Global Views

Weekly commentary on economic and financial market developments

August 31, 2012

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

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Make Or Break — Part 1

- **Please see our full indicator, central bank, auction and event calendars on pp. A3-A7.**

European markets will clearly drive much if not all of the global market tone next week. Bundesbank President Jens Weidmann could attract headlines over the weekend with remarks at the annual Jackson Hole central bank symposium sponsored by the Kansas City Fed. He is opposed to aggressive additional bond buying by the ECB, and ECB President Mario Draghi has recently made spirited attempts to isolate Weidmann's opinions while directly appealing to the German electorate. That will tee-up the ECB announcement on Thursday for potentially heightened market uncertainty. See page 4 for highlights from our fuller piece "ECB Yield Caps: Confusing Symptoms For Causes?" published Aug. 30, 2012. It presents the pros and cons to the notion of yield or spread capping as a way of addressing Europe's debt crisis. While we don't think the ECB will move toward this extreme policy just yet, it is a possibility. A bigger possibility is that the ECB reintroduces a bond buying program, but the market may be set up for disappointment because the ECB would be unlikely to announce a specific program until the ESM has been fully approved including by the German constitutional court on September 12th, and not until it is operational. A further delay on a bond buying program is that the ECB is likely to require that targeted countries first apply to the ESM for assistance and accept the concomitant conditions regarding fiscal and other policies. The Bank of England also makes a policy announcement on Thursday. All but two out of 39 within consensus expect no change in the asset purchase target, and no one expects a rate move. The BoE is likely waiting out an assessment of the impact of its funding for lending program, and previous increases in the asset purchase target. All but four out of 19 economists expect Sweden's Riksbank to stay on hold on the same day, with the minority calling for a 25bps cut to 1.25%. The Central Bank of The Russian Federation is also expected to leave its policy rates on hold.

There will be plenty of headline risk scattered throughout the week with EU Economic and Monetary Affairs Commissioner Olli Rehn debating banking union with EU Financial Services Commissioner Michel Barnier and EU Competition Commissions Joaquin Almunia (Draghi dropped out of this debate). German Finance Minister Schaeuble speaks on the future of Europe's single market. Italian Prime Minister Mario Monti and French President Francois Hollande meet, and so do the EU's Van Rompuy and Hollande. Auction risk is also elevated with Spain and France poised to tap bond markets hours before the ECB announcement and press conference, and each of Belgium, Austria, the UK and Germany auctioning bonds earlier in the week. Data risk will be a distant influence behind the ECB meeting. This includes fresh manufacturing PMI readings for the UK and Italy. German factory orders have been falling for two of the past three months and signaling net downside risk to Germany's factory sector, so fresher data for July will help clarify the trend. So will a round of updates for European trade and industrial production figures.

US markets will continue to digest the implications of Fed Chairman Ben Bernanke's speech at Jackson Hole next week, just as they did in the aftermath of Bernanke's speech at the same venue in 2010. Chairman Bernanke sounded more dovish and markets took his comments as supportive of additional easing in the near term. There were three key aspects to the speech. First, Bernanke rejected near-term data sensitivity in favour of a smoothed trend-based assessment amidst a guarded outlook that on net remains disappointing. Second, Bernanke commented that "...the costs of nontraditional policies, when considered carefully, appear manageable, implying that we should not rule out the further use of such policies if economic conditions warrant." Third, Bernanke spoke of "daunting" challenges, the "stagnation of our labor market," as a "grave concern" and as such intensified his overall dovish tone or at a minimum reinforced the dovishness to the most recent round of FOMC minutes in which he appeared to have consensus in favour of further easing. As a consequence, we remain of the view that there are better-than-even odds in favour of QE3 being introduced in September. On top of this will be added drama by way of interpreting the implications of two key types of releases for the stimulus debate. The ISM manufacturing report is the first to land on Tuesday, but the lesser of the two. We expect ISM to straddle the 50 mark given continued but milder weakness in regional manufacturing surveys. More importantly we've gone off-consensus with our ADP and nonfarm payrolls forecasts. Consensus is expecting job growth to have decelerated in August in both the private payrolls ADP and full payrolls nonfarm reports. Initial jobless claims, however, put in a comparable to mildly lower performance in August to what occurred during the survey reference period for nonfarm payrolls during July. That would be one indication that perhaps we'll get similar job growth tallies in August.

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Canadian markets will not only stand to be buffeted by potentially sharp global market forces next week, they could well face enough of their own domestic risks. The sleeper risk lies in Quebec's provincial election on Tuesday, and along two timelines. One is the immediate aftermath in terms of bond and currency markets digesting the implications for broad policy. Two is the risk of a renewed focus upon a separatist agenda should the Parti Quebecois win a majority. Recent polls have given an edge to the PQ Party over the ruling federalist Liberals (see table), but how this may translate into seats is not clear. Fast money accounts have shown little awareness or interest in the Quebec election to date. The Bank of Canada will also be back in the spotlight next week, if for a fleeting moment when it releases its latest interest rate statement on Wednesday. Governor Carney has employed enormous flexibility in the statement language by using guidance phrases such as 'to the extent' that its forecasts come true, it 'may' hike rates by a 'modest' amount at some point over the 'medium term.' We wouldn't recommend ship navigation along the same line of reasoning, but the tone, style and aggressiveness of the related communications has been interpreted more harshly as hawkish in nature, thus providing a boost to CAD that goes beyond just commodity dynamics. It is unlikely that this tone will change next week despite enormous geopolitical risk ahead of the global economy and downsides to the Canadian economy amid very soft inflation readings. Governor Carney will get a further chance to convey his sentiments at a speaking engagement on Friday which will include a press conference. This may be more significant than the statement itself since Carney's remarks will follow the important ECB meeting the day before and that could carry significant implications for the global and Canadian markets. Carney's remarks will also follow the Canadian jobs report that morning. We are not guided by strong conviction in making a call for a mild 15,000 gain in jobs during August as one of the few drivers we have to go by is simply the 30,000 drop the prior month that poses a soft base effect—particularly given the narrowly based distortions that drove it.

Quebec Elections

Parti Québécois Consistently in the Lead

Poll Date	Polling Co.	Parti Québécois	Parti Liberal	CAQ	Other
Aug. 26	Crop	33	26	28	13
Aug. 24	Léger	33	27	28	12
Aug. 16	Léger	33	28	27	12
Aug. 14	Crop	34	27	25	14
Aug. 8	Léger	32	31	27	10
Aug. 8	Crop	32	29	21	18

Source: Scotia Economics, Léger Marketing, CROP

Asian markets will be largely carried along in one direction or the other by the ECB and the Fed. An exception could lead off the week with China's state manufacturing purchasing managers' index that is to be released this evening. It is expected to hug the 50-line between expansion and contraction, but any surprise will clearly factor into the China-slowing debate. Australia faces the added risk of a very active domestic calendar. Retail sales start it off at the Monday open. Australian consumers have had their wallets open over recent months and their resilience has been one constraint on further easing by the RBA. Thus, this indicator will play into the RBA call on Tuesday. Consensus is almost unanimous in anticipating a hold at a 3.5% cash target rate where the RBA has kept it since May. No sooner will the ink be dry on the RBA's decision than Q2 GDP lands along with the August jobs report. The RBA would have a very advanced understanding of the GDP report when it makes its rate decision. Each of Bank Negara Malaysia and the Bank of Thailand make rate decisions next week, and both are expected to remain on hold at 3.0% benchmark rates.

Like everyone else, **Latam** markets will be overwhelmingly swung in one direction or the other by policy debates elsewhere. There are two exceptions. On Friday, the Bank of Mexico is expected to hold its benchmark rate at 4.5% in a unanimous call. Just before that earlier on Friday morning, Mexico releases CPI figures for August. Governor Agustin Carstens has made it clear that he is looking through a temporary surge in inflation owing to special factors such as drought, and many are instead focused upon downside risks to inflation as these special factors lift and the impact of global weakening is more acutely felt. Thus, the risk going forward is that of a more dovish central bank. Peru is also expected to hold its policy rate at 4.25%.

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ECB Yield Caps: Confusing Symptoms For Causes?

- **ECB imposition of yield or spread caps is being suggested as a solution to the Eurozone crisis. While there is some merit to the idea, on balance the ECB should tread carefully.**

Yield caps — unconditional commitments to buy bonds in order to push down their yields — are a policy fraught with significant risks and we do not believe that the ECB will pursue it at next week's ECB meeting. A link to our full report is available below, and here we simply provide a sampling of some of the concerns.

1. Yield caps are an extreme monetary policy: Because yield caps entail no hard purchase targets, they also imply potentially unlimited central bank balance sheet expansion.

2. Higher inflation risk on euro-denominated bonds: Unlimited ECB balance sheet expansion could unseat long-run inflation expectations. Bond buying to defend the target may push term and country premia lower, but inflation premia higher. Higher inflation premia would then put upward pressure upon nominal yields (or spreads if inflation exerts itself unevenly), thereby requiring more bond buying in a feedback loop that at some point gets short-circuited by inflation concerns.

3. Euro risk: Similarly, unlimited bond buying could cause FX markets to react negatively. As the euro weakens, investors could demand additional yield premium to compensate for currency volatility — again another negative feedback loop that short-circuits the aim that yield caps attempt to achieve.

4. Moral hazard: Yield or spread caps would put European monetary policy under the explicit control of fiscal policy makers in various countries as balance sheet expansion could become a function of debt issuance.

5. Pressure to seek alternate ways of allocating capital: Having removed market mechanisms for allocating capital, a new political calculus will be imposed. In Latam markets where interest rate ceilings have been applied over time the outcome was often credit allocation through let's just say non-market mechanisms. It's not clear to us that southern Europe is immune to this same outcome.

