Global Views

Weekly commentary on economic and financial market developments

June 22, 2012

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

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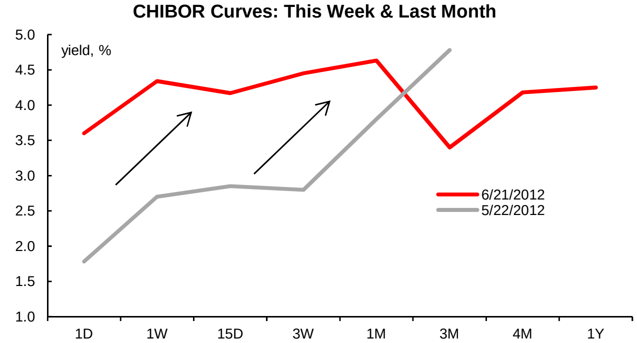
Can Europe Pull Off A Big Week Without Further Disappointment?

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

Europe will set much of the global risk tone next week as EU leaders gather in Belgium for the latest Summit on Thursday and Friday. Before that, Spain faces a Monday deadline to submit a formal request for aid to the EFSF/ESM to recapitalize its banks. Key questions remain such as subordination of claims within the funding apparatus and whether credible capital plans will be presented. The Summit discussions will centre upon refinancing sovereign and bank capital requirements through some or all of the following options: the soon-to-be-enacted European Stability Mechanism, Eurobonds, a banking union, talk of a “growth pact”, an unappealing redemption fund proposal, or euro bills as an incremental step toward eventual Eurobonds. A draft text of what is being discussed was recently leaked (go here: http://www.telegraph.co.uk/finance/financialcrisis/9336766/Exclusive-Secret-EU-summit-document-shows-first-step-to-banking-union.html) and makes it fairly clear that loose objectives surrounding long-run plans will be the emphasis over nearer-term priorities. At issue is therefore whether more talk about needed long-run structural changes will appease markets that are impatiently seeking nearer-term solutions and thus the clear risk would be to repeat the pattern to date of disappointment coming out of major summits—especially in light of persistent German resistance to many of the proposals. Also, Germany’s lower house votes on the ESM and fiscal pact on Friday and is expected to pass the enacting legislation. The fundamentals calendar is fairly lightly populated and focused upon German CPI and unemployment, Eurozone CPI, EC economic and industrial confidence, and UK and French GDP revisions. Italy auctions bonds on the heels of Spain’s successful auctions but in advance of the critical EU Summit which may put the auctions at greater risk of pre-Summit comments and volatility.

Asian markets should generally follow the global tone with two possible exceptions. One is the risk of nearer-term action by China’s central bank. Liquidity conditions have tightened meaningfully in China over the past month, with the CHIBOR rates quoted on Bloomberg indicating that markets are starved for cash and expecting the PBOC to do something about it over the next month or two. The 200bps move in overnight CHIBOR (China’s LIBOR) since May (see left side of chart) could well prompt the PBOC to act either via liquidity operations in markets or even possibly outright policy moves, although we think that a reserve ratio cut in July — after the PBOC can gauge how funding conditions look after quarter end — is the most likely path. Second is that Japan issues its major monthly economic releases. Japanese industrial production is expected to post the sharpest month-over-month decline in over a year while the highest frequency inflation gauges for Tokyo are expected to post ongoing deflation in both headline and core prices excluding food and energy. Retail sales, total household spending, housing starts, and the jobless rate will round out the broad picture for the Japanese economy.

CHIBOR Curves: This Week & Last Month



Source: Bloomberg, Scotia Economics.

Canada faces high but very concentrated data risk next Friday when the April GDP report lands. There is high two-tail risk on the report as what we know about advance indicators is mixed, and so is how technical distortions trade off on one another. Our base case is a 0.2% m/m rise and consensus estimates range from 0.1% to 0.3% which is so tight that it may turn out to understate the two tail risks. We know that retail sales and manufacturing shipments took it on the chin during the month, but wholesale trade and housing were up (mostly due to lower-value-added multis). Also, despite a large 58k job gain during the month that was mostly in full-time jobs, aggregate hours worked were flat which would ordinarily be a warning signal to the downside since GDP equals hours worked times labour productivity. Utilities are a wild card in that unusually warm weather may have lowered heating activity but this downside risk may be offset by earlier-than-usual cooling demand. It’s how the lifting of distortions on potash output versus temporary shutdowns

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in the oil sector trade off that adds to difficulties on the call. The key takeaway, however, is that if we and consensus are anywhere close to the mark for April GDP then, after a tepid 1.9% q/q annualized pace of growth in Q1 that disappointed BoC expectations especially excluding inventory effects, Q2 isn't shaping up to be much better. That is mirrored by the BoC's inflation expectations whereby 2.2% y/y headline inflation was expected for Q2 but instead we're tracking at 1.7%. In all, disappointing growth and softer-than-expected inflation should lead one to weight the BoC's preference for "modest" tightening toward the outer part of its forecast horizon as opposed to during 2012 and in accordance with our longstanding view that the BoC is on hold at least until well into 2013.

US markets won't be where most of next week's action will be, but there may still be enough to whet the appetite of the volatility player without having to look north for leveraged volatility trades fed by frequently changing monetary policy directions. Now that the Fed's blackout window has lifted, Fed speak returns with each of Cleveland Fed President Sandra Pianalto (voting), St. Louis President James Bullard (alternate) and Dallas Fed President Richard Fisher (nonvoting) addressing a combination of monetary policy, housing and the economy. Two out of three are not in favour of additional QE, and Pianalto's position is more centrist which would suggest she'll vote with the power-weighted top of the Fed including Bernanke, Yellen and Dudley. This follows what markets took to be disappointing action by the US Federal Reserve but that very much leaves the door open to QE3 in Q3 in our view. The week's data risk will be mostly focused upon three reports. We think consumer confidence will take a step back as lower gasoline prices are offset by deteriorating jobs data and by weak equities up to the survey period. Durable goods are also likely to come in soft with few aircraft orders and a likely softer vehicle orders component. Personal spending isn't shaping up well either given that we already know that retail sales slipped lower during May, although services spending may be more resilient. In all, the main releases may extend the tone of disappointing higher frequency reports on the health of the US economy in the lead-up to the following week when the big releases like ISM and nonfarm hit. Other releases next week include new home sales following a weak resale report, and pending home sales that may get a lift after the prior month's sharp drop. There are no expected revisions to the final Q1 GDP figures. The US auctions 2s, 5s and 7s next week.

Latam markets will be focused upon an expected policy hold by Colombia's central bank.

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Canada Tightens Mortgage Rules — Again

- **Cumulative effect of regulatory changes is pointing to sharper downside risks to the broader economy.**

Canada took yet another step toward tightening macroprudential rules governing the housing finance sector this week, and the cumulative effects of policy tightening are now becoming binding downside risks to housing and the consumer sector. They take us into a markedly different environment compared to the sharp easing of housing finance terms in 2006-07, and when the BoC cut its overnight rate to 0.25% — both of which served to heat up what had been an already strong market. We are now more convinced of our view that the BoC is on hold until mid-2013 and with fatter tail risk in favour of a longer hold as the composition of risks shifts relatively away from geopolitical concerns and toward elevated domestic risks. Our bias is that strong cumulative pro-cyclical regulatory tightening pushes out rate hikes, supports a buy-Canada-bond bias should our concerns about risks to the economy materialize, poses potential downside risks to CAD, may contribute toward fundamentally altering the psychology of home buyers that has been motivated toward capital gains in housing, and will materially soften growth in housing, consumer spending, jobs, and already weak credit growth.

The Latest Changes

Four major new policy changes were announced:

- The maximum amortization period has been dropped to 25 years where it began before the current Federal government sharply eased lending terms in 2007.
- Insured mortgages will no longer be available for homes priced above C$1 million.
- The refinancing ceiling dropped to 80% from 85%.
- Mortgage payments will now be capped at 39% of gross personal income, and the total debt service ratio will be hard capped at 44%.

CDN Macroprudential Rules Are Clamping Down
• After sharply easing mortgage lending standards in 2006-07, the federal government has since reversed its position
• October 2008: Max 35 year amortization for insured mortgages; minimum 5% down for insured mortgages; consistent minimum credit score; new loan doc standards for property value and incomes
• February 2010: Qualify at 5 yr posted rate instead of 3 yr; lower refi ceiling to 90% from 95%; min 20% down required to get mortgage insurance on non-owner occupied properties
• January 2011: Max 30 year amortization for insured mortgages; refi ceiling for primary occupancy homes dropped to 85% from 90%; withdraw gov't insurance on HELOCs.
• November 2011: Accounting changes to hold more on balance sheet
• 2012-13 Federal Budget: OSFI oversight of CMHC
• Spring 2012: Insurance lifted from covered bonds, portfolio caps at the CMHC, new OSFI lending guidelines to banks
• June 2012: Max 25 year amortization for insured mortgages; insurance dropped for mortgages on homes valued over $1 million (ie: now minimum 25% down); refinancing ceiling dropped to 80% from 85%; mortgage payments and total debt payments capped at 39% and 44% of income respectively.
• January 2013: Basel III

As the accompanying table depicts, these are just the latest steps in a wave of tightening that has been underway since 2008. There are additional uncertainties. One is that since the amortization changes also affect securitized pools administered by the CMHC, there may be unintended trickle-down effects upon uninsured mortgages. The impact upon the broker market may also be adverse.

Cumulative Impact Of Amortization Reduction Is A Sharp Hit To Affordability

Changes such as these cannot be treated in isolation of the cumulative effect and distinct from other changes in the environment. To the latter point, recall that past efforts to tighten mortgage rules occurred during a period of falling mortgage rates that then insulated the impact upon house prices. They also occurred when Canada was bouncing back toward pre-crisis levels of employment via rapid job growth. Today's freshest changes will not get these insulating effects.

Regarding the cumulative impact, while it is virtually impossible to model the impact of all of these changes simultaneously, one example that can be fairly easily evaluated is the impact of shortened amortization periods.

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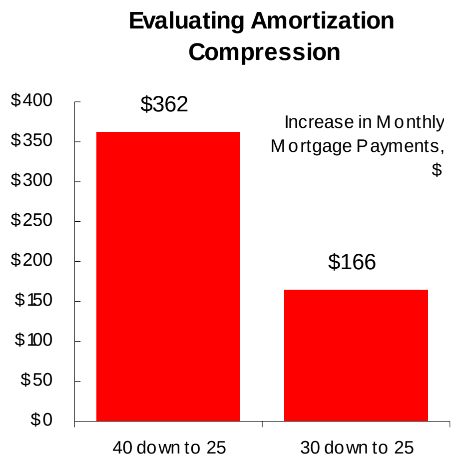
Yes, the incremental impact of a 30 down to 25 year change in amortizations is modest at about an $166 lift in monthly payments for the buyer of an average priced Canadian home ($376,000) and an imputed interest rate shock of about 85bps, but the cumulative impact of going from 40 down to 25 years is sharper yet. In less than four years, a whopping 15 years has been shaved off maximum amortizations that have driven large shares of new mortgage originations during the housing cycle. That means that today's buyer of an average priced home at, say, a 4% 5 year rate with the minimum 5% down has gone up by $362 a month (from $1376 to $1738 assuming bi-weekly payments) via compressed amortizations from 40 down to 25 years (chart 1). That's a 26% increase in monthly payments just through that one policy change alone. Maybe that's positive over the longer haul (although it crowds out legitimate users of the long amortization product), but it's a binding hit to housing without even getting into the other rule changes.

Chart #1

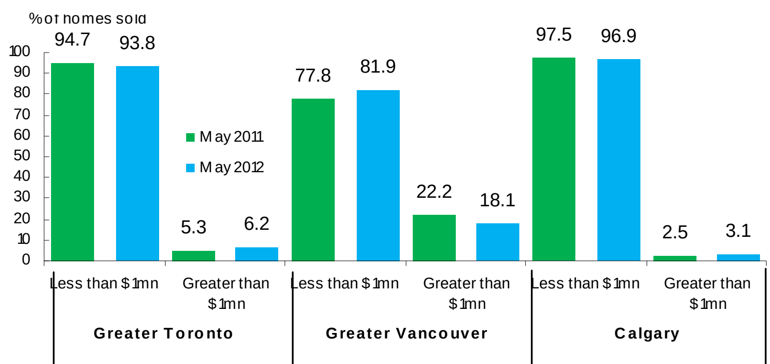


Source: Scotia Economics.

Evaluating The Impact Upon $1 million Homes

It is trickier to evaluate the equivalent rate shock stemming from the elimination of mortgage insurance on homes valued over $1 million that, by corollary, must now attract minimum down payments of 20% instead of 5% previously. A starting point entails recognizing that this is clearly a measure directed at Vancouver in particular where about one-fifth of the market's sales are for over $1 million homes (chart 2), and to a much lesser extent Toronto, Calgary and probably elements of cottage country. The very broad GTA, however, has pockets within it where the share of sales of homes priced over $1 million is far higher than the aggregate GTA. Also note that these changes will not generally affect foreign buyers that have played a large role in driving Vancouver's market since they are unlikely to be financing through insured domestic mortgages.

