

Global Forecast Update



Rebooting Growth

The global economy is transitioning from recession to recovery, with renewed output growth just around the corner. In the harder-hit regions of the developed world, in North America, Europe, and Japan for example, the second quarter will be marked by a substantially reduced pace of economic contraction after the record-breaking plunge in production, shipments and finance that began in the final quarter of last year, and accelerated through the first three months of this year. A few countries, like Australia, already appear to be breaking free from contraction, and even fewer nations, such as China, will post even better growth. But for most developed and developing countries alike, the third quarter represents the important crossover from recession to recovery.

Although the restructuring and retrenchment underway in a number of key sectors and regions will remain a significant drag on the pace of activity, strong cyclical forces are providing much-needed impetus to growth. Canada, and many other countries around the world, are expected to piggyback on the renewed momentum being generated by the globe's primary economic engines, the United States and China. The recovery should become increasingly more broadly based, with the likelihood of accelerating economic gains through the balance of this year extending into 2010.

Even with global output growth turning positive in the second half of the year, the contraction in worldwide real GDP in 2009 is still likely to average 2.7% — a post-war record. But building upon the strengthening economic momentum, global output growth is now expected to average 2.6% in 2010, roughly half a percentage point higher than our previous forecast.

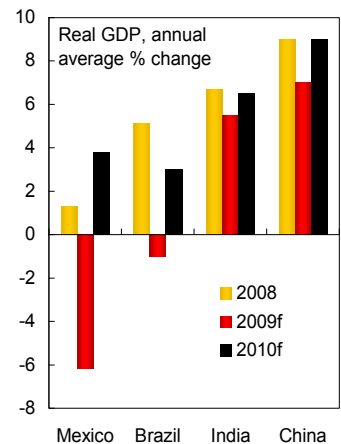
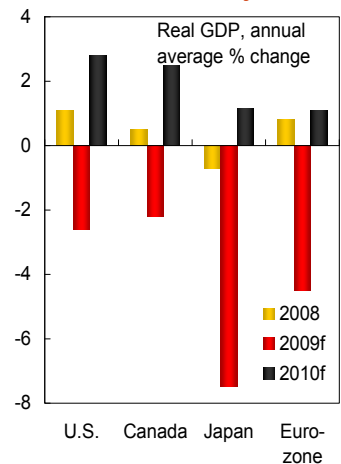
China will continue to be the global growth leader, with the stimulus provided by expansionary fiscal and credit policies and improving international trade boosting economic prospects this year and next (upwardly revised real GDP advances of about 7% and 9%, respectively). However, the largest upward revision to growth occurs in the United States, where we now expect the rapidly changing growth dynamics to produce a 2.8% average advance in 2010 — a full percentage point higher than our prior forecast — and reversing this year's anticipated 2.6% decline.

Canada's economy should be buoyed by strengthening demand in the United States and internationally for manufactured and commodity-related products, although the nation's performance will likely lag the upturn because of competitive issues, including a stronger currency. Mexico will underperform its NAFTA partners in 2009, as a result of the major contraction in industrial and resource activity, as well as the effects of the H1N1 flu, but should post stronger growth next year as the U.S. economy recovers.

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On The Recovery Path



A number of factors, both fundamental and market-oriented, reinforce our view that the global economy has reached an important turning point:

First, policymakers around the world appear to have been relatively successful in erecting the firewalls and creating the credit market conditions needed to contain the global financial crisis and prevent it from further undermining economic conditions.

Second, economic forces are working. Sizeable price discounting, alongside comparatively lower energy costs this year, is helping to recharge purchasing power and spending, particularly in more credit-sensitive developed economies.

Third, an unprecedented period of inventory liquidation around the world is rapidly winding down. While the reduced pace of destocking in the current quarter is helping to limit the contraction in overall output, even a relatively modest addition to inventories in the second half of the year will provide a solid boost to output growth.

Fourth, central banks have unleashed a powerful wave of stimulus by inoculating most countries with historically large and quick monetary injections. Ultra-low short-term interest rates are encouraging refinancing and borrowing activity and facilitating balance sheet and corporate restructuring efforts.

