

Global Forecast Update



From Recession To Recovery

The global economy is moving from recession to recovery, fuelled by massive government stimulus, an uneven revival in consumer demand and the re-ignition of production as firms react to improving sales prospects. China and a number of other emerging nations have already regained altitude, driving energy and commodity prices higher. At the same time, the U.S., major European nations and Japan are still struggling to achieve takeoff, held back by historically high levels of unemployment, weak consumer confidence and the prospect of a protracted period of convalescence in key sectors such as housing.

In many respects, Canada's domestic economic fundamentals are stronger than those in the U.S. and most other developed nations. Our banking system is widely regarded as the strongest in the world. Our labour market has shown greater resilience, with job losses running about half the rate of decline evident south of the border. Household and corporate sector balance sheets also are in relatively better shape. These factors have supported a rebound in consumer spending and the revival of Canada's housing market, where buyers are taking advantage of historically low interest rates at a time when U.S. residential activity remains deeply mired in recession.

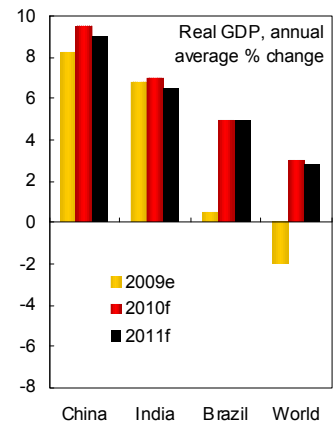
At the same time, Canadian exporters continue to face heavy headwinds, with sales volumes during the summer down roughly 20% from the previous year. Add in steep price declines, and overall receipts have fallen nearly 30%. Commodity producers are beginning to benefit from a rebound in global markets, but with three-quarters of external sales going to the U.S., the pace of recovery will be subdued. The rise in the loonie towards 95 cents(US) — in part, reflecting the recent rebound in commodity prices — also has undercut competitiveness and squeezed earnings. Further Canadian dollar appreciation is likely to act as a drag on domestic economic prospects in 2010 at a time when U.S. exporters — and overall U.S. growth — may receive much-needed support from a broadly based depreciation of the greenback.

While the pathways to recession have differed significantly, both countries will benefit in the months ahead as a plethora of previously announced public infrastructure projects move off the drawing board and into the construction phase. After nearly a year of deep retrenchment, Canadian and U.S. motor vehicle production also is gearing up to replenish depleted dealer inventories now that sales have begun to recover. The impetus from these temporary factors will be sufficient to ensure that both economies achieve lift-off over the winter.

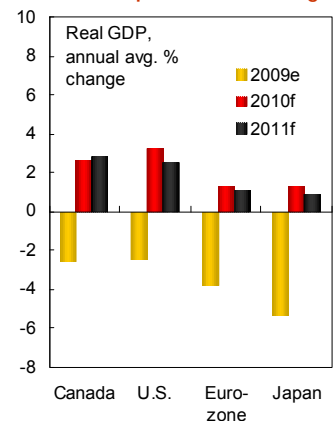
There is a risk of economic relapse in North America and abroad later in 2010 as governments begin unwinding unprecedented monetary and fiscal stimulus. Both the U.S. Federal Reserve and the Bank of Canada

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Developing Economies Lead ...



... Developed Economies Lag





are expected to begin the process of normalizing ultra-low interest rates in mid-2010, gradually raising their benchmark overnight rates by a cumulative two percentage points by the end of the second quarter of 2011.

However, the most likely outcome is not renewed recession, but a fairly turbulent and generally weak take-off. In Canada and the U.S., for example, growth in 2010 will probably be around 3%, doing little more than backfilling the hole created by the steep decline in activity over the past year. Even this modest performance will compare favourably with trends in Europe and Japan, where economic retrenchment has been much deeper and the timetable for regaining lost GDP stretches well beyond 2010.

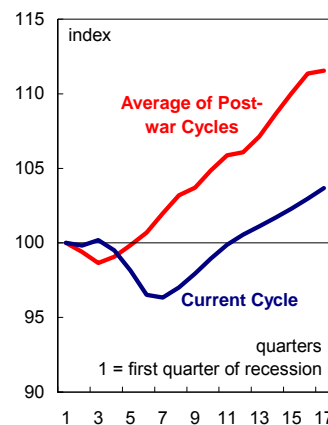
Lingering structural impediments to growth may keep the U.S. and other developed nations on a lower glidepath in 2011. Regulatory reforms and tighter lending practices will restrict leverage and raise funding costs for higher-risk activities. In the U.S., excess capacity and refinancing challenges point to a lengthy recuperation for non-residential construction. U.S. housing activity has bottomed, but prices will continue to be depressed by distressed sales and a huge overhang of unsold properties currently being held off the market until conditions improve.