6. Central banks have not had much success at intervening*:* It is not clear that a central bank can sustainably interfere with price discovery in capital markets. Much like FX intervention, repeated bond buying does not necessarily have a sustainable impact upon markets in isolation of many other market influences.

7. Concessions could rise as a non-price way of rationing sovereign credit demand: If private market participants are unsatisfied with the capped yields, then sovereigns could be forced to pay through non-interest mechanisms (e.g. securing loans against assets via the provision of collateral).

8. Destabilizing dissent at the ECB: German opposition to this program is sufficient that it could permanently alienate the Bundesbank, resulting in serial resignations of German ECB board members in a strange mimicry of Charles De Gaulle's "la politique de la chaise vide" (the empty seats policy) in the 1960s to block decisions at the EU level that were not in favour of France.

9. Unintended consequences: The history of rate caps is replete with unintended consequences. We simply don't know the unintended effects that would flow from yield or spread caps including how perhaps over the longer run issuers and buyers would seek to circumvent such controls.

10. Confusing a symptom of the crisis for its cause: Yield caps ultimately confuse a symptom of Europe's financial stress — high yields in Italy and Spain — for the cause. The ECB's argument that market dysfunction (the 'convertibility premium') is responsible for the high yields demanded of Italy and Spain only makes sense if credible policies are put in place first to address the justified 'risk premia' of Italian and Spanish debt. The extent of discussion of ECB bond purchases obscures the primary significance of the needed restructuring in Italy and Spain — which is ultimately necessary to address high sovereign yields.

For our full report, please visit: http://www.gbm.scotiabank.com/English/bns_econ/cmsr120830.pdf

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Replay?

For the second year in a row, the global economy lost momentum in the first half of the year. Both periods witnessed increasing euro zone distress transmitted globally through decreased trade and increased financial market volatility. Both periods also witnessed a slowdown in U.S. economic activity that corresponded to domestic and international factors, but mainly due to growth-dampening fiscal issues. Both periods also witnessed crude oil price increases that conspired to restrain growth around the world.

Last year's second-half performance saw a revival in global growth with another round of bailouts and central bank bond buying helping to stabilize financial market conditions and prevent economic activity in the euro zone from deteriorating at an even faster pace. A fiscal compromise coupled with a more accommodative Fed policy helped resuscitate growth in the U.S. and its satellite production sites in Canada and Mexico. Consumers also benefitted from an easing back in oil prices, though prices eventually rebounded as international growth prospects began to revive.

Will this year's second-half performance replicate last year's increased traction? Some relief may be forthcoming since central banks have been hinting that they will be priming the monetary pumps again. But for a number of reasons it is unlikely that even last year's relatively moderate economic gains can be realized.

First, the euro zone problems are more severe due to intensifying recessions in the southern peripheral nations aggravated by additional fiscal belt-tightening, deepening financial sector problems that have worsened conditions in the larger countries like Spain, and the increasing drag on German activity.

Second, U.S. growth is being challenged by the increasing uncertainty over higher taxes and lower spending with the 'fiscal cliff' fast approaching. Business caution is reinforcing the slower growth performance despite an improving trend in housing activity.

And third, the slowdown in the emerging market economies has been much greater because of the sharper decline in trade flows attributable to the deteriorating situation in the euro zone and the compounding effect of prior tightening in domestic policies to quell inflation pressures. This is particularly the case in China and Brazil where the pace of activity has dropped out of overdrive and into the slow lane of growth compared with their respective performances in recent years.

For the time being there are more downside than upside risks to the outlook, though policymakers appear ready to take further economic-supportive action soon. The structural economic and political reforms needed to resolve the euro zone debt problems have been slow to evolve, with repeated band-aid solutions needed to stabilize conditions, albeit temporarily. The upcoming U.S. elections will delay implementation of fundamental fiscal reforms required to put federal finances on a more sustainable path, though the competitive realignment of American industry and the fledgling housing recovery will enable the U.S. economy to maintain moderate traction. Renewed policy easing in China and Brazil will help revitalize growth, though the benefits are likely to become more visible in 2013 once bloated inventories come into better balance. Other issues, such as increasing geopolitical risks in the Middle East which again have helped to lift crude oil prices, pose an added drag on near-term growth prospects.

Output growth remains slow even in countries with relatively stronger national balance sheets and financial institutions. These include Canada, Australia, Mexico and a number of other Latin American economies, as well as some in the Asia-Pacific region like Thailand. This performance not only reflects the negative trade repercussions associated with recession in Europe, but also the slowdowns in the world's other regional leaders — the U.S., China, Brazil and India. From a Canadian perspective, the reduced pace of export earnings associated with slower demand and the softness in key commodity prices have coincided with a moderation in housing activity and ongoing federal fiscal restraint. In this less-than-robust environment, borrowing costs are likely to remain exceptionally low for an exceptionally long time.

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Foreign Exchange Outlook: Policy Response To Weak Fundamentals Driving FX

Central bank intervention, growth stimulus in China and Brazil, persistently strong European financial market stress, speculative trading dynamics in commodity markets and uneven directional shifts in emerging-market assets are some of the primary factors swaying capital flows in foreign exchange markets.

The US dollar (USD) has been under pressure following three consecutive months of gains versus other major currencies, with the exception of the Japanese yen (JPY). The USD may be on the defensive as monetary authorities remain committed to maintaining a near-zero short-term interest rate environment and to its large-scale asset purchase program. Currency markets will be impacted materially by the mid-September Federal Reserve decision on further asset purchases (so-called QE3). The US fiscal outlook is complicated by the November election; however, market participants will demand clarity on key government policies before year-end.

The other NAFTA zone currencies, the Canadian dollar (CAD) and the Mexican peso (MXN) have been immersed in a strengthening phase, supported by higher commodity prices, relatively better financial sector strength and, to an extent, interest rate differentials. Credit differentiation dynamics continue to drive capital flows to assets issued by the best-rated sovereign borrowers. Following the recent downward revision to a “negative” outlook for Germany, Canada and Australia are the only major sovereign credits with a triple-A rating and a “stable” outlook. In brief, The Canadian dollar (CAD) appears comfortable close to parity and, though it should appreciate over time, we do not expect it to move dramatically away from parity. The combination of the Bank of Canada’s hawkish tone, a triple-A rating, a large resource base and investor sentiment is supportive of a relatively strong CAD. The MXN is also receiving the benefits of the post-election premium and consolidating its position as a high-yield North American option. Meanwhile, the Brazilian real (BRL) remains within its spring and summer range, with a slight bias towards further weakness.

The European economic landscape remains in a constant state of convulsion. Despite a temporary relief in the sell-off spree, the underlying structural weakness of the peripheral economies, coupled with the governance challenges facing German and French leaders, should keep the euro (EUR) on the defensive for a prolonged period. The growing uncertainty about the future shape of the European currency union has triggered another round of credit rating revisions last month. This bearish outlook for EUR is tempered by the negative USD fundamentals noted above. Meanwhile, the Swiss authorities remain committed to defending the policy-mandated ceiling of 1.20 francs (CHF) per EUR as a means of defending the country’s export sector against damaging currency appreciation. The outlook for the other European currencies is brighter; however the recent strength in the Swedish krona (SEK) seems to have overshot. The Bank of England maintains aggressive policy as the UK finds itself exposed to the European crisis; however, on a relative basis the GBP should fare better than EUR and rally against the USD in 2013.

The Japanese yen (JPY) continues to be treated as a preferred safe-haven asset in times of global financial market stress. However, the fundamental outlook for JPY is negative, as aggressive monetary policy, an anticipated deceleration in growth and demographics weigh on the currency. The CNY is enjoying a gradual revaluation (versus the USD) following three months of depreciation. Persistent correction in equity markets and a slowdown in both the manufacturing and export sectors were key factors weighing on the CNY. The CNY should appreciate only modestly from 2011 year-end levels. The Indian rupee (INR) is enjoying a stabilization phase following a period of acute currency weakness; the INR lost 17% against the USD over the past 12 months and the underlying causes of such softness remain in place. Australia’s enviable sovereign credit position, interest rate differentials and strong foreign demand for high-yield currencies drove up the value of Australian dollar (AUD) during the spring and early summer. However, loosening monetary policy, AUD’s high beta status and fears concerning the end of its mining boom weigh heavily on what would otherwise be a bullish outlook.

See our Monthly FX Outlook for a more detailed discussion of our forecast and analysis.

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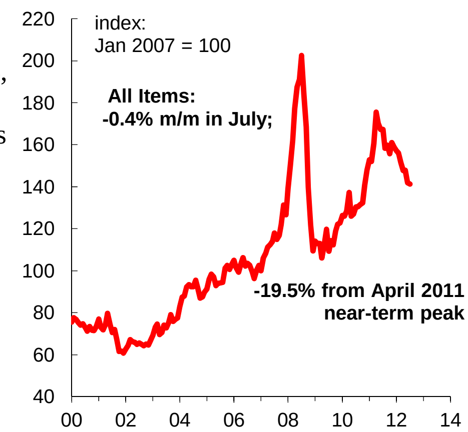
Copper Prices Remain Strong, Despite Global Economic Uncertainty

- **As supply constraints keep copper in 'deficit' in 2012.**

LME copper prices — of major importance to countries such as Chile, Peru, Canada and the United States — remain quite lucrative at US$3.44 per pound. While retreating from a near-term high of US$3.84 in March and an all-time record of US$4.60 on February 14, 2011 amid a slower global economy, prices still yield a profit margin of 47% over full break-even costs including depreciation. Chairman's Bernanke's Jackson Hole presentation, pointing to further monetary policy easing — possibly QE3 — will lift prices for 'riskier' assets such as commodities today.

