

Global Forecast Update



QE2 Sets Sail

We have made minimal changes this month to our global macroeconomic and financial market forecasts. Output growth was raised slightly this year for the U.K. and Germany — with the latter contributing to a small upward revision in euro zone growth as well — reflecting the improved third-quarter performances, with base effect adjustments lifting next year's smaller output gain slightly as well. Our real GDP forecasts for the United States and Canada were left essentially unchanged, as were the much stronger performances expected in the emerging markets internationally.

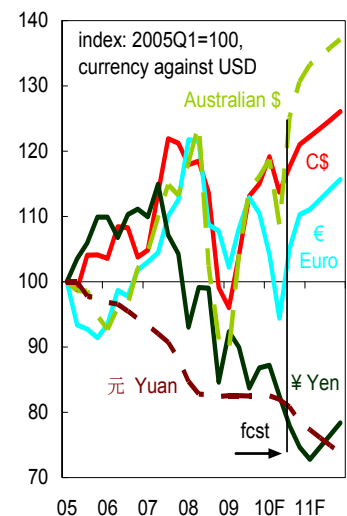
Our core messages remain the same:

- First, around the world, output is transitioning to a slower lane of growth, with downside risks more acute in many of the highly indebted developed nations.
- Second, activity in the Asia-Pacific region and Latin America will continue to post comparatively stronger growth and inflation performances next year, thereby underpinning the demand for, and prices of, commodities.
- Third, price pressures are still unwinding throughout much of the industrialized world, with excess capacity in product and labour markets continuing to offset any tax, regulatory, or commodity-related increases.
- Fourth, monetary policy is expected to remain exceptionally accommodative well into 2011. This is the case throughout most of the developed world where excess labour and industrial capacity persists. In contrast, China, India, and Australia have recently raised their official overnight rates in response to still-strong output growth and incipient price pressures.
- And fifth, the U.S. dollar is expected to remain under pressure, part of the longer-term adjustments needed to help America's yawning savings and investment imbalance.
- With both short- and long-term interest rates already at historically low levels throughout much of the world, the United States, Japan, and potentially the U.K. are again resorting to 'Quantitative Easing' as a means to promote even easier financial market conditions and to reverse the slowdown in both economic growth and inflation. The Federal Reserve announced on November 3 that it would expand its holdings of government securities by an additional US\$600 billion over the next eight months to mid-2011, on top of the reinvestment of almost \$300 billion in principal payments on its existing holdings.

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US\$ — Adjusting Lower





This second round of 'money printing' should reinforce the weakening trend in the greenback against its major trading partners. The Australian dollar is expected to be an outperformer, with the currency's attractiveness enhanced by renewed central bank tightening, and a resource-based economy tied to the strength of the Asia-Pacific region. Notwithstanding official efforts to cheapen the yen, significant capital repatriation is bolstering inflows to Japan. Although fiscal retrenchment will dampen growth prospects in Europe, the euro should benefit from widening short-term rate differentials, the continuing strong economic performance of Germany, and the region's comparatively earlier fiscal consolidation.

Even with the Bank of Canada on hold, the Canadian dollar should continue to strengthen vis-à-vis the greenback, piggybacking on the upward bias in commodity prices associated with stronger growth overseas. The rise in sterling should be more modest than those in the other advanced nations, with the Bank of England potentially easing policy further to offset the drag associated with the significant fiscal restraint being undertaken nationally. Overseas, China's yuan should continue to appreciate, reflecting the country's fundamental strengths of strong growth, large current account surpluses, hefty foreign exchange reserves, and a gradual tightening of credit conditions.

For a more complete analysis of foreign exchange trends, please refer to the just-released November 2010 edition of the *Foreign Exchange Outlook* at http://www.scotiacapital.com/English/bns_econ/fxout.pdf. ■

