

Global Forecast Update



Cooling Trend In Global Growth

Scotia Economics now expects that global growth will advance by 4.4% this year and 3.8% in 2011 (based upon a purchasing power parity weighting of 34 countries), with emerging countries still outpacing the performance of the advanced nations by a considerable margin. This continues a recent pattern of trimming our economic and financial market forecasts to reflect a number of key developments that are restraining activity around the world.

First, we have pared back domestically generated growth in the United States from already soft levels, with the increased economic and financial market uncertainty since late winter further undercutting confidence and business expansion plans. In a chronically weak job market, Americans continue to focus on paying down high levels of household debt. Housing activity has been adjusted lower to reflect downward revisions to sales and building data. The one relative bright spot in the U.S. outlook continues to be business investment in machinery & equipment as firms take advantage of increasing order books and expanding international trade, though the mildly lower trajectory now projected for U.S. real GDP will likely take a bite out of the comparatively solid pace of earnings growth.

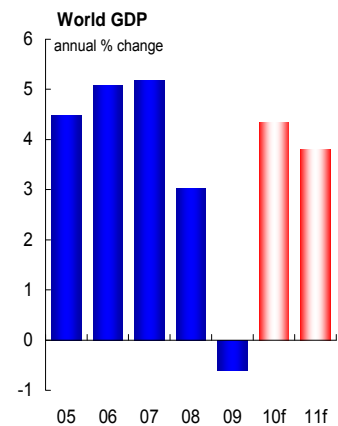
Second, the economic fallout in Europe from the sovereign debt crisis and the budgetary problems in the United Kingdom will progressively ripple through the region and the rest of the world in the second half of the year and in 2011. Beyond the negative economic impact on the region from the financial upheaval, the expected slowdown in domestic spending will dampen activity internationally through reduced imports and the weaker euro. Nevertheless, we have adjusted our 2010 forecast for the United Kingdom slightly higher because of the much better-than-expected results in Q2 attributable to the slowly emerging recovery that preceded the recent turbulence. Looking ahead, the accelerated pace of fiscal consolidation points to a period of slower, rather than faster, economic activity in the second half of this year and into 2011. While 2011 growth prospects for Germany and France will be limited due to fiscal consolidation and an export sector slowdown, the impact will be offset by a pick-up in activity in the euro zone periphery as these countries emerge from recession.

And third, there are more signs that growth in many of the high-flying emerging nations in the Asia-Pacific region and South America is moderating, but from an extraordinarily strong pace of activity over the past year. China is the bellwether, where prior credit tightening initiatives have begun to bite in the overheated real estate sectors of the large coastal metropolises. However, the slowdown is gradual and from generally high levels of activity. While China's moderation in growth will have an impact on regional suppliers, some countries like

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Emerging Economies Are The World's Growth Locomotive



Source: 2005-2009 are IMF estimates; 2010-2011f are Scotia Economics' estimates based on a 2009 PPP-weighted sample of 34 countries.



South Korea are continuing to benefit for the time being from the global boom in sales of autos and technology products. Even though growth in these regions is likely to remain quite strong relative to the rest of the world, the gradual shift to monetary and fiscal restraint to counter excess credit creation and rising inflation (e.g. Brazil and India) should result in a softening of growth trends next year, a development that is already reflected in the levelling off in economically sensitive commodity prices.

Clearly, one 'economic' shoe size doesn't fit all nations. Within North America for example, Canada and Mexico will continue to outperform the United States, while in the euro zone, Germany will do better than most countries. But the dominant trend is towards a slower, but still sustainable growth profile internationally because of the restraining influence attributable to the intensifying deleveraging of the household sector in many over-indebted countries, the discernible shift to fiscal consolidation, and sooner-rather-than-later, throughout most advanced nations, and the tighter regulatory guidelines that financial institutions will be operating under in the future.

