

# Global Forecast Update



## Recovery Road Less Travelled

The global recovery is gaining traction, with unprecedented and highly synchronized monetary and fiscal stimulus internationally continuing to provide much-needed fuel for growth. Reinforcing the momentum is a massive cyclical shift from inventory liquidation to inventory accumulation, as increasing domestic sales and rising foreign trade are encouraging businesses around the world to raise their production sights.

Against this improving backdrop, we expect global growth to average 3% in 2010-11, following last year's contraction of 2%. Nevertheless, the combined results are more than a full percentage point below the average output gain incurred during the first two years of prior recoveries. Fundamental structural adjustments will drag on growth for many years to come. Although progress has been made to redress the financial and economic imbalances that exacerbated the downturn, there is still significant excess capacity in many sectors and regions internationally that is being worked off, and current high levels of private and public indebtedness that will require an extended period of repair.

From an international perspective, the developing economies that were least affected by the credit crisis — yet still implemented meaningful stimulus initiatives — are posting stronger economic results. Output growth in the developing economies is being led by China's resurgence, where growth is expected to advance 9½% in 2010 and 9% in 2011, a pace roughly four times greater than the expected increase in the developed countries. Many of these countries, including India and Brazil — regional growth locomotives in their own right — are pursuing policies aimed at promoting faster domestic growth as per their G20 commitments, a development that is helping to speed up the rebalancing of global demand.

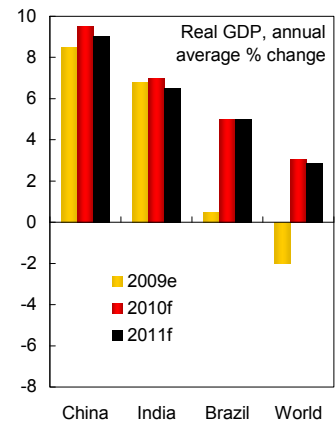
In contrast, the rebound in the developed nations will be far more subdued, not only relative to the performance of the developing nations in the current cycle, but also to the results they experienced in previous recovery periods. We expect that the output growth of the developed world will advance at a comparatively subdued rate of about 2¼% in 2010 and 2011, roughly a third of the performance anticipated among the developing nations.

Real GDP growth in the globe's largest economy, the United States, is estimated to average 3.3% and 2.5% respectively this year and next. Cyclical forces of recovery have witnessed an important upturn in confidence, a resumption in spending and production tied to the significant stimulus initiatives, and an important stabilization in the labour market. We now expect that annualized growth in the final three months of 2009 to have ballooned to around 5½% on the back of a sharp slowdown in the rate of inventory liquidation, with the shift to accumulation sustaining the renewed momentum in the first half of this year.

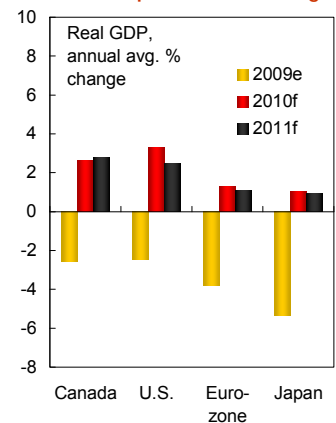
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### Developing Economies Lead ...



### ... Developed Economies Lag



However, a number of growth-inhibiting factors will constrain America's growth performance in 2011 and beyond. Prior overbuilding in the housing sector, combined with a slower pace of credit expansion as the financial sector focuses on rebuilding balance sheets and dealing with increased regulation and capital requirements, will continue to have a material impact on residential activity — one of the key drivers of U.S. growth in the past decade. U.S. households are focussing on reducing large debt burdens and rebuilding low savings, while U.S. businesses, many of which are affected by overcapacity in the retail and wholesale sectors, are expected to continue to consolidate their operations, and pursue export opportunities overseas. With the cyclical recovery unfolding, government officials will begin the process of weaning the economy off exceptionally accommodative monetary and fiscal policies. Other developed countries, the United Kingdom, Ireland and Spain, for example, face similar longer-term restraints on growth due to the unwinding of massive overbuilding and excessive leverage associated with their respective property booms.

Canadian output growth is expected to advance 2.7% in 2010 and 2.8% in 2011, slightly below expectations for the U.S. economy this year, but slightly above next year. Historically, Canada's growth trends track U.S. developments quite closely, in view of a large bilateral trade relationship and closely aligned monetary policies. And this cycle will likely be true to form, with the country's overall performance constrained by a lack of any material improvement in net trade — a function of the sluggishness in U.S.-destined exports and a strong Canadian dollar. However, Canada's domestically generated growth will be considerably faster than in the United States, owing to much stronger balance sheets in the household, business, and financial sectors that give Canadians more flexibility.