Chart #2 Home Sales Activity Over Canadian MLS Systems: Above & Below $1 million



Source: CREA, Scotia Economics.

One way of evaluating the equivalent rate shock is to simply shock the down payment assumption within the annuity or bond math behind mortgage payment calculations and determine the implied interest rate that would be required in order to still be able to buy the house. By our calculations, this could be equivalent to a multiple percentage point rate shock.

Of course the equivalent rate shock could theoretically be infinite by imposing a binding capital constraint if one cannot somehow all of a sudden find such a 20% down payment compared to the earlier 5% minimum. Alternatively, the equivalent rate shock could theoretically even be zero if one judges the opportunity cost to giving up a portfolio of $200k in financial assets for a down payment on a $1 million home to be nearly zero these days after taxes and commissions. A middle ground solution would assume that there is some positive opportunity cost commensurate to the long-run expected return on the financial portfolio that is being given up for a down payment after taxes and commissions. If that's, say, 5%, then the equivalent rate shock is the opportunity cost of 5%. Of course, if one has large capital losses then the tax savings upon liquidating a portfolio to put toward a down payment change the math in the other direction. It all depends upon how well (or poorly) one's portfolio performs. Throughout this, the saved mortgage insurance premium lessens the opportunity cost to giving up the financial portfolio for a down payment.

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The broad takeaway from what is admittedly a confusing set of alternate assumptions is that the equivalent rate shock to eliminating mortgage insurance on homes valued over $1 million and thus requiring 20% down instead of the minimum 5% is highly variable and determined by the individual borrowers' other financial characteristics.

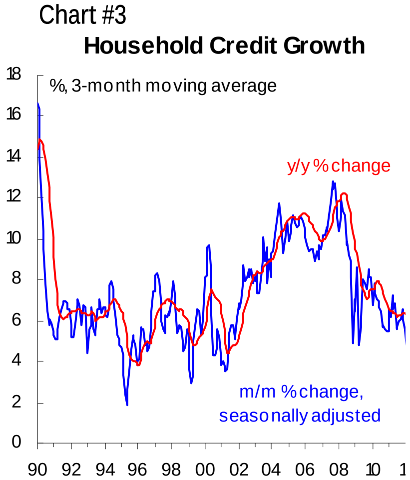
Bigger Picture

In recent years, financial stability has been an added focus for Canadian monetary policy through the lens of longer-run implications for the BoC's inflation target, and to this effect the BoC should be more encouraged by sharply waning growth in household debt than it appears to be. Indeed, the risks are accumulating to the downside for the consumer and housing markets at a rapid pace. That reflects a consumer and housing cycle that is operating at leveraged historic peaks with consumer spending growth having softened into the new year, moribund wage growth, and the cumulative impact of sharp regulatory tightening to date with more effects yet to be felt over the duration of this year and into next year through OSFI lending guidelines to banks, OSFI oversight of the CMHC and Basel III.

Growth in total household credit balances is running at a soft 4.6% y/y (chart 3) which returns Canada to the weakness of the moribund 1990s. Mortgage growth has slowed to 5.6% y/y which is about one-third of the pace prior to the crisis and back to rates of growth of a decade ago before the housing boom really kicked into higher gear (chart 4). Total consumer loans (i.e., everything ex-mortgages) are growing by only 2.3% y/y which is zero growth after inflation (chart 5) and in nominal terms represents the softest growth since the dot-bomb period and the sustained growth trend is the weakest since the recession of the early 1990s.

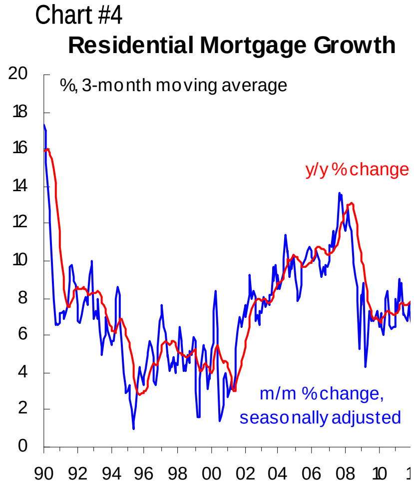
As the Bank of Canada — and Ottawa more generally — continue to emphasize the deeply flawed but still rising debt-to-income metric, it is implicitly communicating that it won't be happy with credit market developments until this ratio plateaus or perhaps drops. As long as income growth remains positive — and it is currently running at a tepid 2.3% y/y pace after taxes and transfers — then a flat debt to income ratio would imply 2.3% y/y growth in aggregate credit is needed while a decline in the ratio would imply credit growth of under 2.3% y/y and a material decline in the ratio would require contracting debt balances. At double that rate of growth in total household credit currently, the policy goal is in favour of a sharper softening in credit growth in order to bring growth in the stock of debt more closely in line with growth in incomes. At such low levels of income growth, the risk is that of policy-imposed deleveraging that magnifies the consequences of cyclical weakness within the Canadian economy.

Chart #3



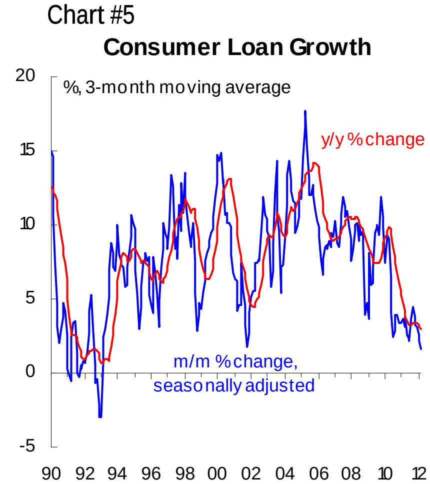
Source: Bank of Canada, Scotia Economics.

Chart #4



Source: Bank of Canada, Scotia Economics.

Chart #5



Source: Bank of Canada, Scotia Economics.

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Global Uncertainty Will Weigh On The U.S. Housing Recovery

- **Underlying U.S. housing fundamentals are increasingly favourable, but weak employment growth, elevated 'shadow' inventories and tight credit conditions remain threats to a sustainable recovery.**

The U.S. housing market appears to be bottoming. Home sales have been on a moderate but steady upward trend since mid-2011, with resale volumes through May up 7% from a year earlier. The pickup, though somewhat uneven, spans all regions of the country. Lenders are likewise reporting a slow improvement in mortgage demand.

Demand is being supported by record high housing affordability, record low interest rates and strengthening household formation. International buyers also have contributed to the turnaround. International purchases of U.S. resale homes totalled $82.5 billion in the 12 months to March, up 24% from a year earlier. These buyers accounted for close to 5% of all U.S. home sales, with the majority coming from just five countries: Canada (24%), China (11%), Mexico (8%), India (6%) and the U.K. (6%).

The improvement in sales has put a floor under prices. The national average existing home price in May was up 2% year-to-date and 6% y/y. The Case-Shiller and FHFA house price indicators show a similar firming trend.

The stabilization in prices mirrors the return of more balanced market conditions. The inventory of resale homes stood a 6.6 months' supply in May, in line with historical norms. Mortgage arrears and foreclosure starts, while still high, are at their lowest since 2008. A falling share of deeply discounted distressed property sales also is helping to support prices. Distressed homes accounted for 25% of sales in May compared with 31% a year earlier.

Residential construction too is accelerating, led by apartment starts. Weak labour markets and mortgage defaults have increased the number of renter households by almost 3 million over the past two years. This in turn has pushed the U.S. rental vacancy rate to its lowest level in over a decade (8.8% in Q1).

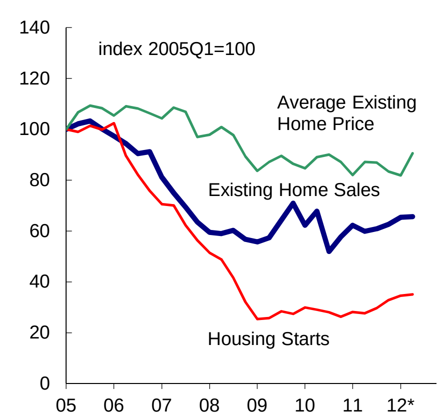
Improving U.S. housing fundamentals lay the groundwork for an eventual solid recovery. From a valuation perspective, many segments of the U.S. housing market offer good buying opportunities for homeowners and long-term investors. For the time being, however, there are at least three major hurdles to a faster turnaround.

High unemployment and weak job growth are constraining household incomes. The U.S. economy, despite being a full three years into recovery, has regained less than half of the almost 9 million jobs lost during the recession. Domestic fiscal policy uncertainty and the renewed loss of global economic momentum point to continued cautious business hiring plans.

Mortgage lending conditions have stabilized in recent quarters, but remain tight for both prime and non-prime loans. Increased global financial market strains could potentially lead to a tightening in loan standards if risk aversion and/or funding pressures increase.

There remains a high level of distressed properties in the pipeline. While mortgage delinquency and new foreclosure rates are easing, the number of loans in the process of foreclosure is still near record highs, reflecting in part the slow judicial process in many states. Combined with held-off-market properties, this represent substantial additional housing inventory that will eventually be returned to the market.

U.S. Housing Metrics Stabilizing



*Through May. Source: Scotia Economics

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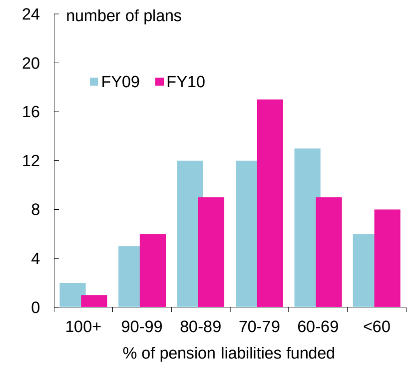
The Ongoing State Pension & Retiree Benefit Challenge

- **Shortfalls underline need for further State pension and retiree benefit reforms.**

For the majority of U.S. State and local governments, the struggle to afford their pension and retiree benefit commitments continues, even after an historic surge in employee contribution increases and benefit reductions. A PEW study this week *(four side charts)* indicates a widening of almost 9% in the gap between States' retirement liabilities and assets from fiscal 2009 (FY09)[1] to FY10, with $757 billion related to pensions and $627 billion pertaining to health and other non-pension benefits. States in FY10 made only 78% of their recommended actuarial pension contribution and 34% of their suggested retiree benefit contribution. In FY00, more than half the States reported pension plans 100% funded; in FY10, 34 State plans were less than 80% funded, the threshold for a healthy system. For retiree benefits, a number of States' pay-as-you-go practice has resulted in assets of just $33 billion to cover a $660 billion liability.

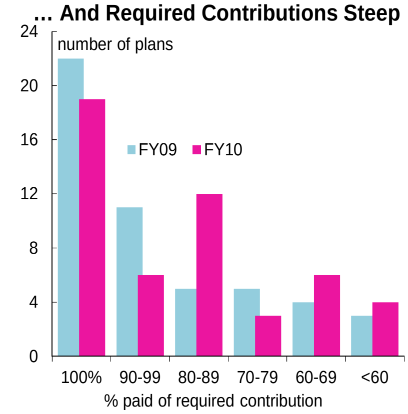
U.S. State Pensions:

Unfunded Liabilities Still Substantial ...



Encouraging was the U.S. Census Bureau's report of a rebound in State and local pension investment earnings, typically the largest source of plan income, to $346 billion in FY10. Though nearly 27% less than FY07 earnings, the FY10 investment return helps to offset the FY08-FY09 loss of $692½ billion. Nevertheless, further pension and retiree benefit reforms appear prudent. Investment earnings since FY10 continue to be subject to historically low interest rates and financial market volatility. The upside for pension plans' other key revenue source, employee and employer contributions, is constrained by recent hikes and State governments' funding squeeze for current spending priorities, given the gradual recovery in State tax receipts *(see FY13 State update, Global Views, June 15, 2012).*

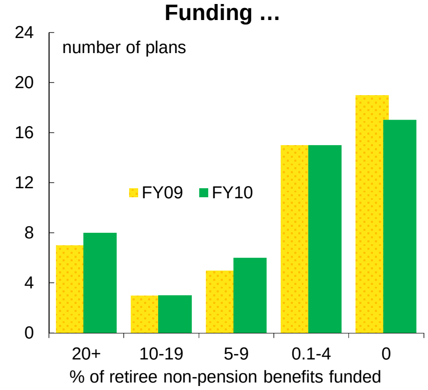
... And Required Contributions Steep



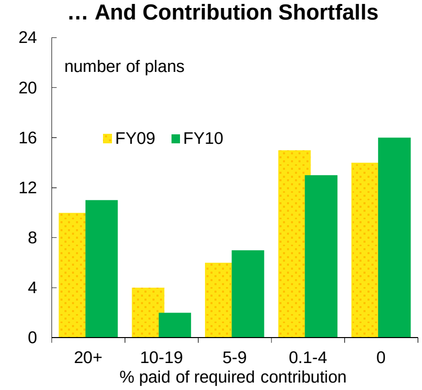
Most of the pension benefit reductions to date, such as lower cost-of-living adjustments, revised benefit formulas, extended vesting periods and less generous early-retirement payouts, have applied only to employee service going forward. Similarly, direct contribution or hybrid pension plans are being substituted for defined benefit plans, but usually only for new hires. Scaling back benefits for past service and retirees is legally difficult. Only a few States have trimmed or eliminated indexation for current retirees. Interestingly, in the subsequent court challenges, judges to date have upheld indexation cuts in four States, though some appeals are anticipated. Reinforcing reforms are possible new rules from the Governmental Accounting Standards Board requiring lower discount rates than the current 8% that would substantially raise the present value of plan liabilities, further eroding funding levels.