In this environment, inflation pressures are likely to remain on the backburner, except in many of the emerging nations that are consistently experiencing above-trend growth. The normalization of short-term interest rates will continue in those countries where operating rates in labour and product markets have moved decisively higher — Canada, India, Brazil, and Australia, for example — though the speed and magnitude of the upward adjustments will be dependent upon emerging conditions both domestically and internationally. For other nations and regions that are operating far below capacity, like the United States and the euro zone, monetary policy is likely to remain on hold into the second half of next year. ■

North America	2000-08	2009	2010f	2011f
	(annual % change)			
Canada				
Real GDP	2.6	-2.5	3.3	2.6
Consumer Spending	3.5	0.4	3.5	2.8
Residential Investment	5.1	-8.2	11.7	1.6
Business Investment	4.9	-19.9	-0.6	7.1
Government	3.3	5.1	5.1	1.7
Exports	0.9	-14.2	8.8	6.0
Imports	3.9	-13.9	12.6	6.2
Nominal GDP	5.6	-4.5	6.2	4.5
GDP Deflator	2.9	-2.1	2.8	1.8
Consumer Price Index	2.3	0.3	1.8	2.1
Core CPI	1.9	1.8	1.8	1.8
Pre-Tax Corporate Profits	7.8	-32.3	24.0	10.5
Employment	1.9	-1.6	1.8	1.5
thousands of jobs	301	-272	296	261
thousands of jobs (Q4/Q4)	285	-253	413	182
Unemployment Rate (%)	6.9	8.3	8.0	7.7
Current Account Balance (C\$ bn.)	20.5	-43.5	-38.7	-38.7
per cent of GDP	1.6	-2.8	-2.4	-2.3
Merchandise Trade Balance (C\$ bn.)	58.1	-4.6	-1.0	-2.0
Federal Budget Balance (C\$ bn.)	8.4	-48	-43	-28
per cent of GDP	0.7	-3.1	-2.7	-1.7
Housing Starts (thousands)	207	149	190	175
Motor Vehicle Sales (thousands)	1,605	1,461	1,525	1,570
Motor Vehicle Production (thousands)	2,590	1,425	2,200	2,300
Industrial Production	0.5	-10.0	4.9	4.5
United States				
Real GDP	2.3	-2.6	3.0	2.5
Consumer Spending	2.8	-1.2	1.5	2.4
Residential Investment	-2.8	-22.9	1.1	3.8
Business Investment	2.9	-17.1	5.8	6.8
Government	2.2	1.6	1.2	1.2
Exports	4.7	-9.5	12.4	7.7
Imports	4.5	-13.8	11.7	7.2
Nominal GDP	4.9	-1.7	3.9	4.2
GDP Deflator	2.5	0.9	0.9	1.7
Consumer Price Index	2.9	-0.3	1.6	1.5
Core CPI	2.2	1.7	1.0	1.3
Pre-Tax Corporate Profits	4.4	-0.4	28.0	7.5
Employment	0.7	-4.3	-0.4	1.6
millions of jobs	0.86	-5.87	-0.53	2.04
millions of jobs (Q4/Q4)	0.53	-5.38	1.29	2.45
Unemployment Rate (%)	5.1	9.3	9.6	9.0
Current Account Balance (US\$ bn.)	-596	-378	-455	-473
per cent of GDP	-4.9	-2.7	-3.1	-3.1
Merchandise Trade Balance (US\$ bn.)	-648	-507	-635	-684
Federal Budget Balance (US\$ bn.)	-197	-1,413	-1,340	-1,220
per cent of GDP	-1.5	-10.0	-9.1	-8.0
Housing Starts (millions)	1.65	0.55	0.60	0.90
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	5.2	3.5
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 lowered our expectations for U.S. output growth for the latter half of the year, primarily reflecting a weaker projected profile for consumer spending and residential investment. We now expect GDP growth of 3.0% and 2.5% for 2010 and 2011, respectively, down 0.2 and 0.1 percentage points from our July *Update*. Employment growth, housing starts, corporate profits and inflation have all been scaled back somewhat.
- We have lowered our forecast for Canadian GDP growth this year by 0.1 percentage points to 3.3%. The modest downward revision reflects the slightly weaker profile for U.S. growth, as well as the recent marked softening in housing activity and less buoyant consumer confidence readings. We continue to forecast growth of 2.6% for 2011, with a ramping up in business investment and healthy consumer outlays helping to offset a ramping down in fiscal stimulus.
- Canada's federal deficit for April and May was narrower than the shortfall a year earlier, in line with our forecast of a moderate narrowing in the fiscal 2010-11 (FY11) deficit to \$43 billion. Uncertainty persists about U.S. federal tax rates as the Bush 2001 and 2003 tax cuts expire at the end of calendar 2010, but unemployment benefits are extended through November 2010.

