markets into year end. This depends one part upon how the process is handled and two parts upon the outcome defined in terms of the magnitude of retrenchment in both taxation and expenditure policies. Via the interconnectedness of the global economy, the ability of Europe and China to stabilize growth risks and market confidence while averting greater turmoil in the Middle East also plays into the outlook for U.S. housing.

The final broad takeaway is to remind our readers that housing and asset bubble corrections like that which the United States has experienced take many years to work through. For instance, it took about seven years for Canadian housing starts to bottom in the correction of the 1990s and it took prices in markets like Toronto a decade and a half to recoup their losses. Canada's deleveraging was considerably less significant in the household sector back then, although it was much more focused upon public and corporate finances. As supply and demand adjust dynamically in the US housing market, a path toward improvement is bound to be long and bumpy.

Chart 10

Mortgage Loans Not Picking Up



Source: MBA, Scotia Economics.

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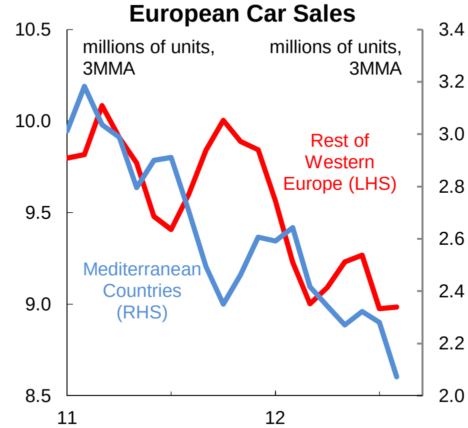
Western European Car Buyers On Vacation

- **The Mediterranean nations remain the epicentre of the downturn, but summer buying weakened throughout the Continent.**

The downturn in car sales across Western Europe accelerated in July and August, with volumes declining 8% y/y — a significant deterioration from a 1.7% y/y slide in June. In fact, on a seasonally adjusted basis, volumes slumped to a low of 11.1 million units (annualized) during the last two months — the lowest level on record (data going back to 1996). As in previous months, the Mediterranean nations — Portugal, Spain, Italy and Greece — accounted for most of the weakness, with volumes slumping 19% below a year earlier, in line with the decline so far this year. However, activity in the rest of Western Europe has weakened during the summer, falling to an annualized 9.0 million units from 9.2 million during the first half of 2012, as the ongoing debt crisis has eroded both consumer confidence and economic activity.

Downshift Continues for European Car Sales



Source: Scotia Economics.

In August, purchases were weakest in Greece and Portugal, plunging year-over-year by 47% and 33% respectively, undercut by rising unemployment and ongoing austerity measures. Sales also dropped by more than 20% y/y in Italy, undermined by unemployment of 10.7% — the highest level since the late 1990s. In contrast, purchases actually improved in Spain as households rushed to beat the increase in the VAT sales tax from 18% to 21% effective September 1st. During August, car sales in Spain increased 3.4% y/y, but the improvement will be reversed in September and full-year volumes will slump below 800,000 units for the first time since the mid-1980s. Annual car sales in Spain peaked at 1.65 million units in 2005.

Outside of the Mediterranean nations, sales were weakest in France last month, dropping 11.4% y/y due to a loss of economic momentum. French GDP has stagnated for three consecutive quarters and unemployment has jumped above 10% for the first time since the late 1990s. As a result, full-year 2012 car sales in France will fall below 2.0 million units — the lowest level since 1998. In contrast, volumes in the U.K. have advanced for six consecutive months, led by a 12% y/y improvement in household purchases. The labour market is healthier in the U.K. than in the euro zone, with employment increasing by 1.6% so far this year — a pace similar to the growth of job creation in the United States — reducing the unemployment rate to 8.1%, down from a peak of 8.4% in late 2011. Strengthening household volumes — which normally account for 40% of the U.K. car market — are likely to lift full-year sales above 2.0 million units in 2012 from 1.94 million in 2011. However, events in the euro zone are weighing on the U.K. and global economy and continue to pose downside risks to the outlook. The U.K. is especially vulnerable, as more than half of its overall merchandise exports are destined to the euro zone. U.K. exports to the euro zone continued to advance through the first quarter, but have weakened in recent months, falling 8.2% y/y in July.

Car sales in Germany — the second-largest destination for U.K. exports and the biggest auto market in Western Europe — had improved moderately in the first half of 2012, but purchases have fallen below a year earlier for two consecutive months, as slowing employment and income growth have reduced consumer confidence to a two-year low. In August, car sales in Germany fell 5% below a year earlier, a sharp deterioration from a 1% y/y advance during the first half of 2012.

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UK Inflation — Bye Bye Carli!

The Wrong Kind of Inflation

- The UK has several measures of inflation. The main ones are:
    - CPI — the headline measure of inflation targeted by the Bank of England — and the methodology harmonised across Eurozone economies;
    - The RPI — the retail price index, created early in the last century designed specifically for wage settlements. This is the reference measure for inflation-linked gilts; and
    - The RPIX — close relative of the RPI, but excluding mortgage interest payments. Prior to 2004 this was the measure targeted by the Bank of England.
- When one measure of inflation breaks, we build a new one. Over the last couple of years when the government introduced indirect tax hikes and cuts, the headline measure of CPI inflation became distorted. At the time, a new measure that stripped out indirect taxes rose to prominence — CPI-CT.
- Not long after that, spikes in energy and agricultural commodity prices pushed even this measure well above the Bank of England's target. This provoked some (including ex-MPC member Adam Posen) to adapt the CPI-CT measure further — stripping out volatile items such as energy and food to give us Core CPI-CT.
- In big picture terms, all you need to know is that UK inflation has been persistently elevated and likely to remain so for the foreseeable future. But at a more micro level, major developments are underway.

The Wrong Clothes

- The clothing component of the CPI and RPI uses the same individual prices, but aggregates them differently. The problem arose from early-2010 when the methodology was tweaked. In simple terms, the CPI showed clothes price inflation around zero, while the RPI showed prices rising at around 10% y/y — despite being based on the same underlying prices.
- Throughout this year, the Consumer Prices Advisory Committee (CPAC) has been considering how to address the problem. This week, we received the best clues as to how this is likely to be done. It is easy to over-complicate the issue, so here is the guts of it:
    - The CPI can't be changed because the methodology is harmonised with Europe. Furthermore, the problem is not with the CPI — it is the near 10% y/y RPI clothing inflation that is dodgy;
    - 30% of the RPI uses a particular averaging formula called Carli. This tends to show a higher pace of inflation when prices are widely dispersed. The clothing component falls into this group (with a weight of around 7%).
    - The CPAC has a number of options. The main ones under consideration are:
        - to abandon this Carli formula for just the troublesome clothing component; or
        - abandon the problematic Carli formula for the entire RPI.
    - If Carli is dumped for just clothing this will reduce RPI inflation by 0.3% y/y forever. Since a sizeable chunk of the national debt has interest payments linked to RPI inflation, this drop in RPI inflation would reduce the Chancellor's annual interest bill by around GBP1bn.
    - If Carli is dumped for the entire RPI, it will reduce RPI inflation by around 0.9% and save the Chancellor GBP3bn per year.
- This is good news if you are the Chancellor, a rail commuter, smoker or heavy drinker (since fares and sin tax increases are linked to the RPI) — you will be better off. Unfortunately, there are likely to be several disgruntled groups — not least holders of inflation-linked bonds who will get less interest from the Chancellor from next year onwards.
- The potential changes will be the subject of a public consultation starting in early October and concluding in November. The CPAC considered less aggressive alternatives, but they simply weren't powerful enough. So the dilemma is between the sledgehammer option (i.e. just change the clothing component) or the nuclear option (get rid of the Carli formula from the entire RPI). On the first, fixing clothing will take