The U.S. consumer, the lynchpin to recovery and renewed expansion, is unlikely to return to previous high-altitude spending patterns. The 'borrow-to-buy' impetus has given way to debt repayment and a focus on rebuilding savings. Spending enthusiasm is being further undermined by double-digit unemployment rates, rising consumer bankruptcies and a drop of nearly 20% in U.S. household net worth since mid-2007. These factors also will impede progress in reversing Washington's \$1.4 trillion deficit, which is equivalent to about 10% of U.S. GDP.

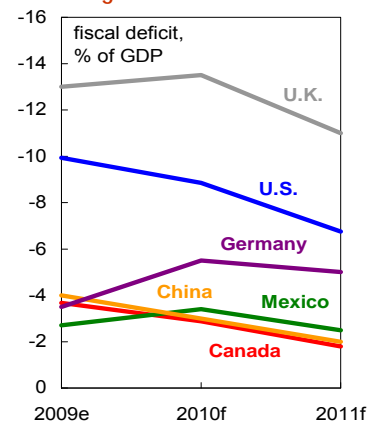
In this environment, China and other fast-growing emerging markets will provide a large share of global locomotion. Even in a year when global output is shrinking by over 2%, China appears to be on track to grow by more than 8% in 2009. Vehicle sales in China will surpass U.S. levels in 2009 and are setting new records in India and Brazil. Trade flows among Asian nations are already double NAFTA levels.

While inflation will continue to be held back by lingering excess capacity in a wide range of industries, financial markets will likely be quite volatile over the next two years. The U.S. dollar is vulnerable to further weakening, with Treasury yields rising from recent extraordinary lows, as the recovery takes hold and global investors diversify away from U.S. asset positions accumulated during the financial crisis. Even though the U.S. dollar is not about to lose its status as the world's reserve currency, gold purchases by central banks in Russia, China and India highlight the quest for investment diversification. Nervousness about continuing to underwrite Washington's fiscal deficit will increase through 2010-11 if the shortfall appears to be stuck above the \$1 trillion threshold. Adding to investor concerns will be a renewed widening of the U.S. trade deficit as the revival in global production boosts demand for industrial commodities and again pushes oil above \$90(US) per barrel. ■

