Global Views

Weekly commentary on economic and financial market developments

October 4, 2013

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

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Stale FOMC Minutes To Remind Markets Of A Close Call

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

Will the **US** government re-open next week? That's anybody's guess but there may still be a lot of scope for market movement next week in the absence of material progress in fiscal policy negotiations. That's because the FOMC minutes will still be released on Wednesday. Following the September 18th FOMC statement, several Federal Reserve officials referenced how the decision not to taper asset purchases was a close call. Compared to the priced-in no-taper decision, that could mean that Treasuries are at risk of cheapening into the minutes should the tone of some of the comments make it appear that tapering still lies near at hand. A counterpoint we would offer, however, is that the FOMC minutes are already stale by virtue of the government shutdown and with no evidence of a funding and debt ceiling agreement in sight. Chairman Bernanke made it obvious since his July congressional testimony that fiscal policy risks could delay tapering and that caution has won out in vindicating the Fed's patience. That might be the tone behind Fed speak next week as five Fed speakers take to the stage. They include Chicago Fed President John Evans (voting 2013, alternate 2014), St. Louis Fed President James Bullard (voting 2013, nonvoting 2014), Cleveland Fed President Sandra Pianalto (alternate 2013, voting 2014), Philly Fed President Charles Plosser (alternate 2013, voting 2014) and San Francisco Fed President John Williams (nonvoting 2013, alternate 2014).

Notwithstanding the uncertainty over how long the government may be shut, the US Treasury may have more negotiating room than is apparent from Treasury guidance that the debt ceiling will be hit on October 17th. That's because the Treasury's math doesn't appear to take full account of the savings associated with the partial shutdown, nor does it fully consider the large roughly $30 billion cash position on hand at the Treasury. There are large bill maturities coming, but they can be rolled over without breeching the ceiling. That puts the focus on a $6 billion interest payment on October 31st. We assume the kids won't be dressed as Treasury Secretary Jack Lew that evening, however, on the assumption that default will be avoided and there are other emergency policy options at hand. Americans may have had difficulty paying their mortgages, but honouring sovereign obligations is sacrosanct to most Americans. For instance, we harken back to the 2011 debate in recalling the creative temporary solutions around the debt ceiling constraint that included issuing into captive pension funds. The options even included issuing a large denomination platinum coin under a legislative loophole, but this is disputed by legal minds and is very unlikely. These options would hardly be ideal, and it's wise for the Treasury to keep the deadline heat on the politicians in the middle of the negotiations. Markets, however, should probably not be fixated upon the October 17th timeline as d-day. More important is that we continue to err on the side of believing that cooler heads will prevail. That's true even if it ultimately takes House Speaker John Boehner going against his Tea Party faction and presenting a cleaner funding bill that would likely garner enough support from all of the House Democrats and enough of the House Republicans to pass. That would jeopardize Boehner's current role as Speaker, but his guidance that he will not allow a US default may suggest where his influence will ultimately come down by way of his short-term career risk in the face of unreasonable posturing by his colleagues versus the country's interests.

Apart from the FOMC minutes, we will also receive another week of jobless claims and mortgage applications, as well as the University of Michigan's consumer sentiment survey. Delayed releases that could come out next week include nonfarm payrolls, construction spending, and factory orders. Possible additional releases that may or may not arise next week include retail sales, trade, and producer prices. We're fortunate not to have a particularly heavy release schedule thus far during the partial government shutdown. The US also auctions 3-year notes, and conducts 10- and 30-year note reopenings as auctions count as an essential service.

Canadian markets will be primarily focused upon next Friday's jobs report. Following the super-sized gain of 59,200 in August, employment could face some downside risk. That's not at all assured, however, as the accompanying chart demonstrates. In fact, out of 33 times when monthly job growth has equalled or exceeded 60,000 since 1978, only six times have been followed by a negative print and four times were largely flat. The odds would therefore favour a repeat gain but we're playing it cautiously with a flat call given the enormous volatility in Canadian job prints this year. Further, job quality was an issue behind the strong August surge.

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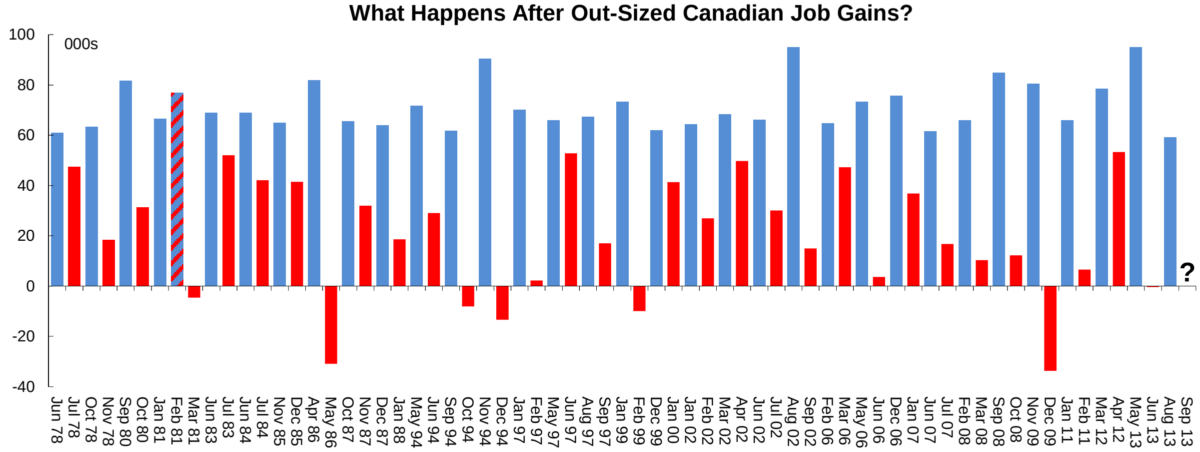
About 70% of the rise was in part-time employment. This lessens our confidence that the large gain is signaling a potential trend break-out in job market strength. That's generally true of the full year-to-date as part-time jobs have driven 62% of the 101,000 jobs created through to August at a non-annualized rate which itself is the weakest pace of job creation in the full job market cycle excluding the 2008-09 crisis years. Most of the rest of the week's focus will then be upon housing figures. Housing starts land Tuesday and have been on a mild three-month downward trend. Starts are now in line with the pace of household formations, but that doesn't necessarily mean much since formations are themselves sensitive to the cycle and not just a slow-moving demographic variable. Weakness in new home sales for the limited markets we can track is consistent with a deteriorating trend for housing starts. This matters much more than the resumption of growth in resale transactions given their low value-added and because resales strength is probably coming at the expense of future months sales as the option to purchase is triggered behind relatively juicy 90-120 day mortgage rate commitments. Also note that Canada releases trade figures for August on Tuesday. Consensus expects a modest narrowing of the nominal trade deficit that doubled itself in July, but the risk is against this in our opinion partly because the Western Canada Select measure of oil prices moved lower in August onward and with that the discount to WTI widened to around the $30 per barrel range now compared to the peak discount of over $40 per barrel late last year. The BoC also releases its two main policy surveys on Friday — the Business Outlook Survey and the Survey of Senior Loan Officer Opinions. Of the two, it is the former that garners the most attention and particularly in terms of what it says about the year-ahead sales outlook. The balance of the over 100 respondents continues to be slightly skewed toward expectations for higher sales volumes over the year ahead, but the survey responses have been whipsawed by headline volatility throughout the past couple of years. The result could well be stale since it is based upon surveys conducted over a period of four to six weeks in advance of its publication and therefore will not be affected by recent US political instability.

What Happens After Out-Sized Canadian Job Gains?



Source: Statistics Canada, Scotiabank Economics.

European markets will be relatively quiet next week. The Bank of England is not expected to make changes to its policy rate or the asset purchase target. It will continue to adhere to its forward rate guidance that positions the BoE as on hold until late 2016 as long as the unemployment rate is 7% or higher and other caveats are not breeched such as financial stability considerations. Also watch ECB President Mario Draghi's two speeches in the US at Harvard and the Economic Club of NY after his cautious take this past week. Data flow won't be particularly heavy from a market sensitivity standpoint, but will include industrial production figures for Germany, Italy, the UK and France, trade figures for Germany, the UK and France, and the NIESR's monthly GDP estimate for the UK.

With Bank Indonesia and the Bank of Korea likely to keep policy rates on hold next week, **Asia-Pacific** markets may instead focus upon BoJ Governor Kuroda's two speeches in the US as he takes the Abenomics pitch-book on the road to skeptical investors. Minutes to the BoJ meeting of September 4-5th will also play into the BoJ related risks. Aggregate company financing figures in China, Australian jobs, trade figures for Indonesia and the Philippines, and industrial output figures for Malaysia round out the regional risks.

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Cloudy, But With A Greater Chance Of Compromise

Regaining and sustaining a higher rate of global economic growth just got a little more difficult again. The U.S. outlook, and that of the world, are being buffeted again by another in a series of recurring economic and political developments that slow, but do not derail growth.

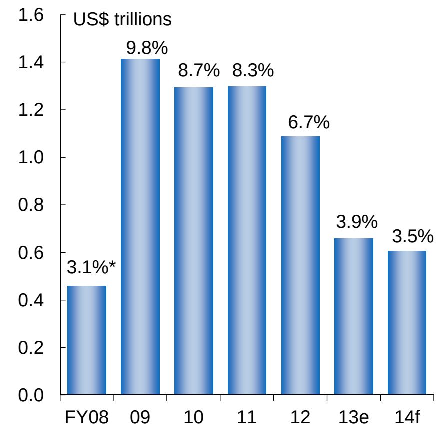
In the past few months, economic growth, investor confidence and financial markets have been sideswiped by a number of developments. First, there were growing expectations that the U.S. Federal Reserve would begin to unwind its extraordinary monetary stimulus. Second, escalating tensions surrounding the civil war in Syria had raised the threat of U.S. military intervention. And third, the headwinds facing the larger emerging market economies appeared to be getting stronger. For the most part, these issues have been largely diffused, although not without some residual negative impact on growth internationally due to unsettled capital and currency market developments.

Currently, the partial shutdown of the U.S. government and the need to extend the government's borrowing authority by mid-October risk undermining the forward momentum of the U.S. economy and its global trading partners if no political compromise can be reached quickly. Prior U.S. government shutdowns were eventually resolved with relatively minor economic repercussions. Eleventh hour debt ceiling compromises have been reached. Although it is still a very low probability, the political, economic and financial market fallout associated with even a relatively brief failure by the U.S. government to service its debt obligations could be much more severe and longer-lasting.

A resolution to the acrimonious debate being played out between the executive and legislative branches will likely be forthcoming, because the economic, financial, and importantly, political consequences of failing to act become much greater the longer it takes to resolve. Financial market volatility has been relatively muted, with risk-averse investors selling equities, and the U.S. dollar and Treasury bond yields benefitting from capital inflows. Despite Washington being the epicentre of the current debate, U.S. 'safe haven' investments are still getting the benefit of the doubt because the U.S dollar remains the world's premier reserve currency, America's fiscal deficit has been roughly halved in nominal dollar values, and the United States remains a diversified and resilient economy that continues to be supported by a very stimulative monetary policy.

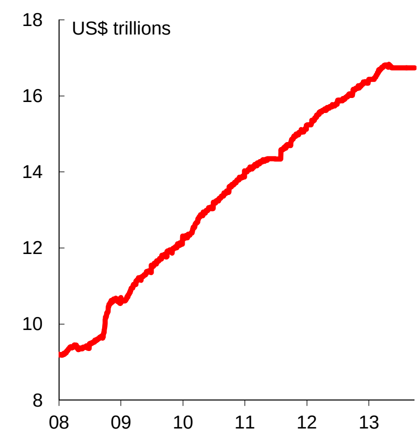
Nevertheless, the risk of a much more severe outcome cannot be ruled out in light of the political intransigence in Washington. In a worst-case scenario where default becomes reality, stock markets would come under significant downward pressure, foreshadowing a much deeper retrenchment in U.S. economic activity and global economic prospects. But instead of global capital inflows that typically would support the U.S. dollar in troubled times, investors may increasingly favour more diversified international portfolios which would result in a much weaker U.S. dollar. Admittedly, it would take a much more significant loss of confidence by Americans and international investors in the U.S. economy and its elected officials to undermine the U.S. dollar, but it is not out of the question. Bond yields and credit spreads would likely move much higher to account for the increasing risk.

U.S. Federal Deficit



* Per cent of GDP.
Source: U.S. Treasury, Scotiabank Economics.

U.S. Federal Publicly Held Debt



Source: U.S. Treasury, Scotiabank Economics.

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The U.S. economy could become increasingly handicapped if the anticipated revival in business investment does not materialize. Any meaningful back-up in borrowing costs would further aggravate already cautious business spending, thereby contributing to a deeper and more protracted slowdown. Instead of creating jobs, businesses would reinforce the emerging slowdown by consolidating operations and cutting back their workforces. Consumer spending and residential activity would increasingly be at risk.

Nonetheless, our base case forecast for the U.S. economy includes a political compromise that will quickly raise the federal debt ceiling. There will be a relatively small impact on U.S. consumer and business investment expenditures in the current quarter, though the anticipated weakness will not be sufficiently large to lower our annual real GDP estimate of 1.6%. We are maintaining our view that the U.S. economy will gain some traction in 2014, with output advancing by an average 2.6%. A slightly weaker economic handoff into the New Year will be offset by a lessening in fiscal drag and the Fed’s recent decision to delay the tapering of its massive monthly bond buying program in a bid to keep downward pressure on longer-term borrowing costs. (A 30-year mortgage rate has declined to 4.32% from a recent high of 4.54%, but remains roughly three-quarters of a percentage point above its most recent low of 3.54%.)