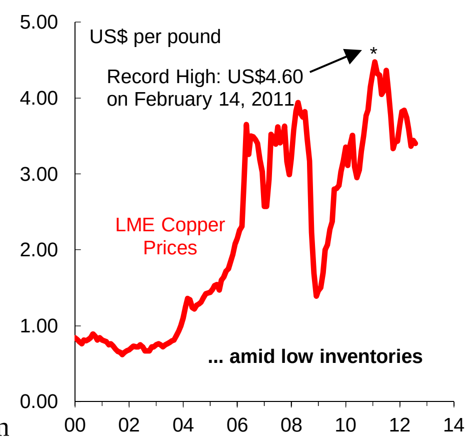
Scotiabank Commodity Price Index



Source: Scotiabank Commodity Price Index.

China's refined copper consumption (40.9% of global demand) will likely advance by 7% in 2012, slower than the 8% of 2011 and 13% of 2010. Several incentive schemes have been introduced to boost activity in the automotive, home appliance, power utility-transport infrastructure industrial segments to re-ignite sales and clear unsold inventories. Incentives for consumers to buy fuel-efficient small cars already appear to be having a positive impact. The home appliance industry took temporary plant downtime over the summer to cut inventories — normally a period of seasonally weak demand — but should be bolstered in coming months by both government and private-sector sales incentives. The Household Electrical Appliances Association will subsidize kitchen appliances by 10% of the price. An improvement in copper power cable orders has still not occurred, but is expected in September. An overall pick-up in China's underlying copper demand is anticipated by 2012:Q4.

Copper Prices Remain Strong…



Source: Scotiabank Commodity Price Index.

LME copper inventories have actually declined in 2012 and overall global inventories are estimated to fall to 47 days of consumption from 51 last year, despite the recent increase in bonded warehouse stocks in China (possibly 620,000 tonnes). Refined copper stocks averaged a higher 61.1 days of consumption from 2000-09. This partly reflects substantial production losses & outages at existing mines this year — Escondida in Chile (-75,000 tonnes), Collahuasi in Chile, Los Bronces in Chile (-60,000 tonnes), Grasberg in Indonesia (-100,000 tonnes) and Lumwana in Zambia (-60,000 tonnes).

Copper mine supply will only increase by a modest 3.7% in 2012 — as new mine development remains slow, after little new capability since 2008 (only +1.2% per annum from 2008 through 2012) in the face of massive growth in demand from China and 'emerging Asia'. Major mining companies deferred new mine development in copper around 2007-2008, fearing that copper prices would not be sufficient to justify the rapid capital cost escalation at that time.

New copper mine development will likely proceed more rapidly in 2013-14 (8% per annum), moderating copper prices. However, BHP Billiton has recently announced deferral of the massive Olympic Dam expansion in Australia (copper, gold & uranium) — again concerned over rapid capital cost escalation (15-20% in 2012) in a more subdued price environment. This decision will help to keep copper prices relatively high in the second half of the decade.

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ECB September Meeting Preview

- **The market is hoping that next week's ECB decision provides concrete details of a possible bond purchasing program. This will be crucial in order to maintain the recent easing in market risk aversion.**
- **Furthermore, the conditionality attached to the possible bond purchases will be a key input into the decision of the Spanish and Italian governments concerning whether or not to ask for the support of the EFSF.**
- **The outcome of the meeting will provide a gauge of the strength of Mr Draghi's leadership, particularly in the face of criticism from the Bundesbank.**
- **Last but not least, while the ECB staff projection for inflation is likely to be revised up, we think that another downward revision to the GDP growth assumptions will open the door to an additional 25 basis point rate cut.**

Looking for details on the possible bond purchasing program

Last month's announcement of the ECB's intentions proved sufficiently strong to calm market fears over the summer break. Since that meeting, euro zone equity markets have rallied significantly:

- On average equities increased by around 7%;
- Italian and Spanish markets are up between 12% and 15%; and
- the EURUSD exchange rate strengthened by 3%.

With regards to fixed income markets, the drop in Italian and Spanish yields in the 2-year sector has been around 100bp and 300bp, respectively. However, on longer maturities, yields remain uncomfortably high with 10-year Italian and Spanish yields at 5.8% and 6.5%, respectively (450bp and 520bp above German yields). Recall that as a requirement for entering the currency union, the Maastricht Treaty calls for 10-year nominal yields of no more than 250bp above those of the best three countries. Just looking at this simple indicator, despite last month's comments by the ECB president regarding the "irreversibility" of the euro, it seems that there is still a lot of doubt in the market.

This meeting needs to deliver concrete details or actions in order for risk aversion to continue to ease or, at the very least, to avoid renewed pressure. This applies to both the market perspective as well as the perspective of the Spanish government and, to a lesser extent, the Italian government. Indeed, while Spanish Prime Minister Rajoy no longer ruled out asking for assistance from the EFSF (the pre-conditions for any ECB actions), he clearly indicated that he would first want to have more specific details on what would be the rewards and benefits, meaning how strong and effective would the ECB action actually be.

Given the recent harsh commentary from the president of the Bundesbank, the outcome of this meeting will also be a gauge of the strength of Mr Draghi's leadership. Indeed, as mentioned in a previous article in this publication ("ECB should tread carefully on Yield or Spread Caps"), this issue raises a lot of pros and cons.

Clarity will be sought in particular on:

- **The objective itself.** There has continued to be considerable speculation about whether the ECB will announce a precise level of intervention on peripheral nominal yields or a spread target relative to German yields. If the idea is to strengthen the irreversibility of the euro, we would say that there could be a need for the ECB to announce a specific spread like the one within the Maastricht entry criteria. However, we doubt that we will get something so concrete, as the ECB has shown that, as with foreign exchange intervention, it prefers to surprise the market and maintain maximum flexibility.
- **The size of any intervention:** limited or unlimited. On this issue, there is a broad consensus view that in order to have maximum efficiency, the ECB president is likely to indicate unlimited firepower.
- **The maturity:** The ECB president indicated that in normal operations, it would be six to nine months but, as seen by the LTRO, it could extend to three years. The magnitude of the rally we have seen on maturities up to two years suggests that the market has been assuming the second option.

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- **The conditionality**: We know that a necessary condition for a country to be supported is to accept going under the EFSF supervision umbrella. But will the ECB add additional conditions above and beyond these? Support from the EFSF is given once a specific program has been accepted by euro area finance ministers. However, looking to past experience, while conditions look onerous for small countries, bigger countries appear to benefit from greater room for manoeuvre. It could be the same for Spain and Italy, which carry a bigger systematic risk for the whole area. The ECB has always been conscious of this fact, referring many times to the mistake of France and Germany's decision to loosen the Stability Pact in the mid-2000's. In order to avoid being tied too closely to volatile government policy decisions, the ECB might set up its own extra conditions.
- **The changes in the status of seniority of the ECB and the possibility that this action will not be sterilised**. As we mentioned one month ago, any changes in these two elements would be significant in our view as it would suggest that the ECB could be moving closer to full quantitative easing. It remains to be seen how these factors will be addressed in order to avoid conflicting with the law forbidding the central bank from debt monetisation.

The ECB president also mentioned the possibility of announcing additional options. So the door remains open for another LTRO, changing collateral rules etc. However, we would not expect too much from this angle as any bond purchasing program targeting the short end would be roughly equivalent to implementing a new LTRO.

Another rate cut in the pipeline

The number one objective of this meeting should be maintaining the easing trend in financial stress. Nonetheless, there are also likely to be significant revisions to the macroeconomic projections. On the back of these, we think that the probability of another 25bp rate cut is high. Last month, the ECB president confirmed that this option had been discussed, although the timing was then judged to be inappropriate. This sounded very much like the "code word" used at the June meeting, which pre-announced the July cut.

The most challenging factor against a rate cut will be the fact that there are signs of renewed upward price pressures. Indeed, the August flash estimate of euro zone inflation showed the y/y pace accelerating to 2.6% from 2.4% in July. This is at odds with last month ECB president's statement that *"inflation is decreasing more quickly than expected"* and that *"inflation will be at around 2% by the end of this year and maybe going below 2% next year or even before next year"*.

The upcoming ECB inflation forecasts could reflect this renewed upside risk. Indeed, the mid-points of the inflation forecasts published in June showed projections of 2.4% and 1.6% for 2012 and 2013, respectively. For 2012, this 2.4% expectation would require inflation slowing sharply to 2.0%/2.2% y/y in the final months of the year. Hence we believe that there is a high chance that this this forecast is revised up to 2.5% y/y.

However, it is next year's forecast which is more important. On this point, compared to June's assumptions, forward Brent prices in euro terms are around 7% higher while the euro effective exchange rate, although strengthening in recent weeks, is also down 2% to 3%. Both factors suggest an upside risk of 0.3% on next year's headline inflation rate. Part of this upside pressure is likely to be offset by a lower growth assumption (and in turn a larger output gap). Nonetheless, all in all, the 1.6% forecast is likely to be revised up, closer to at least 1.8%. Our own EMU inflation forecasts point to the risk of a 2% figure.

So, the ECB president could still argue that inflation is expected to be back into price stability territory next year, but the tone of the statement could be more cautious than last month. Would it be strong enough to prevent a 25bp rate cut? It will not be the first time that the ECB has adjusted rates lower despite raising its inflation forecast. The emphasis of a rate cut would be on dealing with the deceleration in growth. That was the case for example at last December's meeting.