North America	2000-08	2009	2010f	2011f
	(annual % change)			
Canada				
Real GDP	2.6	-2.5	3.0	2.3
Consumer Spending	3.5	0.4	3.4	2.8
Residential Investment	5.1	-8.2	10.4	-1.3
Business Investment	4.9	-19.9	2.3	8.2
Government	3.3	5.1	4.7	1.7
Exports	0.9	-14.2	7.1	5.3
Imports	3.9	-13.9	13.2	6.4
Nominal GDP	5.6	-4.5	5.8	4.0
GDP Deflator	2.9	-2.1	2.7	1.7
Consumer Price Index	2.3	0.3	1.7	1.8
Core CPI	1.9	1.8	1.7	1.6
Pre-Tax Corporate Profits	7.8	-32.3	20.0	11.0
Employment	1.9	-1.6	1.6	1.2
thousands of jobs	301	-272	277	212
thousands of jobs (Q4/Q4)	285	-253	360	172
Unemployment Rate (%)	6.9	8.3	8.1	7.9
Current Account Balance (C\$ bn.)	20.5	-43.5	-44.3	-47.9
per cent of GDP	1.6	-2.8	-2.7	-2.8
Merchandise Trade Balance (C\$ bn.)	58.1	-4.6	-5.6	-10.0
Federal Budget Balance (C\$ bn.)	8.4	-56	-45	-30
per cent of GDP	0.7	-3.6	-2.8	-1.8
Housing Starts (thousands)	207	149	190	175
Motor Vehicle Sales (thousands)	1,605	1,461	1,565	1,590
Motor Vehicle Production (thousands)	2,590	1,425	2,200	2,300
Industrial Production	0.5	-10.0	4.9	4.1
United States				
Real GDP	2.3	-2.6	2.7	2.1
Consumer Spending	2.8	-1.2	1.7	2.3
Residential Investment	-2.8	-22.9	-3.5	-2.1
Business Investment	2.9	-17.1	5.5	6.2
Government	2.2	1.6	1.2	1.2
Exports	4.7	-9.5	11.4	8.1
Imports	4.5	-13.8	14.0	8.1
Nominal GDP	4.9	-1.7	3.7	3.6
GDP Deflator	2.5	0.9	1.0	1.5
Consumer Price Index	2.9	-0.3	1.6	1.2
Core CPI	2.2	1.7	1.0	0.9
Pre-Tax Corporate Profits	4.4	-0.4	28.5	7.0
Employment	0.7	-4.3	-0.5	1.1
millions of jobs	0.86	-5.87	-0.71	1.41
millions of jobs (Q4/Q4)	0.53	-5.38	0.81	2.02
Unemployment Rate (%)	5.1	9.3	9.6	9.2
Current Account Balance (US\$ bn.)	-596	-378	-487	-495
per cent of GDP	-4.9	-2.7	-3.3	-3.3
Merchandise Trade Balance (US\$ bn.)	-648	-507	-672	-718
Federal Budget Balance (US\$ bn.)	-197	-1,413	-1,294	-1,180
per cent of GDP	-1.5	-10.0	-8.8	-7.8
Housing Starts (millions)	1.65	0.55	0.59	0.80
Motor Vehicle Sales (millions)	16.4	10.4	11.5	12.2
Motor Vehicle Production (millions)	11.5	5.6	7.8	8.1
Industrial Production	1.0	-9.3	5.5	3.7
Mexico				
Real GDP	2.8	-6.5	4.8	3.5
Industrial Production	1.6	-7.3	5.2	3.8
Consumer Price Index (year-end)	5.1	3.6	4.9	4.6
Current Account Balance (US\$ bn.)	-11.2	-5.6	-12.2	-21.8
per cent of GDP	-1.6	-0.5	-1.3	-2.2

Forecast Changes

Canada & United States

- We have made only minor adjustments to our Canadian and U.S. forecast relative to our October *Update*. Overall, the slower growth momentum of recent quarters is expected to continue into 2011 on the back of a more cautious consumer, a soft housing market and a winding down of fiscal stimulus. Canadian GDP growth is still pegged at 3.0% and 2.3%, respectively, for this year and next. Canada maintains its modest performance edge over the U.S., where growth is forecast at 2.7% and 2.1%, respectively, in 2010 and 2011.
- We have lowered our expectations for Canadian and U.S. inflation through 2011, notwithstanding the upward drift in many commodity prices. The ongoing deflationary forces permeating through both economies have become quite pervasive, including excess industrial and labour market capacity, moderating wage gains, soft home prices and limited retail pricing power.
- Canada's final \$55.6 billion federal deficit for fiscal 2009-10 (FY10) includes an accounting adjustment on its Harmonized Sales Tax assistance that added just over \$5½ billion to last year's red ink. Ottawa's deficit reduction plan, according to its fall update, remains largely intact, with the budget shortfall still virtually eliminated by FY15.
- While the U.S. federal fiscal outlook remains very uncertain, the fiscal 2010 deficit was narrower than expected, with revenues, after two years of declines, advancing 2.7%. Expenditures contracted 1.8% in fiscal 2010 with the sharp decrease in financial sector support more than offsetting a 5.5% rise in other program outlays.