Canadian exports and output will likely be pressured a bit by the events unfolding south of the border, though the overall impact will be limited by the resiliency in domestic personal spending and housing activity. Increasing exports and business investment should reinforce a slightly stronger pace of growth in 2014, building upon the improving performance expected in the United States, and the encouraging signs that some of the larger emerging market economies, like China, are stabilizing and underpinning the demand and prices of commodities. Similar performances are anticipated in Mexico and in other Latin American countries whose industrial activity and tourism are closely tied to U.S. developments.

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In The Shadow Of The U.S. Debt Ceiling … Again

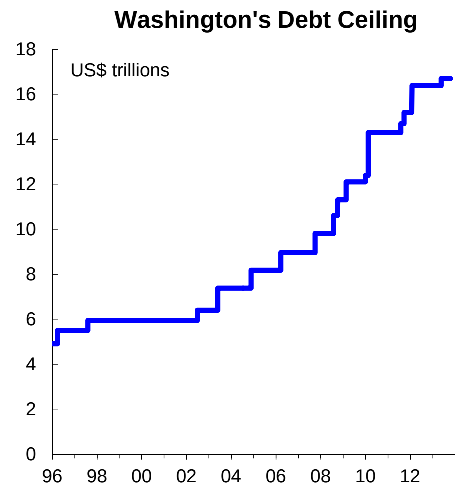
- **Seeking increased borrowing authority and an end to the partial government shutdown.**

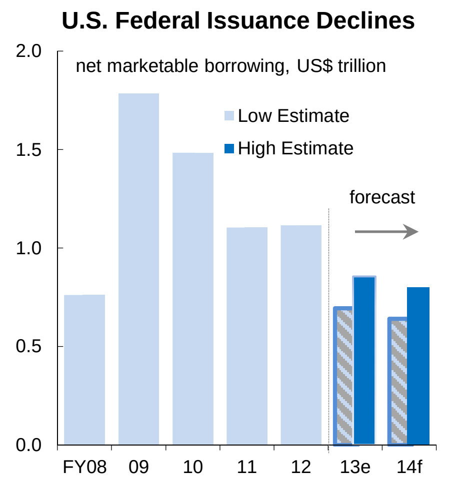
The issue of raising the U.S. federal debt ceiling is once again being leveraged to adjust policy. A distinctive factor this time around is that the 11th hour negotiations that may be required to raise the government's borrowing authority may also have to address Washington's partial shutdown, begun on October 1, whose impact will be intensifying by mid-October.

In fact, Washington has had no room to increase its total borrowing since May 19. *The No Budget, No Pay Act (2013)* suspended the debt ceiling from February 4 through May 18. On May 19, the cumulative borrowing for that period was added to the prior ceiling to establish a new US$16.699 trillion[1] limit. With no additional borrowing authority approved by Congress, the U.S. Treasury since May 17th has relied upon a range of 'extraordinary measures' that trim intergovernmental and other federal obligations that fall under the debt ceiling definition to create room for net new issuance to fund the government's operations. Such measures include: stopping the issuance of new State and Local Government Series securities and savings bonds; halting the issuance of government securities to federal employee retirement plans and the Exchange Stabilization Fund; replacing Treasury securities subject to the debt ceiling with Federal Financing Bank debt not under the ceiling; and, redeeming securities, including Government Account Series (GAS) securities in the Medicare and Social Security trust funds, equal to the expected value of benefit payments.

Facilitated by the sharp $0.4 trillion contraction of the U.S. federal deficit in fiscal 2013 from the $1.09 trillion shortfall in fiscal 2012, the extraordinary measures are allowing government operations to be funded for longer than originally projected. In late September, the U.S. Treasury announced that the extraordinary measures would be exhausted no later than October 17, leaving a $30 billion cash balance that might allow all obligations to be met until October 22. Exact estimates are complicated by unexpected fluctuations in Washington's daily cash inflows and outflows, as well as the potential savings if the partial government shutdown persists. The Social Security benefit payments on October 16, 23, and November 1 and 13, as well as the Medicare Advantage and Medicare Part D benefit payments on November 1 will involve redeeming GAS securities, temporarily providing additional room to borrow from the public. On October 31, however, a $6 billion debt service payment is due; on November 1 required payments include pay for the military, and on November 15, an interest payment of roughly $30 billion is scheduled.

To redress five months of extraordinary measures and comfortably fund government operations to the end of calendar 2014, after the mid-term elections, will require an increase in the debt ceiling at or slightly above $1 trillion. Encouraging for both economic growth and further deficit reduction would be an agreement extending the borrowing authority that involves first steps on entitlement reforms and/or overhauling the U.S. tax code.





Source for charts: U.S.Treasury, Scotiabank Economics.

[1] All dollar data in US dollars. The U.S. federal fiscal year-end is September 30th.

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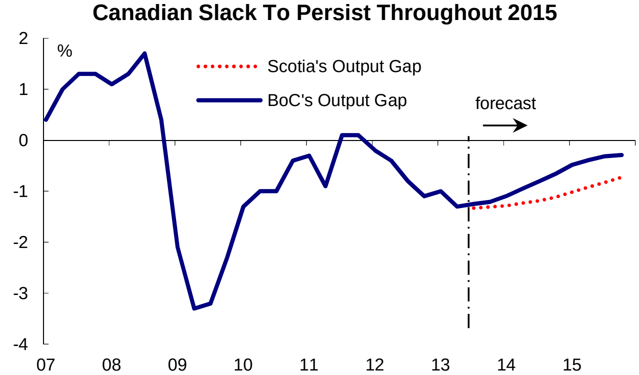
Bank Of Canada Signals A Policy Hold Into 2016

The BoC probably now envisages spare capacity remaining into 2016. It could well push out its forecast to return to the 2% inflation target in the October 23rd statement and MPR. We base this upon updated guidance from the BoC that was provided yesterday. There is now only a small difference of opinion on how spare capacity evolves compared to our longstanding view (see chart). This is nevertheless a change compared to the July BoC statement that forecast the gap to close by mid-2015, and the September statement that did not say when.

Canadian Slack To Persist Throughout 2015



Source: Bank of Canada, Statistics Canada, Scotiabank Economics.

The BoC until now has forecast a return to the 2% inflation target by around mid-2015. Delaying this guidance would be consistent with leaving rates on hold throughout all of 2013-15, with the BoC lagging the Federal Reserve either in timing and/or magnitude under current Fed guidance. Canada 2s are nevertheless currently priced for a rate hike by 2015. While 2s might be cheap, CAD may be dear against the USD in the face of this possible revision, particularly as Canadian growth lagged the US in 2012 and is forecast to do so next year just as the Fed eventually tapers.

In drawing up our inferred BoC output gap forecast before the October statement and MPR, we use the guidance that was unusually provided by Senior Deputy Governor Tiff Macklem in a speech on October 1st. Macklem said that the economy is now expected to grow by 2-2.5% in 2013Q3 and 2013Q4 (down from 3.8% and 2.5% previously). Loose guidance was provided beyond that in terms of growth "strengthening next year" and so we have maintained the BoC's forecasts from 2014Q1 onward until we receive the updated BoC forecasts on October 23rd. A clear risk to our view concerns whether the BoC revises its 2014-15 growth forecasts higher. We did not see much optimism reflected in Macklem's speech to justify this risk and the BoC would face a high bar in explaining why it keeps pushing out optimism. We have also left unchanged the BoC's prior guidance on the potential growth rate of the Canadian economy which is revised only once a year in October; that said, Macklem said potential growth is still judged to be about 2%.

Against the conventional thinking that the BoC would want to hike before spare capacity closes, we continue to think that very easy money will be required even as spare capacity shuts. That's because we don't see the economy slipping into material excess aggregate demand into 2016. Highly stimulative monetary policy may therefore be required even at a resting equilibrium of no spare capacity. An added constraint in this regard is that while the BoC has exercised modest policy independence from the Federal Reserve in the past and with a mixed track record, we continue to view the central bank as being toward the limits of independence from Fed policy. A more rates-bearish policy stance could light up USDCAD and jeopardize hopes for an export-led expansion. Thus, our later-than-consensus view that the BoC will be on hold until 2015Q3 with the fatter tail risk of later rather than sooner could now face support for a policy hold well into 2016. This would be tantamount to coaxing markets to engineer a rate cut, without meeting the very high bar at the BoC for cutting its policy rate outright. As is the case with the Fed and BoE — albeit with differences in explicitness — the BoC's current experiment in lengthened guidance is unprecedented including in comparison to its shorter-lived conditional commitment from April 2009 until June 2010.

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Japan Implements A Consumption Tax Increase For April 2014

- **Tax hike's adverse impact on growth to be partially offset by short-term fiscal stimulus.**

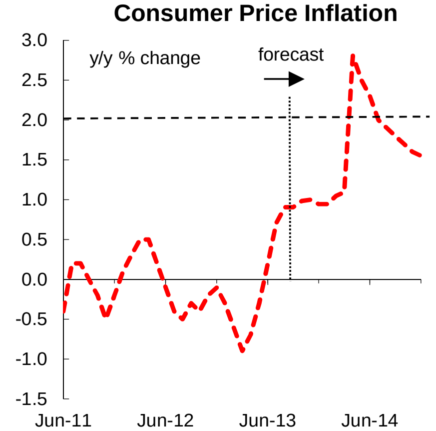
Japan's Prime Minister Shinzo Abe announced on October 1st that the country will implement a consumption tax rate increase in April 2014, taking the rate from 5% to 8%. This is estimated to raise around ¥8 trillion (US$81 billion, 1.6% of GDP) annually helping the government's plan to eliminate the primary deficit by 2020. A second phase of the tax rise is planned for October 2015 when the rate will be raised further to 10%, though the implementation of this step will have to be confirmed by the government next year.

Japan's tax revenues as a share of GDP are currently significantly below the OECD average, while public finances are increasingly pressured by social security costs related to the nation's aging population; in this context, the tax increase will be a key element in the government's fiscal consolidation efforts. Given Japan's weak public finances, a failure to signal commitment to long-term fiscal discipline would have put pressure on the country's sovereign credit ratings and bond yields; two of the three major rating agencies hold a "negative" outlook on Japan's credit assessments. Nevertheless, the tax hike has been subject to intense debate as the sustainability of the ongoing economic recovery is still uncertain.

The economy is on the mend as policymakers' revitalization efforts through aggressive monetary and fiscal stimulus are filtering through the system: earlier improvements in confidence have translated into a pick-up in real activity with industry and consumer–related indicators recuperating. Nevertheless, the recovery is still at an early stage, largely driven by short-term stimulus. Therefore, the timing of the tax hike increases the risk that Japan's economic revival plan may not succeed in the medium-term, as employment and wages ought to rise in an enduring fashion before consumers will be able to maintain or increase spending at higher prices. The previous consumption tax rate increases in 1989 (when a 3% tax rate was introduced) and 1997 (when the tax was raised to 5%) foretell us that prior to the forthcoming hike in April, the economy will likely see a substantial pickup in household spending and residential investment as consumers make pre-emptive purchases; this may be followed by a potentially sharp reversal after the implementation of the levy. To temporarily offset this adverse impact on consumption, Mr. Abe announced an additional fiscal stimulus package equivalent to ¥5 trillion (1% of GDP). The measures will likely focus on boosting capital investment, supporting the low income segment of the population, and may include tax breaks for home buyers and companies to promote job creation and wage growth; details of the package will be unveiled by December. We expect the Japanese economy to grow by 1¾% in 2014 following a 2% expansion this year.

The consumption tax increase will temporarily raise Japanese consumer price inflation, which Mr. Abe aims to bring to 2% y/y over the next year and a half or so. Technically, deflation ended in mid-2013; nevertheless, recent inflation has not been demand-driven but mostly reflected higher energy costs with other categories remaining in deflationary territory. We assess that the consumption tax hike will take annual inflation temporarily above the 2% mark in the second quarter of 2014 before it subsides to around 1½% y/y by year-end.

Consumer Price Inflation



Source: Bloomberg, Scotiabank Economics.

The Abe administration continues to face a multitude of challenges in conducting Japan's economic policy. While the first two arrows (aggressive fiscal and monetary stimulus) of the government's economic revival plan have been perceived by market participants as successful so far — yielding growth and ending deflation, at least temporarily — the third arrow, which focuses on long-term structural reforms, is yet to be announced. In June, Prime Minister Abe said that it will focus on opening up the country and its markets to the world, reorganizing the electricity sector, boosting investment and innovation by reforming the tax system and university education, and encouraging women to participate in the workforce. The implementation of the structural reforms will play a key role in making the stimulus-driven recovery sustainable.

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Bancolombia Vs. Competitors

The following article was published on October 1, 2013.

Our review of Bancolombia's financials over the past few years suggests that the bank is able to use its leading position in the market to grow at faster rates than the competition without lowering prices and while maintaining relatively conservative lending practices. Bancolombia's response to local bond market volatility has been deeper than that of competitors, which should reduce earnings volatility at the expense of diminished earnings from investments.