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RPI inflation back to where it ‘should be’ i.e. before this distortion arose. BUT, it would leave a dark cloud of uncertainty. What if another component randomly begins to develop the same symptoms as clothing? For inflation-linked bond investors there will be a nagging concern that CPAC may eventually go the whole hog and abandon Carli for the rest of the index. We believe that this would dampen appetite for these bonds even though the RPI was spared the more radical treatment.

- Meanwhile, the nuclear option would fix the RPI once and for all and eradicate any uncertainty. However, there will be a lot of upset inflation-linked bond holders (these account for around a third of the national debt) and could make it harder for the government to borrow.

Mind the Gap(s)!

- There are several gaps to consider here. The first is the gap in the overall wedge between RPI and CPI inflation. On average, prior to 2010 that gap was between ½ and ¾ of a percentage point. The second gap to consider is the ‘formula effect’. This describes the difference between the RPI and CPI measures of inflation due to the different averaging techniques. This is currently the biggest contributor to the overall wedge. Prior to 2010, the biggest contributors to gyrations in the overall wedge were the housing components. These are included in the RPI, but not the CPI. So when there were big swings in house price inflation and mortgage rates, the RPI used to diverge from the CPI.
  - The headline RPI-CPI gap is currently 0.4% points;
  - The formula effect is currently 0.9% points.
  - By late next year, if the nuclear option is chosen and nothing else changes, the formula effect should be close to zero — meaning that RPI inflation could be as much as half a percentage point below the CPI measure of inflation.
  - That is not unheard of. In 2009 RPI inflation was well below CPI inflation (and fell to below -1% y/y as the housing components slumped (house price inflation was deeply negative and mortgage rates were falling by over 40% y/y).
  - Indeed, it is the housing components that are likely to cause RPI inflation to be below the CPI by late next year. Mortgage rates *should* be going sideways or down if the BoE is successful with its Funding for Lending Scheme (FLS) or whatever alterative policy measures that it may opt for.
  - Furthermore, at around 1% y/y the house price inflation component of the RPI is a touch high at the moment given that it lags the Nationwide and Halifax measures of house price inflation. This should exert a further drag on the RPI going into next year.
- All in all, change is coming. The only question is how extreme? As far as inflation-linked bonds are concerned, this is bearish for all linkers except the IL-13 which matures before these changes come into force. Given the delay in the changes fully taking effect, shorter-dated linkers are likely to be immunised to some degree since only just over half of the remaining lifetime of the IL-16 will be affected by the changes. The longer end of the linker curve will be hurt more.
- If CPAC opts for the softer sledgehammer option, linkers could in fact rally — since there is a lot of bad news priced in because the CPAC minutes clearly hinted that the nuclear option was a serious contender. If that is the case, then the reverse to the above will be true — the longer end of the curve will benefit more than the shorter end.
- In outright terms, in the very near term the biggest loser is likely to be IL-16. We suspect that the market would be a little surprised if the RPI-CPI wedge were to turn negative as we have described above. In particular, some houses are talking about a 0.4% formula effect.
- Assuming the negative wedge of ½% point described above coupled with the Bank of England’s CPI forecast at the medium-term horizon of close to or slightly below 2% y/y — it is plausible to suggest that RPI inflation could be 1.5% y/y or lower by early-2014. That is far too low in our view — we think the CPI will be much higher than the BoE does. However, we are inflation bulls. There are plenty of others that are not — so brace for talk of CPI in the low 1% ballpark. On a cheery note — that would be good news because taxes on alcohol prices will rise more slowly!

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Key Data Preview

CANADA

Retail sales numbers for July will be released on September 25th and Scotia anticipates a pretty steep contraction of 0.5% m/m with further downside risks. The issue is that most of the consumer economy looks weak: sales at large retailers were dramatically lower, gasoline prices were lower, and turnover at car dealers slowed suddenly. The bottom line is that consumers look to have tapped out during mid-summer, with the shopping spree on big ticket items such as condos and cars during the first half of the year giving way to holstered credit cards as customers retrench.

July GDP will be released on September 28 and Scotia expects a contraction on the order of 0.3% m/m. Our forecast is partially based on what we already know: manufacturing sales were a full 2% lower in volume terms, housing starts were moderately lower, and volumes of crude oil exports decreased implying that total output of crude ought to be weak. Factoring in our forecast for weak retail sales pushes our forecast even lower. The bigger picture is that the Canadian economy performed in the same ballpark as the US during Q2 (1.8% q/q vs. 1.7% in the US) and is tracking even weaker than last quarter heading into the back half of the year. That makes sense in light of the soft global economic outlook and the domestic slow-down that we're seeing in the housing sector; the question is whether or not the US will perform similarly.

UNITED STATES

Has there been an investment slow-down in the US? We'll get a look at fresh numbers when data on **durable goods orders and shipments** for August are released on September 27th. Shipments of capital goods ex-defence and air (which feed into the investment component of US GDP) edged lower during July, and weak new orders of 'core' capital goods imply that there is risk of further erosion this month (see chart). In terms of new orders of durable goods, we're fairly pessimistic as new orders of planes at Boeing plummeted from 260 in July to 1 VIP business jet in August, leading us to forecast an overall decline of 5%. Weak new orders numbers in the regional Fed surveys and ISM Manufacturing PMI add to the sense that investment is stalling.

Source: US Census Bureau, Scotia Economics

A flurry of numbers on the **housing sector** should draw market attention. New Home Sales during July (September 26th) could well increase solidly as foot traffic at model homes looked good in August as did pending home sales during July, leaving us anticipating a 2.5% gain; in light of strong data on existing home sales during August, market expectations will be high. Advances on the Case-Shiller home price index (September 25th) have been one of the more welcome surprises this year, and so markets will be watching the release of July numbers to see if it can meet June's strong +0.94% m/m gain. We're forecasting a 0.3% increase.