U.S. State Retiree Health and Other Non-Pension Benefits:

Funding ...



... And Contribution Shortfalls



[1] Fiscal year-end of June 30 for 46 States. Dollar amounts in US dollars.

Source for charts: PEW Center for the States.

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Economic Situation In Mexico Ahead Of The Presidential Elections

- **Stable economic environment in spite of the July ballot.**

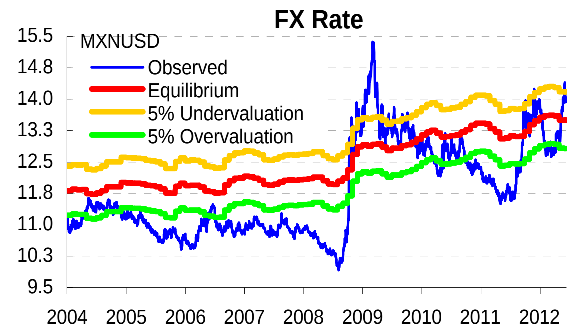
On July 1st Mexicans will go to the polls in order to elect the President, Congress and many local representatives, including six Governors and Mexico City's Head of Government. In this context, and within a very complex global environment, the Mexican economy is very stable.

Most of the key economic indicators are close to equilibrium levels, implying that the current macroeconomic stability provides solid ground for sustained economic growth.

The fiscal balance, for instance, is lower than 3% of GDP even when PEMEX investment spending is included, while total public debt reached 35% of GDP in March. The current account, on the other hand, is practically balanced (a USD$ 47 million dollar deficit was recorded in the first quarter of the year), which means that external financing requirements are not an issue of concern. For this year, the current account deficit is expected to be lower than 1% of GDP. Monetary policy has been applied in a consistent manner for many years, and today Banco de Mexico enjoys a high level of credibility. Additionally, the Mexican financial system is sound, well capitalized and significantly stronger than those of many other countries. According to the latest figures from the Mexican Banks Association, the average capitalization ratio of the banking system is 15.5%, (the regulatory minimum is 8%), and the total past due loan rate is only 2.5%.

From a financial perspective, Mexico has a very strong profile. International reserves currently stand at US$ 155 billion, which represents 128% of the nation's total public sector gross external debt. In addition, the International Monetary Fund maintains a flexible credit line (worth US$72 billion), which could be used in the case of extremely negative global financial conditions. Most public external financing needs have been already addressed. Foreign investment flows continue to favour Mexican peso (MXN) denominated assets, reaching close to US$80 billion at the beginning of June. According to the three major credit rating agencies, Mexico's sovereign debt remains in the investment grade range, and the average maturity of the Federal Government's internal debt is 7.5 years.

Regarding the elections, a few key issues should be highlighted. First, the process itself is not having a significant impact on financial market performance. It is true that vis-à-vis the US dollar (USD), the MXN has shown a high volatility in recent months (as can be seen in the adjacent graph), but this behaviour is mainly explained by the harsh swings in risk aversion in global financial markets due to problems in Europe. Most recent polls show a very consistent advantage of more than 10 percentage points for the PRI candidate, Enrique Peña Nieto, over the leftist PRD candidate, Andrés Manuel López Obrador, and over the candidate from the ruling PAN party, Josefina Vázquez Mota. We estimate that an eventual victory by the front runner will have a positive impact on Mexican financial markets, since most polls shows the PRI will also win the majority in Congress, and this will open the gate to the much expected structural reforms, notably improving the long-term growth prospects for Mexico. If all this proves to be true, and global financial markets recover a less nervous tone; then it is likely that the MXN will return to levels more compatible with the nation's strong macroeconomic fundamentals. We are expecting the MXN to end the year at 13.11 pesos per USD. In a positive scenario in which Europe gets ahead of its many conflicting problems and the United States manages to avoid the "fiscal cliff" while maintaining an adequate rate of growth, then the outlook for the MXN and the Mexican economy could be dramatically better.



Source: Banco de México, Scotia Economics Mexico.

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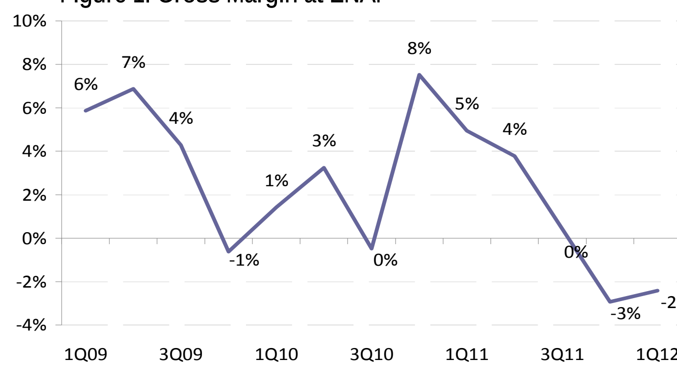
ENAP: When Is The Rescue Coming?

The bond market has completely ignored the problems at Chilean state-owned refinery ENAP, as demonstrated by the negative gross margins in the last two quarters. While we think Congress will eventually authorize new capital for the company, that will not happen immediately, and there exists potential for delays and negative news in the meantime that could hurt the company's bonds.

Recent news about ENAP, the Chilean state-owned refinery have been undoubtedly disappointing. The recovery we saw in 2010, with gross margins rising to a peak of 8% by the fourth quarter, has reversed with a steady deterioration throughout 2011 leading to gross margins of -3% and -2% in the last two reported quarters (see Figure 1).

Figure 1. Gross Margin at ENAP



Source: Company financial reports

To take the most pessimistic scenario, extrapolating from the negative cash flow in the first quarter tells us that the company would use up available cash by the end of the year, and that doesn't even account for nearly $700mn in maturities in 2012, including $290mn of global bonds due in mid-November. Offsetting those concerns is of course the likelihood of government support to rescue the company, and perhaps more immediately the willingness of local Chilean banks who understand better the relationship between ENAP and the government to provide any needed interim funding. In this article, we examine in more detail the likelihood of a rescue and the market's reaction to the news so far.

Why is ENAP having problems?

We start briefly with a discussion of the factors contributing to ENAP's financial problems. We have found in the past that the company is generally less profitable than US refineries, and as the global refining industry suffers, ENAP suffers even more. Over the past year, two additional factors have made the situation worse. First, the spread between Brent and WTI crude has widened. That spread matters because the prices ENAP can charge for its products are set based on the cost of such products in Texas, as produced by refineries that have access to the cheaper WTI oil. ENAP purchases crude from Latin American countries including Ecuador, Brazil, Colombia, Peru, and Argentina, with which Chile has free trade agreements and whose oil prices are more tied to Brent than WTI. Second, Chile has an energy shortage, made worse by the termination of cheap gas imports from Argentina six years ago. According to ENAP, the marginal cost of energy inputs for the refinery has doubled since 2009, as the country is forced to use the most expensive form of energy—diesel—to supply growing demand rather than much cheaper sources like hydro. The problem of high energy costs affects not just ENAP, but other industries as well, and it has no easy solution in the short-term. Third, the company may be run inefficiently thanks to the large number of interest groups represented on the board including the unions. That is of course not an argument that the company itself is likely to make but one that must be popular in some government circles. The government might even prefer to endorse that last explanation because otherwise it would have to admit that the refinery can never be profitable and that they intend to provide support for the company indefinitely.

We don't know what is the primary factor here, but for the current stage of government support it may not matter. We also believe that external problems could lessen on their own. For example, as global oil prices have fallen recently, we imagine Chilean energy prices should come down as well, as might the Brent to WTI spread. If these two developments continue, they would help bring the firm back to the higher margins we saw a year ago, which while not stellar, were at least positive.

When will the government support ENAP?

Investors buy ENAP not for its earnings, but rather for the implicit sovereign support. We explained the reasons for that support in detail in our article, "ENAP: Valuing the sovereign link," covering the roles of

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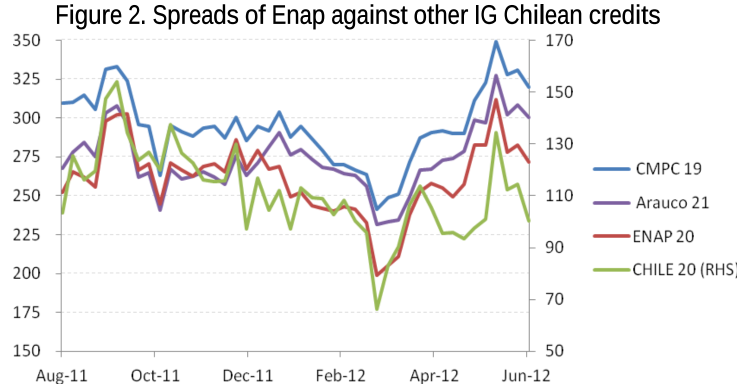
ENAP as a guarantor of national energy security and as a source of public unionized employment, as well as the government's need to support the company in preparation for an eventual privatization. This last factor plays a much smaller role now than two years ago. With President Piñera´s popularity having fallen to the 30% level, it is unlikely that the government would pursue such a right-wing policy. The first two factors remain, however, and we think the government will eventually extend additional support to the company.

The problem is that such support will not occur immediately, and there will be plenty of room for noise and negative news in the meantime. Contrary to some reports in the Chilean press, the finance ministry cannot recapitalize the company without new legislation from Congress. While Congress is aware of the problems at ENAP, there is no such legislation pending in Congress currently, and it is not a priority for the government. A different bill in Congress that eliminates import tariffs for countries with which Chile does not have a free trade agreement is under consideration and would allow ENAP to import oil from additional countries such as Nigeria and Angola where ENAP thinks it could potentially get better prices, even after accounting for higher transport costs. The problem is that the bill is much broader than just what ENAP needs; it would result in a $500mn shortfall in fiscal revenues, and we don't know if that bill will pass.

How have the bonds responded to the news?

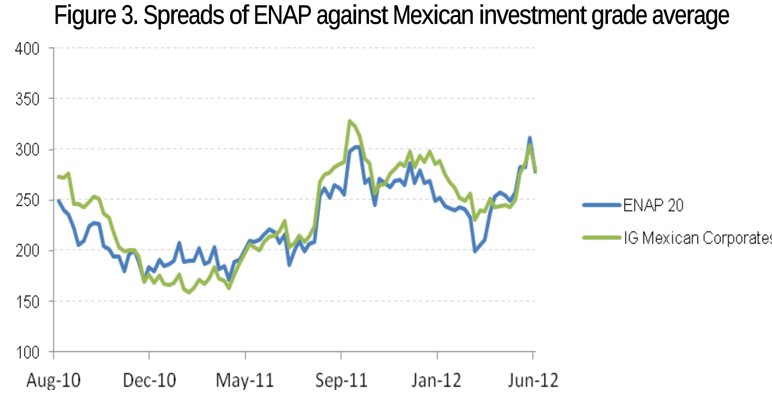
So far, the bond market has completely ignored all the bad news about ENAP. While the spreads of ENAP over the sovereign have widened from about 120bp to over 160bp during the past year, that movement is consistent with the broader selloff in the market. For example, we found that ENAP bonds have actually outperformed Arauco and CMPC, two other Chilean investment grade names that we follow (Figure 2). Yield movements are also extremely close to those of the average for a group of investment grade Mexican names we look at (Figure 3). Finally, the widening in ENAP bonds has coincided with that of Petrobras and of Pemex; fundamentals have also deteriorated at Petrobras, but actually improved at Pemex.

Figure 2. Spreads of Enap against other IG Chilean credits



Source: Company financial reports

Figure 3. Spreads of ENAP against Mexican investment grade average



Source: Company financial reports

The risks to ENAP are ultimately quite small, and we think the state would eventually step in to recapitalize the company. Nevertheless, while there is no emergency at ENAP, there is also no urgency on the part of the government. Suppose that one of the political parties decides to use the company's problems for political gain, delaying support for the company in order to make a a public statement. Certainly, such a tactic would rattle markets. Similarly, if we see no recovery in profits and only delays in approving additional state support, the company could face further downgrades, similar to the one we received from Moody's last week. While we are usually supportive of quasi-sovereigns in general and ENAP in particular as investments that provide a spread pickup to the sovereign for little additional risk, in this case we think the timing is poor and the market should be pricing more bad news. For these reasons, we wait for either some additional widening or some good news before buying ENAP bonds.