The Colombian banking sector has always been of interest to us, not just because we have seen several attractive bond issuances in the past year, but also because the sector continues to grow at double-digit rates. Bloomberg reported last week on BBVA's expansion plans in that country, and our own bank completed the purchase of Banco Colpatria this summer. In this article, we review Bancolombia's strategy by providing historical comparisons with its competition.

Growth exceeds competition

Bancolombia is the largest bank in the country with a loan market share of 24%, higher than Banco de Bogota's 14% and Davivienda's 12%. More interesting, Bancolombia has been growing faster than its competitors, with much of that growth occurring organically in recent years rather than through acquisitions. The boom in loans occurred first following the global financial crisis, with Bancolombia loan portfolio growth rates reaching 32% in 2010 and 26% in 2011; over the past three years, those annual growth rates were about 5% higher than the growth of the banking system overall. Growth in deposits followed, with the highest rate of growth achieved in 2012 at 29%, 11% higher than the banking sector overall. How has Bancolombia pulled even further ahead of its competition?

Loan portfolio characteristics

We see only limited evidence that Bancolombia achieves this growth through aggressive competition on price. It is true that Bancolombia's lending rate before provisions for loan losses, is around 2% lower than those of the sector, and it has been that way at least since 2010. The reason for that, however, is likely that the loans that the bank gives are more conservative. Delinquency rates historically are around 0.5% lower than those of other banks. Moreover, looking at the breakdown by types of loans, we find that Bancolombia charges the same interest rates on commercial loans and mortgages, but lower rates than the competition on consumer loans, microcredit, and consumer leasing. Delinquency rates on mortgages and commercial loans are similar to those of competitors, but delinquency rates on consumption loans are much lower (19% vs. 28% for the banking system). Thus, within the riskiest loan category, Bancolombia seems to be taking a conservative route, which may explain the lower overall lending interest rates. Consumer loans also represent a smaller fraction of Bancolombia's portfolio, at 17%, as opposed to 29% for Davivienda and 19% for Banco de Bogota.

Deposits and capital Structure

Not only is Bancolombia offering similar prices as the competition on loans, but it has actually been able to win market share despite offering worse prices on deposits. Historical data since 2009 shows Bancolombia always paying lower deposit rates than the average for private banks — for example, deposit rates for 2012 were 2.6% for Bancolombia vs. 3.3% for the average bank. Bancolombia is able to capitalize on its leading position in the banking sector, securing above average growth in its deposit base while at the same time paying lower interest rates on deposits than competitors.

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Still, Bancolombia funds less of its loan portfolio with deposits than most other private banks, including Banco de Bogota. The difference is made up for by debt issuance which is higher for Bancolombia than other private banks on average. Davivienda also has a significant amount of debt, though in Davivienda´s case the focus is on senior debt and COP-denominated debt, while Bancolombia´s debt is evenly split between senior and subordinated and is mostly denominated in US dollars.

Figure 1. Bancolombia and Peers as of 2Q13

Country	Bancolombia	Davivienda	Banco Bogotá (6)
Issuer Rating (1)	BBB-/Baa3/BBB	BBB-/Baa3/BBB-	BBB-/Baa3/BBB
Loan Portfolio	39,420	19,368	25,717
Deposits	36,535	17,073	28,882
Net Interest Income (2)	2,724	1,448	2,286
Net Income (2)	768	298	763
Capitalization ratio	17.21%	14.32%	13.12%
Loans Mkt Share	24%	12%	14%
Loan Growth YoY 3Q12(3)	18%	15%	14%
Delinquency ratio	2.70%	4.30%	2.30%
Reserve coverage ratio (4)	174%	104%	120%
Loan strategy	Commercial 72%, Consumer 17%, mortgages 10%	Commercial 52%, Consumer 29%, Mortgage 19%	Commercial 79%, Consumer 19%, Mortgages 1%
Liquidity Ratio Deposits / Loans	93%	88%	112%
Net Interest Margin	5.90%	6.13%	6.28%

Source: Scotiabank with Bloomberg data. In US$Millions.

(1) LT Foreign Issuer rating S&P, Moody´s, Fitch. (2) Annualized as of 3Q12. (3)Change in local currency. (4) Reserves / (Delinquency ratio * Loans). (5) Net Interest Margin = Net Interest Income /(Interest Bearing Assets: Investments + Loan Portfolio + Interbanking Assets). (6) As of Dec. 2012

Investments

In response to the volatility in the local Treasury market and the subsequent drop in net income from investment losses, Bancolombia is the bank that made by far the largest adjustments to investment policies. Data shows the bank decreased its investment holdings of internal government debt by 3 tn. Davivienda only decreased holdings by 140bn, and the banking system as a whole, with the exception of Bancolombia, actually increased holdings by around $1tn. That decrease means that Bancolombia´s results will no longer be so dependent on the bond market, but on the other hand that bank would no longer profit from any potential recovery.

Bond market pricing

The bond market rewards Bancolombia’s leading market position, conservative lending policies, and high capitalization rate with a 336bp spread on senior bonds and 390bp on subordinated bonds, around 30bp tighter than competitor Davivienda, which is the third largest bank (Figures 2 and 3). Relative to Peru’s largest bank, BCP, Bancolombia trades at the same level on subordinated bonds but 20bp wide on senior bonds. Markets value banks that have large foreign parents, as suggested by the fact that Bancolombia trades about 20bp wide to Scotiabank in Peru and BBVA in Mexico.

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While the Central Bank made efforts last year to dampen growth rates somewhat, double-digit growth of the banking sector continues, and we think Bancolombia and other Colombian banks will remain interesting names to follow for bond investors.

Figure 2. Bancolombia USD-denominated Senior Bonds vs. peers

Country	Bank	Maturity	Avg. Bond Rating	G-Spread (bp)
Colombia	Bancolombia	6/3/2021	BBB	336
Colombia	Davivienda	1/29/2018	BBB-	289
Peru	BCP	4/1/2023	BBB	316
Peru	BBVA Continental	8/26/2022	BBB+	303

Source: Scotiabank with Bloomberg data as of October 1, 2013

Figure 3. Bancolombia USD-denominated Subordinated Bonds vs. peers

Country	Bank	Maturity	Avg. Bond Rating	G-Spread (bp)
Colombia	Bancolombia	9/11/2022	BB+	390
Colombia	Banco de Bogotá	2/19/2023	BBB-	375
Colombia	Davivienda	7/9/2022	BB	416
Peru	BCP	4/24/2027	BBB-	391
Peru	Scotiabank	12/13/2027	BBB	363
Mexico	BBVA	9/30/2022	BBB-	370
Mexico	Banorte	10/13/2021	BB+	430

Source: Scotiabank with Bloomberg data as of October 1, 2013.

Recent Research on Colombian banks:
"Davivienda on the rise," February 14, 2013
"Coltes and Colombian bank results," August 16, 2013

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UK Bank Of England Meeting Preview (October)

We expect next week's October MPC decision to come and go without causing any shockwaves. However, this masks some significant developments under the surface which are likely to influence the MPC's stance as the next *Inflation Report* approaches.

Last month's MPC minutes showed a less dovish stance by the MPC, something that took the market a little by surprise and provoked a near 6bp rise in 10-year gilt yields. In particular 2 major themes in the minutes that provoked a market reaction were:

- The two doves (David Miles & Paul Fisher) no longer wanted QE; and
- The MPC did not seem uncomfortable with the rise in gilt yields over the prior month.

Back to Basics

Table 1 provides a scorecard of all the major UK data releases which have been released since the September MPC meeting. Green shading represents a moderate upward surprise, pink represents a moderate downward surprise and red is a big downward surprise.

To summarise, downward surprises have moderately outnumbered upward surprises (10 versus 7). This is in stark contrast to the situation leading up to the September meeting which was a sea of green; with upward surprises massively outnumbering downward surprises — which helped to explain why last month's minutes were less dovish.

The situation ahead of the October meeting is far more of **a mixed bag** and is similar in the UK's main trading partners — the US and eurozone. The bottom line is that on the basis of the data in front of the MPC at this month's meeting, their stance should not evolve dramatically in either direction.

Table 1: UK Live Economic Data Scorecard

Release Date	Category	Indicator	Consensus	Actual	Index Surprise	*Surprise EoD
05 Sep 13	Monetary Policy	BoE	0.5	0.5	0	13.49
06 Sep 13	Activity	Man Prod % m/m	0.2	0.2	0	0.27
06 Sep 13	Activity	Trade Bal	-8200	-9853	-1653	0.27
06 Sep 13	Housing	Halifax % m/m	0.8	0.4	-0.4	0.27
06 Sep 13	Activity	Ind Prod % m/m	0.2	0	-0.2	0.27
09 Sep 13	Housing	RICS	39	40	1	-0.82
11 Sep 13	Labour	Average Weekly Earns	1.3	1.1	-0.2	-2.34
11 Sep 13	Labour	Claimant Count Chg	-21	-32.6	-11.6	-2.34
11 Sep 13	Labour	ILO Unemp Rate	7.8	7.7	-0.1	-2.34
11 Sep 13	Labour	ex-bonus % 3m/yr	1	1	0	-2.34
17 Sep 13	Inflation	Input PPI % m/m	0.2	-0.2	-0.4	-3.18
17 Sep 13	Inflation	Output PPI % y/y	1.8	1.6	-0.2	-3.18
17 Sep 13	Inflation	Core Output PPI % y/y	1.1	1	-0.1	-3.18
17 Sep 13	Inflation	CPI % y/y	2.7	2.7	0	-3.18
17 Sep 13	Inflation	Core CPI % y/y	2.1	2	-0.1	-3.18
17 Sep 13	Inflation	RPI % y/y	3.2	3.3	0.1	-3.18
19 Sep 13	Activity	Retail Sales x-fuel % m/m	0	-1	-1	-8.92
20 Sep 13	Money & Credit	PSNBx	13.3	13.2	-0.1	-10.10
26 Sep 13	Survey	GfK	-11	-10	1	-10.10
26 Sep 13	Activity	GDP % q/q	0.7	0.7	0	-10.10
27 Sep 13	Activity	Services Output	0.5	0.2	-0.3	-9.44
27 Sep 13	Housing	Nationwide % m/m	0.5	0.9	0.4	-9.44
30 Sep 13	Money & Credit	Mortgage Approvals	61.5	62.226	0.726	-7.54
30 Sep 13	Money & Credit	Consumer Credit	0.6	0.6	0	-7.54
30 Sep 13	Money & Credit	M4x Int OFCs		4.3	0	-7.54
01 Oct 13	Survey	CIPS	57.5	56.7	-0.8	-9.48

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FX, Energy and Market Interest Rates

There have been 2-3 key developments since the September meeting. On balance these should contribute to a more dove-friendly tone at this month's meeting. These have been the further appreciation in the GBP exchange rate, a sharp fall in petrol prices and early hints of upcoming utility bill hikes.

- The trade-weighted exchange rate has appreciated by a further 1.6% since the September MPC meeting. That takes the cumulative appreciation since the August *Inflation Report* to 5½%.
- Related to that, petrol prices have dropped sharply. During the final week of September, petrol prices fell by 3.5p to 133.4p per litre. That is the biggest 1-week fall since at least the start of 2012.
- News reports suggest that the first utility bill hike announcement is not far off and we should brace for 8-10% bill increases. If confirmed, this would be higher than the 5% hikes assumed by the BoE.

The minutes of the MPC meeting show that the committee's discussions are now centred on the Bank's forward guidance policy and the knockouts. In this context, the combination of the fall in petrol prices and the appreciation in the exchange rate makes it less likely that the medium-term inflation projection knockout (i.e. that the Bank's CPI forecast 18-24 months exceeds 2.5%) will be triggered. As such, the risk of an interest rate hike has receded.

The only major development to the contrary has been the sharp drop in government bond yields, particularly since the Fed's decision not to embark on operation taper. However, the rise in gilt yields was previously seen as a potential threat to the on-going UK recovery. The fall in yields should imply that the threat has receded somewhat; not that they now imply a boost to the growth outlook since yields still remain more than 50bp above their mid-year levels.

If the Inflation Report was Today…

The November *Inflation Report* is fast approaching and will give an update of how the MPC's stance has evolved. Based on the developments that we have had since the August *Inflation Report*, we think that the thrust will be particularly dovish.

More specifically, Table 2 shows how the key influences on the Bank's medium-term inflation projection have evolved.

Table 2: If the Inflation Report was Today

			02/10/2013		
		Aug-13	**Now**	**% Chg**	**Impact on BoE Inflation Projection**
Oil*	Spot (USD)	107.25	108	0.7	-0.1
	Spot (GBP)	70.5	66.7	-5.4	
GBP*	**Effective GBP**	**78.97**	**83.2**	**5.4**	**-0.54**
Near quarter inflation fcast**		2.82	2.5	-0.32	-0.11
GDP forecast	**2013**	**1.3**	1.55	**0.25**	**0.1**
	2014	**2.4**	2.50	**0.1**	
FTSE All-Share*		3491	3494	0.0	0
Market rate expectations					**-**
Judgement (because of double counting)					**0.2**
					-0.44
*15 working day average					
** average of first two quarters of profile					**Forecast last time:**
					2.46
					Becomes:
					2.02

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In particular, the fall in petrol prices, the appreciation in the effective exchange rate and the downward surprise relative to the Bank's near-term inflation outlook all argue for a substantial downgrade to the Bank's projection 18-24 months ahead. On this occasion there is a risk of double counting since the fall in petrol prices has contributed to the drop in the near-term inflation outlook and the rise in the GBP exchange rate has been the main driver behind lower petrol prices. The flipside is that the GDP growth outlook has improved. However, the BoE was already fairly optimistic and the follow-through to the inflation outlook is also fairly small.