Deeper Downturn, Shallower Recovery



Big Deficits To Persist



North America	2000-08	2009e	2010f	2011f
	(annual % change)			
Canada				
Real GDP	2.6	-2.6	2.7	2.8
Consumer Spending	3.5	0.0	2.4	2.7
Residential Construction	5.3	-8.5	3.5	3.9
Business Investment	4.6	-14.1	1.5	5.7
Government Spending	3.4	4.3	6.4	2.1
Exports	0.9	-14.2	4.1	4.9
Imports	3.9	-13.9	7.4	5.2
Nominal GDP	5.6	-4.6	4.6	4.8
GDP Deflator	2.9	-2.1	1.9	1.9
Consumer Price Index	2.3	0.3	1.7	2.1
Core CPI	1.9	1.7	1.5	2.0
Pre-Tax Corporate Profits	7.7	-33.0	17.5	10.0
Employment	1.9	-1.6	0.7	1.5
thousands of jobs	302	-281	119	258
thousands of jobs (Q4/Q4)	287	-337	235	300
Unemployment Rate (%)	6.9	8.4	8.7	8.4
Current Account Balance (C\$ bn.)	21.0	-44.5	-37.1	-27.2
per cent of GDP	1.7	-2.9	-2.3	-1.6
Merchandise Trade Balance (C\$ bn.)	58.2	-7.2	-1.3	7.5
Federal Budget Balance (C\$ bn.)	8.4	-56.0	-46.0	-30.0
per cent of GDP	0.7	-3.7	-2.9	-1.8
Housing Starts (thousands)	207	142	160	165
Motor Vehicle Sales (thousands)	1,605	1,470	1,525	1,570
Motor Vehicle Production (thousands)	2,590	1,425	1,750	1,850
Industrial Production	0.6	-8.6	3.4	3.2
United States				
Real GDP	2.4	-2.5	3.3	2.5
Consumer Spending	2.8	-0.6	1.7	2.2
Residential Construction	-2.6	-20.4	4.4	6.1
Business Investment	3.0	-17.9	-0.4	4.7
Government Spending	2.3	2.3	5.2	1.1
Exports	4.5	-10.5	6.1	5.9
Imports	4.3	-14.4	5.0	4.8
Nominal GDP	4.9	-1.3	4.5	4.4
GDP Deflator	2.5	1.2	1.2	1.8
Consumer Price Index	2.9	-0.4	2.1	2.3
Core CPI	2.2	1.6	1.4	2.1
Pre-Tax Corporate Profits	5.3	-5.3	13.0	7.0
Employment	0.7	-3.7	0.3	2.2
millions of jobs	0.89	-5.13	0.41	2.87
millions of jobs (Q4/Q4)	0.61	-5.03	2.84	2.67
Unemployment Rate (%)	5.1	9.3	10.1	9.6
Current Account Balance (US\$ bn.)	-601	-438	-521	-580
per cent of GDP	-4.9	-3.1	-3.5	-3.7
Merchandise Trade Balance (US\$ bn.)	-655	-510	-603	-675
Federal Budget Balance (US\$ bn.)	-196	-1,417	-1,320	-1,050
per cent of GDP	-1.5	-9.9	-8.9	-6.7
Housing Starts (millions)	1.65	0.58	0.78	1.14
Motor Vehicle Sales (millions)	16.4	10.2	11.5	12.2
Motor Vehicle Production (millions)	11.5	5.6	7.1	7.4
Industrial Production	1.0	-10.1	3.9	3.5
Mexico				
Real GDP	2.8	-6.8	3.4	3.1
Industrial Production	1.5	-7.9	4.0	3.5
Consumer Price Index (year-end)	5.1	3.8	5.5	4.2
Current Account Balance (US\$ bn.)	-11.4	-9.2	-14.3	-16.5
per cent of GDP	-1.6	-1.0	-1.4	-1.8

Forecast Changes

Canada & United States

- Output growth in Canada should underperform the modest advance expected in the United States next year, largely because of the drag caused by a further erosion in net exports aggravated by a persistently strong Canadian dollar. Domestic-led activity remains quite a bit stronger north of the border as the balance sheets of households, businesses, and financial institutions are in much better shape.
- Employment conditions on both sides of the 49th parallel will be slow to recover in 2010, keeping unemployment rates comparatively high, as businesses focus on raising productivity and restoring profitability.
- U.S. federal budget deficits are likely to remain above US\$1 trillion through fiscal 2011, given the sluggishness in overall growth, ongoing demands for stimulus extensions, possible new job creation incentives, further state government aid, and an expanded military effort. Ottawa's deficits are expected to recede more quickly than the U.S. federal shortfall, with the financial burden relative to Canada's national income narrowing to just under 2% of GDP by FY12.

Mexico

- Mexico is expected to be the NAFTA growth leader over the next two years, benefitting from the industrial recovery in the United States, ongoing support provided by ramped-up monetary and fiscal stimulus, and higher crude oil prices. Excess capacity should limit the inflationary flow-through from indirect tax increases and public sector price revisions, introduced in the recently approved budget package.