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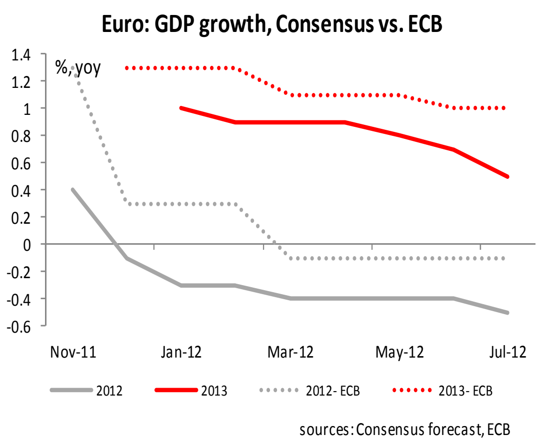
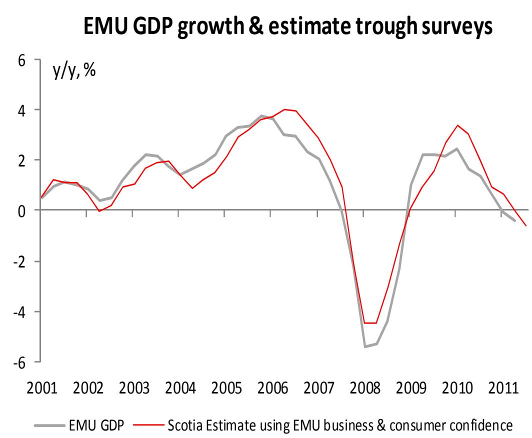
Over the past month, the economic picture has deteriorated. The release of EMU second-quarter GDP growth showed a 0.2% q/q contraction. Furthermore, business sentiment continued to deteriorate in most surveys and the spillover of weak activity and rising unemployment to consumer confidence seems have accelerated. As a result, signals from both the supply and the demand sides point to further GDP declines in the second half of the year, which will likely be reflected in the coming ECB staff forecast.

In June, the ECB indicated a mid-point GDP growth projection at -0.1% for this year and 1% for next year. Such an outcome would require EMU GDP growth to rise between 0.2% and 0.3% q/q in each of the coming six quarters. This is a situation which looks unlikely at this stage and contrary to consensus forecasts which see a rising probability of the whole EMU area being in or very close to recessionary conditions for both this year and next. The August Consensus Economics forecasts showed a downward revision to -0.5% and +0.3% for 2012 and 2013, respectively. Fighting this viscous circle would in our view support further moves on interest rates as one of the impacts would be to further debase the euro, in effect boosting the competitiveness of the region, the only quick way for the time being to offer some growth support.





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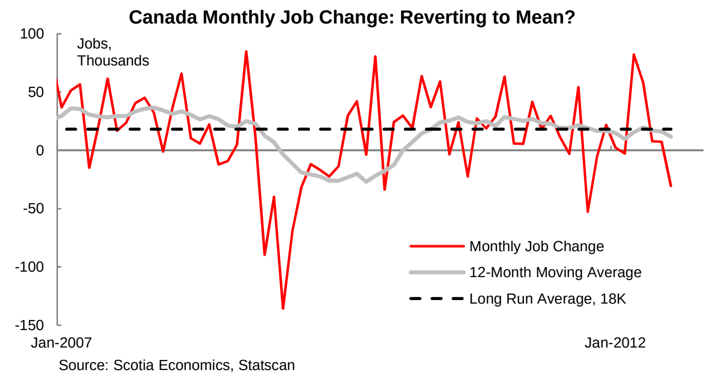
Key Data Preview

CANADA

The August **Labour Force Survey** (September 7) will be the key data release in Canada next week. Scotia is expecting jobs to rebound, growing by 15k after a -30.4k contraction during July. The July number was driven almost entirely by a decline in part-time employment (-51.6k) — full-time employment actually posted a gain of 21.3k. The key takeaway from last month's decline, however is that Canada's labour market has normalized after posting outsized gains through early Q2 and is back to tracking long-run averages and Canada's fairly muted pace of economic growth; in fact, jobs are tracking slightly below where long-run averages would indicate that they ought to (see chart). We're anticipating jobs to rebound somewhat after last month's weak showing, with the risk being that the rebound may be mostly in the part-time jobs category after last month's surprising monster decline.

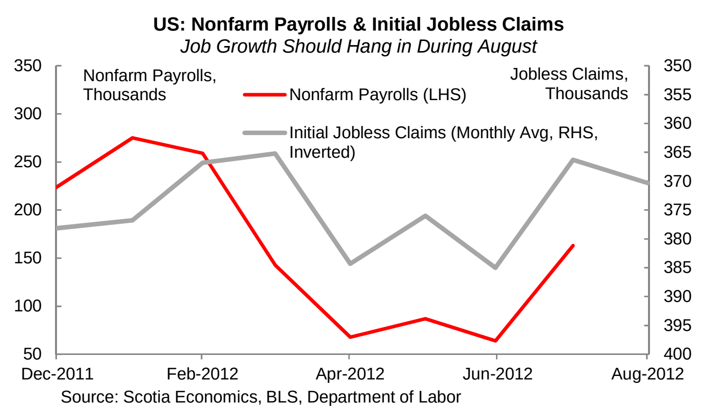


Source: Scotia Economics, Statscan

Data on **building permits** will be released on September 7.

UNITED STATES

The main event on the US economic data calendar will be the Bureau of Labor Statistics' release of **jobs numbers** for August (September 7). Scotia is towards the high end of forecasters anticipating a job gain of 160k — fairly close to the previous month's 163k gain. The story here is that after declining through mid-year perhaps for reasons associated with the calculation of seasonal adjustment factors, jobs have reverted to the underlying 150k-170k pace that they had been tracking at on a moving 12-month average basis — essentially for the past two years. Resiliently low levels of initial jobless claims through August are a plus for the jobs market (see chart), although it's by no means clear that a lower pace of firing reflected in the better jobless claims data will translate into a faster pace of hiring on non-farm payrolls. Areas to watch for in the August report include the participation rate, which is running at multi-decade lows, and the level of employment in the household survey, which has been reverting to the level of job growth reflected by the establishment survey after getting significantly ahead of it earlier this year. The ADP employment report — which is an attempt by consulting firm Macro Advisors to forecast nonfarm payrolls using ADP's payrolls data — will be released prior to the BLS report (September 6).



Source: Scotia Economics, BLS, Department of Labor

The **ISM manufacturing** index will be released on September 4, and Scotia is anticipating a flat reading of 50. It's a fairly difficult month to forecast the ISM manufacturing index under the current circumstances as it has lagged movements in the Philly Fed manufacturing index so far this year, implying that it is likely to follow it lower on the one hand; on the other hand, momentum in the Philly Fed index (and a variety of other regional Fed indices) turned positive (i.e. less negative) in August, which implies moderate strength. In terms of components, we could see strength in the employment category on the basis of better jobless numbers (although the Philly Fed was weak in this sector); new orders looked to have become less bad too. The ISM non-manufacturing index will be released on September 6.

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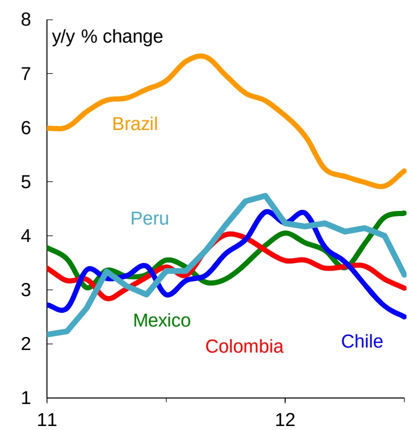
EUROPE

In addition to the European Central Bank policy announcement next Thursday, German factory orders (Thursday) and industrial production (Friday) will also be keenly awaited by Europe-watchers. Manufacturing orders dropped in two of the last three months and the weakness in June implies that the carry-over entering into the third quarter is negative. The monthly trend in orders could be volatile in early summer, impacted by shifts in industrial closing due to holidays. However, beyond this, the drop in the "current orders" assessment in the latest IFO surveys points to ongoing weakness. We do not expect any marked rebound from the soft reading in June as, in particular, poor retail sales figures suggest that household consumption — which remained resilient in the second quarter — is now faltering. So, the downward trend in domestic orders seen over the past two months is likely to continue. All in all, we look for orders to contract 0.5% m/m. Falls in the "current production" index in the July/August IFO surveys, combined with our expectations for further weakness in manufacturing orders in July, mean that output growth in the third quarter will be weak. For July, we expect industrial production to drop an additional 0.3% m/m.

LATIN AMERICA

August inflation figures will be released next week in our core five Latin American economies. Inflation has been uneven across the region. Despite a rise in global food prices, headline inflation in Peru has finally decelerated from levels above 4.0% y/y to 3.3% in July. Excluding food and energy, consumer prices remain within the central bank's tolerance range of 2% +/-1%. We anticipate that inflation will close the year at 3.0%. In Chile, both headline and core inflation remain under the 3.0% mid-point of the central bank's range, with headline inflation decelerating from 2.7% y/y in June to 2.5% in July. The central bank has stated that inflation could reverse its trend due to higher international energy and food prices. We maintain our view that inflation will remain slightly above the 2.0% mark at year-end. In Colombia, consumer prices are also losing speed, leaving the door open for a looser monetary policy in the coming months. In Mexico and Brazil inflationary pressures are building. In former, headline inflation surpassed the upper limit of the central bank's tolerance range, reaching 4.4% y/y in July; while in Brazil, after nine months of trending down, inflation (measured by the IPCA index) rose to 5.2% y/y in July. We anticipate that price pressures could remain high in the coming months, especially in the food component; however, the effect will be transitory.