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Bank Of England MPC Minutes June

On a Knife Edge

- Unsurprisingly, the minutes of the MPC meeting evolved in the dovish direction. Given the incremental news on domestic and international activity, inflation and financial market developments, the thrust was always going to turn more dovish.
- Nonetheless, the vote was more dovish than expected, with 4 members now dissenting in favour of more QE (compared with one the previous month). Even more striking was that the Governor, Mervyn King was on the losing side. King, Posen and Miles wanted GBP50bn of QE. Meanwhile Fisher dissented for the first time in his MPC career, but only cautiously — opting for GBP25bn of additional asset purchases.
- Most MPC members agreed that more *economic stimulus* was required either immediately, or it would probably become warranted.
- So the key questions to come out of these minutes are:
    - What kind of further policy loosening? Are the additional liquidity measures announced in last week's Mansion House speech enough?
    - Furthermore, with even more economic stimulus likely to come from the Bank's Financial Policy Committee (announcement expected Friday 29th) does the MPC really need to conduct more QE as well?
    - Have developments since the June MPC meeting made the case for more policy ease stronger or weaker?

Dissecting the Minutes

The table below summarises the key aspects of these minutes, whether they were hawkish or dovish and any news since then.

Aspect	Key point / Recent News	Hawkish / Dovish
Eurozone fiscal jitters and impact on markets	Spanish yields have risen further to above 7% since June MPC	Dove friendly
UK money market rates	BOR-OIS unchanged, but GBP LIBOR has fallen post-Mansion House	Hawk friendly
Equity prices	Up 1.5 to 2% so far since June MPC	Hawk friendly
GBP exchange rate	Sideways since June MPC	Neutral
International activity	Q1 stronger than expected, Q2 looking weaker - More of the same since then	Dove friendly
Eurozone activity	Looking weaker than expected	Neutral
US activity	Weaker	Dove friendly
Emerging market activity	Weakening	Dove friendly
Oil prices	Down further on the month since June	Dove friendly
Domestic Activity	"likely that underlying GDP had been somewhat stronger than the headline figures suggested. But it has still been weak"	Hawk friendly
Domestic GDP	Consumption more positive than expected. Inventories have the potential to add to growth	Hawk friendly
Net trade	Outlook deteriorating both before and after June MPC	Dove friendly
Forward looking indicators	CIPS surveys (especially services expectations) look worse	Dove friendly
Mortgage spreads and funding costs	Increased on the month and likely to increase further	Dovish
Domestic Inflation	Inflation sharply lower in April and likely to undershoot Bank's projection. May's surprise reinforces this	Dovish
Wage Inflation	Very low, though reflecting bonuses. Slight recovery in May	Dove friendly
Pay settlements	"Basic pay settlements had fallen materially in April" (when the bulk of private sector agreements are made.	Dovish
Employment / Unemployment	Employment robust. Given weakening productivity, unit wage cost growth is at pre-crisis levels	Hawk friendly

To summarise, we judge that there were 11 aspects that were dovish (3 of which were particularly dovish) versus just 5 hawk friendly aspects. That helps to explain the evolution since May's meeting and identify the areas that could swing the decision in the coming months.

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At the end of the day, five members of the committee still voted for no QE at this stage. The summing up section of the minutes told us why that was.

1. Inflation remained elevated;
2. These members were awaiting the outcome of the Greek and French elections; and
3. The outcome of the European Council meeting at the end of June.

The case for further stimulus partly depended on how these evolved. So what has happened?

I. Inflation surprised on the downside, but is still elevated (2.8% y/y);
II. The Greek election was not a disaster — Spanish and Italian bond spreads to bunds have compressed significantly since that result; and
III. No new news.

Unconventional Unconventional Policy Measures

Last but not least, there is the issue of the additional liquidity measures announced in Mervyn King's mansion house speech and the possibility of more to come from the Financial Policy Committee meeting (this coming Friday). Although members agree that further policy ease is desirable, it is not clear that QE is the right tool. A key line was:

> *"Other complementary policy measures that the authorities might take could be better suited to mitigating these problems than asset purchases on their own."*

It is still not clear whether these alternative policy measures substitute for more QE or whether they will come in tandem with more QE.

Possible Bank Rate Cut?

The minutes once again discussed the possibility of a reduction in Bank Rate. While the conclusion was that there was now greater scope than previously to do this, asset purchases were preferable.

Conclusion

The MPC clearly has a dovish bias. The consensus has judged that it is a done deal that the Bank will deliver another GBP50bn of QE at the July meeting. We accept this is becoming more probable — a 5-4 vote with the Governor on the losing side is hard to argue with. The MPC members that dissented in June are less likely to change their vote than the members who have so far resisted voting for more QE.

Even so, we would argue that it is not black and white. Charlie Bean is typically seen as being more dovish than most — yet he resisted voting for more QE. Martin Weale has also been a little more activist than most. Likewise, he sat on his hands in June.

Since the June meeting the Governor announced a substantial package of measures in his Mansion House speech. There has been some dovish news on inflation, but there has also been some relief from the Greek election result. The minutes told us that the 5 members who didn't vote for more QE were awaiting the outcomes of these and to see whether the FPC meeting delivered even further *economic stimulus.* Last but not least, these members were awaiting the European Council meeting at the end of the month. It isn't over until it's over.

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France's Fiscal Path Under The Spotlight

Key Points

- **Early July will see the release of a complete assessment of France's fiscal position. The government will then offer clearer insight on how it will meet its 3% of GDP deficit target for next year.**
- **There are signs of possible slippage in the coming months. However, the main risk to budget deficit reduction comes from growth which, so far, was seen as too optimistic by the new government.**

Early July, a big rendez-vous for assessing the French fiscal position

With the French deputy election now behind us, all agree that the main focus in France will now be on the capacity of the country to reduce the budget deficit and to stick with the 3.0% of GDP target for next year. It was indeed the commitment of the previous government but also of the new socialist one. In this regard, early July is a big rendezvous as the government has indicated that it will wait to have a full auditing of France's fiscal situation before delivering its strategy.

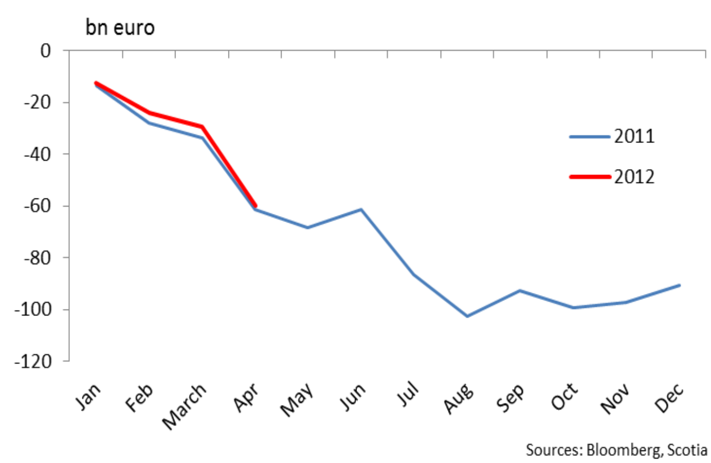
A favourable factor is that the new government benefits from a comfortable majority in the new deputy assembly. The socialist party and its closest allies indeed secured 314 seats, so well above the 289 level required for a majority. It will therefore not depend on the green party which, despite being part of the current government, has proved to be erratic in the past, and even less on the communist party. This means that the government will have enough room to pass any legislation to fulfil its commitments.

A more worrying element is nonetheless the comments from the new Finance Minister three weeks ago that, if nothing were done, there was a risk of the budget deficit being closer to 5.0% this year (instead of 4.5%) and 4.2% next year. While there have been no clear indications as to where these figures come from (a worse-than-expected budget situation, lower growth assumption….?), they would imply finding an extra €30 billion (bn) over the coming two years with €10 bn as soon as the next six months. While the Finance Minister has been quick to mention that the 3% target will be reached, he also indicated that no austerity measures will be implemented. So, the visibility appears low. Also, the fact that release of the auditing of France's fiscal situation has been delayed to after the EU summit on June 28 is not seen as a positive signal. Indeed, it suggests a willingness to avoid weakening Mr Hollande's position and his pro-growth agenda in front of his EU partners, as French budget figures will not be favourable. On the other hand, more optimistic comments would suggest that by sending darker signals on the budget situation, the new government might be back to the harsh reality of the crisis and already preparing the population for harder sacrifices than those pledged during the election campaign.

Overly optimistic growth assumption the main risk

So far, looking to the trend in the budget deficit in the first four months of the year, the French budget Ministry indicated that figures were in line with expectations and the plan set forth in the current fiscal law to reach a 4.5% deficit at the end of this year. While we agree it is overly simplistic to look to monthly budget patterns as they could be impacted by strong seasonality changes, so far, it seems that there is no suggestion that possible worse-than-expected developments could come from a strong deterioration in the early months of the year.

Chart 1: French budget deficit



As of April, the French budget deficit was around €60 bn, around €2.5 bn less than over

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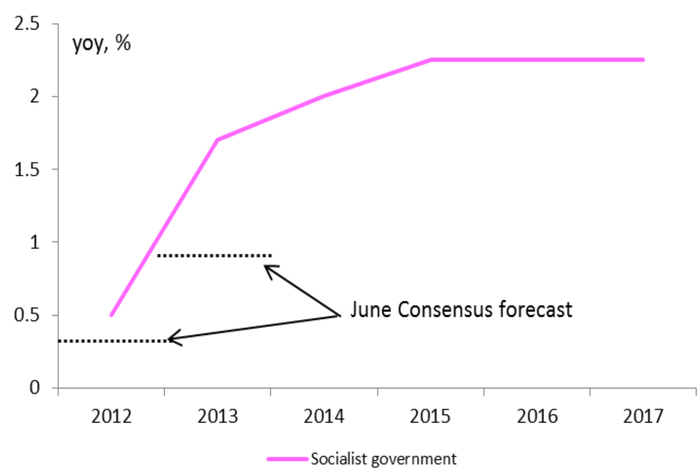
the same period last year. The end point is nonetheless to limit the budget deficit to around €82 bn, that is, roughly €10 bn less than last year. This result was in particular the consequence of higher tax receipts (€91 bn, +2.5 bn vs. April 2011) thanks in particular to the impact of the hike in the VAT reduced rate at the beginning of the year, but also to temporary extra receipts linked to the sale of 4G licences by the government in January (around €1 bn). However, it is true that expenditures were also higher, which could raise nervousness regarding the underlying strength of this deficit reduction.

Further ahead, on the positive side, the French fiscal position this year could benefit from a lower debt service burden thanks to the sharp fall in interest rates since last Autumn. In the initial budget document, the debt service burden was supposed to cost €49 bn. The average maturity of French debt is around 7 years and, since the beginning of the year, 7-year nominal yields dropped around 0.5%, which in our view would imply savings of €1.5 to €2 bn per year.

However, this good news will not be enough to compensate the more negative news items, with the most worrying being that France was condemned by the EU earlier this year regarding unfair taxation on some specific foreign financial placements. The fine will be retroactive and is estimated to cost around €4 bn in the coming months. Furthermore, with the deterioration of the job market, the new government already indicated that it will increase employment by 80K over the next six months, a measure which is dedicated to stabilizing the unemployment rate. The extra cost is estimated to be between €0.4 and €0.5 bn. While this is not a strong risk in the short term, it could nonetheless raise suspicions regarding the capacity of the new government to control spending.

Chart 2: French GDP growth expectations



All in all, there is a risk that the fiscal dynamics over the coming months could be less favourable than previously expected. However, the main risk regarding the capacity of France to meet its budget deficit target is coming from growth itself. For this year, both the former and the new government based their assumptions on a 0.5% growth trend. Looking to the latest consensus forecast on France GDP growth, it seems that we might be a bit short of this target with an expectation of 0.3%, not far from our own forecast at 0.2%. Using traditional elasticities, this would imply a €3-4 bn shortage for this year. It is true that the risk could be on the downside as falling business confidence raises the risk of seeing the French economy in recession in Q2 and Q3. However, it is for next year that this growth issue is the most worrying, as the June consensus forecast expects below 1% growth compared to +1.7% in the socialist economic platform. The risk of too positive growth assumptions has always been mentioned as a factor of fragility in the socialist program and their capacity to reach the 3% budget deficit next year. It seems that this risk has increased. Assuming the 0.9% GDP growth trend currently anticipated by the consensus, it would imply a shortfall of around €9 bn.

All in all, while the new Finance Minister mentioned the risk of a €30 bn shortfall in the coming two years, we can easily identify half of it. The release of the fiscal auditing in two weeks' time will help to provide better insight on the French fiscal position. Already, there are some signs of fragility and there will be a need for the new government to quickly deliver credible measures. However, any announced fiscal plan will have to be backed by new and more conservative GDP growth assumptions to pass the credibility test.