Deflationary conditions have largely been avoided, with the important exception of Japan. With global growth on the mend, many key commodity prices will continue to rise, especially with China and other developing nations adding to their strategic stockpiles (especially of oil). However, inflation pressures will be slow to develop in a world still dominated by significant excess capacity in product markets, and business caution with regard to rehiring.

In this environment, the Reserve Bank of Australia and the Norges Bank will continue to gradually lift their benchmark rates. But for most other central banks, the process of normalizing the emergency level of short-term interest rates should begin around mid-year — led by the ECB, but quickly followed by the Federal Reserve and the Bank of Canada, and belatedly by the Bank of England and the Bank of Japan. Overall, we continue to expect that the Fed will raise the overnight funds rate by 2 percentage points by mid-2011, after which they are likely to remain on hold as the U.S. economy adjusts to a slower growth trajectory. U.S. bond yields should continue to trend higher against a backdrop of a revival in private sector credit demands, a less accommodative central bank stance, and the massive financial requirements associated with large and sustained government deficits.

The prospect of a multi-year period of trillion dollar deficits in the United States should continue to weigh heavily on the U.S. dollar against most currencies through 2011. The Canadian and Australian dollars will likely strengthen further against the greenback, reflecting comparatively sounder fiscal positions and expectations of stronger commodity-related exports. With the U.S. economy outpacing the euro zone, the United Kingdom, and Japan as the year progresses, the Federal Reserve will begin tightening policy more aggressively than its overseas counterparts later this year and early next, leading to some stabilization in the dollar, though it will likely end both years at lower levels than at present. *Further details are available in Scotia Economics' "Foreign Exchange Outlook" report (January 2010) [http://www.scotiacapital.com/English/bns\\_econ/fxout.pdf](http://www.scotiacapital.com/English/bns_econ/fxout.pdf). ■*

North America	2000-08	2009e	2010f	2011f
	(annual % change)			
<b>Canada</b>				
Real GDP	2.6	-2.5	2.7	2.8
Consumer Spending	3.5	0.1	2.4	2.7
Residential Construction	5.3	-8.5	3.6	3.6
Business Investment	4.6	-14.7	0.5	5.4
Government Spending	3.4	4.2	6.0	2.1
Exports	0.9	-14.2	3.9	5.7
Imports	3.9	-13.9	7.2	5.7
Nominal GDP	5.6	-4.6	4.7	4.9
GDP Deflator	2.9	-2.1	2.0	2.0
Consumer Price Index	2.3	0.3	1.7	2.1
Core CPI	1.9	1.8	1.6	2.0
Pre-Tax Corporate Profits	7.7	-33.0	23.0	16.0
Employment	1.9	-1.6	0.8	1.6
thousands of jobs	302	-272	139	277
thousands of jobs (Q4/Q4)	287	-299	238	299
Unemployment Rate (%)	6.9	8.3	8.5	8.2
Current Account Balance (C\$ bn.)	21.0	-44.6	-37.3	-26.3
per cent of GDP	1.7	-2.9	-2.3	-1.6
Merchandise Trade Balance (C\$ bn.)	58.2	-7.3	-1.5	8.3
Federal Budget Balance (C\$ bn.)	8.4	-56	-46	-30
per cent of GDP	0.7	-3.7	-2.9	-1.8
Housing Starts (thousands)	207	143	168	172
Motor Vehicle Sales (thousands)	1,605	1,461	1,525	1,570
Motor Vehicle Production (thousands)	2,590	1,425	1,900	2,050
Industrial Production	0.6	-8.6	3.4	3.2
<b>United States</b>				
Real GDP	2.4	-2.4	3.3	2.5
Consumer Spending	2.8	-0.6	1.8	2.2
Residential Construction	-2.6	-20.7	3.6	6.1
Business Investment	3.0	-18.1	-0.6	4.7
Government Spending	2.3	2.2	5.2	1.1
Exports	4.5	-10.4	7.1	5.9
Imports	4.3	-14.4	5.0	4.8
Nominal GDP	4.9	-1.3	4.5	4.3
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	-5.2	18.0	12.5
Employment	0.7	-3.7	0.4	2.2
millions of jobs	0.89	-5.04	0.55	2.86
millions of jobs (Q4/Q4)	0.61	-4.76	2.78	2.67
Unemployment Rate (%)	5.1	9.2	10.0	9.4
Current Account Balance (US\$ bn.)	-601	-435	-505	-562
per cent of GDP	-4.9	-3.1	-3.4	-3.6
Merchandise Trade Balance (US\$ bn.)	-655	-510	-592	-663
Federal Budget Balance (US\$ bn.)	-196	-1,417	-1,320	-1,100
per cent of GDP	-1.5	-9.9	-8.9	-7.1
Housing Starts (millions)	1.65	0.56	0.73	1.08
Motor Vehicle Sales (millions)	16.4	10.4	11.5	12.2
Motor Vehicle Production (millions)	11.5	5.6	7.2	7.5
Industrial Production	1.0	-10.1	3.9	3.5
<b>Mexico</b>				
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