Taking all of this into account, we believe that this points to a chunky downward shift in the Bank's medium-term inflation projection, from 2.46% y/y down to around 2% y/y. We believe that this would be seen as a dovish surprise by the market. As such it should push back expectations for the timing of the first BoE rate hike and bear down on gilt yields. Clearly the *Inflation Report* is around 6 weeks away so it is still early days. Nonetheless, the minutes of the October meeting could provide the first clues that the MPC's stance is evolving in this way.

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Euro Political Risk Receding?

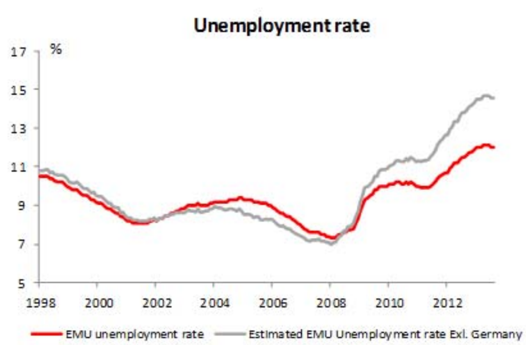
- Could political risk in the euro area see a retrenchment over the coming months? While it is true that the rather quick resolution of the political crisis in Italy this week is encouraging, this assumption could look premature in view of the fragility of numerous coalition governments across the euro area (Italy, Portugal, Greece, Cyprus, the Netherlands…), the uncertainty surrounding the next German government, signs of rising populism in recent elections or polls (Austria, France) or the prospect of the EU parliamentary election in May next year. However, there could be some hope that economic activity data, and especially labour market figures, could provide an important backstop to new political crises.

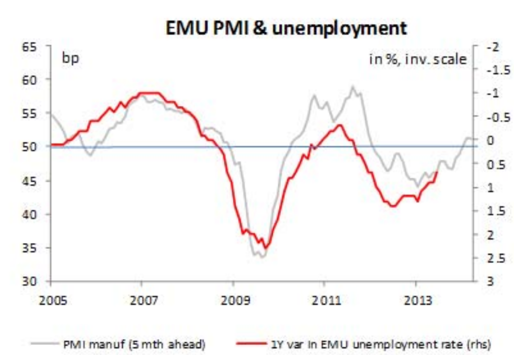
- Political instability and economic policy uncertainties are strongly linked with high unemployment and rising poverty which naturally fuel social protests, growing populism and the presence of extremist parties in parliaments fighting reforms or ready to oust governments, leading to debt crises. On this issue, there could be little to rejoice about as the EMU unemployment rate remains extremely high at 12% in August. However, there could be some rays of hope as:

    - The deterioration of EMU labour markets seems to have stopped. Eurostat indeed revised the peak of EMU unemployment rate from 12.2% to 12.1% which was passed in Q2.

    - The stabilisation in the EMU unemployment rate does not come from only a buoyant labour market in Germany but also from signs of improving trends in some peripheral countries (including Spain, Portugal, Ireland). As a result, the unemployment rate outside Germany seems also to have stabilised over the past two months or even moved slightly down.

Chart 1: EMU unemployment, the worst has passed?





- It is true that, at this stage of the economic cycle, it is worth remaining cautious as improvements in the labour market over the summer/holiday months could be volatile and linked to temporary favourable factors. However, the recovery in EMU business surveys seems to validate the prospect that the labour market situation could have passed its low point.

- Such an assumption could have important implications from a political risk perspective as, looking to its past relationship with the Euro Economic Policy Uncertainty Index, which tries to assess the political risk in the Euro area, the level but also the movements in the unemployment rate seem to matter. Since its peak reached at the end of 2011, the EMU Policy Uncertainty Index has already receded, mirroring the slowdown in the deterioration of the labour market and also the likely impact of the ECB OMT program which has contributed to reduce the risk of spill-over from one country to the others at a time of specific domestic stress. In view of the recent trend in jobs data and business surveys, we could assess that further declines in this Euro Policy Uncertainty Index could be in the pipeline.

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Chart 2: Euro Policy Uncertainty Index & 1-year change in EMU unemployment

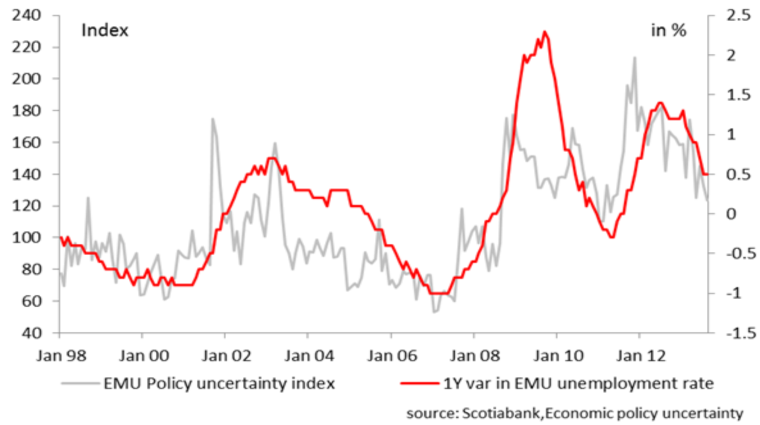
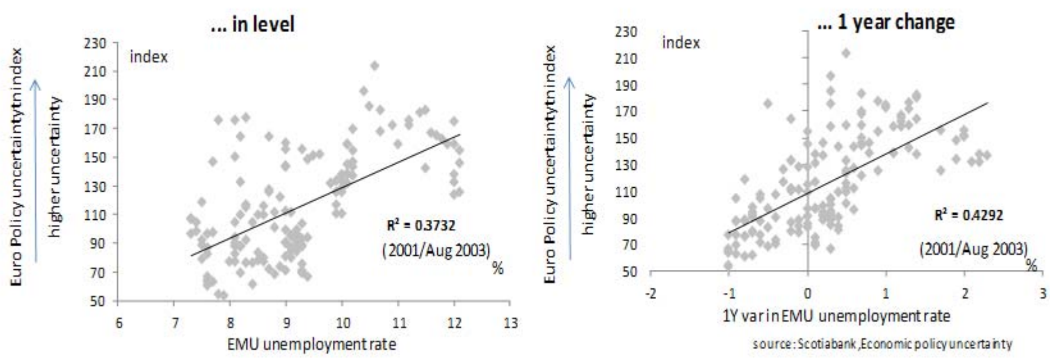


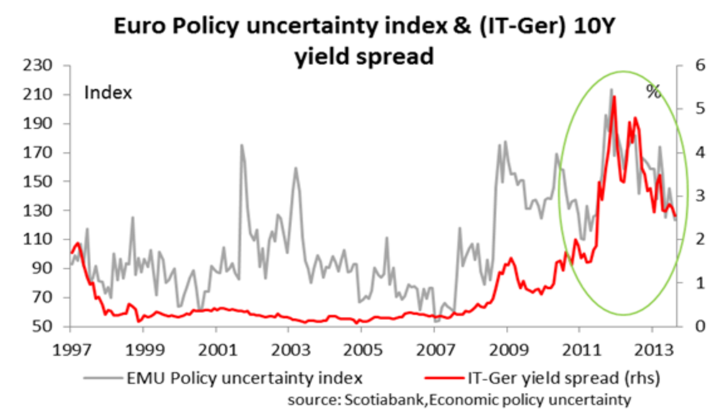
Chart 3: Correlation Euro Policy Uncertainty Index vs. EMU unemployment…



- For fixed income markets, this could be interpreted as a positive signal, playing in particular for a further tightening in spreads between peripheral yields and core countries. The relationship between political uncertainty and peripheral/core country yield spreads is not always constant. However, over the past three to four years, it seems to have explained a lot of the move, especially for a country like Italy. Indeed, since 2010, the 10Y yield spread [Italy-Germany] appears to have been strongly positively correlated with the swings in political uncertainty, rewinding significantly at times of renewing uncertainties. From a rating risk perspective, it could also be seen as positive as rating agencies have brought forward the risk of political instability as one of the key factors behind the risk of further downgrades.

- So looking to the past relationships between the Policy Uncertainty Index, developments on the EMU job market and peripheral/core yield spreads, the tightening trend could continue with the 10Y spread [IT-Ger] narrowing closer to 2.2%/2.3%.

Chart 4: Euro Policy Uncertainty Index vs. [IT-Ger] 10Y yield spread



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FX Markets Are Driven By Central Banks, Politics And Growth

We expect some modest USD strength into the final months of the year and into 2014, with FX markets being driven by three core themes: 1) relative central bank policy; 2) the global growth outlook and 3) politics, including US government gridlock. On a year-to-date basis, the USD has been notably strong against most of the emerging market currencies, with the exception of the Chinese yuan (CNY); meanwhile, its performance against the currencies of the advanced economies has been mixed; most notable has been the resilience of the euro (EUR).

The most important FX driver is relative central bank policy. The US Federal Reserve (Fed) has yet to slow its bond buying quantitative easing (QE) program and continues to add significant stimulus to the US economy. By 2014 the Fed is likely to be slowing additional stimulus but is still a long way from tightening policy; not typically a currency positive environment. However, markets are forward looking and judged against the other G4 policies of the European Central Bank (ECB), Bank of England (BoE) and Bank of Japan, the Fed is likely to be the first to enter its hiking cycle. It is this piece that should support both yields and the USD. Outside of the G4, several small open economies maintain a slight hawkish bias, mainly on the back of financial stability risks. In the developing economies domestic policy has taken several paths with some hiking rates to fight inflation and attract capital while others cutting rates to stimulate growth, but several turning increasingly to intervention.

In terms of growth, the outlook for the advanced economies is improving. The US economy is expected to outperform in 2014 (supporting the USD); in addition, it along with Germany, the UK, Canada and a few others are all expected to achieve at or above trend growth for the first time in several years. In an improving global growth environment the USD should outperform, while the growth sensitive currencies like the CAD, holding their own. The outlook for Asia and Latam is more mixed, but with most countries still struggling to grow back at trend rates. Politics are far more difficult to forecast; however, the combination of recurring gridlock in the US, geopolitical risks and upcoming elections in 2014 leaves politics as an important FX risk.

In the above environment, we foresee the NAFTA zone trading as a block. Central bank policy and growth should help support the USD globally, but so too will a narrowing current account balance, an improved fiscal outlook and building bullish sentiment. Canada is likely to underperform the US in terms of growth but benefit from an improving global growth environment; the Bank of Canada is expected to enter its hiking cycle in tandem with the US. This should create a fairly neutral environment for the Canadian dollar (CAD), with the currency weakening into year end and then holding stable in 2014. Mexico will also benefit from an improving US economy; but with the central bank having cut rates and the currency vulnerable to capital flows, the peso is at risk of sporadic volatility.

In Europe, both the ECB and BoE have introduced forward guidance strategies; but the markets are failing to cooperate, instead pricing the trajectory for interest rates on its own outlook. Even in this context the ECB and BoE are likely to remain dovish far longer than the Fed, proving slow to enter a hiking cycle, which in turn is likely to weigh on the British pound (GBP) and euro (EUR). In addition, though growth in Germany and the UK is expected to shift above trend in 2014, the overall European backdrop is still recovering from a difficult recession. Finally, the flows that have supported the EUR this year are likely to fade, leaving both the EUR and GBP vulnerable to downside risks. The Swiss National Bank is expected to maintain its credible EURCHF floor; while the NOK and the SEK could ultimately be supported by improving growth outlooks and central banks who turn hawkish ahead of the G4.

With the exception of the CNY, which leading into the fourth quarter had gained almost 2% year-to-date, the Asian currencies have depreciated materially in 2013. The Indonesian rupiah, Indian rupee and Japanese yen have been the hardest hit, all down more than 10% year-to-date. It is the domestic landscape that has driven their FX performance. In Japan, Prime Minister Abe's policies combined with an aggressive Bank of Japan have forced a revaluation of the currency. We expect the yen to underperform throughout 2014. In India and Indonesia, structural issues and capital outflows have been the main culprit, but the majority of the market-

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induced adjustment has been completed. The Thai baht, Malaysian ringgit and Philippine peso do not suffer from the same structural issues as India and Indonesia but have been and are likely to continue to be exposed to near term capital outflows. Finally, as China continues to make slow and steady progress towards a more flexible currency regime, we maintain our outlook for a slow and measured pace of CNY appreciation interrupted by periods of complete stability.

In Australia, the central bank has proven itself highly sensitive to Australian dollar (AUD) strength. Accordingly, any currency appreciation is likely to be capped by potential policy action. Much like the CAD, we expect the AUD to weaken into year-end but then stabilize in 2014. We have a more favourable outlook for the New Zealand dollar, mainly as the central bank has introduced a hawkish tone and is widely anticipated to be the first central bank of the advanced economies to enter its hiking cycle.