International	2000-08	2009e	2010f	2011f
Real GDP (annual % change)				
World	3.3	-2.0	3.1	2.9
United Kingdom	2.4	-4.5	1.2	1.1
Euro zone	1.9	-3.8	1.3	1.1
Germany	1.4	-4.9	1.5	1.1
France	1.9	-2.1	1.5	1.5
Italy	1.1	-4.7	0.4	0.3
Japan	1.4	-5.3	1.3	0.9
Australia	3.2	0.5	2.5	3.0
China	10.0	8.3	9.5	9.0
India	7.3	6.8	7.0	6.5
Korea	4.9	0.2	4.0	4.5
Brazil	3.3	0.5	5.0	5.0
Chile	4.2	-1.5	5.0	5.0
Peru	5.6	1.4	4.2	6.0
Consumer Prices (y/y % change, year-end)				
United Kingdom	2.1	2.3	1.5	2.0
Euro zone	2.2	0.8	1.3	1.8
Germany	1.8	0.7	1.3	1.7
France	2.0	1.0	1.5	2.0
Italy	2.5	0.8	1.7	2.0
Japan	-0.1	-2.0	0.3	0.5
Australia	3.3	2.2	2.5	3.0
China	2.1	-0.2	1.5	2.0
India	5.3	5.5	6.0	5.5
Korea	3.2	3.0	2.5	3.0
Brazil	6.9	4.3	4.8	5.0
Chile	4.0	-1.0	2.8	3.0
Peru	2.7	1.0	3.0	3.0
Current Account Balance (% of GDP)				
United Kingdom	-2.1	-1.1	-1.2	-1.6
Euro zone	0.2	-0.6	-0.6	-0.8
Germany	3.8	2.9	4.0	3.4
France	0.1	-1.5	-1.8	-2.0
Italy	-1.5	-2.3	-2.5	-2.8
Japan	3.3	2.5	3.0	3.1
Australia	-4.9	-2.6	-3.9	-4.6
China	5.5	6.2	4.7	3.5
India	-0.3	-1.2	-2.0	-2.3
Korea	1.5	4.1	2.0	0.4
Brazil	-0.8	-1.2	-2.3	-1.8
Chile	0.5	-1.9	0.5	1.4
Peru	-0.7	1.0	0.5	-0.3
Commodities (annual average)				
WTI Oil (US\$/bbl)	49.93	62	90	92
Nymex Natural Gas (US\$/mmbtu)	6.15	4.15	5.50	5.50
Copper (US\$/lb)	1.72	2.32	2.95	3.30
Zinc (US\$/lb)	0.73	0.74	0.85	0.90
Nickel (US\$/lb)	7.16	6.85	7.45	7.50
Gold, London PM Fix (US\$/oz)	472	975	1,200	1,050
Pulp (US\$/tonne)	662	720	790	850
Newsprint (US\$/tonne)	574	560	580	670
Lumber (US\$/mfbm)	286	178	215	240

Forecast Changes

International

- Emerging Asia will remain the international growth leader. China will lead the way, though the authorities will adopt measures to help stabilize and sustain the comparatively rapid expansion. India's growth is expected to average around 7% through 2011.
- Output growth in the developed economies overseas will be constrained in 2011 by the phasing out of fiscal and monetary stimulus, and persistently high joblessness. Adverse demographics and a massive public sector debt will limit Japan's prospects. Currency strength will constrain the euro zone's growth potential. Massive budget deficits will weigh heavily on the U.K.'s growth outlook.
- Global inflation should be well-contained. The impact of a recovery in oil prices will be offset by subdued growth in domestic spending, still-ample production capacity, and currency strength vis-à-vis the U.S. dollar.
- Brazil's real GDP is expected to average around 5% over the next two years, supported by ongoing fiscal stimulus, improving manufacturing and commodity conditions, and strengthening job gains that will help to buoy domestic spending. Chile and Peru should bounce back strongly, as their comparatively large resource sectors benefit from substantial trade links with the stronger Asian economies.

Commodities

- Global oil supply/demand conditions should gradually tighten in 2010. World petroleum demand will rise by 1.3 mb/d (led by 'emerging' Asia) in the face of non-OPEC supply increases of 0.8 mb/d. Although natural gas prices have recently rallied, new 'game-changing' drilling technology for 'unconventional' shale and tight sands has lowered the industry cost curve, suggesting lower trend prices ahead.
- Gold & silver prices should climb higher over the next six months as the U.S. dollar moves irregularly lower. While copper prices could retreat now that China has built up large stocks, prices will be supported by G7 re-stocking and hedge fund interest.