Data on **personal consumption expenditure**, income, and the deflators used to arrive at inflation-adjusted consumption numbers will be released on September 28th and Scotia's anticipating an outsized gain in consumption of +0.7% on the strength of even stronger nominal retail sales data during the month (+0.8%). It's not all good news, as income growth was muted according to BLS data leading us to expect a limited 0.1% increase in incomes resulting in a deterioration in the savings rate.

The **Conference Board's consumer confidence** metric will be released on September 25th and we're expecting a fairly soft 61.5 print as jobs data for September have been weak and the Conference Board's measure weights the jobs outlook rather heavily.

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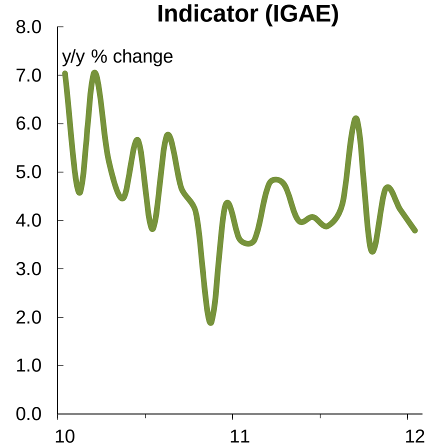
EUROPE

Preliminary September inflation figures for several euro zone countries will be reported next week. After a period of moderation, price pressures accelerated across the major euro economies in August (with the exception of Italy). Inflation rose to 2.6% y/y in the region overall, up from the 2.4% rate registered in each of the prior three months. The major contributor to August's 0.4% m/m increase was higher energy costs, given the roughly 30% rise in the price of Brent oil between June and August. The headline annual rate is expected to ease slightly in September to around 2.4% y/y. However, the inflation trajectory is now higher than was projected a few months ago, with higher indirect taxes (related to austerity programs) and food prices (resulting from the droughts and other inclement weather around the world) partly offsetting the effects of slowing economic activity. By country, we expect a modest deceleration in Germany, from 2.2% y/y to 2.1%. Italy's rate will see a sharper fall, from 3.3% to 2.4%, due to base effects generated by a VAT hike and the methodological change to the CPI calculation, which boosted last September's reading. Conversely, the Spanish inflation rate will likely rise higher, to at least 3.0% y/y, after jumping half a percentage point in the prior month, given the increase in the VAT (from 18% to 21%) on September 1st. The sharp rise in prices in Spain in the second half of the year will further impair the distressed economy, eroding household purchasing power and overall competitiveness. Moreover, stronger inflationary pressures — even if they are coming from factors such as food supply shortages and geopolitical tensions, which are generally beyond the scope of monetary policy — may prevent the European Central Bank from directly easing policy conditions any further (i.e., through an interest rate cut).

LATIN AMERICA

Recent data confirm that the Mexican economy remained resilient in the third quarter of the year; however, we anticipate that the rate of output expansion will moderate slightly in the coming quarters, compared to the first half of the year. Industrial production accelerated to 4.9% y/y in July, mainly driven by the construction and the manufacturing sectors, while retail sales growth slowed to 2.6% y/y from rates above 5.0% in the previous two months. The global economic activity indicator will be released on September 25th and we anticipate an increase of 3.4% y/y in July, slightly below the 4.2% average of the previous three months.

Mexican Global Economic Indicator (IGAE)



Source: Thomson Reuters.

ASIA

The sluggish performance of Japanese industrial production is likely to continue in the months ahead, reflecting softer demand for the country's exports. Industrial output decreased by 1.0% m/m in July; preliminary data for August will be released on September 27th, and we expect a reading of -0.8% m/m. On September 19th, the Bank of Japan joined the US Federal Reserve and the European Central Bank in providing additional monetary stimulus to the economy by increasing the size and the length of its asset purchase program. By these actions, Japanese policymakers are seeking to ward off deflation and to provide a boost to private spending, as well as to dampen the yen's appreciating pressures stemming from further rounds of monetary easing by global central banks. Nevertheless, persistent investor risk aversion continues to support the yen, keeping the currency stronger that the country's economic fundamentals would warrant, while hurting the nation's exporters.

Japan's Industrial Production

Source: Bloomberg.

Key Indicators for the week of September 24 - 28

North America

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
MX	09/24	09:00	Bi-Weekly Core CPI (% change)	Sep 15	--	0.3	0.1
MX	09/24	09:00	Bi-Weekly CPI (% change)	Sep 15	0.5	0.3	0.2
US	09/24	10:30	Dallas Fed. Manufacturing Activity	Sep	--	--	-1.6
CA	09/25	08:30	Retail Sales (m/m)	Jul	-0.5	0.2	-0.4
CA	09/25	08:30	Retail Sales ex. Autos (m/m)	Jul	-0.3	0.2	-0.4
MX	09/25	09:00	Global Economic Indicator IGAE (y/y)	Jul	3.4	4.1	3.8
US	09/25	09:00	S&P/Case-Shiller Home Price Index (m/m)	Jul	0.3	0.7	0.9
US	09/25	10:00	Consumer Confidence Index	Sep	61.5	63.1	60.6
US	09/25	10:00	Richmond Fed Manufacturing Index	Sep	-5.0	-6.0	-9.0
US	09/26	07:00	MBA Mortgage Applications (w/w)	SEP 21	--	--	-0.2
MX	09/26	09:00	Trade Balance (US$ mn)	Aug P	--	-556.0	-426.9
US	09/26	10:00	New Home Sales (000s a.r.)	Aug	381	380	372
US	09/27	08:30	Durable Goods Orders (m/m)	Aug	-5.0	-4.5	4.1
US	09/27	08:30	Durable Goods Orders ex. Trans. (m/m)	Aug	0.2	0.4	-0.6
US	09/27	08:30	GDP (q/q a.r.)	2Q T	1.7	1.7	1.7
US	09/27	08:30	GDP Deflator (q/q a.r.)	2Q T	1.7	1.6	1.6
US	09/27	08:30	Initial Jobless Claims (000s)	SEP 22	380	375	382
US	09/27	08:30	Continuing Claims (000s)	SEP 15	3310	3271	3272
US	09/27	10:00	Pending Home Sales (m/m)	Aug	0.0	0.0	2.4
CA	09/28	08:30	Real GDP (m/m)	Jul	-0.3	0.1	0.2
US	09/28	08:30	PCE Deflator (m/m)	Aug	0.4	0.5	0.0
US	09/28	08:30	PCE Deflator (y/y)	Aug	--	1.5	1.3
US	09/28	08:30	PCE ex. Food & Energy (m/m)	Aug	0.1	0.1	0.0
US	09/28	08:30	PCE ex. Food & Energy (y/y)	Aug	--	1.6	1.6
US	09/28	08:30	Personal Spending (m/m)	Aug	0.7	0.5	0.4
US	09/28	08:30	Personal Income (m/m)	Aug	0.1	0.2	0.3
US	09/28	09:45	Chicago PMI	Sep	53.0	53.0	53.0
US	09/28	09:55	U. of Michigan Consumer Sentiment	Sep F	79.0	79.0	79.2