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Reform Agenda On A Key Plenum

- In November, the Chinese Communist Party will hold the Third Plenary Session (Plenum) of its Central Committee. Since assuming power last November, the Xi-Li leadership has repeatedly portrayed itself as “reformists”. And in this Plenum they are expected to disclose their roadmap for reform in the coming years. Frankly, no matter what is announced during the Plenum, the short-term market impact on the global raw materials sectors will be minimal, in our view; however, the outcome of this Plenum could have significant ramifications for the Chinese economy in the medium term. Therefore, for those investors who follow structural issues of the Chinese economy, we offer a checklist of what, in our view, a successful Plenum would achieve.

Fiscal Reform

- **First, we would consider the Plenum a success even if it were to launch only one reform: fiscal reform.** Many of China’s current economic issues are linked to one simple fact: local governments collect only about 50% of fiscal revenue but are responsible for 85% of fiscal expenditures. And local governments are not allowed to directly issue public debt.

- This arrangement makes local governments reliant on three means to meet their spending obligations: 1) fiscal transfers from the central government, 2) land sales, and 3) debt assumed via local government investment vehicles (LGIV). These three means contribute greatly to three major problems in today’s Chinese economy: 1) fiscal transfers are highly arbitrary and therefore a source of power abuse and corruption; 2) if the local governments have a vested interest in land sales, it leads to high land prices and unsustainably high home prices; and 3) LGIVs are major borrowers from China’s shadow banking system and their borrowing has a structural issue of duration mismatch.

- Therefore, in our view, fiscal reform should tackle these issues from two angles: 1) the central government should shoulder more spending obligations such as social security, healthcare, and education; and 2) provincial governments should be allowed to issue bonds so that they can partially replace LGIV debt with public debt, as this would help mitigate duration risk and reduce the interest burdens of local governments. In essence, we hope the fiscal reform will deleverage local governments and leverage up the central government. China’s overall debt level is not high — even if the overall debt level in the country remains the same, this reform would sharply reduce risks in China’s economic system.

Rural Land and Hukou Reform

- According to Premier Li, the biggest potential for China’s economic growth lies in continuous urbanization. To deepen urbanization, two related reforms are required, in our view. First, in small- and medium-sized cities, household registration (called Hukou) should be open to all people. This means that a farmer could move to those cities and have equal access to local social services and welfare. And, second, farmers who are willing to move to cities should be able to sell and monetize their rights of use of rural land for a consideration that reflects market value. This would give the farmers some initial financial resources to establish themselves as urban residents. To facilitate such land rights transactions, a nationwide land rights registration system would have to be established and various active land right markets would have to be set up.

Institutional Reform

- We believe institutional reform in China should focus on three areas: government, the legal system, and state-owned enterprises (SOEs).

- As in most countries, government reform in China is always ideological, philosophical, and hard to implement, but it is critical for the country’s long-term productivity gain. In essence, we hope the government will change its philosophy of managing economic affairs from “pre-event management” to

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"post-event regulation". In China, the old way is pre-event management, with government agencies approving projects, issuing licences, and administering quotas. Ideally, we think the government should replace these approval processes with simple registration processes and let market forces "approve" projects. The government should instead focus on regulations that foster a fair and competitive market environment. If governments at all levels could trim their size, reduce the number of items to be approved, refrain from direct market intervention, and focus on compliance and enforcement, we believe it would greatly reduce the cost of business and improve the business environment in China.

- Reform of China's legal system is also imperative, in our view. For instance, a major anti-corruption campaign is ongoing in China. Unfortunately, the new leadership seems to have been relying on an old-fashioned political campaign to promote its anti-corruption and austerity agenda. Ideally, the anti-corruption campaign should be institutionalized. A starting point could be to allow local courts and prosecutors to function totally independently from the local governments. An independent anti-corruption organization might also be considered.

- And lastly, reform of SOEs should not be ignored. Focus of the SOE reform could be on two fronts. First, the government should genuinely open up to private investment those sectors that are currently dominated (or even monopolized) by big SOEs. These sectors include, among others, banking, insurance, communications, railways, the electricity grid, oil and gas, and media. Second, big SOEs should pay higher dividends to the government, which should in turn use the additional income to enhance China's social security system.

Financial Reform

- There appears to already be consensus on the goals of financial reform in China: interest rate liberalization, internationalization of the yuan, gradual opening-up of the capital account, securitization of certain bank assets, and development of debt and asset-backed securities markets. We hope the Plenum will reinforce these goals and add new momentum to their implementation.

Demographic Reform

- The relaxation of the one-child policy is widely expected. As a first step, we think the government might allow parents to have a second child if either the husband or the wife is a single child.

Conclusion

- As we wrote upfront, we would consider the Plenum a success as long as it launches fiscal reform to rebalance the fiscal income and spending obligations of the central and local governments. For other reforms, we expect only the declaration of broad reform principles and goals, as many of the reforms discussed above will have to be experimented first and then implemented gradually over a multiple-year timeframe.

- In this note, we have tried to use simple language and logic to present our understanding of China's reform agenda. The reality, however, is not that simple. As Hegel said: "What is rational is actual and what is actual is rational." ("*Was vernünftig ist, das ist wirklich; und was wirklich ist, das ist vernünftig.*") Much of "what is actual" in China, such as the one-child policy, the Hukou system, the closed capital account, interest rate regulation, monopolies in certain sectors, and even the shadow banking system, has inherent rationality. Violating such rationality does pose risks. Also, after years of existence, there are vast vested interests in the current system, and some of the vested interest groups, such as SOE officials, are virtually the same as the current ruling elite. As such, the majority of the reforms mentioned in this note will never be easy and will always be risky. As such, it will be fascinating to see how the Plenum plays out, and how China and the Chinese economy evolve in the coming years.

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Key Data Preview

CANADA

Numbers on Canadian **jobs** for September are due out next week (Oct. 11) and we're anticipating a fairly soft month after 59.2k jobs were added in August. As we discuss in the *Week Ahead* column, it's not as though job gains in the 60k vicinity necessarily are followed by weak numbers (in fact, that only happens ~20% of the time). Context matters too, of course, and as the economy in our view is tracking only modest growth (1.5-2% q/q SAAR), we're not expecting overt strength in the labour market. Our forecast is for no job gain and for the unemployment rate to rise to 7.2%.

Trade data for August (Oct. 8) could be fairly weak as the crude prices for the oil that Canada imports increased (Brent crude, +2.8%) while the crude that Canada exports fell fairly substantially in value (-4% for WCS — see chart). The C$ was flat against the USD but weak for much of the month. We're anticipating that the trade deficit will widen modestly to CAD 1bn from CAD 900m in July.

Canadian **housing starts** data (Oct. 8) have been fairly resilient in the 175-200k range through 2013 (with the exception of a very weak January when starts came in at 161k). We're expecting more of the same in September, anticipating starts to come in at 185k, essentially flat relative to the 180k starts registered in August. The hopper is still full of building permits, and while builders have been fairly cautious compared to last year, they have maintained levels consistent with the quantity of permits issued — which points to a 185k number for September.

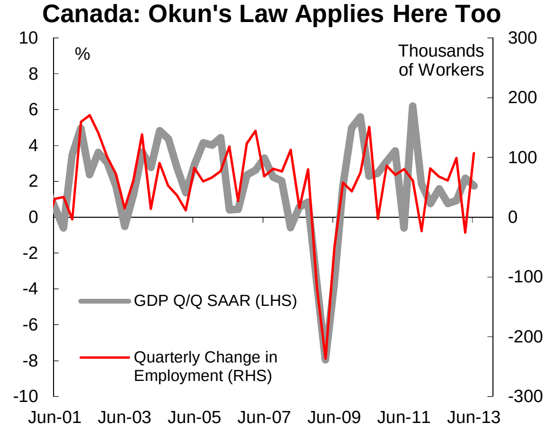
UNITED STATES

While U.S. data may not be released next week (contingent on whether the government shutdown ends), should the government release economic figures, trade and retail sales would both be scheduled to come out.

Retail sales (Oct. 11) could well come in flat or even negative as the ICSC sales index fell, retail gasoline prices fell, and car sales fell. Our official call is for a 0% m/m print with downside risks.

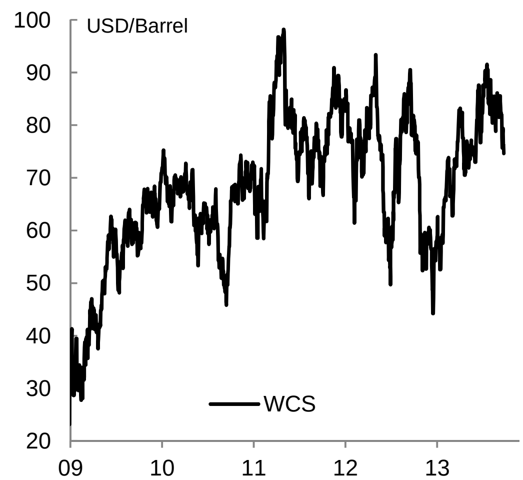
On the **trade** front (Oct. 8), Brent crude prices were up moderately, and the trade weighted USD was weak in August (-1.6%). Commodity foodstuff prices should make up for some of the weakness, but not enough to prevent the trade balance from eroding. Our outlook is for a slight widening of the trade deficit to USD40bn. Note that swings in Brent prices impact the trade deficit less than they used to now that the U.S. is importing less crude (see chart).

Canada: Okun's Law Applies Here Too



Source: Scotiabank Economics, Statistics Canada

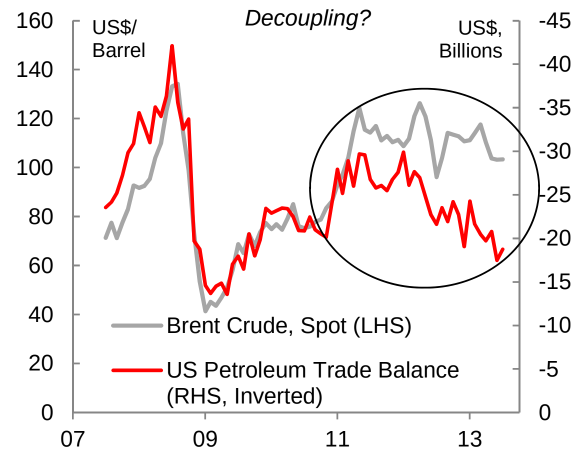
Western Canada Select



Source: Bloomberg, Scotiabank Economics

U.S. Petroleum Trade Balance & Brent Crude

Decoupling?



Source: Bloomberg, Scotiabank Economics

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EUROPE

German factory orders and industrial production (IP) data for August will be released next week (October 8th and 9th, respectively). Real economic activity data continues to fluctuate in the euro area, as opposed to the gradual upward trend in most survey indicators over the last six months. The July orders and IP data in Germany surprised on the downside (2.7% m/m loss in orders, 1.7% fall in IP), after posting strong gains in June. We expect a mild rebound in both indicators this time around, with a 0.8% m/m expansion in factory orders and a 0.6% pick-up in IP. Currency strength (the euro has gained over 6% versus the US dollar since July), higher oil prices and a softer growth outlook in certain key emerging markets are among the factors currently preventing the nascent recovery in the euro area from gaining material traction. Nevertheless, we remain of the view that the bottom of the economic cycle has passed and conditions will continue to gradually improve over the coming quarters.

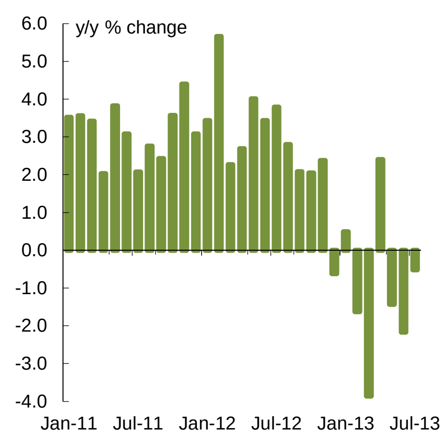
German IP and Factory Orders

Source: Bloomberg.

LATIN AMERICA

Mexican industrial production (IP) has weakened since the beginning of the year contracting (in annual terms) in five out of seven months In July, IP fell for a third consecutive month (-0.5% y/y); however, the pace of decline was the lowest this year. The construction and mining sectors continue to weigh on IP performance, decreasing by 6.3% y/y and by 2.1% y/y in July, respectively. Manufacturing activity and energy generation and distribution components continue to outperform, although at lower growth rates, not being able to offset the negative performance of the other two sectors. We expect IP gains to stabilize in positive territory for the remainder of the year, bringing the 2013 IP growth rate close to 0.6% y/y.

Mexican Industrial Production



Source: Thomson Reuters.

ASIA

Singapore will release preliminary estimates of third-quarter real GDP growth on October 8th; we assess that output grew by around 3½% y/y. The economy expanded by 3.8% y/y in the second quarter of the year following a 0.2% gain in the January-March period. The country's real GDP is on track to increase by 2½% this year as a whole. Economic expansion has lately been driven by domestic demand, though signs are emerging that the external sector is contributing to growth as well. Nevertheless, following solid gains in the second quarter, performance of the export-intensive manufacturing industry — a major contributor to GDP — has been slightly softer in the past three months. Household spending continues to be supported by wage gains that reflect tight labour market conditions, while investment will remain underpinned by public sector infrastructure development. In 2014, the outlook for the trade-dependent Singaporean economy will gradually improve as the global economy recuperates. Real GDP growth is expected to reach 3½% in 2014.