Inflation in Latin America



Source: Bloomberg.

Key Indicators for the week of September 3 - 7

North America

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	09/04	10:00	Construction Spending (m/m)	Jul	0.4	0.4	0.4
US	09/04	10:00	ISM Manufacturing Index	Aug	50.0	50.0	49.8
US	09/04	17:00	Domestic Vehicle Sales (mn a.r.)	Aug	11.0	11.0	11.0
US	09/04	17:00	Total Vehicle Sales (mn a.r.)	Aug	14.1	14.17	14.05
US	09/05	07:00	MBA Mortgage Applications (w/w)	AUG 31	--	--	-4.3
US	09/05	08:30	Productivity (q/q a.r.)	2Q F	--	1.8	1.6
US	09/05	08:30	Unit Labor Costs (q/q a.r.)	2Q F	--	1.5	1.7
CA	09/05	09:00	**BoC Interest Rate Announcement (%)**	Sep 5	**1.00**	**1.00**	**1.00**
US	09/06	08:15	ADP Employment Report (000s m/m)	Aug	170	140	163
US	09/06	08:30	Initial Jobless Claims (000s)	SEP 1	370	370	374
US	09/06	08:30	Continuing Claims (000s)	AUG 25	3315	3315	3316
US	09/06	10:00	ISM Non-Manufacturing Composite	Aug	52.5	52.5	52.6
CA	09/07	08:30	Building Permits (m/m)	Jul	--	--	-2.5
CA	09/07	08:30	Employment (000s m/m)	Aug	15.0	10.5	-30.4
CA	09/07	08:30	Unemployment Rate (%)	Aug	7.3	7.3	7.3
US	09/07	08:30	Nonfarm Employment Report (000s m/m)	Aug	160	127	163
US	09/07	08:30	Household Employment Report (000s m/m)	Aug	50	--	-195
US	09/07	08:30	Unemployment Rate (%)	Aug	8.3	8.3	8.3
MX	09/07	09:00	Bi-Weekly Core CPI (% change)	Aug 31	--	--	0.16
MX	09/07	09:00	Bi-Weekly CPI (% change)	Aug 31	--	--	0.14
MX	09/07	09:00	Consumer Prices (m/m)	Aug	0.3	0.29	0.56
MX	09/07	09:00	Consumer Prices (y/y)	Aug	4.6	4.55	4.42
MX	09/07	09:00	Consumer Prices Core (m/m)	Aug	0.3	0.27	0.31
MX	09/07	10:00	**Overnight Rate (%)**	Sep 7	**4.50**	**4.50**	**4.50**

Europe

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
IT	09/03	03:45	Manufacturing PMI	Aug	--	45	44.3
FR	09/03	03:50	Manufacturing PMI	Aug F	46.2	46.2	46.2
GE	09/03	03:55	Manufacturing PMI	Aug F	45.1	45.1	45.1
UK	09/03	04:30	Manufacturing PMI	Aug	47.5	46.1	45.4
UK	09/03	06:59	Halifax House Price (3 month, y/y)	Aug	-0.7	-0.8	-0.6
RU	09/03	07:59	**Russia Refinancing Rate (%)**	Sep 3	**8.00**	**8.00**	**8.00**
IT	09/03	13:00	Budget Balance (€ bn)	Aug	--	--	2.3
IT	09/03	13:00	Budget Balance YTD (€ bn)	Aug	--	--	-27.4
UK	09/04	04:30	PMI Construction	Aug	--	50	50.9
EC	09/04	05:00	PPI (m/m)	Jul	--	0.2	-0.5
IT	09/05	03:45	Services PMI	Aug	--	43.3	43
FR	09/05	03:50	Services PMI	Aug F	50.2	50.2	50.2
GE	09/05	03:55	Services PMI	Aug F	48.3	48.3	48.3
UK	09/05	04:30	Official Reserves (£ bn)	Aug	--	--	528
UK	09/05	04:30	Services PMI	Aug	53	51.1	51
EC	09/05	05:00	Retail Trade (m/m)	Jul	--	-0.2	0.2
SW	09/06	03:30	**Riksbank Interest Rate (%)**	Sep 6	**1.50**	**1.50**	**1.50**
EC	09/06	05:00	GDP (q/q)	2Q P	-0.2	-0.2	-0.2
GE	09/06	06:00	Factory Orders (m/m)	Jul	-0.5	0.3	-1.7
UK	09/06	07:00	BoE Asset Purchase Target (£ bn)	Sep	375	375	375
UK	09/06	07:00	**BoE Policy Announcement (%)**	Sep 6	**0.50**	**0.50**	**0.50**
EC	09/06	07:45	**ECB Announces Interest Rates (%)**	Sep 6	**0.50**	**0.50**	**0.75**

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

Key Indicators for the week of September 3 - 7

North America *(continued from previous page)*

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
GE	09/07	02:00	Current Account (€ bn)	Jul	--	13.5	16.5
GE	09/07	02:00	Trade Balance (€ bn)	Jul	--	15.3	17.9
FR	09/07	02:45	Central Government Balance (€ bn)	Jul	--	--	-56.7
FR	09/07	02:45	Trade Balance (€ mn)	Jul	--	-5700.0	-5990.0
SP	09/07	03:00	Industrial Output NSA (y/y)	Jul	--	--	-6.9
UK	09/07	04:30	Industrial Production (m/m)	Jul	2.0	1.5	-2.5
UK	09/07	04:30	Manufacturing Production (m/m)	Jul	2.5	1.8	-2.9
UK	09/07	04:30	PPI Input (m/m)	Aug	2.0	1.7	1.3
UK	09/07	04:30	PPI Output (m/m)	Aug	0.3	0.2	0.0
GE	09/07	06:00	Industrial Production (m/m)	Jul	-0.3	0.0	-0.9

Asia Pacific

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
AU	09/02	21:30	Retail Sales (m/m)	Jul	--	0.2	1.0
ID	09/03	00:00	Trade Balance (US$ mn)	Jul	--	-1540.0	-1321.9
JN	09/03	01:00	Vehicle Sales (y/y)	Aug	--	--	36.1
IN	09/03	01:30	Exports (y/y)	Jul	--	--	-5.5
IN	09/03	01:30	Imports (y/y)	Jul	--	--	-13.5
JN	09/03	07:59	Official Reserve Assets (US$ bn)	Aug	--	--	1272.8
JN	09/03	19:50	Monetary Base (y/y)	Aug	--	--	8.6
AU	09/03	21:30	Current Account (AUD bn)	2Q	--	-12200	-14892
AU	09/04	00:30	**RBA Cash Target Rate (%)**	Sep 4	**3.50**	**3.50**	**3.50**
AU	09/04	21:30	GDP (q/q)	2Q	--	0.8	1.3
TH	09/05	03:30	**BoT Repo Rate (%)**	Sep 5	**3.00**	**3.00**	**3.00**
AU	09/05	21:30	Employment (000s)	Aug	--	5.0	14.0
AU	09/05	21:30	Unemployment Rate (%)	Aug	--	5.3	5.2
MA	09/06	06:00	**Overnight Rate**		**--**	**3.00**	**3.00**
AU	09/06	21:30	Trade Balance (AUD mn)	Jul	--	-300.0	9.0
MA	09/07	00:01	Trade Balance (MYR bn)	Jul	--	9.4	9.2
JN	09/07	01:00	Coincident Index CI	Jul P	--	93.2	94.1
JN	09/07	01:00	Leading Index CI	Jul P	--	91.6	93.2
JN	09/07	01:00	New Composite Leading Economic Index	Jul P	--	91.6	93.2
TA	09/07	04:00	Trade Balance (US$ bn)	Aug	--	1.6	0.9

Latin America

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
PE	09/01	07:00	Consumer Price Index (m/m)	Aug	--	0.4	0.1
PE	09/01	07:00	Consumer Price Index (y/y)	Aug	--	3.4	3.3
BZ	09/03	09:00	PMI Manufacturing Index	Aug	--	--	48.7
BZ	09/03	14:00	Trade Balance (FOB) - Monthly (US$ mn)	Aug	--	3000.0	2879.0
BZ	09/04	08:00	Industrial Production SA (m/m)	Jul	--	0.0	0.2
BZ	09/04	08:00	Industrial Production (y/y)	Jul	--	-3.4	-5.5
CL	09/05	07:30	Economic Activity Index SA (m/m)	Jul	--	--	0.4
CL	09/05	07:30	Economic Activity Index NSA (y/y)	Jul	--	5.7	6.2
BZ	09/05	08:00	IBGE Inflation IPCA (m/m)	Aug	--	0.4	0.4
BZ	09/05	08:00	IBGE Inflation IPCA (y/y)	Aug	--	5.2	5.2
CO	09/05	20:00	Consumer Price Index (m/m)	Aug	--	0.1	0.0
CO	09/05	20:00	Consumer Price Index (y/y)	Aug	--	3.1	3.0
PE	09/06	19:00	**Reference Rate (%)**	Sep	**4.25**	**4.25**	**4.25**
CL	09/07	07:00	CPI (m/m)	Aug	--	0.3	0.0
CL	09/07	07:00	CPI (y/y)	Aug	--	2.6	2.5

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

Global Auctions for the week of September 3 - 7

North America

Country	Date	Time	Event
US	09/04	11:30	U.S. to Sell USD32 Bln 3-Month Bills
US	09/04	11:30	U.S. to Sell USD28 Bln 6-Month Bills
US	09/05	11:30	U.S. to Sell 4-Week Bills