Provincial	2000-08	2009e	2010f	2011f	2000-08	2009e	2010f	2011f
	Real GDP (annual % change)				Budget Balance, FY March 31* (\$millions)			
Canada	2.6	-2.6	2.7	2.8	10,666	-5,755	-56,000	-46,000
Newfoundland & Labrador	4.6	-4.0	2.9	3.2	-149	2,434	-750	n.a.
Prince Edward Island	1.9	-1.2	1.9	2.0	-25	-33	-85	n.a.
Nova Scotia	2.0	-1.4	2.2	2.1	60	20	-592	n.a.
New Brunswick	2.0	-1.3	2.1	2.3	79	-192	-754	-749
Quebec	2.1	-1.7	2.2	2.5	-128	0	-4,695	n.a.
Ontario	2.4	-3.2	2.7	2.6	-90	-6,409	-24,716	n.a.
Manitoba	2.4	-1.0	2.6	2.7	n.a.	470	48	n.a.
Saskatchewan	2.3	-1.5	2.8	3.1	207	2,389	425	n.a.
Alberta	3.5	-2.6	2.9	3.5	4,837	0	0	n.a.
British Columbia	2.9	-2.5	3.0	2.9	660	78	-2,775	n.a.
	Employment (annual % change)				Unemployment Rate (annual average, %)			
Canada	1.9	-1.6	0.7	1.5	6.9	8.4	8.7	8.4
Newfoundland and Labrador	1.0	-2.8	0.8	1.6	15.4	15.4	15.5	15.0
Prince Edward Island	1.7	-1.7	0.7	1.1	11.3	12.3	12.4	12.1
Nova Scotia	1.3	-0.2	0.5	1.1	8.7	9.2	9.6	9.4
New Brunswick	1.3	0.1	0.6	1.3	9.6	8.9	9.1	8.8
Quebec	1.7	-1.0	0.6	1.3	8.3	8.5	8.9	8.7
Ontario	1.9	-2.5	0.7	1.5	6.5	9.2	9.6	9.3
Manitoba	1.3	0.0	0.5	1.4	4.8	5.1	5.6	5.3
Saskatchewan	0.9	1.4	0.7	1.7	5.1	4.9	5.4	5.1
Alberta	3.0	-1.2	0.8	1.9	4.3	6.6	6.9	6.6
British Columbia	2.2	-2.5	1.0	1.4	6.4	7.7	7.9	7.7
	Housing Starts (annual, thousands of units)				Motor Vehicle Sales (annual, thousands of units)			
Canada	207	142	160	165	1,605	1,470	1,525	1,570
Atlantic	12	11	11	11	113	112	116	120
Quebec	44	43	43	43	405	393	407	419
Ontario	77	48	54	57	615	538	558	572
Manitoba	4	4	5	5	44	43	45	46
Saskatchewan	4	4	4	5	40	46	48	50
Alberta	37	17	22	22	207	188	196	203
British Columbia	29	15	21	22	181	150	155	160

* FY09-FY11 prov. balances: government estimates.

Forecast Changes

Provincial

- Ontario's recovery is taking hold as auto manufacturing rebounds and infrastructure investments accelerate. The province's diversified service sector will underpin growth into 2011.
- After sidestepping the worst of the economic downturn, the recovery in Quebec and the Atlantic provinces through 2011 will be more moderate. Renewed activity in mining and aluminum smelting, plus hydro and wind power projects, should help boost Quebec, with potash development in New Brunswick and the offshore energy sector and nickel processing buoying Newfoundland and Labrador.
- Manitoba's solid economic outlook mirrors its diversified economy and the projected completion of the Wuskwatim hydro installation in 2011. For Saskatchewan, growth should improve by the second half of 2010 as global potash shipments recover and the province benefits from the Bakken light oil play. Alberta should benefit from the reversal of its steep residential construction and retail sales corrections, with work resuming on several heavy oil sands projects in 2010-11.
- The Olympic Games and increasing infrastructure expenditures will lift B.C. output to a 3% gain in 2010. Growth in 2011 will be supported by healthy markets for coal and natural gas development.
- The aggregate provincial deficit is now expected to widen to \$34 billion in fiscal 2009-10 (FY10) and narrow to less than \$30 billion in FY2011 alongside stronger commodity prices and increased expenditure management. The federal/provincial commitment to more competitive corporate taxes, including Ontario's and B.C.'s shift to a Harmonized Sales Tax in July 2010, and N.B.'s tax reform, should assist growth.