Europe

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
GE	09/24	04:00	IFO Business Climate Survey	Sep	102.0	102.5	102.3
GE	09/24	04:00	IFO Current Assessment Survey	Sep	110.5	111.0	111.2
GE	09/24	04:00	IFO Expectations Survey	Sep	95.5	95.0	94.2
UK	09/24	06:59	Nationwide House Prices (m/m)	Sep	--	0.0	1.3
SP	09/25	06:59	Budget Balance YTD (€ mn)	Aug	--	--	-48500
HU	09/25	08:00	**Base Rate (%)**	Sep 25	**6.75**	**6.63**	**6.75**
GE	09/26	08:00	CPI (y/y)	Sep P	1.9	2.0	2.1
GE	09/26	08:00	CPI - EU Harmonized (m/m)	Sep P	0.0	0.0	0.4
GE	09/26	08:00	CPI - EU Harmonized (y/y)	Sep P	2.1	2.1	2.2
SP	09/27	03:00	Real Retail Sales (y/y)	Aug	--	--	-6.9
GE	09/27	03:55	Unemployment (000s)	Sep	10.0	10.0	9.0
GE	09/27	03:55	Unemployment Rate (%)	Sep	6.8	6.8	6.8
UK	09/27	04:30	Business Investment (q/q)	2Q F	--	-1.5	-1.5
UK	09/27	04:30	Current Account (£ bn)	2Q	--	-12.2	-11.2
UK	09/27	04:30	GDP (q/q)	2Q F	--	-0.5	-0.5
EC	09/27	05:00	Business Climate Indicator	Sep	--	-1.2	-1.2
EC	09/27	05:00	Economic Confidence	Sep	--	86.1	86.1
EC	09/27	05:00	Industrial Confidence	Sep	--	-15.0	-15.3
UK	09/27	19:01	GfK Consumer Confidence	Sep	--	-28.0	-29.0

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

Key Indicators for the week of September 24 - 28

Europe *(continued from previous page)*

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
FR	09/28	01:30	GDP (q/q)	2Q F	0.0	0.0	0.0
FR	09/28	02:45	Consumer Spending (m/m)	Aug	-1.0	-0.3	0.1
FR	09/28	02:45	Producer Prices (m/m)	Aug	--	0.6	-0.9
SP	09/28	03:00	CPI (y/y)	Sep P	--	2.8	2.7
SP	09/28	03:00	CPI - EU Harmonized (y/y)	Sep P	3.0	3.0	2.7
UK	09/28	04:30	Index of Services (m/m)	Jul	--	1.5	-1.7
EC	09/28	05:00	Euro zone CPI Estimate (y/y)	Sep	2.4	2.4	2.6
IT	09/28	05:00	CPI (y/y)	Sep P	--	3.1	3.2
IT	09/28	05:00	CPI - EU Harmonized (m/m)	Sep P	1.1	1.3	0.0
IT	09/28	05:00	CPI - EU Harmonized (y/y)	Sep P	2.4	2.6	3.3
SP	09/28	06:59	Current Account (€ bn)	Jul	--	--	-0.3

Asia Pacific

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
VN	09/24	06:59	Exports (y/y)	Sep	--	--	17.8
VN	09/24	06:59	Imports (y/y)	Sep	--	--	6.7
PH	09/24	21:00	Imports (y/y)	Jul	--	--	13.3
PH	09/24	21:00	Trade Balance (US$ mn)	Jul	--	--	-787.0
HK	09/25	04:30	Exports (y/y)	Aug	--	--	-3.5
HK	09/25	04:30	Imports (y/y)	Aug	--	--	-1.8
HK	09/25	04:30	Trade Balance (HK$ bn)	Aug	--	--	-40.1
CH	09/26	21:30	Industrial Profits YTD (y/y)	Aug	--	--	-2.7
JN	09/27	19:30	Household Spending (y/y)	Aug	--	1.1	1.7
JN	09/27	19:30	Jobless Rate (%)	Aug	--	4.3	4.3
JN	09/27	19:30	National CPI (y/y)	Aug	--	-0.5	-0.4
JN	09/27	19:30	Tokyo CPI (y/y)	Sep	--	-0.6	-0.7
JN	09/27	19:50	Industrial Production (m/m)	Aug P	-0.8	-0.5	-1.0
JN	09/27	19:50	Large Retailers' Sales (y/y)	Aug	--	-1.7	-4.4
JN	09/27	19:50	Retail Trade (m/m)	Aug	--	-0.3	-1.5
JN	09/27	19:50	Retail Trade (y/y)	Aug	--	-0.3	-0.7
JN	09/28	01:00	Housing Starts (y/y)	Aug	--	-7.5	-9.6
TH	09/28	03:30	Exports (y/y)	Aug	--	--	-3.9
TH	09/28	03:30	Imports (y/y)	Aug	--	--	13.3
TH	09/28	03:30	Trade Balance (US$ mn)	Aug	--	--	483.0

Latin America

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
BZ	09/25	09:30	Current Account (US$ mn)	Aug	--	-2300	-3766
CO	09/28	07:59	**Overnight Lending Rate (%)**	Sep 28	**4.75**	**4.75**	**4.75**
CL	09/28	08:00	Industrial Production (y/y)	Aug	--	1.2	0.6
CL	09/28	08:00	Retail Sales (y/y)	Aug	--	7.5	7.9
CL	09/28	08:00	Unemployment Rate (%)	Aug	--	6.5	6.5
CO	09/28	12:00	Urban Unemployment Rate (%)	Aug	--	11.0	11.5

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

Global Auctions for the week of September 24 - 28

North America

Country	Date	Time	Event
US	09/24	11:00	U.S. Fed to Purchase USD1.50-2.00 Bln Notes
US	09/24	13:00	U.S. to Sell USD32 Bln 3-Month Bills
US	09/24	13:00	U.S. to Sell USD28 Bln 6-Month Bills
CA	09/25	10:30	Canada to Sell CAD8.6 Bln 99-Day Bills
CA	09/25	10:30	Canada to Sell CAD3.2 Bln 182-Day Bills
CA	09/25	10:30	Canada to Sell CAD3.2 Bln 364-Day Bills
US	09/25	11:00	U.S. Fed to Purchase USD4.50-5.50 Bln Notes
US	09/25	11:30	U.S. to Sell 4-Week Bills
US	09/25	13:00	U.S. to Sell USD35 Bln 2-Year Notes
US	09/26	11:00	U.S. Fed to Purchase USD4.25-5.00 Bln Notes
CA	09/26	12:00	Canada to Sell CAD3.3 Bln 2-Year Notes
US	09/26	13:00	U.S. to Sell USD35 Bln 5-Year Notes
US	09/27	11:00	U.S. Fed to Sell USD7.00-8.00 Bln Notes
US	09/27	13:00	U.S. to Sell USD29 Bln 7-Year Notes
US	09/28	11:00	U.S. Fed to Purchase USD1.50-2.00 Bln Notes