Europe

Country	Date	Time	Event
NE	09/03	05:00	Netherlands to Sell Up to EUR2 Bln 86-Day Bills
NE	09/03	05:00	Netherlands to Sell Up to EUR2 Bln 204-Day Bills
NO	09/03	05:10	Norway to Sell NOK3 Bln 2% 2023 Bonds
BE	09/03	06:00	Belgium to Sell Bonds
FR	09/03	09:00	France to Sell Bills (BTF)
DE	09/04	04:30	Denmark to Sell Up To DKK5 Bln 1.5% 2023 Bonds
AS	09/04	05:00	Austria to Sell Bonds
GR	09/04	05:00	Greece to Sell Bills
BE	09/04	05:30	Belgium to Sell Bills
SZ	09/04	05:30	Switzerland to Sell 3-Month Bills
SW	09/05	05:03	Sweden to Sell SEK3.5 Bln 3.75% 2017 Bonds
UK	09/05	05:30	U.K. to Sell GBP1.75 Bln 4.5% 2042 Bonds
GE	09/05	05:30	Germany to Sell EU5 Bln 10-Year Notes
SP	09/06	04:30	Spain to Sell Bonds
FR	09/06	05:00	France to Sell Bonds (OAT)
SW	09/06	05:03	Sweden to Sell SEK500 Mln 0.5% 2017 I/L Bonds
SW	09/06	05:03	Sweden to Sell Inflation-Linked Bonds

Asia Pacific

Country	Date	Time	Event
JN	09/03	23:45	Japan to Sell 10-Year Bonds
CH	09/04	21:30	China to Sell CNY30 Bln 7-Year Bonds
CH	09/04	23:00	China to Sell 7-Year Bonds
JN	09/04	23:35	Japan to Sell 6-Month Bills
NZ	09/05	22:30	New Zealand Plans to Sell Bonds
JN	09/05	23:35	Japan to Sell 3-Month Bills
JN	09/05	23:45	Japan to Sell 30-Year Bonds

Source: Bloomberg, Scotia Economics.

Events for the week of September 3 - 7

North America

Country	Date	Time	Event
CA	09/05	09:00	**Bank of Canada Rate**
MX	09/07	10:00	**Overnight Rate**
CA	09/07	11:40	Bank of Canada Governor Mark Carney Speaks in Calgary

Europe

Country	Date	Time	Event
EC	09/03	06:45	ECB's Fratzscher Speaks at Brussels Think Tank
EC	09/03	09:30	ECB's Draghi Addresses EU Parliament Panel on Bank Union
EC	09/03	11:15	Rehn, Barnier, Almunia Debate Bank Union at EU Parliament
GE	09/03	12:00	Schaeuble Speaks on Future of Europe's Single Market, Hanover
AS	09/03	13:00	ECB's Nowotny Speaks at Panel Discussion in Vienna
UK	09/03		Commons Reconvenes After Summer Recess
EC	09/04	06:30	EU's Van Rompuy Meets Germany's Merkel in Berlin
IT	09/04	07:00	Italian Prime Minister Monti Meets French President Hollande
GR	09/04		Schaeuble, Greece's Stournaras Meet on Crisis in Berlin
GE	SEP 4-5		Schaeuble, Asmussen, Gabriel Attend Bank Event: Frankfurt
EC	09/05	09:00	EU's Van Rompuy Meets France's Hollande in Paris
EC	09/06	03:30	EU's Barnier Speaks in Brussels
SW	09/06	03:30	**Riksbank Interest Rate**
EC	09/06	05:30	Bundesbank's Dombret, Nagel Speak at Event in Tokyo
UK	09/06	07:00	Bank of England Monetary Policy Committee Decision
UK	09/06	07:00	BoE Asset Purchase Target
UK	09/06	07:00	**BoE Annouces Rates**
EC	09/06	07:45	**ECB Announces Interest Rates**
EC	09/06	08:30	ECB'S Draghi Holds Press Conference After Rate Decision
GE	09/06	13:00	Draghi, Schaeuble Speak at Award Event in Potsdam
EC	09/06	13:30	ECB's Mersch, Coene Speak in Luxembourg
GE	09/06		Merkel, Rajoy Hold Talks on Euro Crisis in Madrid
EC	09/07	04:00	EU's De Gucht Speaks on EU-Russia Relations in Helsinki
IT	09/07	05:00	Bank of Italy to Release Balance-Sheet Aggregates for Aug.
EC	09/07	08:10	ECB's Constancio Speaks in Amsterdam
EC	SEP 7-8		EU Foreign Ministers Meet in Cyprus
EC	SEP 7-9		EU's Van Rompuy, Rehn, Almunia at Conference in Cernobbio

Asia Pacific

Country	Date	Time	Event
NZ	09/02	22:00	Treasury Publishes Monthly Economic Indicators
AU	09/04	00:30	**RBA Cash Target Rate**
NZ	09/04	17:00	Prime Minister Speaks on Chinese Relationship
JN	09/04	21:30	BOJ Board Member Miyao's Speech and Press Conference
TH	09/05	09:00	**BoT Repo Rate**
JN	09/05	23:40	BoJ Governor Shirakawa to Speak
MA	09/06	06:00	**Overnight Rate**

Latin America

Country	Date	Time	Event
BZ	09/06	07:30	COPOM Monetary Policy Meeting Minutes
PE	09/06	19:00	**Reference Rate**

Source: Bloomberg, Scotia Economics.

Global Central Bank Watch

North America

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Bank of Canada – Overnight Target Rate	1.00	September 5, 2012	1.00	1.00
Federal Reserve – Federal Funds Target Rate	0.25	September 13, 2012	0.25	--
Banco de México – Overnight Rate	4.50	September 7, 2012	4.50	4.50

BoC: Scotia anticipates that the Bank of Canada will remain on hold at its Sept. 5 meeting while maintaining its "modest withdrawal of monetary policy stimulus may become appropriate" language in its statement. Subdued inflation (CPI came in at 1.3% y/y in July) and slow GDP growth (1.8% q/q SAAR) are further signs of slack in the economy that will cause the BoC to remain on hold. Fed: Scotia continues to expect that the Fed will undertake quantitative easing during H2 2012 with high odds that it will commence its purchasing program at its September 13 meeting. Minutes from the FOMC's Aug. 1 meeting openly discussed undertaking further QE "unless incoming information pointed to a substantial and sustainable strengthening in the pace of the economic recovery" – which has not happened. Chairman Bernanke's speech at Jackson Hole reinforced this view.

Banxico: Although inflation has been accelerating in the last two months as a result of higher food prices, we do not anticipate any changes to the monetary policy reference rate in Mexico at the next meeting. Since June, headline inflation has exceeded the upper limit of the central bank's tolerance range, reaching 4.4% y/y in July; however, the authorities anticipate that current prices shocks will be transitory. The country's economic performance remains solid; nevertheless, the international environment remains under pressure, a factor which sets a more cautious tone to the central bank's risk assessment.

Europe

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
European Central Bank – Refinancing Rate	0.75	September 6, 2012	0.50	0.50
Bank of England – Bank Rate	0.50	September 6, 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	September 3, 2012	8.00	8.00
Hungarian National Bank – Base Rate	7.00	September 25, 2012	7.00	--
Central Bank of the Republic of Turkey – 1 Wk Repo Rate	5.75	September 18, 2012	5.75	--
Sweden Riksbank – Repo Rate	1.50	September 6, 2012	1.50	1.50
Norges Bank – Deposit Rate	1.50	October 31, 2012	1.50	--

We remain of the view that the European Central Bank (ECB) will lower the benchmark refinancing rate by another 25 basis points, likely at its next policy-setting meeting on September 6th (though it should be a close call). The ECB is also expected to announce the details of an upcoming round of government bond purchases, in addition to providing updated staff growth and inflation projections. The Bank of England (BoE), which also meets next Thursday, is unlikely to adjust monetary policy at this time. The likelihood of additional easing has diminished; any possible expansion of asset purchases (QE) will depend on how third-quarter economic data play out over the next couple of months. We also expect an unchanged interest rate from the Riksbank next week. Though Swedish inflation is currently well below the 2% target, at 0.7% y/y in July, concerns linger with respect to high household debt, an overvalued property market and domestic financial sector risks. The krona's three-month strengthening phase came to a pause in mid-August as markets wait on news from the Fed and ECB. Finally, the central bank of Russia will likely leave the policy rate unchanged at 8.0% after the meeting on Monday. Headline inflation has received a boost from administered price increases and drought-related food costs. However, these effects are considered temporary, and underlying price pressures are low on account of slowing growth.

Asia Pacific

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Bank of Japan – Target Rate	0.10	September 19, 2012	0.10	--
Reserve Bank of Australia – Cash Target Rate	3.50	September 4, 2012	3.50	3.50
Reserve Bank of New Zealand – Cash Rate	2.50	September 12, 2012	2.50	2.50
People's Bank of China – Lending Rate	6.00	TBA	--	--
Reserve Bank of India – Repo Rate	8.00	September 17, 2012	8.00	--
Bank of Korea – Bank Rate	3.00	September 12, 2012	2.75	--
Bank of Thailand – Repo Rate	3.00	September 5, 2012	3.00	3.00
Bank Indonesia – Reference Interest Rate	5.75	September 13, 2012	5.75	--

We expect the Reserve Bank of Australia (RBA) to leave the benchmark cash rate unchanged at 3.50% on September 4th, maintaining room for further policy accommodation later in the year should further evidence materialize regarding slowing growth in China and/or moderating investment activity the mining sector. Inflation is currently low due to earlier currency appreciation, but is expected to rise as a result of the newly-introduced carbon tax, before returning to the middle of the 2-3% target range by end-2013.