Key Indicators for the week of October 7– 11

North America

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	10/07	08:30	Building Permits (m/m)	Aug	--	-5.7	20.7
US	10/07	15:00	Consumer Credit (US$ bn m/m)	Aug	--	12.0	10.4
CA	10/08	08:15	Housing Starts (000s a.r.)	Sep	185.0	186.5	180.2
CA	10/08	08:30	Merchandise Trade Balance (C$ bn)	Aug	-1.0	-0.6	-0.9
US	10/08	08:30	Trade Balance (US$ bn)	Aug	-40.0	-39.4	-39.1
US	10/08	10:00	IBD/TIPP Economic Optimism Index	Oct	--	44.5	46.0
US	10/09	07:00	MBA Mortgage Applications (w/w)	OCT 4	--	--	-0.4
MX	10/09	09:00	Consumer Prices (m/m)	Sep	0.5	0.4	0.3
MX	10/09	09:00	Consumer Prices (y/y)	Sep	3.6	3.5	3.5
MX	10/09	09:00	Consumer Prices Core (m/m)	Sep	0.37	0.34	0.09
US	10/09	10:00	Wholesale Inventories (m/m)	Aug	--	0.3	0.1
US	10/10	06:59	Treasury Budget (US$ bn)	Sep	--	62.5	-147.9
CA	10/10	08:30	New Housing Price Index (m/m)	Aug	--	0.2	0.2
US	10/10	08:30	Initial Jobless Claims (000s)	OCT 5	310	310	308
US	10/10	08:30	Continuing Claims (000s)	SEP 28	2900	2863	2925
US	10/10	08:30	Export Prices (m/m)	Sep	--	0.2	0.0
US	10/10	08:30	Import Prices (m/m)	Sep	--	0.2	0.0
CA	10/11	08:30	Employment (000s m/m)	Sep	0.0	16.0	59.2
CA	10/11	08:30	Unemployment Rate (%)	Sep	7.2	7.1	7.1
US	10/11	08:30	PPI (m/m)	Sep	--	0.2	0.3
US	10/11	08:30	PPI ex. Food & Energy (m/m)	Sep	--	0.1	0.0
US	10/11	08:30	Retail Sales (m/m)	Sep	0.0	0.1	0.2
US	10/11	08:30	Retail Sales ex. Autos (m/m)	Sep	0.1	0.4	0.1
MX	10/11	09:00	Industrial Production (m/m)	Aug	--	--	-0.1
MX	10/11	09:00	Industrial Production (y/y)	Aug	--	0.2	-0.5
US	10/11	09:55	U. of Michigan Consumer Sentiment	Oct P	77.0	76.0	77.5
US	10/11	10:00	Business Inventories (m/m)	Aug	--	0.3	0.4
CA	10/11	10:30	BoC Senior Loan Officer Survey	3Q	--	--	-12.7
CA	10/11	10:30	Business Outlook Future Sales	3Q	--	--	9.0

Europe

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
GE	10/08	02:00	Current Account (€ bn)	Aug	--	13.0	14.3
GE	10/08	02:00	Trade Balance (€ bn)	Aug	--	15.0	16.1
FR	10/08	02:45	Central Government Balance (€ bn)	Aug	--	--	-80.8
FR	10/08	02:45	Trade Balance (€ mn)	Aug	--	-5000.0	-5109.0
SP	10/08	03:00	Industrial Output NSA (y/y)	Aug	--	--	0.4
GE	10/08	06:00	Factory Orders (m/m)	Aug	0.8	1.0	-2.7
UK	10/09	04:30	Industrial Production (m/m)	Aug	--	0.4	0.0
UK	10/09	04:30	Manufacturing Production (m/m)	Aug	--	0.4	0.2
UK	10/09	04:30	Visible Trade Balance (£ mn)	Aug	--	-8850.0	-9853.0
GE	10/09	06:00	Industrial Production (m/m)	Aug	0.6	1.0	-1.7
FR	10/10	02:45	Industrial Production (m/m)	Aug	--	0.6	-0.6
FR	10/10	02:45	Industrial Production (y/y)	Aug	--	-2.7	-1.8
FR	10/10	02:45	Manufacturing Production (m/m)	Aug	--	0.6	-0.7
IT	10/10	04:00	Industrial Production (y/y)	Aug	--	-4.2	-4.3
UK	10/10	07:00	BoE Asset Purchase Target (£ bn)	Oct	375	375.0	375
UK	10/10	07:00	**BoE Policy Announcement (%)**	Oct 10	**0.50**	**0.50**	**0.50**
GE	10/11	02:00	CPI (y/y)	Sep F	1.4	1.4	1.4
GE	10/11	02:00	CPI - EU Harmonized (y/y)	Sep F	1.6	1.6	1.6
FR	10/11	02:45	Current Account (€ bn)	Aug	--	--	-3.2
SP	10/11	03:00	CPI (y/y)	Sep F	0.3	0.3	0.3
SP	10/11	03:00	CPI - EU Harmonized (y/y)	Sep F	0.5	0.5	0.5
IT	10/11	04:00	CPI - EU Harmonized (y/y)	Sep F	0.9	0.9	0.9

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

Key Indicators for the week of October 7– 11

Asia Pacific

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
JN	10/06	19:50	Official Reserve Assets (US$ bn)	Sep	--	--	1254.2
TA	10/06	20:30	CPI (y/y)	Sep	-0.2	0.1	-0.8
JN	10/07	01:00	Coincident Index CI	Aug P	--	107.6	107.7
JN	10/07	01:00	Leading Index CI	Aug P	--	106.6	107.9
JN	10/07	01:00	New Composite Leading Economic Index	Aug P	--	106.6	107.9
TA	10/07	04:00	Exports (y/y)	Sep	--	-1.2	3.6
TA	10/07	04:00	Imports (y/y)	Sep	--	-0.9	-1.2
TA	10/07	04:00	Trade Balance (US$ bn)	Sep	--	4.2	4.6
JN	10/07	19:50	Current Account (¥ bn)	Aug	--	548.0	577.3
JN	10/07	19:50	Trade Balance - BOP Basis (¥ bn)	Aug	--	-880.0	-943.3
CH	10/07	21:45	HSBC Services PMI	Sep	--	--	52.8
SI	10/08	06:59	Real GDP (y/y)	3Q A	3.5	3.9	3.8
ID	10/08	07:59	**BI Reference Interest Rate (%)**	Oct 8	**7.25**	**7.25**	**7.25**
JN	10/08	07:59	Eco Watchers Survey (current)	Sep	--	52.0	51.2
JN	10/08	07:59	Eco Watchers Survey (outlook)	Sep	--	--	51.2
NZ	10/08	19:00	QV House Prices (y/y)	Sep	--	--	8.5
JN	10/09	02:00	Machine Tool Orders (y/y)	Sep P	--	--	-1.7
NZ	10/09	17:30	Business NZ PMI	Sep	--	--	57.5
JN	10/09	19:50	Bank Lending (y/y)	Sep	--	--	2.0
JN	10/09	19:50	Machine Orders (m/m)	Aug	--	2.5	0.0
JN	10/09	19:50	Tertiary Industry Index (m/m)	Aug	--	0.4	-0.4
AU	10/09	20:00	Consumer Inflation Expectation (%)	Oct	--	--	1.5
AU	10/09	20:30	Employment (000s)	Sep	--	15.0	-10.8
AU	10/09	20:30	Unemployment Rate (%)	Sep	5.8	5.8	5.8
PH	10/09	21:00	Exports (y/y)	Aug	--	18.5	2.3
SK	10/09	21:00	**BoK Base Rate (%)**	Oct 10	**2.50**	**2.50**	**2.50**
MA	10/10	00:01	Industrial Production (y/y)	Aug	--	6.0	7.6
JN	10/10	01:00	Consumer Confidence	Sep	--	43.5	43.0
CH	10/10	06:59	Aggregate Financing (CNY bn)	Sep	--	1200.0	1570.0
CH	10/10	06:59	Foreign Reserves (US$ bn)	Sep	--	3520.0	3496.7
CH	10/10	06:59	New Yuan Loans (bn)	Sep	--	662.1	711.3
IN	10/10	06:59	Exports (y/y)	Sep	--	--	13.00
IN	10/10	06:59	Imports (y/y)	Sep	--	--	-0.68
JN	10/10	19:50	Japan Money Stock M2 (y/y)	Sep	--	3.70	3.70
JN	10/10	19:50	Japan Money Stock M3 (y/y)	Sep	--	3.0	3.0
IN	10/11	08:00	Industrial Production (y/y)	Aug	--	--	2.6

Latin America

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CO	10/05	13:00	Consumer Price Index (m/m)	Sep	--	0.2	0.1
CO	10/05	13:00	Consumer Price Index (y/y)	Sep	2.3	2.2	2.3
CL	10/07	07:30	Economic Activity Index SA (m/m)	Aug	--	0.8	0.0
CL	10/07	07:30	Economic Activity Index NSA (y/y)	Aug	--	3.8	5.3
CL	10/08	07:00	CPI (m/m)	Sep	--	0.5	0.2
CL	10/08	07:00	CPI (y/y)	Sep	2.2	1.9	2.2
BZ	10/09	07:59	**SELIC Target Rate (%)**	Oct 9	**9.50**	**9.50**	**9.00**
BZ	10/09	08:00	IBGE Inflation IPCA (m/m)	Sep	--	0.3	0.2
BZ	10/09	08:00	IBGE Inflation IPCA (y/y)	Sep	6.2	5.9	6.1
PE	10/10	06:59	Trade Balance (USD mn)	Aug	--	--	-486.0
PE	10/10	19:00	**Reference Rate (%)**	Oct	**4.25**	**4.25**	**4.25**

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

Global Auctions for the week of October 7– 11

North America

Country	Date	Time	Event
US	10/07	11:00	U.S. Fed to Purchase USD2.75-3.50 Bln Notes
US	10/07	11:30	U.S. to Sell USD35 Bln 3-Month Bills
US	10/07	11:30	U.S. to Sell USD30 Bln 6-Month Bills
US	10/08	11:00	U.S. Fed to Purchase USD1.25-1.75 Bln Notes
US	10/08	11:30	U.S. to Sell 4-Week Bills
US	10/08	13:00	U.S. to Sell USD30 Bln 3-Year Notes
CA	10/09	12:00	Canada to Sell 3-Year Bonds
US	10/09	13:00	U.S. to Sell USD21 Bln 10-Year Notes Reopening
US	10/10	11:00	U.S. Fed to Purchase USD1.00-1.50 Bln Notes
US	10/10	13:00	U.S. to Sell USD13 Bln 30-Year Bonds Reopening
US	10/11	11:00	U.S. Fed to Purchase USD1.25-1.75 Bln Notes

Europe

Country	Date	Time	Event
NE	10/07	06:00	Netherlands to Sell Up to EUR2 Bln 82-Day Bills
NE	10/07	06:00	Netherlands to Sell Up to EUR2 Bln 264-Day Bills
FR	10/07	08:50	France to Sell Bills
NO	10/08	05:00	Norway to Sell NOK2 Bln 2% 2023 Bonds
NE	10/08	05:00	Netherlands to Sell EUR2.5 Bln 1.25% 2019 Bonds
SZ	10/08	05:30	Switzerland to Sell 182-Day Bills
UK	10/08	05:30	U.K. to Sell GBP1.75 Bln 0.125% I/L 2019 Bonds
SZ	10/09	05:30	Switzerland to Sell Bonds
GE	10/09	05:30	Germany to Sell EUR4 Bln 1% 2018 Bonds
IT	10/10	05:00	Italy to Sell Bills
SW	10/10	05:03	Sweden to Sell I/L Bonds
SW	10/10	05:03	Sweden to Sell Inflation-Linked Bonds
IT	10/11	05:00	Italy to Sell Bonds
BE	10/11	06:00	Belgium to Sell Bonds (OLO ORI)
UK	10/11	06:10	UK to Sell Bills

Asia Pacific

Country	Date	Time	Event
JN	10/07	23:35	Japan to Sell 6-Month Bill
JN	10/07	23:45	Japan to Sell 10-Year Inflation-Linked Bonds
JN	10/08	23:35	Japan to Sell 2-Month Bill
NZ	10/09	21:05	NZ Plans to Sell Nominal Bonds
CH	10/09	23:00	China to Sell 3-Year Savings Bonds
CH	10/09	23:00	China to Sell 5-Year Savings Bonds
CH	10/09	23:00	Jiangsu Muni to Sell CNY7.65 Bln 5-Year Bonds
CH	10/09	23:00	Jiangsu Muni to Sell CNY7.65 Bln 7-Year Bonds
CH	10/09	23:00	Agricul Dev Bank of China to Sell CNY10 Bln 2-Year Bonds
JN	10/09	23:35	Japan to Sell 3-Month Bills
JN	10/09	23:45	Japan to Sell 30-Year Bonds
CH	10/10	23:00	China to Sell CNY15 Bln 91-Day Bills

Source: Bloomberg, Scotiabank Economics.