Europe

Country	Date	Time	Event
NO	09/24	05:10	Norway to Sell Bonds
GE	09/24	05:30	Germany to Sell EU3 Bln 12-Mth Bills
BE	09/24	06:00	Belgium to Sell Bonds (OLO)
FR	09/24	09:00	France to Sell Bills (BTF)
NE	09/25	04:00	Netherlands to Sell Bonds
SP	09/25	04:30	Spain to Sell 3-Month and 6-Month Bills
IT	09/25	05:00	Italy to Sell Zero coupon/BTP€i
SZ	09/25	05:30	Switzerland to Sell 3-Month Bills
IT	09/26	05:00	Italy to Sell Bills
GE	09/26	05:30	Germany to Sell Add'l EU5 Bln 10-Year Notes
IT	09/27	05:00	Italy to Sell Bonds/Floating/Zero Coupon

Asia Pacific

Country	Date	Time	Event
JN	09/25	04:00	Japan Auction for Enhanced-Liquidity
CH	09/25	23:00	China to Sell CNY28 Bln 20-Year Bonds
NZ	09/26	22:30	New Zealand Plans to Sell Bonds
JN	09/26	23:35	Japan to Sell 3-Month Bills
JN	09/26	23:45	Japan to Sell 2-Year Bonds

Latin America

Country	Date	Time	Event
BZ	09/25	11:00	Brazil to Sell I/L Bonds due 8/15/2016 - NTN-B
BZ	09/25	11:00	Brazil to Sell I/L Bonds due 8/15/2018 - NTN-B
BZ	09/25	11:00	Brazil to Sell I/L Bonds due 8/15/2022 - NTN-B
BZ	09/27	10:00	Brazil to Sell Bills due 10/1/2013 - LTN
BZ	09/27	10:00	Brazil to Sell Bills due 7/1/2014 - LTN
BZ	09/27	10:00	Brazil to Sell Bills due 1/1/2016 - LTN

Source: Bloomberg, Scotia Economics.

Events for the week of September 24 - 28

North America

Country	Date	Time	Event
MX	SEP 17-24		Mexican President-Elect Nieto's Latin America Tour
US	09/24	12:30	IMF's Lagarde Speaks at Peterson Institute in Washington
US	09/24	15:30	Fed's Williams Speaks at the City Club of San Francisco
CA	SEP 24-25		Carney and Flaherty to speak at conference in Ottawa
US	09/25	12:00	Fed's Plosser Speaks on Economic Outlook in Philadelphia
US	09/25	13:30	Secretary Geithner Speaks at Clinton Global Initiative
CA	09/25	14:15	Bank of Canada Deputy Governor Lane Speaks in Calgary
US	09/26	13:15	Fed's Evans Speaks in Indiana
US	09/27	10:30	IMF Releases World Economic Report Analytic Chapters

Europe

Country	Date	Time	Event
GE	09/22	06:30	Merkel, Hollande Meet to Fete German-French Ties: Ludwigsburg
EC	09/22	09:30	ECB Announces Bond Purchases
EC	09/23	04:00	ECB's Coeure Speaks in Ramallah
GE	SEP 23-24		G-20 Meeting of Finance Ministry and Central Bank Deputies
IT	09/24	03:30	Monti, Gurria, Grilli, Padoan at Conference on Competitiveness
EC	09/24	04:00	EU General Affairs Ministers Meet in Brussels
GE	09/24	08:00	Public Hearing in Parliament on Swiss-German Tax Accord
PO	09/24	14:00	Portugal Year-to-Date Budget Report
EC	09/24		European Parliament Committee Hearing on Libor Scandal
GE	09/25	04:00	Merkel Speaks at BDI Industry Group's Annual Congress: Berlin
EC	09/25	09:00	ECB's Draghi Speaks at BDI Industry Event in Berlin
EC	09/25	19:00	ECB's Constancio Speaks in London
LX	09/25		Italy, Spain Challenge Unitary Patent Procedure At EU Court
EC	09/26	10:00	Bundesbank's Weidmann, Italy's Grilli GIve Press Conference
IT	09/27	03:00	Italian Prime Minister Mario Monti Gives Speech in NY
SP	09/27	08:00	Spanish Cabinet Due to Approve 2013 Budget
GE	09/27	12:00	Merkel Speaks in Honor of Helmut Kohl at Anniversary Event
SP	09/27	19:00	Spanish 2013 Budget Due to be Presented to Parliament
LX	09/27		EU Challenges Cancellation of Aalberts EU100.8 Million Fine
GE	09/28	03:45	Merkel Gives Speech to Global Female Executives Group
EC	09/28	04:00	WTO Dispute Settlement Body Meets
PO	09/28	07:00	ECB's Godeffroy Speaks at Conference in Oporto
EC	09/28	07:30	ECB's Asmussen Speaks in Berlin
EC	09/28	14:00	European Socialist Leaders Hold Dinner Meeting in Brussels

Source: Bloomberg, Scotia Economics.

Events for the week of September 24 - 28

Asia Pacific

Country	Date	Time	Event
US	SEP 16-22		U.S. Defense Secretary Leon Panetta Visits Asia
IN	09/22	00:30	RBI Deputy Governor Khan Speaking at Globoil India 2012
JN	09/23	19:50	BOJ Minutes of Aug. 8-9 meeting to be released
JN	SEP 23-24		BOJ Deputy Governor Yamaguchi Speaks at Event in Tokyo
AU	09/24	21:30	Reserve Bank Board - Financial Stability Review
AU	09/25	04:30	RBA's Debelle Speaks in Melbourne at Deakin University Event
NZ	09/25	18:45	Statistics New Zealand on Merchandise Trade
JN	SEP 25-26		Liberal Democratic Party of Japan Holds Leadership Election
IN	09/26	07:00	182 Day T-Bill Cutoff Yield
IN	09/26	07:00	91 Day T-Bill Cutoff Yield
NZ	09/26	21:00	National Bank Business Confidence Report
NZ	09/27	18:45	Statistics New Zealand on New Dwelling Approvals
MA	09/28	04:00	Malaysia Releases 2013 Budget

Latin America

Country	Date	Time	Event
CL	09/26	07:30	Central Bank's Traders Survey
CO	09/28		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	October 23, 2012	1.00	--
Federal Reserve – Federal Funds Target Rate	0.25	October 24, 2012	0.25	--
Banco de México – Overnight Rate	4.50	October 26, 2012	4.50	--

BoC: With Governor Carney due to make a speech on opportunities for Canadian companies in Asia this week, we expect export competitiveness (or lack thereof) to remain a priority for the BoC. a) Weak incoming economic data, b) a slowing housing market, and c) the strong easing measures undertaken by the Fed cumulatively imply that the BoC will need to remain on hold for an extended period. We think that this will cause the BoC to moderate the hawkish bias in its communications. Fed: Communications by Fed regional Presidents and Governors following last week's meeting reinforce the likelihood that the FOMC's asset purchases will continue for some time yet. Whether the MBS purchases will need to be matched with further Treasury purchases will depend on the strength of the US economy and markets at year-end when the Maturity Extension Program ('Operation Twist') concludes.