International	2000-08	2009	2010f	2011f
Real GDP (annual % change)				
World	4.0	-0.6	4.5	3.7
United Kingdom	2.4	-4.9	1.8	1.6
Euro zone	1.8	-4.1	1.9	1.5
Germany	1.2	-4.7	3.5	2.4
France	1.9	-2.5	1.8	1.5
Italy	1.0	-5.1	1.2	1.1
Japan	1.4	-5.2	2.9	1.3
Australia	3.2	0.8	3.0	3.0
China	10.3	9.1	10.0	9.0
India	7.2	6.7	8.3	7.0
Korea	4.9	0.2	5.5	4.5
Brazil	3.3	-0.2	7.5	5.0
Chile	4.3	-1.5	4.8	5.8
Peru	5.6	0.9	7.0	5.4
Consumer Prices (y/y % change, year-end)				
United Kingdom	2.1	2.9	2.7	2.5
Euro zone	2.2	0.9	1.5	1.6
Germany	1.8	0.8	1.2	1.5
France	2.0	1.0	1.5	1.7
Italy	2.5	1.1	1.9	1.9
Japan	-0.1	-1.7	0.3	0.5
Australia	3.3	2.1	2.5	3.0
China	2.1	0.7	3.0	2.5
India	5.3	9.9	7.0	5.5
Korea	3.2	2.8	3.0	2.5
Brazil	6.9	4.3	5.8	4.8
Chile	4.0	-1.4	3.7	3.5
Peru	2.7	0.3	2.8	3.0
Current Account Balance (% of GDP)				
United Kingdom	-2.1	-1.2	-2.1	-1.8
Euro zone	0.1	-0.6	-0.4	-0.1
Germany	3.5	5.0	5.1	5.2
France	-0.1	-2.0	-2.2	-2.3
Italy	-1.5	-3.2	-3.1	-3.2
Japan	3.3	2.5	2.9	3.0
Australia	-4.9	-2.6	-3.9	-4.6
China	5.4	6.0	5.0	3.9
India	-0.4	-1.6	-2.3	-2.3
Korea	1.5	5.2	2.0	0.4
Brazil	-0.8	-1.2	-3.0	-3.2
Chile	0.6	2.2	-0.5	-2.1
Peru	-0.7	0.2	-0.4	-0.2
Commodities (annual average)				
WTI Oil (US\$/bbl)	49.93	61.78	79	87
Nymex Natural Gas (US\$/mmbtu)	6.15	4.15	4.30	4.30
Copper (US\$/lb)	1.72	2.34	3.40	4.00
Zinc (US\$/lb)	0.73	0.75	0.98	1.10
Nickel (US\$/lb)	7.16	6.65	9.92	10.00
Gold, London PM Fix (US\$/oz)	472	973	1,225	1,400
Pulp (US\$/tonne)	662	720	953	918
Newsprint (US\$/tonne)	574	560	608	680
Lumber (US\$/mfbm)	286	178	249	250

Forecast Changes

International

- The U.K.'s output expanded by a solid 0.8% q/q non-annualized (and 2.8% y/y) in Q3, with details showing a broad-based expansion across the services, manufacturing and construction sectors. Accordingly, we have revised up our 2010 growth forecast to 1.8%. Fiscal consolidation will adversely impact 2011 prospects, with growth slowing to 1.6%.
- Leading indicators of the euro zone economy indicate that growth momentum remained relatively intact in Q3. Therefore, we now expect euro zone real GDP to expand by 1.9% this year. Softer export sector performance and fiscal consolidation in the core economies will dampen growth prospects in 2011, partly offset by the peripheral euro zone nations emerging from recession; output will likely expand by 1.5% next year.

Commodities

- WTI oil prices have strengthened to US\$86 per barrel in early November, boosted by a weak U.S. dollar and prospects for fresh stimulus from the Fed to revive a lacklustre U.S. economy. Global supply/demand conditions are largely balanced, with OPEC output roughly in line with the 'call' for OPEC crude at 29.1 mb/d. Global consumption in 2010 at about 86.9 mb/d (+2.5%) has surpassed pre-recessionary levels in 2007 (largely reflecting strong growth in emerging markets, with an incomplete recovery in the United States and a structural decline in Europe). While world consumption growth will likely slow in 2011 (+1.2%), the increase in non-OPEC supply from oil & biofuels will be only 0.5 mb/d, keeping the market in rough balance. China may be starting to build a second round of petroleum reserves. WTI oil should average an upwardly revised US\$87 in 2011. The ongoing strength of China's demand, together with a weak U.S. dollar, will continue to lift overall commodity prices in 2011.