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Appetite For LATAM Remains Strong Despite FX Weakness, Hedge Unwinding Could Support FX

- **Latin American (LATAM) FX has broadly weakened since March 2012, as Euro-centric uncertainty has buffeted global financial markets.**
- **Despite a weakening trend across global financial markets, global investors have given LATAM a vote of confidence by broadly increasing their share in the region's equity & fixed income markets.**
- **Although lack of outflows could limit LATAM FX rebound, we see potential support from hedge unwinding.**

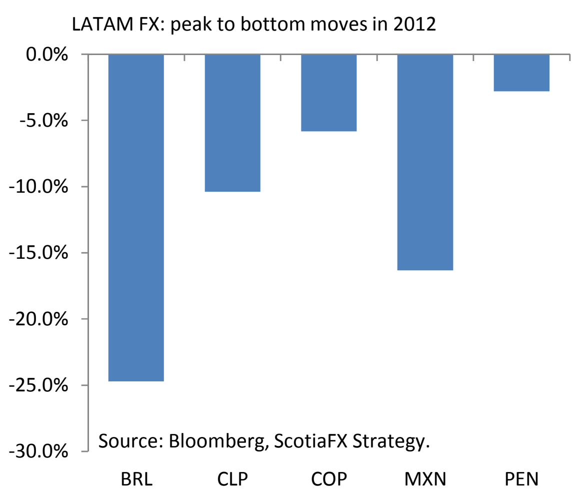
LATAM FX experienced relatively sharp sell-offs since the end of February as Euro-centric uncertainty and concerns about softening US & Chinese data, weighed on global markets. During that period BRL and MXN both saw "top-to-bottom" drops of >15%, while CLP (8.9% peak to bottom) and COP (5.8% peak to bottom) also experienced relatively large depreciations. The depreciation of LATAM FX suggests potential outflows of foreign capital from domestic markets such as what we saw in the foreign holdings of cetes last fall, which dropped from a high of 32% to a low of 20%.

Interestingly, despite the volatility we have seen in LATAM FX, foreign investors' share of domestic equity markets in the regions is now higher than it was before this spring's sell-off began (although at points over the past few months, fund flows data has shown outflow from Emerging Market equities). In part the higher share could be due to cheaper currencies making LATAM equity markets look more compelling, but we also see it as a vote of confidence in LATAM from global investors, given global uncertainty remains high.

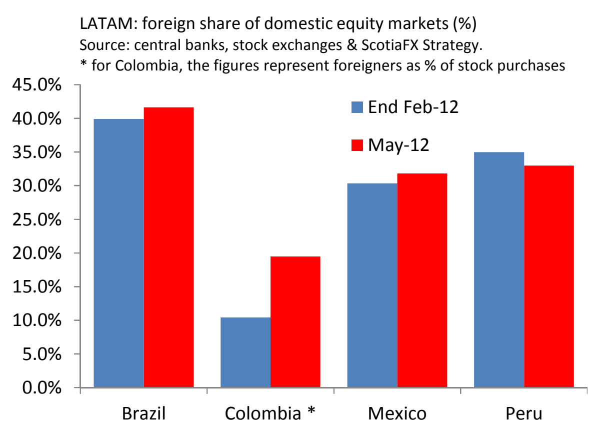
In the fixed income market we saw a similar pattern, with foreign holdings remaining stable or rising in most LATAM markets. Interestingly, contrary to what we saw during last fall's sell-off, where foreign positions in cetes were scaled back substantially, this time around foreigners do not appear to be exiting local debt markets (the data on some markets is lagged, but the volatile cetes data could be a timely proxy).

Bottom line: given that we saw relatively light selling of local assets, the potential for a LATAM FX rebound as risk aversion settles, driven by foreign investors re-establishing positions is lower than it has been in the past.

LATAM FX has weakened substantially



Foreigners seemingly remain comfortable with their LATAM equity holdings



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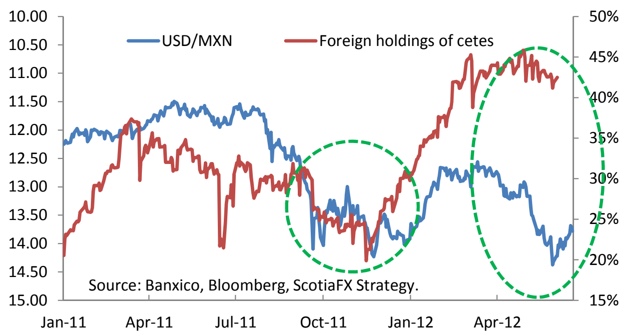
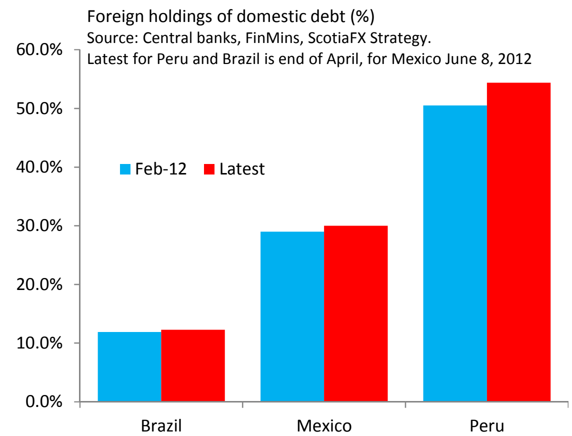
However, anecdotal evidence and price action suggest that a large share of local market positions are hedged. If this were not the case, we believe that local fixed income and equity positions would have been stopped out and outflows observed. Accordingly, we see room for LATAM FX to rally as hedges are unwound, particularly in the higher beta LATAM FX where hedges are likely more prevalent.

Contrary to last fall, foreign cetes holdings de-coupled from MXN



Local debt market holdings reinforce the signaled vote of confidence on LATAM fundamentals



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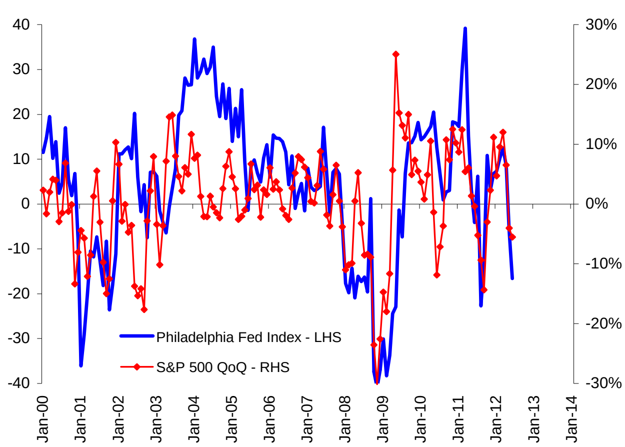
ISM To Follow Philly Fed Lower, S&P 500 Half-Way There

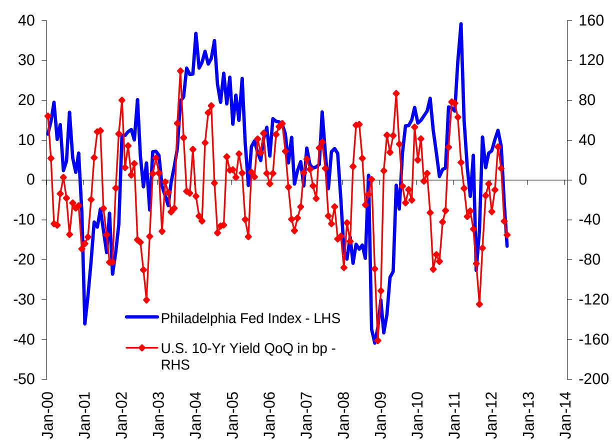
- As a very tough second quarter winds down for equities and commodities, recent economic releases in Europe, China, and the U.S. are keeping the spotlight on downside risks. Commodities prices took another hit this week, with WTI easing under US$80/bbl (WTI is down 24% in Q2) and copper slumping to US$3.30/lb (-14% in Q2).
- The latest Euro zone PMI index stood at 44.8 and China's flash PMI slipped to 48.1. In the U.S., the Philadelphia Fed survey tumbled to -17 last month, its worst level since August 2011 when markets were gripping with the U.S. credit downgrade. To be fair, recent jobless claims and housing releases remain disappointing, but not as alarming as the Philly Fed.
- Although last year's collapse in the Philly Fed index was never matched (not even close) by the broader ISM manufacturing survey, investors should expect weaker ISM visibility through Q3. Hence, we believe that the ISM (now at 53.5) should trend towards the 48-50 level in coming months.
- One of the many reasons we like to monitor the Philly Fed (and ISM/PMI type indices) is because of the positive correlation with the S&P 500. As illustrated in Exhibits 1 and 2, the S&P 500 correction appears to be half-way through the Philly Fed slide, while U.S. 10-Yr yields are already pricing the Philly Fed collapse. Bottom line: yields could be closer to a bottom, equities have modest downside until Philly/ISM settles.
- From a strategy perspective, we tend to turn bullish on cyclicals/equities/EM when PMI/ISM manufacturing indices bottom. We are not there yet and view this as a late Q3 scenario. Negative earnings revisions remain a threat in the near term, especially in commodity sensitive indices such as the TSX.

Philadelphia Fed & S&P 500 (2000-2012)



Source: Scotiabank GBM, Bloomberg.

Philadelphia Fed & U.S. 10-Yr Yields (2000-2012)



Source: Scotiabank GBM, Bloomberg.

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Narrowing Policy Options, Evolving Leadership

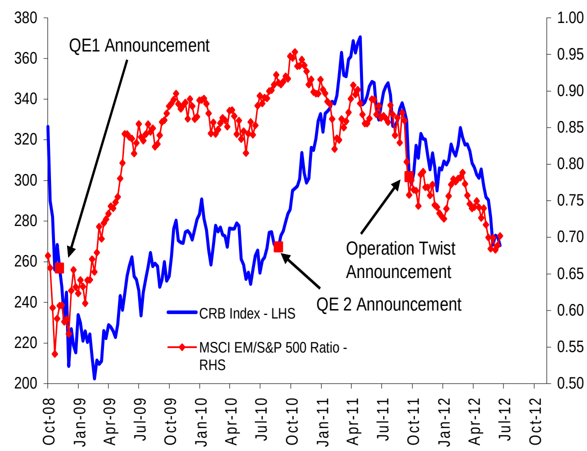
Limited policy options…

- This week's FOMC meeting and "Operation Twist" extension highlighted the extent to which monetary policy continues to influence investor sentiment. Economists and media headlines are continuously debating the ECB, the Fed, or the PBoC's next move, fuelling sporadic risk-on/risk-off leadership cycles. As debt woes continue in Europe, and with U.S. fiscal adjustments looming in coming years, muted GDP growth should keep policy decisions in the spotlight for many years.
- A growing concern among investors is that policy options are increasingly limited as ammunition dries up. In terms of scope, interest rates are already at historical lows in most G-7 countries. Benchmark rates stand at 0% in the U.S. and Japan, 0.50% in the U.K., 1% in Europe and Canada. Long term yields hover between 0.8% in Japan and 1.6% in the U.S. Hence, further rate cuts or additional bond-buying schemes (QE) would be beneficial from a "time extension" standpoint, but they could hardly kick-start growth in moribund economies.
- Developing countries such as China, India, and Brazil also find themselves in a different position than in '08/'09, which limits the magnitude of potential easing initiatives. Sticky inflation and falling currencies are currently restricting easing options in Brazil and India, whereas China's growth objectives argue against a repeat of the 2009 monster stimulus package.
- Although money supply growth remains supportive in the U.S., M1 signals are more muted in Europe, China, and Brazil, thus supporting an extended easing bias.

…different leadership

- As investors hold on to never-ending hopes of further quantitative easing, market leadership has evolved and is increasingly reflecting limited policy options. And for all the chatter about pending QE3 and additional "money printing", we would that currencies (stronger USD), commodities (lower bullion), and EM (underperforming S&P500 for the last 18 months) have already gone in a different directions.
- Commodities and EM were the indisputable winners post-QE1, but their leadership quickly faded post-QE2 and did not pan out after last year's Twist announcement. As highlighted in Exhibit 1, the CRB index and EM (relative to S&P500) have lagged in recent months even though easing policy hopes have increased.

CRB Index, EM/S&P 500 Ratio, and QE Hopes (2010-2012)



Source: Scotiabank GBM, Bloomberg.

Negative earnings revisions challenging equity rebound

- Global central banks are likely to remain accommodative for an extended period, but lower input costs, oil and gasoline specifically, may eventually be the silver lining after four years of sustained easing. Lower commodities prices could however extend the string of negative earnings revisions for resource-sensitive areas.
- Equity markets had shrugged off a lot of bad news in early/mid June and the risk trade was fuelled by prospects of fresh stimulus from the Federal Reserve. U.S. data has undoubtedly weakened in the second quarter and global risks have increased in both Europe and developing countries. The Fed has mentioned numerous times that it was prepared to act and, in our view, the current situation certainly dictates a more dovish statement from the U.S. central bank. However, the extent of additional easing measures, not to mention their tangible consequences, could still disappoint investors.

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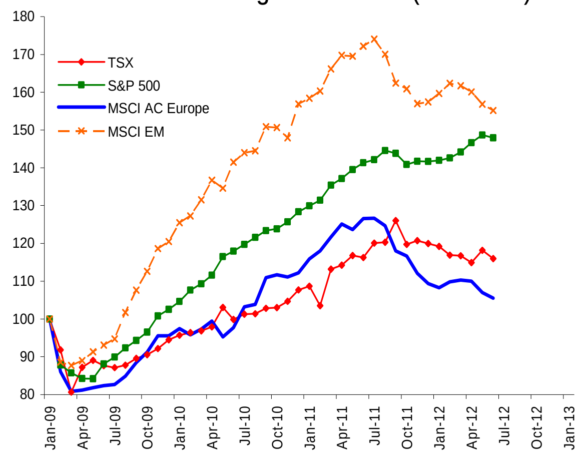
- In our opinion, a more sustainable cyclical equity recovery needs to be supported by positive earnings revisions. As highlighted in Exhibit 2, forward (next 12-months) earnings estimates are still trending downward in Europe, Canada, and Emerging Markets. S&P 500 estimates had bucked the trend, but the June estimates have slipped to US$111 from US$112. TSX forward earnings currently stand at $972, but based on spot commodity prices, our model points to C$820-C$870 levels, hence further downside revisions risk remains.