Events for the week of October 7– 11

North America

Country	Date	Time	Event
US	OCT 7-11		U.S. Data Releases Subject to Delay as a Result of the Government Shutdown
CA	OCT 4-8		Canadian Prime Minister Harper Visits Malaysia, Indonesia
US	10/08	12:25	Fed's Pianalto Speaks on Economy in Pittsburgh
US	10/08	12:30	Fed's Plosser Speaks on Economic Outlook and Monetary Policy
US	10/09	14:00	Fed Releases Minutes from Sept 17-18 FOMC Meeting
US	10/10	09:45	Fed's Bullard to Speak on Monetary Policy in St. Louis
US	10/10	14:30	Fed's Williams Speaks on the Economy in Boise, Idaho
CA	10/11	16:00	Bank of Canada Deputy Governor Murray Speaks on IMF Panel

Europe

Country	Date	Time	Event
IT	OCT 4-5		Prime Minister Letta Attends Conference in Pontignano
IR	OCT 4-5		Global Irish Economic Forum
PO	10/05	04:30	EU's Barroso, Portugal's Coelho to Speak in Algarve, Portugal
EC	10/07	03:15	EU, U.S. Start Second Round of Trans-Atlantic Trade Talks
IT	10/07	05:00	Bank of Italy Report on Balance-Sheet Aggregates
SP	10/07	05:00	Spain Economy Minister Luis de Guindos Speaks at Event
EC	10/07	05:30	ECB's Asmussen Speaks in Potsdam
EC	10/07	05:30	Bundesbank's Ulbrich Speaks at Brussels Think Tank
SW	10/07	05:30	Swedish debt office seminar on banking sector
EC	10/07	07:15	ECB's Praet Speaks at Brussels Think Tank
HU	10/08	02:50	Hungary Eco Minister Varga, Central Bank Chief Matolcsy Speak
PO	10/08	04:00	ECB's Costa Speaks at Lisbon Economist Association Conference
PO	10/08	08:00	Bank of Portugal Releases Autumn Economic Bulletin
EC	10/08	11:00	Germany's Schaeuble, Weidmann Speak in Berlin
EC	10/08	11:45	ECB's Weidmann Speaks in Berlin
UK	10/08		Commons Reconvenes After Conference Recess
PO	10/08		Bank of Portugal Releases Data on Banks
SZ	10/08		SNB President Jordan speaks at Peterson Institute, Washington
PO	10/09	13:00	Portugal's Coelho Speaks at Economist Association Conference
EC	10/09	18:00	ECB's Draghi Speaks in Cambridge, Massachusetts
EC	10/10	05:30	EU's Van Rompuy Speaks at Brussels Think Tank
UK	10/10	07:00	**Bank of England Bank Rate**
UK	10/10	07:00	BOE Asset Purchase Target
SP	10/10	10:00	Spain Economy Minister Speaks at Forum in Washington
EC	10/10	12:20	ECB's Draghi Speaks in New York
EC	10/10	15:00	ECB's Asmussen speaks in Washington
EC	10/11	08:30	ECB's Praet Speaks in Washington
EC	10/11	09:30	EU, U.S. Negotiators Brief Press After Free-Trade Talks
EC	10/11	13:45	ECB's Coeure Speaks in Washington
SZ	10/11	14:00	SNB's Danthine Speaks at Conference in Lugano

Source: Bloomberg, Scotiabank Economics.

Events for the week of October 7– 11

Asia Pacific

Country	Date	Time	Event
ID	SEPT 30-OCT 8		APEC Leaders' Week and Annual Meeting
CH	OCT 4-5		Economist China Summit
ID	OCT 4-7		APEC CEO Summit in Indonesia
CA	OCT 4-8		Canadian Prime Minister Harper Visits Malaysia, Indonesia
NZ	10/06	23:00	N.Z. Government Full-Year Financial Statements
JN	10/07	01:00	Bank of Japan's Monthly Economic Report for October
ID	OCT 7-8		**Bank Indonesia Reference Rate**
JN	10/08	19:50	Bank of Japan September 4-5 meeting minutes
JN	10/08	21:00	BOJ Deputy Governor Nakaso Speaks and Holds Press Conference
ID	OCT 8-10		23rd ASEAN Summit and Related Meetings
SK	10/09	21:00	**BoK 7-Day Repo Rate**
JN	10/10	07:45	Bank of Japan Governor Kuroda speaks at CFR in New York
JN	10/10	12:00	Bank of Japan Governor Kuroda talks at Bretton Woods Committee

Latin America

Country	Date	Time	Event
CO	10/09	01:00	Finance Ministers of the Americas Meet in Washington
BZ	10/09		**Selic Rate**
PE	10/10	19:00	**Reference Rate**

Source: Bloomberg, Scotiabank Economics.

Global Central Bank Watch

North America

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Bank of Canada – Overnight Target Rate	1.00	October 23, 2013	1.00	--
Federal Reserve – Federal Funds Target Rate	0.25	October 30, 2013	0.25	--
Banco de México – Overnight Rate	3.75	October 25, 2013	3.25	--

BoC: In light of the downgrade of Canadian growth expectations delivered in a speech by Senior Deputy Governor Macklem this week, we think there's a decent probability that the BoC will push out its forecast for the closure of the output gap potentially as far out as 2016. **Fed**: Many government statistical bureaus are closed due to the shutdown, making things difficult for the data-dependent Fed. The fiscal uncertainty currently being experienced essentially negates the possibility of an October taper and further highlights our call for tapering to occur in January 2014.

Europe

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
European Central Bank – Refinancing Rate	0.50	November 7, 2013	0.50	--
Bank of England – Bank Rate	0.50	October 10, 2013	0.50	0.50
Swiss National Bank – Libor Target Rate	0.00	December 12, 2013	0.00	--
Central Bank of Russia – Refinancing Rate	8.25	TBA	8.25	--
Hungarian National Bank – Base Rate	3.60	October 29, 2013	3.60	3.40
Central Bank of the Republic of Turkey – 1 Wk Repo Rate	4.50	October 23, 2013	4.50	--
Sweden Riksbank – Repo Rate	1.00	October 24, 2013	1.00	--
Norges Bank – Deposit Rate	1.50	October 24, 2013	1.50	--

We do not anticipate any policy changes from the Bank of England (BoE) next week. Since the last meeting there have been a few more negative data surprises than positive. Nevertheless, after last month's unexpected hawkish turn (which saw two previous dissenters rescind their votes for increased asset purchases), we do not expect the minutes from Thursday's meeting (to be released subsequently) to show any major shift in tone among Monetary Policy Committee members. For more analysis, please see "UK BoE Meeting Preview" by Alan Clarke earlier in this publication.

Asia Pacific

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Bank of Japan – Target Rate	0.10	October 31, 2013	0.10	--
Reserve Bank of Australia – Cash Target Rate	2.50	November 4, 2013	2.50	2.50
Reserve Bank of New Zealand – Cash Rate	2.50	October 30, 2013	2.50	2.50
People's Bank of China – Lending Rate	6.00	TBA	--	--
Reserve Bank of India – Repo Rate	7.50	October 29, 2013	7.50	--
Bank of Korea – Bank Rate	2.50	October 9, 2013	2.50	2.50
Bank of Thailand – Repo Rate	2.50	October 16, 2013	2.50	--
Bank Indonesia – Reference Interest Rate	7.25	October 8, 2013	7.25	7.25

South Korean monetary conditions will likely remain unchanged following the next policy meeting on October 9th, as the Bank of Korea's authorities will allow previous monetary and fiscal stimulus measures to filter through the economy. While a bias towards monetary tightening remains in place in Indonesia, we expect that Bank Indonesia will leave the benchmark interest rate temporarily on hold at its policy meeting on October 8th. The reference rate has been raised by 150 basis points since June in order to control inflation, stabilise the rupiah and limit capital outflows.

Latin America

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
Banco Central do Brasil – Selic Rate	9.00	October 9, 2013	9.50	9.50
Banco Central de Chile – Overnight Rate	5.00	October 17, 2013	5.00	5.00
Banco de la República de Colombia – Lending Rate	3.25	October 25, 2013	3.25	3.25
Banco Central de Reserva del Perú – Reference Rate	4.25	October 10, 2013	4.25	4.25

We maintain our view that the Brazilian central bank will continue to hike the reference rate by another 50 basis points (bps) to 9.50% in the upcoming meeting scheduled for October 9th. This would take the cumulative rate increases to 200 bps since the beginning of the tightening cycle in April. Although inflation decelerated in the last two months from its record high of 6.7% y/y in June, it remains persistently above the 6.0% y/y mark.
We do not anticipate any changes to the reference rate in Peru for the remainder of the year; authorities have been loosening monetary conditions by reducing the reserve requirements in local currency aiming to improve liquidity in soles. Peru's economic activity moderated in the first half of 2013; however, headline inflation remains elevated at 2.8% y/y in September.

Africa

Rate	Current Rate	Next Meeting	Scotia's Forecasts	Consensus Forecasts
South African Reserve Bank – Repo Rate	5.00	November 21, 2013	5.00	--

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

Forecasts as at October 1, 2013*	2000-11	2012	2013f	2014f	2000-11	2012	2013f	2014f
Output and Inflation (annual % change)		Real GDP				Consumer Prices[2]		
World[1]	3.7	3.1	2.8	3.5				
Canada	2.2	1.7	1.6	2.3	2.1	1.5	1.2	1.8
United States	1.9	2.8	1.6	2.6	2.5	2.1	1.6	2.1
Mexico	2.3	3.8	1.9	3.7	4.8	3.6	4.0	4.0
United Kingdom	1.9	0.2	1.5	2.1	2.3	2.7	2.5	2.2
Euro Zone	1.4	-0.6	-0.5	0.7	2.1	2.2	1.2	1.6
Japan	0.8	2.0	2.0	1.8	-0.3	-0.1	0.9	1.5
Australia	3.0	3.7	2.4	2.7	3.1	2.2	2.5	3.0
China	9.4	7.7	7.3	7.3	2.4	2.5	3.0	3.3
India	7.4	5.1	5.0	5.8	6.6	7.3	6.1	6.5
South Korea	4.5	2.0	2.5	3.2	3.2	1.4	1.5	2.8
Thailand	4.0	6.5	3.7	4.0	2.6	3.6	1.7	3.0
Brazil	3.6	0.9	2.3	2.8	6.6	5.8	6.0	6.0
Chile	4.4	5.6	4.6	4.4	3.4	1.5	2.7	3.3
Peru	5.6	6.3	5.7	5.7	2.6	2.6	2.9	3.0

Central Bank Rates (%, end of period)	12Q4	13Q1	13Q2	13Q3f	13Q4f	14Q1f	14Q2f	14Q3f
Bank of Canada	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Federal Reserve	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
European Central Bank	0.75	0.75	0.50	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	3.00	3.00	2.75	2.50	2.50	2.50	2.75	2.75
Exchange Rates (end of period)								
Canadian Dollar (USDCAD)	0.99	1.02	1.05	1.03	1.06	1.07	1.07	1.06
Canadian Dollar (CADUSD)	1.01	0.98	0.95	0.97	0.94	0.93	0.93	0.94
Euro (EURUSD)	1.32	1.28	1.30	1.35	1.31	1.29	1.27	1.25
Sterling (GBPUSD)	1.63	1.52	1.52	1.62	1.55	1.53	1.51	1.50
Yen (USDJPY)	87	94	99	98	103	105	107	109
Australian Dollar (AUDUSD)	1.04	1.04	0.91	0.93	0.90	0.90	0.91	0.92
Chinese Yuan (USDCNY)	6.2	6.2	6.1	6.1	6.1	6.1	6.1	6.1
Mexican Peso (USDMXN)	12.9	12.3	12.9	13.1	13.1	13.0	12.9	12.8
Brazilian Real (USDBRL)	2.05	2.02	2.23	2.22	2.30	2.32	2.35	2.38

Commodities (annual average)	2000-11	2012	2013f	2014f
WTI Oil (US$/bbl)	57	94	100	102
Brent Oil (US$/bbl)	58	112	109	109
Nymex Natural Gas (US$/mmbtu)	5.67	2.83	3.75	4.00
Copper (US$/lb)	2.10	3.61	3.30	3.10
Zinc (US$/lb)	0.77	0.88	0.88	1.05
Nickel (US$/lb)	7.62	7.95	6.95	7.75
Gold, London PM Fix (US$/oz)	668	1,670	1,420	1,325
Pulp (US$/tonne)	718	872	930	900
Newsprint (US$/tonne)	581	640	608	630
Lumber (US$/mfbm)	272	299	350	390

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

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

North America

Canada	2012	13Q1	13Q2	Latest	
Real GDP (annual rates)	1.7	2.2	1.7		
Current Acc. Bal. (C$B, ar)	-62.2	-53.8	-58.3		
Merch. Trade Bal. (C$B, ar)	-12.0	-7.4	-11.6	-11.2	(Jul)
Industrial Production	0.9	0.4	-0.2	0.5	(Jul)
Housing Starts (000s)	215	175	190	180	(Aug)
Employment	1.2	1.7	1.2	1.5	(Aug)
Unemployment Rate (%)	7.3	7.1	7.1	7.1	(Aug)
Retail Sales	2.5	1.0	2.7	3.0	(Jul)
Auto Sales (000s)	1673	1680	1755	1721	(Jul)
CPI	1.5	0.9	0.8	1.1	(Aug)
IPPI	0.6	0.8	0.2	-1.7	(Aug)
Pre-tax Corp. Profits	-4.9	-10.5	-7.9		