Provincial	2000-08	2009	2010f	2011f	2000-08	2009	2010f	2011f
	Real GDP (annual % change)				Budget Balance, FY March 31 (\$millions)			
Canada	2.6	-2.5	3.0	2.3	10,666	-5,755	-55,598	-45,400
Newfoundland & Labrador	4.7	-10.2	3.1	3.1	-151	2,350	-295	-194
Prince Edward Island	2.0	-0.1	2.2	1.9	-25	-33	-84	-55
Nova Scotia	1.9	-0.1	1.9	1.9	60	26	-330 *	-203
New Brunswick	2.0	-0.3	1.9	2.0	79	-192	-738 *	-749
Quebec	2.1	-0.3	2.7	1.9	-128	0	-4,257	-4,506
Ontario	2.3	-3.6	3.5	2.0	-90	-6,409	-19,262 *	-19,677
Manitoba	2.3	0.0	2.2	2.5	n.a.	451	-201 *	-545
Saskatchewan	2.2	-3.9	2.9	3.3	207	2,389	425 *	20
Alberta	3.5	-4.5	3.0	3.5	4,837	0	0 *	0
British Columbia	3.0	-1.8	3.1	2.8	958	75	-1,779 *	-1,380
	Employment (annual % change)				Unemployment Rate (annual average, %)			
Canada	1.9	-1.6	1.6	1.2	6.9	8.3	8.1	7.9
Newfoundland and Labrador	1.0	-2.5	3.2	1.4	15.4	15.5	14.5	14.0
Prince Edward Island	1.7	-1.1	3.2	0.7	11.3	12.0	10.9	10.9
Nova Scotia	1.3	-0.1	0.5	0.9	8.7	9.2	9.2	9.2
New Brunswick	1.3	0.1	-0.5	0.4	9.6	8.9	9.3	9.3
Quebec	1.7	-1.0	1.8	1.1	8.3	8.5	8.0	8.0
Ontario	1.9	-2.4	1.8	1.2	6.5	9.0	8.7	8.6
Manitoba	1.3	0.0	1.9	1.1	4.8	5.2	5.2	5.1
Saskatchewan	0.9	1.5	1.4	1.0	5.1	4.8	5.0	5.0
Alberta	3.0	-1.3	0.5	2.4	4.3	6.6	6.5	6.0
British Columbia	2.2	-2.4	2.0	1.3	6.4	7.6	7.3	7.3
	Housing Starts (annual, thousands of units)				Motor Vehicle Sales (annual, thousands of units)			
Canada	207	149	190	175	1,605	1,461	1,565	1,590
Atlantic	12	11	13	12	113	115	122	123
Quebec	44	43	51	44	405	392	413	420
Ontario	77	50	61	58	615	535	584	592
Manitoba	4	4	5	5	44	43	45	46
Saskatchewan	4	4	5	5	40	44	46	47
Alberta	37	20	29	27	207	182	200	205
British Columbia	29	16	26	24	181	150	155	157

* Final results; other FY10-FY11 provincial data: government estimates.

Forecast Changes

Provincial

- Although our national GDP growth forecast for 2010 remained unchanged, we made modest adjustments to the provincial profile. Manitoba's manufacturing sector continues to move at sluggish pace, slowing growth for this year. PEI has seen tourist visits jump over 20% this year, contributing to strong consumer activity.
- British Columbia, Saskatchewan and Manitoba have all experienced healthy employment growth through Q3. This brisk pace should moderate through 2011, in line with slower economic expansion. Alberta, on the other hand, has lagged its western counterparts until recently. Significant employment growth is expected in 2011, as investment in the resource sector hits full steam.
- Job creation has been swift in Newfoundland and Labrador, fuelled by growth in the retail sector, transportation, and tourism industries, prompting us to revise up our 2010 employment forecast. Conversely, employment conditions in New Brunswick remain lacklustre. Although the province's labour market weathered the recession well, job losses in the public and manufacturing sectors have dragged down payrolls this year, with a turnaround unlikely to take hold until 2011.
- As provincial governments plan their deficit reduction strategies, several are proceeding with corporate tax cuts to strengthen their competitiveness. As well, British Columbia, to assist its residents with the shift to a Harmonized Sales Tax (HST) this past July 1, recently announced a 15% rate reduction for its two lowest personal income tax brackets.