Fifth, governments are actively ramping up fiscal measures to support hard-hit sectors and regions, and promote renewed economic growth through large increases in spending and tax incentives. Some of this stimulus is beginning to filter through — China is a case in point — though in most nations, the full impact will not be visible until later this year and in 2010. For many developing nations with evolving credit markets, the major fiscal pulse will be the key driver of growth.

And sixth, many market indicators are also in turnaround mode, suggesting a higher degree of investor confidence that the economic and financial sector downdrafts are behind us. Around the world, equities have consistently moved higher since early March, with impressive gains signalling better times ahead for corporate earnings. Longer-term interest rates have moved higher as well. Deflationary concerns are giving way to inflationary ones now that the economic downturn is moderating, and government borrowing is rapidly increasing. The U.S. yield curve has again resumed a steep positive slope — a bellwether for better growth times ahead. Commodity prices, led by economy-sensitive oil and copper, have rallied strongly. Financial stress levels have been substantially reduced, with LIBOR and the TED spread plunging to record lows, and bond differentials narrowing between corporate and sovereign credits. And the U.S. dollar is losing its 'risk aversion' mantle as it broadly weakens against the globe's major floating currencies.

Throughout much of the developed world, and in the United States in particular, the recovery will be marked by the comparatively large contribution to growth provided by the government sector. Outside of the quarterly volatility triggered by the large adjustments to inventories, output gains will be far from robust, as the private sector will be constrained by household deleveraging, industrial restructuring, and a more cautious banking sector. Canada's performance should roughly match the sub-par U.S. recovery, though the composition of growth will largely reflect the stepped-up demand for resources by emerging markets, as well as gradually improving domestic demand.

In both countries, inflationary pressures will be slow to build. Excess labour and industrial capacity and early productivity gains should largely offset the price pressures stemming from the large monetary and fiscal applications. Nevertheless, the inflationary bias associated with the 'debt-weight' drag on the U.S. dollar will likely force the Federal Reserve to begin raising borrowing costs in the first quarter of 2010. By the end of next year, the funds rate is expected to climb back to 2.50%, and help flatten a very steep yield curve as the sharp rise in bond yields we anticipate begins to slow. The Bank of Canada will also start to tighten policy early next year, though it will lag U.S. developments because of growth and competitive concerns related to the strengthening loonie. Nevertheless, on both sides of the border, there is a growing risk of even larger short-term rate hikes and steeper, not flatter, yield curves if governments are unable to rein in the large, multi-year fiscal imbalances. ■