- Our forecast for Canadian and U.S. GDP growth for 2010 and 2011 is unchanged from our prior Update, though we have made modest adjustments to the quarterly output pattern. Canada is expected to underperform the U.S. this year despite its more resilient consumer and housing sectors, as the strong Canadian dollar contributes to a further erosion in net exports.
- We have lifted our forecast of Canadian housing starts this year and next to 168,000 and 172,000 units, respectively. Strong home sales and falling inventories have led to a sharp pick-up in building permit issuance in recent months. We have reduced slightly our expectations for U.S. housing starts in both years amid continuing weak conditions south of the border.
- A stronger-than-expected rebound in vehicle production is bolstering momentum in manufacturing activity across North America. Automakers have scheduled a sequential 8% quarter-to-quarter jump in assemblies in the opening months of 2010 and a sharp 70% y/y surge above the depressed levels of early 2009, when many plants were closed due to excessive inventories.
- Our forecast is unchanged for annual U.S. federal budget deficits wider than US\$1 trillion through fiscal 2011, with no easing in pressures such as state governments' need for additional federal aid. In Canada, as Ottawa looks towards a March 4th *Budget*, the year-over-year decline in revenues for the first seven months of fiscal 2009-10 is close to 12%, compared with the government's estimate of a 7% drop for the entire fiscal year.

### Mexico

- Growth in Mexico should rebound significantly in 2010, as accommodative public policies underpin domestic activity, and the U.S. and global recoveries boost industrial output and exports.

International	2000-08	2009e	2010f	2011f
<b>Real GDP (annual % change)</b>				
World	3.3	-2.0	3.1	2.9
United Kingdom	2.4	-4.6	1.4	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	1.6	1.5
Italy	1.1	-4.6	0.7	0.4
Japan	1.4	-5.3	1.0	0.9
Australia	3.2	0.8	2.8	3.0
China	10.1	8.5	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
<b>Consumer Prices (y/y % change, year-end)</b>				
United Kingdom	2.1	2.3	1.5	2.0
Euro zone	2.2	0.9	1.3	1.8
Germany	1.8	0.8	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	2.0	2.5
India	5.3	5.5	6.0	5.5
Korea	3.2	2.8	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
<b>Current Account Balance (% of GDP)</b>				
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	3.9	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	6.7	5.4	4.2
India	-0.4	-1.2	-2.0	-2.3
Korea	1.5	5.3	2.0	0.4
Brazil	-0.8	-1.2	-2.3	-1.8
Chile	0.5	-1.9	0.5	1.3
Peru	-0.7	0.9	0.5	-0.2
<b>Commodities (annual average)</b>				
WTI Oil (US\$/bbl)	49.93	61.78	90	92
Nymex Natural Gas (US\$/mmbtu)	6.15	4.15	5.50	5.50
Copper (US\$/lb)	1.72	2.34	2.95	3.30
Zinc (US\$/lb)	0.73	0.75	0.85	0.90
Nickel (US\$/lb)	7.16	6.50	7.45	7.50
Gold, London PM Fix (US\$/oz)	472	973	1,100	1,000
Pulp (US\$/tonne)	662	720	790	850
Newsprint (US\$/tonne)	574	560	563	655
Lumber (US\$/mfbm)	286	178	215	240

## Forecast Changes

### International

- The ongoing recovery in housing prices may provide a modest lift to U.K. growth in 2010, though post-election fiscal retrenchment will weigh on the 2011 results.
- Downward revisions to third-quarter Japanese national accounts data foreshadow muted growth over the next two years.
- Elevated commodity prices and widespread increases in government fees (as part of the process of fiscal retrenchment) will push headline consumer inflation rates higher through 2011.
- Brazil, Chile and Peru are expected to post strong economic results and lead countries in the developing Americas this year. The regional rebound is being supported by the nascent recovery underway around the world, continued firming in commodity markets and expanded trade and investment links with Asia.