International	2000-08	2009	2010f	2011f
Real GDP (annual % change)				
World	4.0	-0.6	4.4	3.8
United Kingdom	2.4	-4.9	1.4	1.2
Euro zone	1.9	-4.1	0.8	1.0
Germany	1.4	-4.9	1.4	1.2
France	1.9	-2.8	1.3	1.3
Italy	1.0	-5.1	0.6	0.6
Japan	1.4	-5.2	2.5	1.3
Australia	3.2	0.8	2.8	3.0
China	10.1	9.1	10.0	9.0
India	7.3	6.7	8.0	7.0
Korea	4.9	0.2	5.5	4.5
Brazil	3.3	0.5	7.5	5.0
Chile	4.3	-1.5	4.2	5.8
Peru	5.6	0.9	7.0	5.4
Consumer Prices (y/y % change, year-end)				
United Kingdom	2.1	2.9	2.5	2.0
Euro zone	2.2	0.9	1.3	1.6
Germany	1.8	0.8	1.2	1.4
France	2.0	1.0	1.5	1.5
Italy	2.5	1.1	1.5	1.8
Japan	-0.1	-1.7	0.3	0.5
Australia	3.3	2.1	2.5	3.0
China	2.1	1.9	3.0	2.5
India	5.3	9.9	7.0	5.5
Korea	3.2	2.8	2.5	3.0
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	-2.0	-1.5	-1.2	-1.2
Euro zone	0.2	-0.6	-0.5	-0.8
Germany	3.8	4.0	3.8	3.7
France	0.0	-2.1	-2.1	-2.2
Italy	-1.5	-3.1	-2.9	-3.0
Japan	3.3	2.5	3.0	3.0
Australia	-4.9	-2.6	-3.9	-4.6
China	5.5	6.0	5.3	4.0
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	-2.3
Peru	-0.7	0.2	-0.4	-0.2
Commodities (annual average)				
WTI Oil (US\$/bbl)	49.93	61.78	79	80
Nymex Natural Gas (US\$/mmbtu)	6.15	4.15	4.75	4.75
Copper (US\$/lb)	1.72	2.34	3.05	3.05
Zinc (US\$/lb)	0.73	0.75	0.88	0.85
Nickel (US\$/lb)	7.16	6.50	8.95	8.95
Gold, London PM Fix (US\$/oz)	472	973	1,175	1,200
Pulp (US\$/tonne)	662	720	970	815
Newsprint (US\$/tonne)	574	560	600	680
Lumber (US\$/mfbm)	286	178	235	240

Forecast Changes

International

- Following the U.K.'s strong Q2 GDP data, we are revising the country's output growth forecast to 1.4% for 2010 and to 1.2% for 2011. While private spending and investment will pick up in 2011, fiscal tightening and lower global demand for British exports will limit growth prospects in 2011.
- The Japanese economy performed surprisingly well during the first half of the year. Notwithstanding the recent export slowdown, domestic consumers seem to be finally feeling confident about the economic recovery. Better job market conditions have led to higher labour participation rates as domestic demand prospects continue to improve. We have revised our 2010 GDP growth expectation to 2.5%, from 2.2%.
- Emerging Asia's growth momentum moderated in the second quarter after the extraordinary rates of expansion recorded in the first. The region will continue to lead the global recovery as economic activity converges towards sustainable growth in the second half of the year.

Commodities

- Spot gold prices reached an all-time record high of US\$1,265.30 per ounce in intraday trading on June 25 — fuelled by concern over high government debt burdens in many advanced nations. However, gold prices moderated in July, as China stated there will be a limit on gold holdings within its foreign exchange reserves, and on news that in early 2010 central banks swapped gold reserves to raise cash at the Bank for International Settlements.