Latin America

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Banco Central do Brasil – Selic Rate	8.00	October 10, 2012	7.25	--
Banco Central de Chile – Overnight Rate	5.00	September 13, 2012	5.00	5.00
Banco de la República de Colombia – Lending Rate	4.75	September 28, 2012	4.25	--
Banco Central de Reserva del Perú – Reference Rate	4.25	September 6, 2012	4.25	4.25

We expect the central bank of Peru to maintain the reference rate unchanged at 4.25% at the next meeting (September 6). In July, headline inflation decelerated for the first time in nine months to below the 4.0% y/y mark; however, inflationary pressures have proven to be persistent as food prices remain high. Additionally, economic activity remains robust with the monthly indicator expanding at an average pace of 7.0% y/y in the June-July period.

Africa

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

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

Forecasts as at August 30, 2012*	2000-10	2011	2012f	2013f	2000-10	2011	2012f	2013f
Output and Inflation (annual % change)	Real GDP				Consumer Prices[2]			
World[1]	3.7	4.0	3.1	3.4				
Canada	2.2	2.4	1.9	1.8	2.1	2.9	1.7	2.0
United States	1.8	1.8	2.2	1.9	2.5	3.1	2.0	2.2
Mexico	2.1	4.2	3.9	3.6	4.9	3.8	4.2	4.0
United Kingdom	2.0	0.7	-0.4	1.2	2.1	4.2	2.2	3.0
Euro Zone	1.4	1.5	-0.7	0.2	2.1	2.7	1.9	1.9
Japan	0.9	-0.7	2.3	1.5	-0.3	-0.2	0.1	0.3
Australia	3.1	2.1	3.2	3.1	3.1	3.1	2.3	2.8
China	9.4	9.3	7.8	8.2	2.3	4.1	4.0	4.4
India	7.5	10.0	6.0	6.3	6.4	7.7	6.5	6.8
South Korea	4.6	3.6	3.0	3.8	3.1	4.8	3.3	3.0
Thailand	4.4	0.1	5.0	4.0	2.7	3.5	3.0	2.8
Brazil	3.7	2.7	2.0	4.0	6.6	6.5	5.0	5.5
Chile	4.6	6.1	5.2	5.2	3.4	4.4	2.1	2.9
Peru	5.5	7.0	6.3	5.6	2.4	4.7	3.0	3.0

Central Bank Rates (%, end of period)	12Q1	12Q2f	12Q3f	12Q4f	13Q1f	13Q2f	13Q3f	13Q4f
Bank of Canada	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Federal Reserve	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
European Central Bank	1.00	1.00	0.50	0.50	0.50	0.50	0.50	0.50
Bank of England	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Swiss National Bank	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bank of Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Reserve Bank of Australia	3.75	3.50	3.25	3.25	3.25	3.25	3.50	3.50
Exchange Rates (end of period)								
Canadian Dollar (USDCAD)	1.00	1.02	1.02	0.99	0.98	0.97	0.97	0.97
Canadian Dollar (CADUSD)	1.00	0.98	0.98	1.01	1.02	1.03	1.03	1.03
Euro (EURUSD)	1.33	1.27	1.21	1.23	1.22	1.22	1.21	1.21
Sterling (GBPUSD)	1.60	1.57	1.55	1.59	1.62	1.63	1.64	1.64
Yen (USDJPY)	83	80	78	80	84	85	86	87
Australian Dollar (AUDUSD)	1.03	1.02	1.02	1.02	1.04	1.04	1.05	1.05
Chinese Yuan (USDCNY)	6.3	6.4	6.3	6.3	6.3	6.2	6.2	6.1
Mexican Peso (USDMXN)	12.8	13.4	13.3	13.1	13.2	13.1	13.2	13.4
Brazilian Real (USDBRL)	1.83	2.01	2.02	1.95	1.92	1.87	1.88	1.90

Commodities (annual average)	2000-10	2011	2012f	2013f
WTI Oil (US$/bbl)	54	95	95	100
Brent Oil (US$/bbl)	52	112	112	112
Nymex Natural Gas (US$/mmbtu)	5.81	4.03	2.75	3.00
Copper (US$/lb)	1.93	4.00	3.65	3.45
Zinc (US$/lb)	0.75	0.99	0.89	1.02
Nickel (US$/lb)	7.36	10.38	7.85	7.80
Gold, London PM Fix (US$/oz)	586	1,569	1,665	1,650
Pulp (US$/tonne)	694	977	880	900
Newsprint (US$/tonne)	575	640	640	660
Lumber (US$/mfbm)	273	255	280	315

[1] World GDP for 2000-10 are IMF PPP estimates; 2011-13f are Scotia Economics' estimates based on a 2010 PPP-weighted sample of 38 countries.
[2] CPI for Canada and the United States are annual averages. For other countries, CPI are year-end rates.

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

North America

Canada	2011	12Q1	12Q2	Latest	
Real GDP (annual rates)	2.4	1.8	1.8		
Current Acc. Bal. (C$B, ar)	-48.4	-40.6	-64.1		
Merch. Trade Bal. (C$B, ar)	2.3	8.7	-13.2	-21.7	(Jun)
Industrial Production	3.5	1.0	2.9	3.5	(Jun)
Housing Starts (000s)	193	206	230	209	(Jul)
Employment	1.6	0.9	1.2	0.8	(Jul)
Unemployment Rate (%)	7.5	7.4	7.3	7.3	(Jul)
Retail Sales	4.1	4.3	2.6	1.7	(Jun)
Auto Sales (000s)	1588	1701		1719	(May)
CPI	2.9	2.3	1.6	1.3	(Jul)
IPPI	4.6	1.8	0.6	-0.3	(Jul)
Pre-tax Corp. Profits	15.4	4.2	0.4		

United States	2011	12Q1	12Q2	Latest	
Real GDP (annual rates)	1.8	2.0	1.7		
Current Acc. Bal. (US$B, ar)	-466	-549			
Merch. Trade Bal. (US$B, ar)	-738	-778	-743	-690	(Jun)
Industrial Production	4.1	4.0	4.9	4.1	(Jul)
Housing Starts (millions)	0.61	0.71	0.74	0.75	(Jul)
Employment	1.1	1.6	1.3	1.4	(Jul)
Unemployment Rate (%)	9.0	8.3	8.2	8.3	(Jul)
Retail Sales	8.3	6.4	4.3	3.7	(Jul)
Auto Sales (millions)	12.7	14.1	14.1	14.0	(Jul)
CPI	3.2	2.8	1.9	1.4	(Jul)
PPI	6.0	3.4	1.1	0.5	(Jul)
Pre-tax Corp. Profits	2.1	18.0	14.0		

Mexico	2011	12Q1	12Q2	Latest	
Real GDP	3.9	4.5	4.1		
Current Acc. Bal. (US$B, ar)	-11.1	4.7	1.8		
Merch. Trade Bal. (US$B, ar)	-1.5	7.1	6.1	-5.1	(Jul)
Industrial Production	4.0	4.4	3.6	3.7	(Jun)
CPI	3.4	3.9	3.9	4.4	(Jul)

Europe

Euro Zone	2011	12Q1	12Q2	Latest	
Real GDP	1.5	-0.1	-0.4		
Current Acc. Bal. (US$B, ar)	-3	-32	71	236	(Jun)
Merch. Trade Bal. (US$B, ar)	6.9	28.0	128.8	213.7	(Jun)
Industrial Production	3.5	-1.6	-2.4	-2.0	(Jun)
Unemployment Rate (%)	10.1	10.8	11.2	11.3	(Jul)
CPI	2.7	2.7	2.5	2.4	(Jul)

Germany	2011	12Q1	12Q2	Latest	
Real GDP	3.1	1.2	1.0		
Current Acc. Bal. (US$B, ar)	202.6	215.8	182.0	247.7	(Jun)
Merch. Trade Bal. (US$B, ar)	216.2	223.3	245.2	245.2	(Jun)
Industrial Production	8.0	0.7	-0.5	-0.2	(Jun)
Unemployment Rate (%)	7.1	6.8	6.8	6.8	(Aug)
CPI	2.3	2.2	1.9	2.0	(Aug)

France	2011	12Q1	12Q2	Latest	
Real GDP	1.7	0.3	0.3		
Current Acc. Bal. (US$B, ar)	-54.5	-50.6	-77.0	-51.5	(Jun)
Merch. Trade Bal. (US$B, ar)	-51.4	-53.6	-54.2	-57.4	(Jun)
Industrial Production	2.0	-1.7	-1.9	-2.3	(Jun)
Unemployment Rate (%)	9.6	10.0	10.1	10.3	(Jul)
CPI	2.1	2.3	2.0	1.9	(Jul)

United Kingdom	2011	12Q1	12Q2	Latest	
Real GDP	0.8	-0.2	-0.5		
Current Acc. Bal. (US$B, ar)	-46.5	-76.4			
Merch. Trade Bal. (US$B, ar)	-160.9	-157.5	-179.1	-189.0	(Jun)
Industrial Production	-0.7	-3.1	-2.8	-4.3	(Jun)
Unemployment Rate (%)	8.1	8.2		8.0	(May)
CPI	4.5	3.5	2.7	2.6	(Jul)

Italy	2011	12Q1	12Q2	Latest	
Real GDP	0.5	-1.4	-2.5		
Current Acc. Bal. (US$B, ar)	-0.07	-0.07	-0.01	0.02	(Jun)
Merch. Trade Bal. (US$B, ar)	-34.2	-17.5	16.7	37.8	(Jun)
Industrial Production	0.2	-5.5	-7.9	-7.9	(Jun)
CPI	2.8	3.4	3.3	3.1	(Jul)

Russia	2011	12Q1	12Q2	Latest	
Real GDP	4.3	4.9	4.0		
Current Acc. Bal. (US$B, ar)	98.8	39.3	19.2		
Merch. Trade Bal. (US$B, ar)	16.5	19.7	16.7	14.0	(Jun)
Industrial Production	4.8	4.1	2.3	3.4	(Jul)
CPI	8.4	3.9	3.8	5.6	(Jul)

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

Source: Bloomberg, Global Insight, Scotia Economics.