### Commodities

- WTI oil prices have strengthened in early January to US\$83 per barrel. A global cold front, affecting much of the United States, Britain and parts of Asia (northern China, South Korea and India) has boosted demand for heating oil. U.S. middle distillate stocks are declining, with overall petroleum product inventories now only 1.4% above a year earlier. Gains in Purchasing Manager Indices in the United States, China and India also point to rising industrial demand.
- Copper and other base metal prices are also starting 2010 on a strong note. While a strike at Codelco's Chuquicamata mine (the second-largest copper mine in the world) has now been resolved, prices remain at a 17-month high. China has restocked copper, though much of this inventory is 'willingly' held and solid medium-term fundamentals point to ongoing interest by investment funds.

Provincial	2000-08	2009e	2010f	2011f	2000-08	2009e	2010f	2011f
	<u>Real GDP</u> (annual % change)				<u>Budget Balance, FY March 31*</u> (\$millions)			
<b>Canada</b>	2.6	-2.5	2.7	2.8	10,666	-5,755	-56,000	-46,000
Newfoundland & Labrador	4.6	-4.0	2.9	3.3	-149	2,434	-750	n.a.
Prince Edward Island	1.9	-1.2	1.9	2.1	-25	-33	-85	n.a.
Nova Scotia	2.0	-1.4	2.3	2.2	60	20	-592	n.a.
New Brunswick	2.0	-1.3	2.1	2.3	79	-192	-754	-749
Quebec	2.1	-1.7	2.4	2.4	-128	0	-4,695	n.a.
Ontario	2.4	-3.2	2.9	2.5	-90	-6,409	-24,716	n.a.
Manitoba	2.4	-1.0	2.6	2.8	n.a.	470	-592	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.
	<u>Employment</u> (annual % change)				<u>Unemployment Rate</u> (annual average, %)			
<b>Canada</b>	1.9	-1.6	0.8	1.6	6.9	8.3	8.5	8.2
Newfoundland and Labrador	1.0	-2.5	0.8	1.6	15.4	15.5	15.6	15.2
Prince Edward Island	1.7	-1.0	0.7	1.1	11.3	12.0	12.1	11.9
Nova Scotia	1.3	-0.1	0.5	1.1	8.7	9.2	9.5	9.2
New Brunswick	1.3	0.1	0.6	1.3	9.6	8.9	9.1	8.7
Quebec	1.7	-1.0	0.6	1.4	8.3	8.5	8.8	8.5
Ontario	1.9	-2.4	0.8	1.5	6.5	9.0	9.2	8.9
Manitoba	1.3	0.0	0.5	1.4	4.8	5.2	5.6	5.3
Saskatchewan	0.9	1.5	0.7	1.7	5.1	4.8	5.1	4.8
Alberta	3.0	-1.3	0.9	2.0	4.3	6.6	6.8	6.5
British Columbia	2.2	-2.4	1.0	1.6	6.4	7.6	7.9	7.6
	<u>Housing Starts</u> (annual, thousands of units)				<u>Motor Vehicle Sales</u> (annual, thousands of units)			
<b>Canada</b>	207	143	168	172	1,605	1,470	1,525	1,570
Atlantic	12	11	11	11	113	112	116	120
Quebec	44	42	43	43	405	393	407	419
Ontario	77	49	58	60	615	538	558	572
Manitoba	4	4	5	5	44	43	45	46
Saskatchewan	4	4	5	5	40	46	48	50
Alberta	37	18	24	25	207	188	196	203
British Columbia	29	15	22	23	181	150	155	160

\* FY09-FY11 prov. balances: government estimates.

## Forecast Changes

### Provincial

- As anticipated, Ontario has entered 2010 with significant momentum, with the re-ignition of the province's auto sector. A pronounced rebound in retail sales has also emerged, fuelling growth even further. The province's growth is expected to level off in the second half of 2010, leading to a moderate advance in 2011.
- Quebec's manufacturing sector has also picked up traction heading into 2010, trailing only Ontario in shipments growth since the lows recorded in both provinces in mid-2009. The scheduled one percentage point increase in the Quebec Sales Tax set for January 2011 is expected to encourage consumer spending in late 2010 followed by some easing in outlays early in 2011.
- Nova Scotia's exports will be fuelled by increased production at the recently completed Deep Panuke natural gas field. Estimates indicate that production volumes this year will rise to levels not seen since 2004.
- Employment in Quebec, Ontario and British Columbia has shown a slight upward trend over the past few months, while the rest of the provinces are now starting to gain momentum heading into 2010 — Alberta and Newfoundland in particular.
- The expected pick-up in resource receipts will assist several Provinces in narrowing their budget shortfalls for fiscal 2010-11 (FY11), following the aggregate deficit of close to \$35 billion in FY10 projected by the respective Provinces.