United States	2012	13Q1	13Q2	Latest	
Real GDP (annual rates)	2.8	1.1	2.5		
Current Acc. Bal. (US$B, ar)	-440	-420	-396		
Merch. Trade Bal. (US$B, ar)	-741	-718	-703	-703	(Jul)
Industrial Production	3.6	2.4	2.0	2.5	(Aug)
Housing Starts (millions)	0.78	0.96	0.87	0.89	(Aug)
Employment	1.7	1.6	1.6	1.7	(Aug)
Unemployment Rate (%)	8.1	7.7	7.6	7.3	(Aug)
Retail Sales	5.0	3.9	4.7	4.8	(Aug)
Auto Sales (millions)	14.4	15.3	15.5	16.0	(Aug)
CPI	2.1	1.7	1.4	1.5	(Aug)
PPI	1.9	1.5	1.6	1.4	(Aug)
Pre-tax Corp. Profits	18.5	1.4	3.7		

Mexico	2012	13Q1	13Q2	Latest	
Real GDP	3.8	0.6	1.5		
Current Acc. Bal. (US$B, ar)	-14.2	-21.3	-24.0		
Merch. Trade Bal. (US$B, ar)	0.0	-4.1	-3.4	-2.8	(Aug)
Industrial Production	2.8	-1.7	-0.4	-0.5	(Jul)
CPI	4.1	3.7	4.5	3.5	(Aug)

Europe

Euro Zone	2012	13Q1	13Q2	Latest	
Real GDP	-0.6	-1.0	-0.5		
Current Acc. Bal. (US$B, ar)	157	172	281	417	(Jul)
Merch. Trade Bal. (US$B, ar)	127.1	171.6	275.5	321.0	(Jul)
Industrial Production	-2.3	-2.3	-1.1	-2.7	(Jul)
Unemployment Rate (%)	11.3	12.0	12.0	12.0	(Aug)
CPI	2.5	1.9	1.4	1.3	(Aug)

Germany	2012	13Q1	13Q2	Latest	
Real GDP	0.9	-0.3	0.5		
Current Acc. Bal. (US$B, ar)	238.8	237.7	240.0	224.7	(Jul)
Merch. Trade Bal. (US$B, ar)	243.2	266.4	250.7	229.0	(Jul)
Industrial Production	-0.4	-2.4	-0.8	-2.3	(Jul)
Unemployment Rate (%)	6.8	6.9	6.8	6.9	(Sep)
CPI	2.0	1.5	1.5	1.4	(Sep)

France	2012	13Q1	13Q2	Latest	
Real GDP	0.0	-0.5	0.4		
Current Acc. Bal. (US$B, ar)	-57.3	-65.7	-36.2	-25.0	(Jul)
Merch. Trade Bal. (US$B, ar)	-52.0	-47.6	-44.6	-46.9	(Jul)
Industrial Production	-2.5	-2.3	0.2	-1.8	(Jul)
Unemployment Rate (%)	10.3	10.8	10.8	11.0	(Aug)
CPI	2.0	1.1	0.8	0.9	(Aug)

United Kingdom	2012	13Q1	13Q2	Latest	
Real GDP	0.1	0.2	1.3		
Current Acc. Bal. (US$B, ar)	-94.8	-149.2	-75.0		
Merch. Trade Bal. (US$B, ar)	-172.4	-162.2	-155.4	-179.6	(Jul)
Industrial Production	-2.4	-2.6	-0.8	-1.5	(Jul)
Unemployment Rate (%)	8.0	7.8	7.8	7.7	(Jun)
CPI	2.8	2.8	2.7	2.7	(Aug)

Italy	2012	13Q1	13Q2	Latest	
Real GDP	-2.6	-2.5	-2.2		
Current Acc. Bal. (US$B, ar)	-11.3	-31.0	29.0	93.0	(Jul)
Merch. Trade Bal. (US$B, ar)	13.8	14.1	50.0	93.4	(Jul)
Industrial Production	-6.3	-4.3	-3.7	-4.4	(Jul)
CPI	3.1	1.9	1.2	1.0	(Aug)

Russia	2012	13Q1	13Q2	Latest	
Real GDP	3.4	1.6	1.2		
Current Acc. Bal. (US$B, ar)	74.8	25.0	3.4		
Merch. Trade Bal. (US$B, ar)	16.0	16.1	14.2	13.3	(Jul)
Industrial Production	-5.3	-0.1	0.3	0.1	(Aug)
CPI	5.1	7.1	7.2	6.1	(Sep)

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

Source: Bloomberg, Global Insight, Scotiabank Economics.

Asia Pacific

Australia	2012	13Q1	13Q2	Latest
Real GDP	3.7	2.5	2.6	
Current Acc. Bal. (US$B, ar)	-56.8	-40.4	-21.7	
Merch. Trade Bal. (US$B, ar)	5.9	14.3	33.0	22.0 (Aug)
Industrial Production	3.8	3.4	3.9	
Unemployment Rate (%)	5.2	5.5	5.6	5.8 (Aug)
CPI	1.8	2.5	2.4	

Japan	2012	13Q1	13Q2	Latest
Real GDP	2.0	0.1	1.3	
Current Acc. Bal. (US$B, ar)	60.4	66.4	65.9	69.5 (Jul)
Merch. Trade Bal. (US$B, ar)	-86.0	-115.7	-86.7	-97.0 (Aug)
Industrial Production	0.2	-6.5	-3.1	1.1 (Aug)
Unemployment Rate (%)	4.4	4.2	4.0	4.1 (Aug)
CPI	0.0	-0.6	-0.3	0.9 (Aug)

South Korea	2012	13Q1	13Q2	Latest
Real GDP	2.0	1.5	2.3	
Current Acc. Bal. (US$B, ar)	43.1	39.9	79.2	68.8 (Aug)
Merch. Trade Bal. (US$B, ar)	28.3	22.6	57.3	44.6 (Sep)
Industrial Production	1.2	-0.8	-1.7	3.7 (Aug)
CPI	2.2	1.4	1.1	0.8 (Sep)

China	2012	13Q1	13Q2	Latest
Real GDP	10.4	7.7	7.5	
Current Acc. Bal. (US$B, ar)	290.0			
Merch. Trade Bal. (US$B, ar)	230.7	168.1	263.5	342.2 (Aug)
Industrial Production	10.3	8.9	8.9	10.4 (Aug)
CPI	2.5	2.1	2.7	2.6 (Aug)

Thailand	2012	13Q1	13Q2	Latest
Real GDP	6.5	5.4	2.8	
Current Acc. Bal. (US$B, ar)	-1.5	1.5	-6.7	
Merch. Trade Bal. (US$B, ar)	0.5	-0.1	-0.2	2.2 (Aug)
Industrial Production	2.1	3.7	-5.1	-2.1 (Aug)
CPI	3.0	3.1	2.3	1.4 (Sep)

India	2012	13Q1	13Q2	Latest
Real GDP	5.1	4.4	0.0	
Current Acc. Bal. (US$B, ar)	-91.5	-18.1	-21.8	
Merch. Trade Bal. (US$B, ar)	-16.2	-15.1	-16.9	-10.9 (Aug)
Industrial Production	0.7	2.2	-1.1	2.6 (Jul)
WPI	7.5	6.7	4.8	6.1 (Aug)

Indonesia	2012	13Q1	13Q2	Latest
Real GDP	6.2	6.0	5.8	
Current Acc. Bal. (US$B, ar)	-24.4	-5.8	-9.8	
Merch. Trade Bal. (US$B, ar)	-0.1	-0.1	-1.0	0.1 (Aug)
Industrial Production	4.1	9.0	6.1	3.2 (Jul)
CPI	4.3	5.3	5.6	8.4 (Sep)

Latin America

Brazil	2012	13Q1	13Q2	Latest
Real GDP	0.8	1.8	3.2	
Current Acc. Bal. (US$B, ar)	-54.2	-99.2	-74.5	
Merch. Trade Bal. (US$B, ar)	19.4	-20.6	8.3	25.8 (Sep)
Industrial Production	-2.7	1.3	3.3	-0.7 (Aug)
CPI	5.4	6.4	6.6	6.1 (Aug)

Chile	2012	13Q1	13Q2	Latest
Real GDP	5.6	4.5	4.1	
Current Acc. Bal. (US$B, ar)	-0.1	-7.4	-6.5	
Merch. Trade Bal. (US$B, ar)	12.4	2.5	4.9	-6.3 (Aug)
Industrial Production	2.8	3.3	1.4	2.5 (Aug)
CPI	3.0	1.5	1.3	2.2 (Aug)

Peru	2012	13Q1	13Q2	Latest
Real GDP	9.2	4.5	5.6	
Current Acc. Bal. (US$B, ar)	-7.1	-2.7	-3.1	
Merch. Trade Bal. (US$B, ar)	0.5	0.1	-0.2	-0.5 (Jul)
Unemployment Rate (%)	7.0	6.3	5.7	5.6 (Aug)
CPI	3.7	2.6	2.5	2.8 (Sep)

Colombia	2012	13Q1	13Q2	Latest
Real GDP	4.2	2.7	4.2	
Current Acc. Bal. (US$B, ar)	-12.2	-3.2	-2.7	
Merch. Trade Bal. (US$B, ar)	0.4	0.2	0.4	-0.2 (Jul)
Industrial Production	0.1	-6.6	-0.2	0.2 (Jul)
CPI	3.2	1.9	2.1	2.3 (Aug)

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

Source: Bloomberg, Global Insight, Scotiabank Economics.

Interest Rates (%, end of period)

Canada	13Q2	13Q3	Sep/27	Oct/04*	United States	13Q2	13Q3	Sep/27	Oct/04*
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	1.02	0.97	0.97	0.97	3-mo. T-bill	0.03	0.01	0.01	0.02
10-yr Gov't Bond	2.44	2.54	2.56	2.58	10-yr Gov't Bond	2.49	2.61	2.62	2.63
30-yr Gov't Bond	2.90	3.07	3.08	3.12	30-yr Gov't Bond	3.50	3.68	3.69	3.72
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US$B)	70.0	68.8	69.8	(Aug)	FX Reserves (US$B)	135.2	134.7	134.7	(Aug)
Germany					**France**				
3-mo. Interbank	0.14	0.15	0.17	0.16	3-mo. T-bill	0.03	0.06	0.05	0.06
10-yr Gov't Bond	1.73	1.78	1.78	1.83	10-yr Gov't Bond	2.35	2.32	2.34	2.36
FX Reserves (US$B)	66.6	66.1	65.9	(Aug)	FX Reserves (US$B)	52.6	51.4	52.4	(Aug)
Euro Zone					**United Kingdom**				
Refinancing Rate	0.50	0.50	0.50	0.50	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	0.21	0.18	0.09	0.08	3-mo. T-bill	0.39	0.40	0.40	0.40
FX Reserves (US$B)	326.6	324.9	327.8	(Aug)	10-yr Gov't Bond	2.44	2.72	2.71	2.73
					FX Reserves (US$B)	88.4	90.2	90.8	(Aug)
Japan					**Australia**				
Discount Rate	0.30	0.30	0.30	0.30	Cash Rate	2.75	2.50	2.50	2.50
3-mo. Libor	0.09	0.09	0.09	0.09	10-yr Gov't Bond	3.76	3.81	3.86	4.03
10-yr Gov't Bond	0.85	0.69	0.68	0.65	FX Reserves (US$B)	46.7	45.0	46.3	(Aug)
FX Reserves (US$B)	1215.0	1209.4	1219.9	(Aug)					

Exchange Rates (end of period)

USDCAD	1.05	1.03	1.03	1.03	¥/US$	99.14	98.27	98.24	97.07
CADUSD	0.95	0.97	0.97	0.97	US¢/Australian$	0.91	0.93	0.93	0.94
GBPUSD	1.521	1.619	1.614	1.607	Chinese Yuan/US$	6.14	6.12	6.12	6.12
EURUSD	1.301	1.353	1.352	1.360	South Korean Won/US$	1142	1075	1074	1070
JPYEUR	0.78	0.75	0.75	0.76	Mexican Peso/US$	12.931	13.091	13.141	13.134
USDCHF	0.95	0.90	0.91	0.90	Brazilian Real/US$	2.232	2.217	2.252	2.207

Equity Markets (index, end of period)

United States (DJIA)	14910	15130	15258	15011	U.K. (FT100)	6215	6462	6513	6464
United States (S&P500)	1606	1682	1692	1684	Germany (Dax)	7959	8594	8662	8625
Canada (S&P/TSX)	12129	12787	12844	12767	France (CAC40)	3739	4143	4187	4169
Mexico (IPC)	40623	40185	40904	41088	Japan (Nikkei)	13677	14456	14760	14024
Brazil (Bovespa)	47457	52338	53739	52245	Hong Kong (Hang Seng)	20803	22860	23207	23139
Italy (BCI)	849	950	968	984	South Korea (Composite)	1863	1997	2012	1997

Commodity Prices (end of period)

Pulp (US$/tonne)	950	945	945	945	Copper (US$/lb)	3.06	3.31	3.29	3.24
Newsprint (US$/tonne)	605	605	605	605	Zinc (US$/lb)	0.83	0.85	0.85	0.83
Lumber (US$/mfbm)	292	333	359	357	Gold (US$/oz)	1192.00	1326.50	1341.00	1309.75
WTI Oil (US$/bbl)	96.56	102.33	102.87	103.90	Silver (US$/oz)	18.86	21.68	21.61	21.65
Natural Gas (US$/mmbtu)	3.57	3.56	3.59	3.51	CRB (index)	275.62	285.54	286.98	285.98

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

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Foreign Exchange Strategy

Guest Column

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Guest Column

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