Financial Markets	09Q4	10Q1	10Q2	10Q3	10Q4f	11Q1f	11Q2f	11Q3f	11Q4f
(% , end of period)									
Canada									
BoC Overnight Target Rate	0.25	0.25	0.50	1.00	1.00	1.00	1.00	1.25	1.75
3-month T-bill	0.31	0.30	0.61	1.01	1.00	1.05	1.10	1.40	1.95
2-year Canada	1.47	1.74	1.39	1.38	1.40	1.45	1.55	1.70	2.00
5-year Canada	2.76	2.90	2.33	2.03	2.05	2.15	2.25	2.35	2.50
10-year Canada	3.61	3.57	3.08	2.76	2.85	2.95	3.00	3.10	3.20
30-year Canada	4.08	4.07	3.65	3.36	3.55	3.65	3.75	3.75	3.80
Real GDP (q/q, ann. % change)	4.9	5.8	2.0	1.5	2.2	2.4	2.4	2.5	2.7
Real GDP (y/y, % change)	-1.1	2.2	3.4	3.6	2.9	2.0	2.1	2.4	2.5
Consumer Prices (y/y, % change)	0.8	1.6	1.4	1.8	2.0	1.9	1.8	1.8	1.8
Core CPI (y/y % change)	1.6	1.9	1.8	1.6	1.5	1.5	1.5	1.7	1.7
United States									
Fed Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50
3-month T-bill	0.08	0.15	0.17	0.15	0.15	0.20	0.20	0.30	0.60
2-year Treasury	1.14	1.02	0.60	0.42	0.35	0.50	0.65	0.80	1.05
5-year Treasury	2.68	2.54	1.77	1.26	1.10	1.25	1.60	1.75	1.90
10-year Treasury	3.84	3.83	2.93	2.51	2.55	2.70	2.80	3.10	3.40
30-year Treasury	4.64	4.71	3.89	3.68	4.10	4.15	4.20	4.25	4.25
Real GDP (q/q, ann. % change)	5.0	3.7	1.7	2.0	1.2	2.2	2.4	2.6	2.6
Real GDP (y/y, % change)	0.2	2.4	3.0	3.1	2.2	1.8	1.9	2.1	2.4
Consumer Prices (y/y, % change)	1.5	2.4	1.9	1.2	0.9	0.7	1.3	1.3	1.3
Core CPI (y/y % change)	1.7	1.3	1.0	0.9	0.8	0.9	0.9	0.9	1.0
Spreads									
Target Rate	0.00	0.00	0.25	0.75	0.75	0.75	0.75	1.00	1.25
3-month T-bill	0.23	0.15	0.44	0.86	0.85	0.85	0.90	1.10	1.35
2-year	0.33	0.72	0.79	0.96	1.05	0.95	0.90	0.90	0.95
5-year	0.08	0.36	0.56	0.76	0.95	0.90	0.65	0.60	0.60
10-year	-0.23	-0.26	0.15	0.25	0.30	0.25	0.20	0.00	-0.20
30-year	-0.56	-0.64	-0.24	-0.33	-0.55	-0.50	-0.45	-0.50	-0.45
Central Bank Rates									
European Central Bank	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.25
Bank of England	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75
Swiss National Bank	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75
Bank of Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Reserve Bank of Australia	3.75	4.00	4.50	4.50	4.75	4.75	4.75	4.75	4.75
Exchange Rates									
Canadian Dollar (USDCAD)	1.05	1.02	1.06	1.03	1.00	0.99	0.98	0.97	0.96
Canadian Dollar (CADUSD)	0.95	0.98	0.94	0.97	1.00	1.01	1.02	1.03	1.04
Euro (EURUSD)	1.43	1.35	1.22	1.36	1.43	1.44	1.46	1.48	1.50
Euro (EURGBP)	0.89	0.89	0.82	0.87	0.89	0.89	0.90	0.90	0.90
Sterling (GBPUSD)	1.62	1.52	1.49	1.57	1.60	1.61	1.63	1.65	1.67
Yen (USDJPY)	93	93	88	84	80	78	80	82	84
Australian Dollar (AUDUSD)	0.90	0.92	0.84	0.97	1.01	1.03	1.04	1.05	1.06
Chinese Yuan (USDCNY)	6.8	6.8	6.8	6.7	6.5	6.4	6.3	6.2	6.1
Mexican Peso (USDMXN)	13.1	12.4	12.9	12.6	12.4	12.3	12.4	12.5	12.6
Brazilian Real (USDBRL)	1.74	1.78	1.80	1.69	1.65	1.64	1.62	1.61	1.60

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