Financial Markets	09Q4e	10Q1f	10Q2f	10Q3f	10Q4f	11Q1f	11Q2f	11Q3f	11Q4f
(% , end of period)									
<b>Canada</b>									
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	0.31	0.35	0.75	1.05	1.75	2.10	2.30	2.25	2.25
2-year Canada	1.47	1.65	1.75	2.10	2.70	2.70	2.60	2.50	2.45
5-year Canada	2.76	3.00	3.10	3.20	3.70	3.85	3.65	3.55	3.45
10-year Canada	3.61	3.70	3.85	4.10	4.50	4.80	4.60	4.55	4.50
30-year Canada	4.08	4.40	4.50	4.60	4.90	5.20	5.00	4.95	4.90
Real GDP (q/q, ann. % change)	3.4	4.2	3.2	2.8	2.6	2.7	2.9	2.9	3.1
Real GDP (y/y, % change)	-1.4	1.2	2.8	3.4	3.2	2.8	2.8	2.8	2.9
Consumer Prices (y/y, % change)	0.9	1.4	1.3	1.9	2.1	2.1	2.1	2.1	2.2
Core CPI (y/y % change)	1.6	1.5	1.5	1.7	1.7	1.9	1.9	2.0	2.1
<b>United States</b>									
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	0.08	0.35	0.65	1.00	1.75	2.10	2.30	2.25	2.25
2-year Treasury	1.14	1.40	1.50	2.00	2.70	2.70	2.60	2.50	2.45
5-year Treasury	2.68	2.90	3.00	3.10	3.60	3.75	3.60	3.55	3.50
10-year Treasury	3.84	4.00	4.15	4.40	4.80	5.10	4.90	4.85	4.80
30-year Treasury	4.64	4.85	5.00	5.10	5.40	5.70	5.50	5.45	5.40
Real GDP (q/q, ann. % change)	5.5	4.1	3.1	2.6	2.3	2.3	2.5	2.6	2.8
Real GDP (y/y, % change)	2.0	2.7	3.7	3.8	3.0	2.6	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
<b>Spreads</b>									
Target Rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month T-bill	0.23	0.00	0.10	0.05	0.00	0.00	0.00	0.00	0.00
2-year	0.33	0.25	0.25	0.10	0.00	0.00	0.00	0.00	0.00
5-year	0.08	0.10	0.10	0.10	0.10	0.10	0.05	0.00	-0.05
10-year	-0.23	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30
30-year	-0.56	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
<b>Central Bank Rates</b>									
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	0.10	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
<b>Exchange Rates</b>									
Canadian Dollar (USD/CAD)	1.05	1.02	1.00	0.98	0.97	0.97	0.96	0.95	0.95
Canadian Dollar (CAD/USD)	0.95	0.98	1.00	1.02	1.03	1.03	1.04	1.05	1.05
Euro (EUR/USD)	1.43	1.50	1.55	1.53	1.53	1.51	1.49	1.47	1.46
Euro (EUR/GBP)	0.89	0.91	0.94	0.92	0.92	0.92	0.91	0.91	0.90
Sterling (GBP/USD)	1.62	1.64	1.65	1.66	1.67	1.65	1.63	1.62	1.62
Yen (USD/JPY)	93	90	88	87	87	89	90	91	92
Australian Dollar (AUD/USD)	0.90	0.93	0.94	0.96	0.97	0.98	0.99	1.00	1.00
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)	13.1	13.4	13.5	13.7	13.8	13.9	13.8	13.9	14.0
Brazilian Real (USD/BRL)	1.74	1.78	1.82	1.86	1.90	1.92	1.95	1.97	2.00

**Scotia Economics**

Scotia Plaza 40 King Street West, 63rd Floor  
 Toronto, Ontario Canada M5H 1H1  
 Tel: (416) 866-6253 Fax: (416) 866-2829  
 Email: [scotia\\_economics@scotiacapital.com](mailto:scotia_economics@scotiacapital.com)