Provincial	2000-08	2009	2010f	2011f	2000-08	2009	2010f	2011f	
	<u>Real GDP*</u> (annual % change)				<u>Budget Balance, FY March 31</u> (\$millions)				
Canada	2.6	-2.5	3.3	2.6	10,666	-5,755	-48,000	-43,000	
Newfoundland & Labrador	4.6	-10.2	3.2	3.0	-149	2,350	-295	-194	
Prince Edward Island	1.9	0.6	2.0	2.2	-25	-33	-84	-55	
Nova Scotia	2.0	-0.5	2.1	2.2	60	26	-242 *	-222	
New Brunswick	2.0	-0.8	2.2	2.3	79	-192	-743	-749	
Quebec	2.1	-1.0	3.0	2.3	-128	0	-4,257	-4,506	
Ontario	2.4	-3.1	3.7	2.3	-90	-6,409	-21,330	-19,690	
Manitoba	2.4	-0.2	3.0	2.5	n.a.	470	-555	-545	
Saskatchewan	2.3	-6.3	3.3	3.4	207	2,389	425 *	20	
Alberta	3.5	-5.1	3.6	3.5	4,837	0	0 *	0	
British Columbia	2.9	-2.3	3.4	2.9	660	75	-1,779 *	-1,715	
* 2009 provincial GDP are preliminary industry-based estimates from Statistics Canada.					* Final results; other FY10-FY11 provincial data: government estimates.				
Provincial	<u>Employment</u> (annual % change)				<u>Unemployment Rate</u> (annual average, %)				
	2000-08	2009	2010f	2011f	2000-08	2009	2010f	2011f	
Canada	1.9	-1.6	1.8	1.5	6.9	8.3	8.0	7.7	
Newfoundland and Labrador	1.0	-2.5	2.9	1.6	15.4	15.5	14.2	13.6	
Prince Edward Island	1.7	-1.1	2.8	1.1	11.3	12.0	10.6	10.4	
Nova Scotia	1.3	-0.1	0.6	1.0	8.7	9.2	9.1	9.0	
New Brunswick	1.3	0.1	0.4	1.1	9.6	8.9	9.0	8.9	
Quebec	1.7	-1.0	1.9	1.4	8.3	8.5	7.9	7.7	
Ontario	1.9	-2.4	1.8	1.5	6.5	9.0	8.7	8.4	
Manitoba	1.3	0.0	2.0	1.2	4.8	5.2	4.9	4.9	
Saskatchewan	0.9	1.5	1.7	1.5	5.1	4.8	4.8	4.7	
Alberta	3.0	-1.3	1.0	2.0	4.3	6.6	6.9	6.6	
British Columbia	2.2	-2.4	2.0	1.6	6.4	7.6	7.4	7.2	
Provincial	<u>Housing Starts</u> (annual, thousands of units)				<u>Motor Vehicle Sales</u> (annual, thousands of units)				
	2000-08	2009	2010f	2011f	2000-08	2009	2010f	2011f	
Canada	207	149	190	175	1,605	1,461	1,525	1,570	
Atlantic	12	11	13	11	113	115	119	121	
Quebec	44	43	51	44	405	392	402	416	
Ontario	77	50	62	60	615	535	557	572	
Manitoba	4	4	4	5	44	43	45	46	
Saskatchewan	4	4	5	5	40	44	46	48	
Alberta	37	20	29	26	207	182	198	205	
British Columbia	29	16	26	24	181	150	158	162	

Forecast Changes

Provincial

- Central Canada has seen solid employment and production gains over the first half of the year. While restructuring continues in Ontario's motor vehicle sector, stronger planned assembly volumes in Q3, plus sustained growth in the services sector, suggest slightly higher growth for the province in 2010.
- Growth prospects for Western Canada have been tempered somewhat. Flooding in Saskatchewan has caused extensive damage to the canola crop, and to a lesser extent, wheat. Employment growth in Alberta remains sluggish, slowing the rebound in retail sales. In the post-Olympics period, British Columbia's economic prospects are being dampened by the softness in lumber shipments to the weak U.S. housing market.
- We have raised our job growth forecast for most provinces for 2010 based on better-than-expected job increases to date. The exceptions are Nova Scotia, New Brunswick, and Alberta, though a significant pick-up is expected in the latter province.
- Provincial and federal governments' commitment to restrain pay and benefit increases across their departments and partner agencies is reflected in wage settlement data from March to May easing to an average 1.3%, less than half the pace of settlements during the prior 12 months.