Asia Pacific

Australia	2011	12Q1	12Q2	Latest
Real GDP	2.1	4.3		
Current Acc. Bal. (US$B, ar)	-33.1	-66.0		
Merch. Trade Bal. (US$B, ar)	35.7	1.5	29.9	34.3 (Jun)
Industrial Production	-1.1	4.7		
Unemployment Rate (%)	5.1	5.2	5.1	5.2 (Jul)
CPI	3.4	1.6	1.2	

Japan	2011	12Q1	12Q2	Latest
Real GDP	-0.7	2.8	3.6	
Current Acc. Bal. (US$B, ar)	119.2	101.1	49.0	65.6 (Jun)
Merch. Trade Bal. (US$B, ar)	-33.3	-72.6	-71.0	-49.5 (Jul)
Industrial Production	-2.3	2.7	5.1	-2.5 (Jul)
Unemployment Rate (%)	4.6	4.5	4.4	4.3 (Jul)
CPI	-0.3	0.3	0.2	-0.4 (Jul)

South Korea	2011	12Q1	12Q2	Latest
Real GDP	3.6	2.8	2.4	
Current Acc. Bal. (US$B, ar)	26.5	10.2	44.8	73.2 (Jul)
Merch. Trade Bal. (US$B, ar)	30.8	5.7	37.4	33.1 (Jul)
Industrial Production	6.9	2.9	2.3	0.1 (Jul)
CPI	4.0	3.0	2.4	1.5 (Jul)

China	2011	12Q1	12Q2	Latest
Real GDP	10.4	8.1	7.6	
Current Acc. Bal. (US$B, ar)	201.7			
Merch. Trade Bal. (US$B, ar)	155.0	1.7	274.1	301.8 (Jul)
Industrial Production	12.8	11.9	9.5	9.2 (Jul)
CPI	4.1	3.6	2.2	1.8 (Jul)

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

India	2011	12Q1	12Q2	Latest
Real GDP	7.5	5.3	5.5	
Current Acc. Bal. (US$B, ar)	-62.8	-21.7		
Merch. Trade Bal. (US$B, ar)	-13.4	-15.9	-13.4	-10.3 (Jun)
Industrial Production	4.8	0.6	-0.1	-1.8 (Jun)
WPI	9.5	7.3	7.4	6.9 (Jul)

Indonesia	2011	12Q1	12Q2	Latest
Real GDP	6.5	6.3	6.4	
Current Acc. Bal. (US$B, ar)	1.7	-3.2	-6.9	
Merch. Trade Bal. (US$B, ar)	2.2	0.9	-0.8	-1.3 (Jun)
Industrial Production	4.1	5.4		3.0 (May)
CPI	5.4	3.7	4.5	4.6 (Jul)

Latin America

Brazil	2011	12Q1	12Q2	Latest
Real GDP	2.5	0.6	0.4	
Current Acc. Bal. (US$B, ar)	-52.5	-48.3	-53.1	
Merch. Trade Bal. (US$B, ar)	29.8	9.8	18.6	34.5 (Jul)
Industrial Production	0.4	-3.5	-4.5	-4.3 (Jun)
CPI	6.6	5.8	5.0	5.2 (Jul)

Chile	2011	12Q1	12Q2	Latest
Real GDP	6.0	5.3	5.5	
Current Acc. Bal. (US$B, ar)	0.0	-0.5	-9.8	
Merch. Trade Bal. (US$B, ar)	10.0	10.2	5.1	-1.1 (Jul)
Industrial Production	6.9	3.9	2.8	0.6 (Jul)
CPI	3.3	4.1	3.1	2.5 (Jul)

Peru	2011	12Q1	12Q2	Latest
Real GDP	6.9	6.0		
Current Acc. Bal. (US$B, ar)	-3.3	-1.0		
Merch. Trade Bal. (US$B, ar)	0.9	0.8	0.2	0.4 (Jun)
Unemployment Rate (%)	7.7	8.3	7.2	6.2 (Jul)
CPI	3.4	4.2	4.1	3.3 (Jul)

Colombia	2011	12Q1	12Q2	Latest
Real GDP	5.9	4.7		
Current Acc. Bal. (US$B, ar)	-10.0	-1.8		
Merch. Trade Bal. (US$B, ar)	0.4	0.7	0.2	-0.2 (Jun)
Industrial Production	4.8	1.9	-0.1	2.8 (Jun)
CPI	3.4	3.5	3.4	3.0 (Jul)

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

Source: Bloomberg, Global Insight, Scotia Economics.

Interest Rates (%, end of period)

Canada	12Q1	12Q2	Aug/24	Aug/31*	United States	12Q1	12Q2	Aug/24	Aug/31*
BoC Overnight Rate	1.00	1.00	1.00	1.00	Fed Funds Target Rate	0.25	0.25	0.25	0.25
3-mo. T-bill	0.91	0.88	1.01	1.03	3-mo. T-bill	0.07	0.08	0.09	0.09
10-yr Gov't Bond	2.11	1.74	1.83	1.76	10-yr Gov't Bond	2.21	1.64	1.69	1.60
30-yr Gov't Bond	2.66	2.33	2.41	2.33	30-yr Gov't Bond	3.34	2.75	2.80	2.73
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US$B)	69.2	66.0	66.1	(Jul)	FX Reserves (US$B)	138.0	138.8	138.3	(Jul)
Germany					**France**				
3-mo. Interbank	0.71	0.53	0.12	0.11	3-mo. T-bill	0.07	0.04	-0.02	0.00
10-yr Gov't Bond	1.79	1.58	1.36	1.35	10-yr Gov't Bond	2.89	2.69	2.06	2.16
FX Reserves (US$B)	67.9	68.2	67.8	(Jul)	FX Reserves (US$B)	49.2	49.6	50.1	(Jul)
Euro Zone					**United Kingdom**				
Refinancing Rate	1.00	1.00	0.75	0.75	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	0.39	0.38	0.11	0.11	3-mo. T-bill	0.37	0.37	0.34	0.34
FX Reserves (US$B)	319.8	328.7	327.9	(Jul)	10-yr Gov't Bond	2.20	1.73	1.53	1.49
					FX Reserves (US$B)	82.4	84.4	86.0	(Jul)
Japan					**Australia**				
Discount Rate	0.30	0.30	0.30	0.30	Cash Rate	4.25	3.50	3.50	3.50
3-mo. Libor	0.13	0.13	0.13	0.13	10-yr Gov't Bond	3.98	3.04	3.24	3.09
10-yr Gov't Bond	0.99	0.84	0.81	0.80	FX Reserves (US$B)	47.7	44.1	45.1	(Jul)
FX Reserves (US$B)	1247.8	1231.2	1232.8	(Jul)					

Exchange Rates (end of period)

USDCAD	1.00	1.02	0.99	0.99	¥/US$	82.87	79.79	78.67	78.33
CADUSD	1.00	0.98	1.01	1.01	US¢/Australian$	1.03	1.02	1.04	1.03
GBPUSD	1.601	1.571	1.581	1.587	Chinese Yuan/US$	6.29	6.36	6.36	6.35
EURUSD	1.334	1.267	1.251	1.260	South Korean Won/US$	1132	1141	1135	1134
JPYEUR	0.91	0.99	1.02	1.01	Mexican Peso/US$	12.811	13.363	13.169	13.247
USDCHF	0.90	0.95	0.96	0.95	Brazilian Real/US$	1.827	2.012	2.027	2.030

Equity Markets (index, end of period)

United States (DJIA)	13212	12880	13158	13140	U.K. (FT100)	5768	5571	5777	5727
United States (S&P500)	1408	1362	1411	1407	Germany (Dax)	6947	6416	6971	6959
Canada (S&P/TSX)	12392	11597	12082	11934	France (CAC40)	3424	3197	3433	3407
Mexico (IPC)	39521	40200	40211	39999	Japan (Nikkei)	10084	9007	9071	8840
Brazil (Bovespa)	64511	54355	58426	57571	Hong Kong (Hang Seng)	20556	19441	19880	19483
Italy (BCI)	859	761	806	808	South Korea (Composite)	2014	1854	1920	1905

Commodity Prices (end of period)

Pulp (US$/tonne)	870	900	880	880	Copper (US$/lb)	3.85	3.45	3.45	3.44
Newsprint (US$/tonne)	640	640	640	640	Zinc (US$/lb)	0.91	0.84	0.83	0.82
Lumber (US$/mfbm)	279	283	312	312	Gold (US$/oz)	1662.50	1598.50	1667.00	1648.50
WTI Oil (US$/bbl)	103.02	84.96	96.15	95.77	Silver (US$/oz)	32.43	27.08	30.37	30.52
Natural Gas (US$/mmbtu)	2.13	2.82	2.70	2.79	CRB (index)	308.46	284.19	306.04	307.82

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

Fixed Income Strategy (London)

www.gbm.scotiabank.com

Fixed Income Strategy (Paris)

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