Forward Earnings Normalized (2009-2012)



Source: Scotiabank, Thomson Financial.

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Key Data Preview

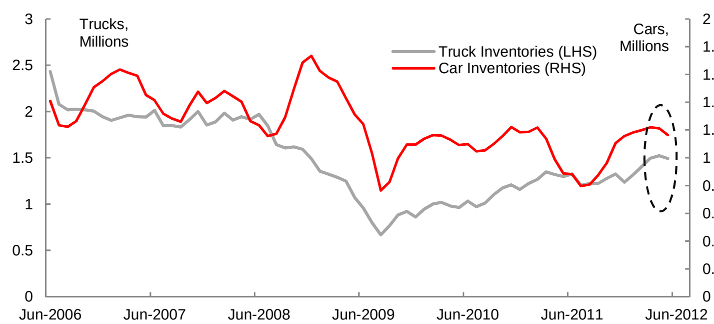
CANADA

April GDP data will be released on June 29 and Scotia anticipates a muted gain of 0.2% m/m. Retail sales volumes fell by 0.8% m/m, wholesale sales were up by 1.3%, and manufacturing output decreased by a fairly steep 0.6% m/m. Housing starts were higher due to a surge in condo starts, but those add less to GDP per-housing unit than does construction of single family dwellings (therefore the magnitude of their pass-through into construction activity is fairly low). On the basis of those four components of GDP, we would be tracking a slight contraction in GDP (approximately -0.1% m/m). Things get trickier, however, once we try to account for volatility in the natural resource sector during April. Potash and fertilizer plant that had been idled from January through March came back online in April providing a surge in output that echoed through a variety of macroeconomic aggregates (e.g., exports of fertilizers and fertilizer materials were up by 51.8% m/m). On the other hand, there were temporary maintenance-related shutdowns at oil and gas refineries resulting in lower output in the oil and gas sector. It's hard to say how the two swings will bear out in the aggregated data as oil and gas output is twice as significant as mining output — of which potash mining is a subset — but the relative magnitude of the swing in the agriculture sector was greater. We're expecting the surge in agriculture-related output to trump the oil and gas maintenance, hence our 0.2% m/m GDP call. The bottom line is that the Canadian economy is increasingly geared to commodities output, so much so that swings in fossil fuel and potash output are key factors in forecasting GDP.

UNITED STATES

US durable goods orders for May will be released on June 27 and Scotia anticipates a flat headline print following on April's flat 0% m/m reading. Orders at Boeing increased from 4 in April to 8 in May, which should result in an increase in the aircraft and parts orders category. Conversely, orders of new cars picked up markedly in April (+5.8%) and there's a strong likelihood that orders cooled in May both in line with the seasonal pattern, but moreover, in line with a larger development in the retail automotive inventory cycle. Orders of cars follow a fairly standard pattern through the year, corresponding with the inventory stocking and de-stocking cycle (see chart). The issue this year is that inventories (in absolute terms) peaked back at a level approaching a 'normal' pre-crisis annual low in April, leading to hopes that finally the car inventory level was normalizing to the pre-2008 level. This hope seems to be premature as the inventory de-stocking cycle is likely to pick up steam over the summer — as it does every year — dragging down the total inventory with it. Moreover, there is a risk that the inventory level is too high, as the US has fewer car dealers, fewer car companies, and leaner automotive distribution compared to 2007. That means that car dealers should have been fairly satisfied with the quantity of units that they were holding on lots in May, and there is a risk that they tempered their ordering of new stock.

US Car & Truck Inventories at Dealers at Seasonal Peak



Source: Scotia Economics, Automotive News, Bloomberg

Scotia expects a flat personal spending reading (0% m/m) and a slight increase in personal income (+0.1%) when **PCE** data are released on June 29. US consumers went on a car shopping spree during H1 2012, increasing the volume of car purchases by 12% over the 2011 average. This is somewhat of a surprise as job growth, while better than during 2011, was fairly subdued (164/k per month on average through May), while nominal personal income increased by a scant 1.3%. In part because of the spike in car purchases, personal consumption expenditure increased by 1.8% through April in nominal terms and +1.1% in real terms. The implication is that the shopping has been financed out of savings, and indeed the personal savings rate has fallen from 4.2% in December 2011 to 3.4% in April 2012. Average hourly wages were slightly higher in May (+0.1%) while retail sales, which include car sales, were lower by 0.2%. In short, it looks like there is a good chance that consumers retrenched during May.

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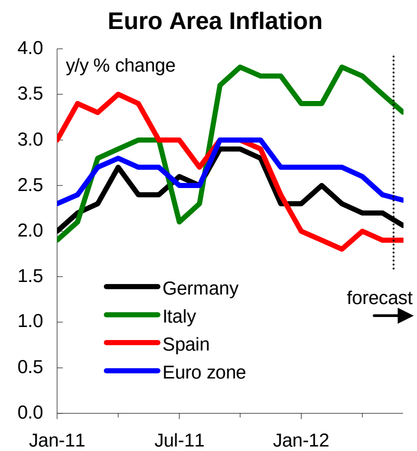
EUROPE

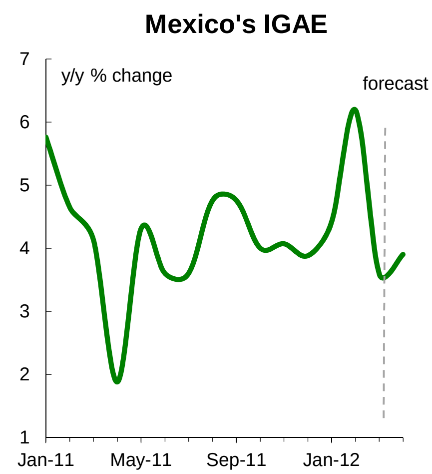
The June flash estimates for consumer price inflation in the euro area will be released next week. Headline inflation experienced a marked slowdown across the currency union last month, with the aggregate annual figure easing from 2.6% y/y in April to 2.4% in May (prices fell 0.1% from the previous month). Core prices (excluding energy, food, alcohol and tobacco) were flat in May, keeping the year-over-year rate at 1.6% y/y for the third consecutive month. Lower energy and telecommunications prices caused the drop in the CPI last month and we anticipate more of the same this month, with the price of Brent oil having shed another 10% so far in June. We expect next week's data to show declines of 0.1% in monthly terms in Germany (Wednesday), Italy (Thursday) and the euro zone (Friday), and a 0.2% m/m fall in Spain (Thursday), bringing the respective annual inflation rates to 2.1% y/y, 3.3%, 2.3% and 1.9%. Should this further moderation in inflationary pressures materialize, the case for a rate cut by the European Central Bank (ECB) at the next rate-setting meeting on July 5th will be strengthened, particularly in light of the continued deterioration in the region's purchasing managers' indexes. We continue to expect a 25 basis point reduction in the main refinancing rate, which will bring the policy rate to a record-low 0.75%.



Source: Bloomberg, Scotia Economics.

LATIN AMERICA

In the first quarter of the year, the Mexican economy showed a solid economic performance, with GDP expanding by 4.6% y/y, its highest rate in one-and-a-half years. The industrial sector, especially the automotive sector, has not yet reflected the slowdown in external demand, while construction activity has been reignited mainly driven by government spending in an election year. Additionally, local consumption remains robust. The global economic activity indicator (monthly GDP) for April will be released next Tuesday and we expect it to have grown by 3.9% y/y. We maintain our view that the Mexican economy will present a solid performance in the second quarter of the year, and then decelerate somewhat in the second half.



Source: Thomson Reuters

ASIA

One of the highlights of Japan's busy data calendar next week (including CPI, retail sales, household spending, unemployment and housing starts) will be the preliminary estimate for industrial production in May, due out on Friday. We anticipate a contraction of 3.2% on a monthly basis to follow April's 0.2% loss (downwardly revised from +0.2% m/m). It is expected that a high base effect in the auto sector in April, as well as chemical plant shutdowns for inspections in May will drag the headline industrial output figure down. External factors also continue to weigh on Japan's fragile recovery, including in particular the euro crisis (Japan posted its first-ever trade deficit with the European Union in May), and the resulting risk aversion in global financial markets, which keeps upward pressure on the yen to the detriment of Japanese exporters. Though industrial production will likely rebound to some extent in the months ahead on the back of ongoing reconstruction spending, the fundamental situation in Japan remains quite weak, and volatility in real economic data will continue to reflect this fact. After a strong first quarter in which the economy expanded 4.1% y/y, we expect the pace of growth to moderate, resulting in an average rate of 2% in 2012.

Key Indicators for the week of June 25 - 29

North America

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
MX	06/25	09:00	Trade Balance (US$ mn)	MAY P	--	-45.0	560.2
US	06/25	10:00	New Home Sales (000s a.r.)	MAY	337	345	343
MX	06/26	09:00	Global Economic Indicator IGAE (y/y)	APR	3.87	4.2	3.6
US	06/26	09:00	S&P/Case-Shiller Home Price Index (y/y)	APR	--	-2.5	-2.6
US	06/26	10:00	Consumer Confidence Index	JUN	61.0	64.0	64.9
US	06/26	10:00	Richmond Fed Manufacturing Index	JUN	--	5.0	4.0
US	06/27	07:00	MBA Mortgage Applications (w/w)	JUN 22	--	--	-0.8
US	06/27	08:30	Durable Goods Orders (m/m)	MAY	0.0	0.5	0.0
US	06/27	08:30	Durable Goods Orders ex. Trans. (m/m)	MAY	0.4	0.7	-0.9
CA	06/27	09:00	Teranet - National Bank HPI (y/y)	MAY	--	--	5.9
US	06/27	10:00	Pending Home Sales (m/m)	MAY	1.3	1.3	-5.5
US	06/28	08:30	Continuing Claims (000s)	JUN 16	3300	--	3299
US	06/28	08:30	Initial Jobless Claims (000s)	JUN 23	388	385	387
US	06/28	08:30	GDP (q/q a.r.)	1Q T	1.9	1.9	1.9
US	06/28	08:30	GDP Deflator (q/q a.r.)	1Q T	1.7	1.7	1.7
CA	06/29	08:30	IPPI (m/m)	MAY	--	0.1	0.0
CA	06/29	08:30	Raw Materials Price Index (m/m)	MAY	--	-1.5	-2.0
CA	06/29	08:30	Real GDP (m/m)	APR	0.2	0.2	0.1
US	06/29	08:30	PCE Deflator (m/m)	MAY	--	-0.1	0.0
US	06/29	08:30	PCE Deflator (y/y)	MAY	1.6	1.5	1.8
US	06/29	08:30	PCE ex. Food & Energy (m/m)	MAY	--	0.2	0.1
US	06/29	08:30	PCE ex. Food & Energy (y/y)	MAY	--	1.8	1.9
US	06/29	08:30	Personal Consumption (m/m)	MAY	0.0	0.0	0.3
US	06/29	08:30	Personal Income (m/m)	MAY	0.1	0.2	0.2
US	06/29	09:45	Chicago PMI	JUN	51.5	53.0	52.7
US	06/29	09:55	U. of Michigan Consumer Sentiment	JUN F	74.0	74.4	74.1

Europe

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
UK	06/25	06:59	Nationwide House Prices (m/m)	JUN	--	0.1	0.3
UK	06/26	04:30	PSNB ex. Interventions (£ bn)	MAY	--	14.8	-16.5
UK	06/26	04:30	Public Finances (PSNCR) (£ bn)	MAY	--	4.0	-23.2
UK	06/26	04:30	Public Sector Net Borrowing (£ bn)	MAY	--	14.0	-18.8
SP	06/26	06:59	Budget Balance YTD (€ mn)	MAY	--	--	-25462
HU	06/26	08:00	Base Rate (%)	JUN 26	--	7.0	7.0
GE	06/27	08:00	CPI (m/m)	JUN P	-0.1	0.0	-0.2
GE	06/27	08:00	CPI (y/y)	JUN P	1.7	1.8	1.9
GE	06/27	08:00	CPI - EU Harmonized (m/m)	JUN P	-0.1	-0.1	-0.2
GE	06/27	08:00	CPI - EU Harmonized (y/y)	JUN P	2.1	2.1	2.2
SP	06/28	03:00	CPI (y/y)	JUN P	--	2.0	1.9
SP	06/28	03:00	CPI - EU Harmonized (y/y)	JUN P	1.9	1.9	1.9
GE	06/28	03:55	Unemployment (000s)	JUN	10	3.0	0.0
GE	06/28	03:55	Unemployment Rate (%)	JUN	6.8	6.7	6.7
UK	06/28	04:30	Business Investment (q/q)	1Q F	--	3.6	3.6
UK	06/28	04:30	Current Account (£ bn)	1Q	--	-9.0	-8.5
UK	06/28	04:30	GDP (q/q)	1Q F	-0.3	-0.3	-0.3
EC	06/28	05:00	Business Climate Indicator	JUN	--	-0.9	-0.8
EC	06/28	05:00	Economic Confidence	JUN	--	89.6	90.6
EC	06/28	05:00	Industrial Confidence	JUN	--	-12.0	-11.3