Europe

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
European Central Bank – Refinancing Rate	0.75	October 4, 2012	0.50	--
Bank of England – Bank Rate	0.50	October 4, 2012	0.50	0.50
Swiss National Bank – Libor Target Rate	0.00	December 13, 2012	0.00	--
Central Bank of Russia – Refinancing Rate	8.25	October 10, 2012	8.25	--
Hungarian National Bank – Base Rate	6.75	September 25, 2012	6.75	6.75
Central Bank of the Republic of Turkey – 1 Wk Repo Rate	5.75	October 18, 2012	5.75	--
Sweden Riksbank – Repo Rate	1.25	October 25, 2012	1.50	--
Norges Bank – Deposit Rate	1.50	October 31, 2012	1.50	--

The central bank of Hungary is expected to leave monetary policy unchanged on September 25th after unexpectedly cutting the reference rate by 25 basis points last month to 6.75%. The split decision (by a vote of 4-3) was underpinned by concerns of slowing growth; with negative output growth in the second quarter, the economy is now technically in recession. Though further economic weakness is anticipated, inflationary pressures and potential near-term forint depreciation will likely prevent the authorities from easing policy further at this point. Indirect tax increases and higher food and energy costs pushed the headline inflation rate up to 6.0% y/y in August, its fastest pace since January 2010 and the highest in the EU, while the core rate remained unchanged at 5.1%.

Asia Pacific

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Bank of Japan – Target Rate	0.10	October 5, 2012	0.10	--
Reserve Bank of Australia – Cash Target Rate	3.50	October 2, 2012	3.50	3.50
Reserve Bank of New Zealand – Cash Rate	2.50	October 24, 2012	2.50	--
People's Bank of China – Lending Rate	6.00	TBA	--	--
Reserve Bank of India – Repo Rate	8.00	October 30, 2012	8.00	--
Bank of Korea – Bank Rate	3.00	October 10, 2012	2.75	--
Bank of Thailand – Repo Rate	3.00	October 17, 2012	3.00	--
Bank Indonesia – Reference Interest Rate	5.75	October 11, 2012	5.75	--

Latin America

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Banco Central do Brasil – Selic Rate	7.50	October 10, 2012	7.25	7.50
Banco Central de Chile – Overnight Rate	5.00	October 18, 2012	5.00	--
Banco de la República de Colombia – Lending Rate	4.75	September 28, 2012	4.50	4.75
Banco Central de Reserva del Perú – Reference Rate	4.25	October 11, 2012	4.25	4.25

We maintain our view that Colombia's central bank will retain a dovish tone and reduce the reference rate by 25 basis points to 4.5% next week, marking the third consecutive monthly cut since July. High frequency indicators such as retail sales and industrial production continue to support our expectation for a slowdown in economic activity. Headline inflation continues to fluctuate around the mid-point of the central bank's tolerance range.

Africa

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
South African Reserve Bank – Repo Rate	5.00	November 22, 2012	5.00	--

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

Forecasts as at August 30, 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	3.4				
Canada	2.2	2.4	1.9	1.8	2.1	2.9	1.7	2.0
United States	1.8	1.8	2.2	1.9	2.5	3.1	2.0	2.2
Mexico	2.1	4.2	3.9	3.6	4.9	3.8	4.2	4.0
United Kingdom	2.0	0.7	-0.4	1.2	2.1	4.2	2.2	3.0
Euro Zone	1.4	1.5	-0.7	0.2	2.1	2.7	1.9	1.9
Japan	0.9	-0.7	2.3	1.5	-0.3	-0.2	0.1	0.3
Australia	3.1	2.1	3.2	3.1	3.1	3.1	2.3	2.8
China	9.4	9.3	7.8	8.2	2.3	4.1	4.0	4.4
India	7.5	10.0	6.0	6.3	6.4	7.7	6.5	6.8
South Korea	4.6	3.6	3.0	3.8	3.1	4.8	3.3	3.0
Thailand	4.4	0.1	5.0	4.0	2.7	3.5	3.0	2.8
Brazil	3.7	2.7	2.0	4.0	6.6	6.5	5.0	5.5
Chile	4.6	6.1	5.2	5.2	3.4	4.4	2.1	2.9
Peru	5.5	7.0	6.3	5.6	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	1.00	1.00
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	0.50	0.50	0.50	0.50	0.50	0.50
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	3.25	3.25	3.25	3.50	3.50

Exchange Rates (end of period)	12Q1	12Q2f	12Q3f	12Q4f	13Q1f	13Q2f	13Q3f	13Q4f
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	1.21	1.23	1.22	1.22	1.21	1.21
Sterling (GBPUSD)	1.60	1.57	1.55	1.59	1.62	1.63	1.64	1.64
Yen (USDJPY)	83	80	78	80	84	85	86	87
Australian Dollar (AUDUSD)	1.03	1.02	1.02	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	13.2	13.4
Brazilian Real (USDBRL)	1.83	2.01	2.02	1.95	1.92	1.87	1.88	1.90

Commodities (annual average)	2000-10	2011	2012f	2013f
WTI Oil (US$/bbl)	54	95	95	100
Brent Oil (US$/bbl)	52	112	112	112
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	7.85	7.80
Gold, London PM Fix (US$/oz)	586	1,569	1,665	1,650
Pulp (US$/tonne)	694	977	880	900
Newsprint (US$/tonne)	575	640	640	660
Lumber (US$/mfbm)	273	255	280	315

[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.

North America

Canada	2011	12Q1	12Q2	Latest	
Real GDP (annual rates)	2.4	1.8	1.8		
Current Acc. Bal. (C$B, ar)	-48.4	-40.6	-64.1		
Merch. Trade Bal. (C$B, ar)	2.3	8.4	-13.9	-28.0	(Jul)
Industrial Production	3.5	1.0	2.9	3.5	(Jun)
Housing Starts (000s)	193	206	230	224	(Aug)
Employment	1.6	0.9	1.2	1.0	(Aug)
Unemployment Rate (%)	7.5	7.4	7.3	7.3	(Aug)
Retail Sales	4.1	4.3	2.6	1.7	(Jun)
Auto Sales (000s)	1589	1703	1670	1615	(Jul)
CPI	2.9	2.3	1.6	1.2	(Aug)
IPPI	4.6	1.8	0.6	-0.3	(Jul)
Pre-tax Corp. Profits	15.4	4.2	0.4		