Financial Markets	09Q4	10Q1	10Q2	10Q3f	10Q4f	11Q1f	11Q2f	11Q3f	11Q4f
(% , end of period)									
Canada									
BoC Overnight Target Rate	0.25	0.25	0.50	1.00	1.00	1.50	2.00	2.25	2.25
3-month T-bill	0.31	0.30	0.61	0.95	1.10	1.60	2.10	2.35	2.30
2-year Canada	1.47	1.74	1.39	1.75	1.90	2.15	2.45	2.55	2.50
5-year Canada	2.76	2.90	2.33	2.55	2.70	2.85	3.05	3.20	3.50
10-year Canada	3.61	3.57	3.08	3.25	3.35	3.45	3.55	3.65	3.95
30-year Canada	4.08	4.07	3.65	3.75	3.80	3.85	3.90	4.00	4.30
Real GDP (q/q, ann. % change)	4.9	6.1	2.6	2.6	2.4	2.5	2.7	2.8	2.8
Real GDP (y/y, % change)	-1.1	2.2	3.6	4.0	3.4	2.5	2.6	2.6	2.7
Consumer Prices (y/y, % change)	0.8	1.6	1.4	2.0	2.2	2.2	2.2	2.0	2.1
Core CPI (y/y % change)	1.6	1.9	1.8	1.8	1.8	1.8	1.7	1.8	1.9
United States									
Fed Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.75	1.25	1.75
3-month T-bill	0.08	0.15	0.17	0.20	0.25	0.40	0.95	1.55	1.85
2-year Treasury	1.14	1.02	0.60	0.70	0.75	1.00	1.25	1.60	2.10
5-year Treasury	2.68	2.54	1.77	1.95	2.15	2.35	2.45	2.65	3.15
10-year Treasury	3.84	3.83	2.93	3.05	3.15	3.25	3.45	3.80	4.25
30-year Treasury	4.64	4.71	3.89	3.95	4.00	4.05	4.10	4.25	4.65
Real GDP (q/q, ann. % change)	5.0	3.7	2.4	2.7	2.5	2.4	2.2	2.6	2.7
Real GDP (y/y, % change)	0.2	2.4	3.2	3.5	2.8	2.5	2.5	2.4	2.5
Consumer Prices (y/y, % change)	1.5	2.4	1.9	1.2	0.9	1.0	1.6	1.7	1.7
Core CPI (y/y % change)	1.7	1.3	1.0	0.8	0.7	1.1	1.2	1.4	1.5
Spreads									
Target Rate	0.00	0.00	0.25	0.75	0.75	1.25	1.25	1.00	0.50
3-month T-bill	0.23	0.15	0.44	0.75	0.85	1.20	1.15	0.80	0.45
2-year	0.33	0.72	0.79	1.05	1.15	1.15	1.20	0.95	0.40
5-year	0.08	0.36	0.56	0.60	0.55	0.50	0.60	0.55	0.35
10-year	-0.23	-0.26	0.15	0.20	0.20	0.20	0.10	-0.15	-0.30
30-year	-0.56	-0.64	-0.24	-0.20	-0.20	-0.20	-0.20	-0.25	-0.35
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	0.75	1.00	1.25
Swiss National Bank	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.00	1.25
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	1.01	1.00	0.99	0.98	0.97	0.97
Canadian Dollar (CADUSD)	0.95	0.98	0.94	0.99	1.00	1.01	1.02	1.03	1.03
Euro (EURUSD)	1.43	1.35	1.22	1.22	1.24	1.26	1.28	1.29	1.30
Euro (EURGBP)	0.89	0.89	0.82	0.81	0.81	0.82	0.82	0.83	0.84
Sterling (GBPUSD)	1.62	1.52	1.49	1.50	1.53	1.54	1.56	1.56	1.55
Yen (USDJPY)	93	93	88	90	92	94	95	95	97
Australian Dollar (AUDUSD)	0.90	0.92	0.84	0.88	0.90	0.91	0.92	0.93	0.94
Chinese Yuan (USDCNY)	6.8	6.8	6.8	6.8	6.6	6.5	6.4	6.3	6.2
Mexican Peso (USDMXN)	13.1	12.4	12.9	12.7	12.8	12.9	13.0	13.1	13.2
Brazilian Real (USDBRL)	1.74	1.78	1.80	1.80	1.80	1.82	1.85	1.87	1.90

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