Financial Markets	09Q4f	10Q1f	10Q2f	10Q3f	10Q4f	11Q1f	11Q2f	11Q3f	11Q4f
(% , end of period)									
Canada									
BoC Overnight Target Rate	0.25	0.25	0.25	0.75	1.25	1.75	2.25	2.25	2.25
3-month T-bill	0.30	0.35	0.40	1.05	1.75	2.10	2.30	2.25	2.25
2-year Canada	1.10	1.25	1.65	2.10	2.70	2.70	2.60	2.50	2.45
5-year Canada	2.40	2.55	3.10	3.20	3.75	3.85	3.65	3.55	3.45
10-year Canada	3.25	3.60	3.95	4.10	4.50	4.80	4.60	4.55	4.50
30-year Canada	3.80	4.10	4.40	4.60	4.90	5.20	5.00	4.95	4.90
Real GDP (q/q, ann. % change)	3.2	4.3	3.0	2.8	2.6	2.7	2.9	2.9	3.1
Real GDP (y/y, % change)	-1.5	1.2	2.7	3.3	3.2	2.8	2.8	2.8	2.9
Consumer Prices (y/y, % change)	1.0	1.5	1.3	1.9	2.1	2.1	2.1	2.0	2.1
Core CPI (y/y % change)	1.4	1.4	1.3	1.5	1.7	1.9	1.9	2.0	2.1
United States									
Fed Funds Target Rate	0.25	0.25	0.25	0.75	1.25	1.75	2.25	2.25	2.25
3-month T-bill	0.05	0.15	0.35	1.00	1.75	2.10	2.30	2.25	2.25
2-year Treasury	0.80	1.10	1.50	2.00	2.70	2.70	2.60	2.50	2.45
5-year Treasury	2.15	2.35	2.90	3.00	3.60	3.75	3.60	3.55	3.50
10-year Treasury	3.30	3.75	4.15	4.40	4.80	5.10	4.90	4.85	4.80
30-year Treasury	4.25	4.55	4.90	5.10	5.40	5.70	5.50	5.45	5.40
Real GDP (q/q, ann. % change)	3.9	4.2	3.8	2.7	2.3	2.3	2.5	2.6	2.8
Real GDP (y/y, % change)	2.0	2.5	3.7	3.7	3.2	2.8	2.4	2.4	2.5
Consumer Prices (y/y, % change)	0.9	1.9	2.3	2.0	2.1	2.1	2.1	2.3	2.6
Core CPI (y/y % change)	1.3	1.2	1.3	1.4	1.8	1.8	1.9	2.1	2.5
Spreads									
Target Rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month T-bill	0.25	0.20	0.05	0.05	0.00	0.00	0.00	0.00	0.00
2-year	0.30	0.15	0.15	0.10	0.00	0.00	0.00	0.00	0.00
5-year	0.25	0.20	0.20	0.20	0.15	0.10	0.05	0.00	-0.05
10-year	-0.05	-0.15	-0.20	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30
30-year	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
Central Bank Rates									
European Central Bank	1.00	1.00	1.25	1.50	1.75	2.00	2.00	2.00	2.00
Bank of England	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.50	1.50
Swiss National Bank	0.25	0.25	0.50	0.75	1.00	1.00	1.25	1.25	1.50
Bank of Japan	0.10	0.10	0.10	0.10	0.25	0.25	0.25	0.50	0.50
Reserve Bank of Australia	3.75	4.00	4.25	4.50	4.75	5.00	5.00	5.00	5.00
Exchange Rates									
Canadian Dollar (USD/CAD)	1.04	1.02	1.00	0.98	0.97	0.97	0.96	0.95	0.95
Canadian Dollar (CAD/USD)	0.96	0.98	1.00	1.02	1.03	1.03	1.04	1.05	1.05
Euro (EUR/USD)	1.50	1.53	1.56	1.58	1.60	1.60	1.59	1.58	1.57
Euro (EUR/GBP)	0.91	0.93	0.94	0.95	0.95	0.94	0.94	0.94	0.94
Sterling (GBP/USD)	1.65	1.65	1.66	1.67	1.68	1.70	1.70	1.68	1.67
Yen (USD/JPY)	87	90	88	86	85	86	87	89	90
Australian Dollar (AUD/USD)	0.93	0.94	0.96	0.98	0.99	1.00	1.00	1.01	1.01
Chinese Yuan (USD/CNY)	6.8	6.7	6.6	6.5	6.4	6.3	6.2	6.1	6.0
Mexican Peso (USD/MXN)	13.3	13.5	13.6	13.7	13.8	13.9	13.9	14.0	14.2
Brazilian Real (USD/BRL)	1.75	1.79	1.82	1.86	1.90	1.92	1.95	1.97	2.00

Scotia Economics

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