United States	2011	12Q1	12Q2	Latest	
Real GDP (annual rates)	1.8	2.0	1.7		
Current Acc. Bal. (US$B, ar)	-466	-534	-470		
Merch. Trade Bal. (US$B, ar)	-738	-777	-743	-687	(Jul)
Industrial Production	4.1	4.0	4.9	3.1	(Aug)
Housing Starts (millions)	0.61	0.71	0.74	0.75	(Aug)
Employment	1.1	1.6	1.3	1.4	(Aug)
Unemployment Rate (%)	9.0	8.3	8.2	8.1	(Aug)
Retail Sales	8.3	6.4	4.3	4.4	(Aug)
Auto Sales (millions)	12.7	14.1	14.1	14.5	(Aug)
CPI	3.2	2.8	1.9	1.7	(Aug)
PPI	6.0	3.4	1.1	2.0	(Aug)
Pre-tax Corp. Profits	2.1	18.0	14.0		

Mexico	2011	12Q1	12Q2	Latest	
Real GDP	3.9	4.5	4.1		
Current Acc. Bal. (US$B, ar)	-11.1	4.7	1.8		
Merch. Trade Bal. (US$B, ar)	-1.5	7.1	6.1	-5.1	(Jul)
Industrial Production	4.0	4.4	3.7	4.9	(Jul)
CPI	3.4	3.9	3.9	4.6	(Aug)

Europe

Euro Zone	2011	12Q1	12Q2	Latest	
Real GDP	1.4	-0.1	-0.5		
Current Acc. Bal. (US$B, ar)	-3	-32	79	235	(Jul)
Merch. Trade Bal. (US$B, ar)	6.9	28.0	128.6	183.9	(Jul)
Industrial Production	3.5	-1.7	-2.4	-2.6	(Jul)
Unemployment Rate (%)	10.1	10.8	11.2	11.3	(Jul)
CPI	2.7	2.7	2.5	2.6	(Aug)

Germany	2011	12Q1	12Q2	Latest	
Real GDP	3.1	1.2	1.0		
Current Acc. Bal. (US$B, ar)	202.6	215.8	192.1	189.3	(Jul)
Merch. Trade Bal. (US$B, ar)	216.2	223.3	245.3	237.3	(Jul)
Industrial Production	8.0	0.7	-0.3	-1.4	(Jul)
Unemployment Rate (%)	7.1	6.8	6.8	6.8	(Aug)
CPI	2.3	2.2	1.9	2.1	(Aug)

France	2011	12Q1	12Q2	Latest	
Real GDP	1.7	0.3	0.3		
Current Acc. Bal. (US$B, ar)	-54.5	-50.6	-77.0	-6.1	(Jul)
Merch. Trade Bal. (US$B, ar)	-51.9	-54.4	-55.8	-41.7	(Jul)
Industrial Production	1.9	-1.8	-2.1	-3.1	(Jul)
Unemployment Rate (%)	9.6	10.0	10.1	10.3	(Jul)
CPI	2.1	2.3	2.0	2.1	(Aug)

United Kingdom	2011	12Q1	12Q2	Latest	
Real GDP	0.8	-0.2	-0.5		
Current Acc. Bal. (US$B, ar)	-46.5	-76.4			
Merch. Trade Bal. (US$B, ar)	-160.3	-159.8	-177.6	-133.7	(Jul)
Industrial Production	-0.7	-2.8	-2.5	-0.8	(Jul)
Unemployment Rate (%)	8.1	8.2	8.1	8.1	(Jun)
CPI	4.5	3.5	2.7	2.5	(Aug)

Italy	2011	12Q1	12Q2	Latest	
Real GDP	0.5	-1.5	-2.6		
Current Acc. Bal. (US$B, ar)	-0.07	-0.07	-0.01	0.02	(Jul)
Merch. Trade Bal. (US$B, ar)	-34.2	-17.5	16.7	66.2	(Jul)
Industrial Production	0.3	-5.4	-7.8	-7.0	(Jul)
CPI	2.8	3.4	3.3	3.2	(Aug)

Russia	2011	12Q1	12Q2	Latest	
Real GDP	4.3	4.9	4.0		
Current Acc. Bal. (US$B, ar)	98.8	39.3	19.2		
Merch. Trade Bal. (US$B, ar)	16.5	19.7	16.7	11.1	(Jul)
Industrial Production	4.8	4.1	2.3	2.1	(Aug)
CPI	8.4	3.9	3.8	5.9	(Aug)

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

Source: Bloomberg, Global Insight, Scotia Economics.

Asia Pacific

Australia	2011	12Q1	12Q2	Latest	
Real GDP	2.1	4.4	3.7		
Current Acc. Bal. (US$B, ar)	-33.1	-61.6	-32.9		
Merch. Trade Bal. (US$B, ar)	35.7	1.4	28.4	20.3	(Jul)
Industrial Production	-1.2	3.9	0.5		
Unemployment Rate (%)	5.1	5.2	5.1	5.1	(Aug)
CPI	3.4	1.6	1.2		

Japan	2011	12Q1	12Q2	Latest	
Real GDP	-0.7	2.8	3.3		
Current Acc. Bal. (US$B, ar)	119.2	101.1	49.0	95.0	(Jul)
Merch. Trade Bal. (US$B, ar)	-33.2	-70.2	-73.2	-72.1	(Aug)
Industrial Production	-2.3	2.7	5.1	-2.2	(Jul)
Unemployment Rate (%)	4.6	4.5	4.4	4.3	(Jul)
CPI	-0.3	0.3	0.2	-0.4	(Jul)

South Korea	2011	12Q1	12Q2	Latest	
Real GDP	3.6	2.8	2.3		
Current Acc. Bal. (US$B, ar)	26.5	10.2	44.8	73.2	(Jul)
Merch. Trade Bal. (US$B, ar)	30.8	5.5	37.8	24.0	(Aug)
Industrial Production	6.9	2.9	2.3	0.1	(Jul)
CPI	4.0	3.0	2.4	1.2	(Aug)

China	2011	12Q1	12Q2	Latest	
Real GDP	10.4	8.1	7.6		
Current Acc. Bal. (US$B, ar)	201.7				
Merch. Trade Bal. (US$B, ar)	155.0	1.7	274.1	319.9	(Aug)
Industrial Production	12.8	11.9	9.5	0.0	(Sep)
CPI	4.1	3.6	2.2	1.8	(Jul)

Thailand	2011	12Q1	12Q2	Latest	
Real GDP	0.1	0.4	4.2		
Current Acc. Bal. (US$B, ar)	5.3	0.6	-2.5		
Merch. Trade Bal. (US$B, ar)	1.4	0.4	0.5	0.5	(Jul)
Industrial Production	-9.5	-7.1	-1.5	-5.9	(Jul)
CPI	3.8	3.4	2.5	2.7	(Aug)