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

Key Indicators for the week of June 25 - 29

Europe *(continued from previous page)*

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
IT	06/28	05:00	CPI (m/m)	JUN P	--	0.1	0.0
IT	06/28	05:00	CPI (y/y)	JUN P	--	--	3.2
IT	06/28	05:00	CPI - EU Harmonized (m/m)	JUN P	-0.1	--	0.0
IT	06/28	05:00	CPI - EU Harmonized (y/y)	JUN P	3.3	--	3.5
UK	06/28	19:01	GfK Consumer Confidence	JUN	--	-29.0	-29.0
FR	06/29	01:30	GDP (q/q)	1Q F	0.0	0.0	0.0
FR	06/29	02:45	Producer Prices (m/m)	MAY	--	-0.6	-0.1
UK	06/29	04:30	Index of Services (m/m)	APR	--	0.0	0.5
EC	06/29	05:00	Euro zone CPI Estimate (y/y)	JUN	2.3	2.4	2.4
SP	06/29	06:59	Current Account (€ bn)	APR	--	--	-3.2

Asia Pacific

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
VN	06/24	06:59	Exports (y/y)	JUN	--	--	24.1
VN	06/24	06:59	Imports (y/y)	JUN	--	--	6.6
PH	06/25	21:00	Imports (y/y)	APR	--	--	-3.3
PH	06/25	21:00	Trade Balance (US$ mn)	APR	--	--	-1049
HK	06/26	04:30	Exports (y/y)	MAY	--	1.0	5.6
HK	06/26	04:30	Imports (y/y)	MAY	--	2.0	5.0
HK	06/26	04:30	Trade Balance (HK$ bn)	MAY	--	--	-42.9
JN	06/27	19:50	Large Retailers' Sales (y/y)	MAY	--	-1.0	-0.6
JN	06/27	19:50	Retail Trade (m/m)	MAY	--	0.2	-0.4
JN	06/27	19:50	Retail Trade (y/y)	MAY	--	3.0	5.7
JN	06/28	19:30	Household Spending (y/y)	MAY	--	2.5	2.6
JN	06/28	19:30	Jobless Rate (%)	MAY	--	4.5	4.6
JN	06/28	19:30	National CPI (y/y)	MAY	--	0.2	0.4
JN	06/28	19:30	Tokyo CPI (y/y)	JUN	--	-0.5	-0.5
JN	06/28	19:50	Industrial Production (m/m)	MAY P	-3.2	-2.8	-0.2
CH	06/28	21:30	Industrial Profits YTD (y/y)	MAY	--	--	-1.6
JN	06/29	01:00	Housing Starts (y/y)	MAY	--	6.5	10.3
TH	06/29	03:30	Exports (y/y)	MAY	--	--	-3.5
TH	06/29	03:30	Imports (y/y)	MAY	--	--	9.0
TH	06/29	03:30	Trade Balance (US$ mn)	MAY	--	--	-734.0

Latin America

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CO	06/29	07:59	**Overnight Lending Rate (%)**	JUN 29	**5.25**	**5.25**	**5.25**
CL	06/29	09:00	Industrial Production (y/y)	MAY	--	--	2.6
CL	06/29	09:00	Retail Sales (y/y)	MAY	--	--	7.1
CL	06/29	09:00	Unemployment Rate (%)	MAY	--	6.8	6.5
CO	06/29	12:00	Urban Unemployment Rate (%)	MAY	--	11.0	11.4

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

Global Auctions for the week of June 25 - 29

North America

Country	Date	Time	Event
US	06/25	11:00	U.S. Fed Sells US8.592 Bln Notes
US	06/25	11:30	U.S. to Sell USD30 Bln 3-Month Bills
US	06/25	11:30	U.S. to Sell USD27 Bln 6-Month Bills
US	06/26	11:00	U.S. Fed to Purchase USD4.50-5.50 Bln Notes
US	06/26	11:30	U.S. to Sell USD25 Bln 52-Week Bills
US	06/26	11:30	U.S. to Sell 4-Week Bills
US	06/26	13:00	U.S. to Sell USD35 Bln 2-Year Notes
US	06/27	11:00	U.S. Fed to Purchase USD1.50-2.25 Bln Notes
US	06/27	13:00	U.S. to Sell USD35 Bln 5-Year Notes
US	06/28	11:00	U.S. Fed to Sell US8.00-8.75 Bln Notes
US	06/28	13:00	U.S. to Sell USD29 Bln 7-Year Notes
US	06/29	11:00	U.S. Fed to Purchase USD4.25-5.25 Bln Notes

Europe

Country	Date	Time	Event
GE	06/25	05:30	Germany to Sell EU3 Bln 12-Mth Bills
FR	06/25	09:00	France to Sell Bills (BTF)
NE	06/26	04:00	Netherlands to Sell Up to EUR3 Bln 2.25% 2022 Bonds
SP	06/26	04:30	Spain to Sell 3-Month and 6-Month Bills
IT	06/26	05:00	Italy to Sell Bond/Zero Coupon
SZ	06/26	05:30	Switzerland to Sell 3-Month Bills
UK	06/26	05:30	U.K. to Sell GBP1.25 Bln 0.125% I/L 2029 Bonds
IT	06/27	05:00	Italy to Sell Bills
IT	06/28	05:00	Italy to Sell Bonds/Floating/Zero Coupon
UK	06/29	06:10	U.K. to Sell Bills

Asia Pacific

Country	Date	Time	Event
CH	06/24	22:00	Agricultural Dev. Bank China to Sell CNY15 Bln 7-Year Bonds
CH	06/25	22:00	China Development Bank Sells CNY20 Bln 7-Year Floaters
JN	06/25	23:45	Japan to Sell 2-Year Bonds
CH	06/26	22:00	Export-Import Bank Of China to Sell CNY15 Bln 5-Yr Bonds
CH	06/26	23:00	China to Sell CNY28 Bln 30-Year Bonds

Latin America

Country	Date	Time	Event
BZ	06/26	11:00	Brazil to Sell IPCA Consumer Price-Indexed Note 08/15/2016
BZ	06/26	11:00	Brazil to Sell IPCA Consumer Price-Indexed Note 08/15/2018
BZ	06/26	11:00	Brazil to Sell IPCA Consumer Price-Indexed Note 08/15/2022
BZ	06/28	11:00	Brazil to Sell Zero Coupon Fixed Rate Bill 04/01/2013
BZ	06/28	11:00	Brazil to Sell Zero Coupon Fixed Rate Bill 07/01/2014
BZ	06/28	11:00	Brazil to Sell Zero Coupon Fixed Rate Bill 01/01/2016

Source: Bloomberg, Scotia Economics.

Events for the week of June 25 - 29

North America

Country	Date	Time	Event
US	06/26	10:00	OECD Holds Washington News Conference on U.S. Economic Survey
US	06/28	11:30	Fed's Pianalto Speaks in Cleveland
US	06/28	19:00	Fed's Fisher Speaks in Aspen on the Economy
US	06/29		Fed's Rosengren Speaks on Banking Crisis in Amsterdam
US	06/29	09:05	Fed's Bullard Speaks on Economy in Arkansas

Europe

Country	Date	Time	Event
EC	06/23	18:00	BIS Holds Global Central Bank Meeting
EC	06/25	03:30	EU Foreign Ministers Meet in Luxembourg
EC	06/25	12:00	ECB's Asmussen Speaks in Frankfurt
EC	06/26	03:30	EU General Affairs Ministers Meet in Luxembourg
GE	06/26	03:30	Schaeuble Holds Keynote Speech at Franco-German Event, Berlin
UK	06/26	05:00	BOE's King, Dale, Miles Broadbent Attend TSC in London
EC	06/26	06:00	EU's Barroso Speaks at Brussels Think Tank
SP	06/26	07:00	Spain New Central Banker Takes Over Bank of Spain
WW	JUN 26-27		World Banking & Finance Summit 2012, UK
GE	06/27	08:00	Merkel Attends Energy & Water Federation Event: Berlin
GE	06/27	11:00	Merkel Attends CDU's Konrad Adenauer Foundation Event: Berlin
EC	06/27	12:00	Italy's Monti, Luxembourg's Juncker Speak in Brussels
EC	06/28	07:00	ECB's Constancio Speaks in Madrid
EC	06/28		The 6th meeting of the ESMA SMSG
EC	JUN 28-29		European Union Leaders' Summit in Belgium
GE	06/29		Germany's Lower House Votes on Pact

Asia Pacific

Country	Date	Time	Event
AU	06/25	23:50	RBA's Debelle Speaks on Mortgage Conference Panel in Adelaide
NZ	06/27	20:20	Finance Minister Speaks at Federated Farmers Conference

Latin America

Country	Date	Time	Event
PO	JUN 22-23		Portuguese Prime Minister Visits Colombia
AR	JUN 23-25		Chinese Premier Wen Jiabao Arrives in Argentina
CL	JUN 25-26		Chinese Premier Wen Jiabao Arrives in Chile
CL	06/27	08:30	Central Bank's Traders Survey
CO	06/29		**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	July 17, 2012	1.00	--
Federal Reserve – Federal Funds Target Rate	0.25	August 1, 2012	0.25	--
Banco de México – Overnight Rate	4.50	July 20, 2012	4.50	--

Fed: The Fed extended its 'Maturity Extension Program' on June 20. It plans to swap the remaining US$267bn of US Treasury securities with current maturities of 3.5 years or less that it holds for longer duration securities. We expect further easing in Q3. Over and above the volatile global economic environment, there is a strong domestic fundamental case for Fed easing: Weak jobs data (69k in April, 77k in March), downward revisions to GDP (1.9% Q/Q SAAR in Q1), and weak CPI (1.7% y/y in May). Incremental easing could take the form of further quantitative easing and/or an extension of the period during which the FOMC believes that the Fed Funds Rate will be held between 0-0.25%. BoC: Fiscal policies aimed at reducing momentum in property markets have done the 'real-estate market tightening' that the BoC has implied that it may undertake, making additional action unnecessary. Markets are now pricing very slight odds of BoC easing this summer although the odds increase further out the OIS curve. We think that easing is rather unlikely barring a global liquidity and funding crisis – a risk that the BoC highlighted in its Financial Stability Report but by no means our base case (or the (or the BoC's). We expect the BoC to revise its growth and CPI projections lower in the July MPR but to remain on hold at least until mid-2013.

Europe

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
European Central Bank – Refinancing Rate	1.00	July 5, 2012	0.75	--
Bank of England – Bank Rate	0.50	July 5, 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	July 13, 2012	8.00	--
Hungarian National Bank – Base Rate	7.00	June 26, 2012	7.00	7.00
Central Bank of the Republic of Turkey – 1 Wk Repo Rate	5.75	July 19, 2012	5.75	--
Sweden Riksbank – Repo Rate	1.50	July 4, 2012	1.50	--
Norges Bank – Deposit Rate	1.50	August 29, 2012	1.50	--

Economic and financial developments in Hungary since the last rate-setting meeting have favoured a looser monetary policy stance. Inflation fell in May to 5.3% y/y from 5.7%, industrial production sank another 3.1% y/y in April, and the forint has strengthened roughly 6% versus the euro so far in June. Moreover, the Hungarian government has accepted the proposed changes to its central bank law backed by the IMF and ECB, opening the door to finally begin talks for an official financial assistance package, and in turn restoring some of the market confidence lost in recent months. Nevertheless, we expect the Hungarian National Bank to leave benchmark policy rate at 7% on June 26th. It would be premature to lower rates at this point given the prevailing political and price risks. The central bank will likely wait to loosen policy until more concrete progress is made in both fiscal consolidation and negotiations with the EU and IMF.

Asia Pacific

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Bank of Japan – Target Rate	0.10	July 12, 2012	0.10	--
Reserve Bank of Australia – Cash Target Rate	3.50	July 3, 2012	3.75	3.50
Reserve Bank of New Zealand – Cash Rate	2.50	July 25, 2012	2.50	--
People's Bank of China – Lending Rate	6.31	TBA	--	--
Reserve Bank of India – Repo Rate	8.00	July 31, 2012	7.75	--
Bank of Korea – Bank Rate	3.25	July 11, 2012	3.25	--
Bank of Thailand – Repo Rate	3.00	July 25, 2012	3.00	--
Bank Indonesia – Reference Interest Rate	5.75	July 12, 2012	5.75	--

Latin America

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Banco Central do Brasil – Selic Rate	8.50	July 11, 2012	8.00	--
Banco Central de Chile – Overnight Rate	5.00	July 12, 2012	5.00	--
Banco de la República de Colombia – Lending Rate	5.25	June 29, 2012	5.25	5.25
Banco Central de Reserva del Perú – Reference Rate	4.25	July 12, 2012	4.25	4.25

We maintain our view that the central bank of Colombia will likely keep the reference rate unchanged at 5.25%. After two increases in January and February (25 basis points each), the central bank has remained on the sidelines, with a more hawkish tone regarding strong credit expansion. However, recent indicators suggest that economic growth has moderated, especially in the industrial and trade sectors, which will set a less aggressive tone to the central bank's statement.