India	2011	12Q1	12Q2	Latest	
Real GDP	7.5	5.3	5.5		
Current Acc. Bal. (US$B, ar)	-62.8	-21.7			
Merch. Trade Bal. (US$B, ar)	-13.5	-15.7	-13.4	-15.5	(Jul)
Industrial Production	4.8	0.6	-0.2	0.1	(Jul)
WPI	9.5	7.3	7.5	7.6	(Aug)

Indonesia	2011	12Q1	12Q2	Latest	
Real GDP	6.5	6.3	6.4		
Current Acc. Bal. (US$B, ar)	1.7	-3.2	-6.9		
Merch. Trade Bal. (US$B, ar)	2.2	0.9	-0.8	-0.2	(Jul)
Industrial Production	4.1	5.4		3.0	(May)
CPI	5.4	3.7	4.5	4.6	(Aug)

Latin America

Brazil	2011	12Q1	12Q2	Latest	
Real GDP	2.5	0.6	0.4		
Current Acc. Bal. (US$B, ar)	-52.5	-48.3	-53.1		
Merch. Trade Bal. (US$B, ar)	29.8	9.8	18.6	38.7	(Aug)
Industrial Production	0.4	-3.5	-4.5	-4.3	(Jul)
CPI	6.6	5.8	5.0	5.2	(Aug)

Chile	2011	12Q1	12Q2	Latest	
Real GDP	6.0	5.3	5.5		
Current Acc. Bal. (US$B, ar)	0.0	-0.5	-9.8		
Merch. Trade Bal. (US$B, ar)	10.0	10.2	5.1	-10.1	(Aug)
Industrial Production	6.9	3.9	2.8	0.6	(Jul)
CPI	3.3	4.1	3.1	2.6	(Aug)

Peru	2011	12Q1	12Q2	Latest	
Real GDP	6.9	6.0			
Current Acc. Bal. (US$B, ar)	-3.3	-1.0			
Merch. Trade Bal. (US$B, ar)	0.9	0.8	0.2	-0.2	(Jul)
Unemployment Rate (%)	7.7	8.3	7.2	6.7	(Aug)
CPI	3.4	4.2	4.1	3.5	(Aug)

Colombia	2011	12Q1	12Q2	Latest	
Real GDP	5.9	4.7	4.9		
Current Acc. Bal. (US$B, ar)	-10.0	-1.8			
Merch. Trade Bal. (US$B, ar)	0.4	0.7	0.2	-0.2	(Jul)
Industrial Production	4.8	1.9	-0.1	2.8	(Jun)
CPI	3.4	3.5	3.4	3.1	(Aug)

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

Source: Bloomberg, Global Insight, Scotia Economics.

Interest Rates (%, end of period)

	12Q1	12Q2	Sep/14	Sep/21*		12Q1	12Q2	Sep/14	Sep/21*
Canada					**United States**				
BoC Overnight Rate	1.00	1.00	1.00	1.00	Fed Funds Target Rate	0.25	0.25	0.25	0.25
3-mo. T-bill	0.91	0.88	0.99	0.98	3-mo. T-bill	0.07	0.08	0.10	0.11
10-yr Gov't Bond	2.11	1.74	1.97	1.86	10-yr Gov't Bond	2.21	1.64	1.87	1.77
30-yr Gov't Bond	2.66	2.33	2.54	2.43	30-yr Gov't Bond	3.34	2.75	3.09	2.96
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US$B)	69.2	66.0	66.1	(Jul)	FX Reserves (US$B)	138.0	138.8	138.3	(Jul)
Germany					**France**				
3-mo. Interbank	0.71	0.53	0.11	0.17	3-mo. T-bill	0.07	0.04	0.00	0.00
10-yr Gov't Bond	1.79	1.58	1.71	1.60	10-yr Gov't Bond	2.89	2.69	2.26	2.28
FX Reserves (US$B)	67.9	68.2	67.8	(Jul)	FX Reserves (US$B)	49.2	49.6	50.1	(Jul)
Euro Zone					**United Kingdom**				
Refinancing Rate	1.00	1.00	0.75	0.75	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	0.39	0.38	0.10	0.10	3-mo. T-bill	0.37	0.37	0.36	0.36
FX Reserves (US$B)	319.8	328.7	327.9	(Jul)	10-yr Gov't Bond	2.20	1.73	1.97	1.84
					FX Reserves (US$B)	82.4	84.4	86.0	(Jul)
Japan					**Australia**				
Discount Rate	0.30	0.30	0.30	0.30	Cash Rate	4.25	3.50	3.50	3.50
3-mo. Libor	0.13	0.13	0.13	0.13	10-yr Gov't Bond	3.98	3.04	3.28	3.29
10-yr Gov't Bond	0.99	0.84	0.80	0.80	FX Reserves (US$B)	47.7	44.1	45.1	(Jul)
FX Reserves (US$B)	1247.8	1231.2	1232.8	(Jul)					

Exchange Rates (end of period)

USDCAD	1.00	1.02	0.97	0.98	¥/US$	82.87	79.79	78.39	78.17
CADUSD	1.00	0.98	1.03	1.02	US¢/Australian$	1.03	1.02	1.06	1.05
GBPUSD	1.601	1.571	1.622	1.626	Chinese Yuan/US$	6.30	6.35	6.32	6.31
EURUSD	1.334	1.267	1.313	1.300	South Korean Won/US$	1133	1145	1117	1119
JPYEUR	0.90	0.99	0.97	0.98	Mexican Peso/US$	12.811	13.361	12.715	12.822
USDCHF	0.90	0.95	0.93	0.93	Brazilian Real/US$	1.827	2.009	2.012	2.024

Equity Markets (index, end of period)

United States (DJIA)	13212	12880	13593	13626	U.K. (FT100)	5768	5571	5916	5852
United States (S&P500)	1408	1362	1466	1466	Germany (Dax)	6947	6416	7412	7460
Canada (S&P/TSX)	12392	11597	12499	12440	France (CAC40)	3424	3197	3582	3534
Mexico (IPC)	39521	40200	40693	40352	Japan (Nikkei)	10084	9007	9159	9110
Brazil (Bovespa)	64511	54355	62105	62044	Hong Kong (Hang Seng)	20556	19441	20630	20735
Italy (BCI)	859	761	883	854	South Korea (Composite)	2014	1854	2008	2002

Commodity Prices (end of period)

Pulp (US$/tonne)	870	900	850	850	Copper (US$/lb)	3.85	3.45	3.81	3.76
Newsprint (US$/tonne)	640	640	640	640	Zinc (US$/lb)	0.91	0.84	0.94	0.95
Lumber (US$/mfbm)	279	283	298	294	Gold (US$/oz)	1662.50	1598.50	1775.50	1784.50
WTI Oil (US$/bbl)	103.02	84.96	99.00	93.22	Silver (US$/oz)	32.43	27.08	34.71	34.69
Natural Gas (US$/mmbtu)	2.13	2.82	2.94	2.87	CRB (index)	308.46	284.19	320.92	308.79

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

Fixed Income Strategy (London)

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