Africa

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
South African Reserve Bank – Repo Rate	5.50	July 19, 2012	5.50	--

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

Forecasts as at June 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	3.2	3.7				
Canada	2.2	2.4	2.0	2.1	2.1	2.9	2.1	2.1
United States	1.8	1.7	2.1	2.3	2.5	3.1	2.3	2.1
Mexico	2.1	4.2	3.7	3.6	4.9	3.8	3.9	4.1
United Kingdom	2.0	0.7	0.4	1.7	2.1	4.2	2.9	2.6
Euro Zone	1.4	1.5	-0.6	0.7	2.1	2.7	2.0	1.9
Japan	0.9	-0.7	2.1	1.7	-0.3	-0.2	0.1	0.3
Australia	3.1	2.0	3.1	3.4	3.1	3.1	2.5	2.8
China	9.4	9.3	8.0	8.5	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	3.6	6.6	6.5	5.5	5.0
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	1.25	1.50	1.75
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	1.05	1.02	0.99	0.98	0.97	0.97	0.96
Canadian Dollar (CADUSD)	1.00	0.95	0.98	1.01	1.02	1.03	1.03	1.04
Euro (EURUSD)	1.33	1.22	1.23	1.23	1.22	1.22	1.21	1.21
Sterling (GBPUSD)	1.60	1.56	1.59	1.60	1.62	1.63	1.64	1.64
Yen (USDJPY)	83	79	81	83	84	85	86	87
Australian Dollar (AUDUSD)	1.03	0.96	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	13.8	13.3	13.1	13.2	13.1	13.1	13.3
Brazilian Real (USDBRL)	1.83	2.00	1.96	1.95	1.92	1.87	1.88	1.90

Commodities (annual average)	2000-10	2011	2012f	2013f
WTI Oil (US$/bbl)	54	95	95	98
Brent Oil (US$/bbl)	52	111	108	108
Nymex Natural Gas (US$/mmbtu)	5.81	4.03	2.50	2.75
Copper (US$/lb)	1.93	4.00	3.60	3.45
Zinc (US$/lb)	0.75	0.99	0.89	1.10
Nickel (US$/lb)	7.36	10.38	7.93	8.00
Gold, London PM Fix (US$/oz)	586	1,569	1,650	1,600
Pulp (US$/tonne)	694	977	875	915
Newsprint (US$/tonne)	575	640	650	670
Lumber (US$/mfbm)	273	255	265	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	7.9	-4.4	(Apr)
Industrial Production	3.5	3.0	1.0	0.0	(Mar)
Housing Starts (000s)	193	199	206	211	(May)
Employment	1.6	1.2	0.9	1.3	(May)
Unemployment Rate (%)	7.5	7.5	7.4	7.3	(May)
Retail Sales	4.1	4.2	4.3	3.4	(Apr)
Auto Sales (000s)	1588	1603	1701	1603	(Apr)
CPI	2.9	2.7	2.3	5.1	(May)
IPPI	4.6	3.9	1.7	-0.4	(Apr)
Pre-tax Corp. Profits	15.4	13.7	5.4		

Mexico

	2011	11Q4	12Q1	Latest	
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	6.7	(Apr)
Industrial Production	4.0	3.5	4.4	3.6	(Apr)
CPI	3.4	3.5	3.9	7.3	(May)

Chile

	2011	11Q4	12Q1	Latest	
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	-1.8	(May)
Industrial Production	6.9	2.1	3.9	2.6	(Apr)
CPI	3.3	4.0	4.1	3.1	(May)

Germany

	2011	11Q4	12Q1	Latest	
Real GDP	3.1	2.0	1.2		
Current Acc. Bal. (US$B, ar)	204.1	256.1	215.8	176.7	(Apr)
Merch. Trade Bal. (US$B, ar)	216.2	224.1	223.3	255.4	(Apr)
Industrial Production	8.0	3.4	1.0	-0.7	(Apr)
Unemployment Rate (%)	7.1	6.9	6.8	6.7	(May)
CPI	2.3	2.3	2.2	4.2	(May)

Euro Zone

	2011	11Q4	12Q1	Latest	
Real GDP	1.5	0.7	-0.1		
Current Acc. Bal. (US$B, ar)	-4	183	-37	26	(Apr)
Merch. Trade Bal. (US$B, ar)	6.4	76.9	10.1	94.2	(Apr)
Industrial Production	3.6	-0.1	-1.5	-2.5	(Apr)
Unemployment Rate (%)	10.1	10.5	10.8	11.0	(Apr)
CPI	2.7	2.9	2.7	5.2	(May)

Japan

	2011	11Q4	12Q1	Latest	
Real GDP	-0.7	-0.5	2.7		
Current Acc. Bal. (US$B, ar)	119.2	48.0	114.5	49.2	(Apr)
Merch. Trade Bal. (US$B, ar)	-33.4	-75.3	-73.5	-98.9	(May)
Industrial Production	-2.3	0.0	2.7	12.9	(Apr)
Unemployment Rate (%)	4.6	4.5	4.5	4.6	(Apr)
CPI	-0.3	-0.3	0.3	0.5	(Apr)

China

	2011	11Q4	12Q1	Latest	
Real GDP	10.4	8.9			
Current Acc. Bal. (US$B, ar)	201.7				
Merch. Trade Bal. (US$B, ar)	155.0	193.0	3.5	224.4	(May)
Industrial Production	12.8	12.8	9.3	9.6	(May)
CPI	4.1	4.1	3.6	3.0	(May)

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	-778	(Apr)
Industrial Production	4.1	4.0	4.0	4.9	(May)
Housing Starts (millions)	0.61	0.68	0.71	0.71	(May)
Employment	1.1	1.3	1.6	2.1	(May)
Unemployment Rate (%)	9.0	8.7	8.3	8.2	(May)
Retail Sales	8.2	7.5	6.4	14.3	(May)
Auto Sales (millions)	12.7	13.4	14.5	13.7	(May)
CPI	3.2	3.3	2.8	5.4	(May)
PPI	6.0	5.4	3.4	8.3	(May)
Pre-tax Corp. Profits	4.2	9.3	14.8		

Brazil

	2011	11Q4	12Q1	Latest	
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	35.4	(May)
Industrial Production	0.4	-1.7	-3.2	-2.7	(Apr)
CPI	6.8	6.7		6.6	(Jan)

Italy

	2011	11Q4	12Q1	Latest	
Real GDP	0.5	-0.5	-1.4		
Current Acc. Bal. (US$B, ar)	-0.07	-0.03	-0.08	-0.02	(Apr)
Merch. Trade Bal. (US$B, ar)	-34.2	-8.3	-17.5	-3.2	(Apr)
Industrial Production	0.2	-3.2	-5.4	-8.8	(Apr)
CPI	2.8	3.3	3.4	6.0	(May)

France

	2011	11Q4	12Q1	Latest	
Real GDP	1.7	1.2	0.3		
Current Acc. Bal. (US$B, ar)	-60.1	-58.2	-53.2	-66.2	(Apr)
Merch. Trade Bal. (US$B, ar)	-50.9	-45.9	-53.0	-52.9	(Apr)
Industrial Production	2.4	0.4	-1.5	0.9	(Apr)
Unemployment Rate (%)	9.7	9.8	10.1	10.2	(Apr)
CPI	2.1	2.4	2.3	4.1	(May)

United Kingdom

	2011	11Q4	12Q1	Latest	
Real GDP	0.7	0.5	-0.1		
Current Acc. Bal. (US$B, ar)	-46.4	-45.4			
Merch. Trade Bal. (US$B, ar)	-159.8	-152.5	-160.3	-194.1	(Apr)
Industrial Production	-1.2	-3.0	-3.0	-1.0	(Apr)
Unemployment Rate (%)	8.1	8.4	8.2	8.2	(Mar)
CPI	4.5	4.7	3.5	7.2	(May)

Australia

	2011	11Q4	12Q1	Latest	
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	29.0	2.3	33.8	(Apr)
Industrial Production	-1.1	1.3	4.7		
Unemployment Rate (%)	5.1	5.2	5.2	5.1	(May)
CPI	3.4	3.1	1.6		

South Korea

	2011	11Q4	12Q1	Latest	
Real GDP	3.6	3.3	2.8		
Current Acc. Bal. (US$B, ar)	26.5	46.0	10.2	21.3	(Apr)
Merch. Trade Bal. (US$B, ar)	30.8	36.6	5.8	27.1	(May)
Industrial Production	6.9	5.2	2.9	2.8	(Apr)
CPI	4.0	4.0	3.0	6.6	(May)

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

Source: Bloomberg, Scotia Economics.

Interest Rates (%, end of period)

Canada	11Q4	12Q1	Jun/15	Jun/22*	United States	11Q4	12Q1	Jun/15	Jun/22*
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	0.80	0.91	0.89	0.88	3-mo. T-bill	0.01	0.07	0.09	0.08
10-yr Gov't Bond	1.94	2.11	1.72	1.78	10-yr Gov't Bond	1.88	2.21	1.58	1.66
30-yr Gov't Bond	2.49	2.66	2.33	2.34	30-yr Gov't Bond	2.89	3.34	2.68	2.73
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US$B)	65.7	69.2	69.4	(Apr)	FX Reserves (US$B)	136.9	138.0	141.4	(Apr)
Germany					**France**				
3-mo. Interbank	1.35	0.71	0.57	0.55	3-mo. T-bill	-0.06	0.07	0.06	0.02
10-yr Gov't Bond	1.83	1.79	1.44	1.58	10-yr Gov't Bond	3.15	2.89	2.59	2.60
FX Reserves (US$B)	66.9	67.9	68.9	(Apr)	FX Reserves (US$B)	48.6	49.2	50.2	(Apr)
Euro Zone					**United Kingdom**				
Refinancing Rate	1.00	1.00	1.00	1.00	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	0.63	0.39	0.33	0.33	3-mo. T-bill	0.37	0.37	0.36	0.37
FX Reserves (US$B)	316.7	319.9	325.5	(Apr)	10-yr Gov't Bond	1.98	2.20	1.67	1.72
					FX Reserves (US$B)	79.3	82.4	84.3	(Apr)
Japan					**Australia**				
Discount Rate	0.30	0.30	0.30	0.30	Cash Rate	4.25	4.25	3.50	3.50
3-mo. Libor	0.13	0.13	0.13	0.13	10-yr Gov't Bond	3.67	3.98	2.99	3.05
10-yr Gov't Bond	0.99	0.99	0.85	0.83	FX Reserves (US$B)	42.8	47.7	45.6	(Apr)
FX Reserves (US$B)	1258.2	1247.8	1248.9	(Apr)					

Exchange Rates (end of period)

USDCAD	1.02	1.00	1.02	1.03	¥/US$	76.91	82.87	78.73	80.54
CADUSD	0.98	1.00	0.98	0.97	US¢/Australian$	1.02	1.03	1.01	1.01
GBPUSD	1.554	1.601	1.572	1.556	Chinese Yuan/US$	6.30	6.30	6.37	6.36
EURUSD	1.296	1.334	1.264	1.254	South Korean Won/US$	1152	1133	1166	1157
JPYEUR	1.00	0.90	1.01	0.99	Mexican Peso/US$	13.936	12.811	13.920	13.857
USDCHF	0.94	0.90	0.95	0.96	Brazilian Real/US$	1.867	1.827	2.051	2.061

Equity Markets (index, end of period)

United States (DJIA)	12218	13212	12767	12626	U.K. (FT100)	5572	5768	5479	5516
United States (S&P500)	1258	1408	1343	1331	Germany (Dax)	5898	6947	6229	6281
Canada (S&P/TSX)	11955	12392	11525	11396	France (CAC40)	3160	3424	3088	3097
Mexico (Bolsa)	37078	39521	37739	38699	Japan (Nikkei)	8455	10084	8569	8798
Brazil (Bovespa)	56754	64511	56105	55253	Hong Kong (Hang Seng)	18434	20556	19234	18995
Italy (BCI)	806	859	730	755	South Korea (Composite)	1826	2014	1858	1847

Commodity Prices (end of period)

Pulp (US$/tonne)	890	870	900	900	Copper (US$/lb)	3.43	3.85	3.41	3.32
Newsprint (US$/tonne)	640	640	640	640	Zinc (US$/lb)	0.83	0.91	0.87	0.82
Lumber (US$/mfbm)	261	266	307	292	Gold (US$/oz)	1531.00	1662.50	1627.25	1565.50
WTI Oil (US$/bbl)	98.83	103.02	84.03	79.33	Silver (US$/oz)	28.18	32.43	28.66	26.81
Natural Gas (US$/mmbtu)	2.99	2.13	2.47	2.66	CRB (index)	305.30	308.46	272.23	268.50

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

Emerging Markets Strategy

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