North America	2000-07	2008	2009f	2010f
	(annual % change)			
Canada				
Real GDP	2.9	0.4	-2.2	2.5
Consumer Spending	3.6	3.0	-0.6	1.8
Residential Construction	6.3	-2.7	-16.3	-2.8
Business Investment	5.1	0.2	-14.0	-0.4
Government Spending	3.2	4.8	3.7	6.0
Exports	1.6	-4.7	-14.0	2.0
Imports	4.2	0.9	-16.6	2.5
Nominal GDP	5.7	4.4	-4.4	4.5
GDP Deflator	2.7	3.9	-2.2	2.0
Consumer Price Index	2.3	2.4	0.4	1.9
Core CPI	1.9	1.7	1.5	1.4
Pre-Tax Corporate Profits	7.9	5.7	-16.5	10.0
Employment	2.0	1.5	-1.9	0.8
thousands of jobs	307	258	-328	139
thousands of jobs (Q4/Q4)	306	134	-430	376
Unemployment Rate (%)	6.9	6.1	8.5	8.9
Current Account Balance (C\$ bn.)	22.6	8.1	-39.5	-34.5
per cent of GDP	1.8	0.5	-2.6	-2.2
Merchandise Trade Balance (C\$ bn.)	59.6	46.9	0.0	4.0
Federal Budget Balance (C\$ bn.)	10.2	-4.5	-54.0	-42.0
per cent of GDP	0.8	-0.3	-3.5	-2.6
Housing Starts (thousands)	207	211	135	150
Motor Vehicle Sales (thousands)	1,601	1,642	1,420	1,500
Motor Vehicle Production (thousands)	2,653	2,088	1,400	1,750
Industrial Production	1.2	-4.1	-7.7	2.2
United States				
Real GDP	2.5	1.1	-2.6	2.8
Consumer Spending	3.2	0.2	-1.5	0.9
Residential Construction	0.3	-20.8	-21.6	0.4
Business Investment	2.5	1.6	-20.1	-1.7
Government Spending	2.2	2.9	3.0	7.9
Exports	4.4	6.2	-13.9	1.9
Imports	5.3	-3.5	-16.1	1.5
Nominal GDP	5.1	3.3	-1.0	4.1
GDP Deflator	2.6	2.2	1.6	1.3
Consumer Price Index	2.8	3.8	-0.6	1.8
Core CPI	2.2	2.3	1.5	1.3
Pre-Tax Corporate Profits	8.6	-10.1	-10.5	8.5
Employment	0.8	-0.4	-3.5	0.7
millions of jobs	1.08	-0.56	-4.76	0.97
millions of jobs (Q4/Q4)	0.97	-2.27	-4.08	2.80
Unemployment Rate (%)	5.0	5.8	9.3	9.6
Current Account Balance (US\$ bn.)	-583	-673	-380	-470
per cent of GDP	-5.0	-4.7	-2.7	-3.2
Merchandise Trade Balance (US\$ bn.)	-629	-821	-509	-599
Federal Budget Balance (US\$ bn.)	-164	-459	-1,995	-1,420
per cent of GDP	-1.3	-3.2	-14.1	-9.7
Housing Starts (millions)	1.74	0.90	0.50	0.70
Motor Vehicle Sales (millions)	16.8	13.2	10.2	11.5
Motor Vehicle Production (millions)	11.8	8.7	5.5	7.1
Industrial Production	1.4	-2.2	-9.8	2.1
Mexico				
Real GDP	2.9	1.3	-6.2	3.8
Industrial Production	1.8	-0.7	-7.2	4.7
Consumer Price Index (year-end)	4.9	6.5	4.9	4.8
Current Account Balance (US\$ bn.)	-10.8	-15.5	-20.2	-26.6
per cent of GDP	-1.6	-1.4	-2.2	-2.7

Forecast Changes

Canada & United States

- We have adjusted our 2009-2010 forecasts for Canada and the United States to reflect the better-than-expected economic data of the past few months. While we anticipate somewhat smaller output declines for both countries in 2009 relative to our May *Update*, the estimated contractions in real GDP are nonetheless still sizeable, at 2.2% and 2.6%, respectively.
- We have also raised our 2010 GDP growth forecasts for Canada and the United States, to 2.5% and 2.8%, respectively. This stronger economic performance is front-end loaded to the final quarter of 2009 and the first half of 2010, reflecting the timing of fiscal stimulus and inventory adjustments. We expect a weaker second-half 2010 performance in both countries, with the unwinding of fiscal stimulus not fully offset by private sector demand.
- Further substantial assistance to the auto sector is expected to keep the U.S. federal fiscal deficit close to US\$2 trillion in FY09. Despite some offset from the impact of higher interest rates on the debt service, the FY10 deficit should narrow due to the stronger growth outlook. In Canada, data to date confirm a relatively modest deficit for FY09. In FY10, auto-sector aid plus the broad consequences of slower growth have pushed the federal government's deficit estimate to more than \$50 billion.

Mexico

- We now expect Mexican real GDP to contract 6.2% in 2009, down from our previous estimate of a 4.5% decline. The downgrade incorporates a more acute deterioration in the industrial sector during the first quarter of 2009, and evidence that the fragile industrial situation has spread to the rest of the economy, as well as the effect of the H1N1 flu epidemic on retail and tourism activity. Reflecting our improved outlook for the U.S. economy, we have revised our GDP growth outlook for 2010 to 3.8%, up from 1.7%.

International	2000-07	2008	2009f	2010f
Real GDP (annual % change)				
World	3.4	2.0	-2.7	2.6
United Kingdom	2.6	0.7	-3.6	1.2
Euro zone	2.0	0.8	-4.5	1.1
Germany	1.5	1.0	-6.1	1.2
France	2.1	0.4	-3.1	1.5
Italy	1.3	-1.0	-4.1	0.5
Japan	1.7	-0.7	-7.5	1.2
Australia	3.3	2.3	-0.5	2.0
China	10.1	9.0	7.0	9.0
India	7.3	6.7	5.5	6.5
Korea	5.2	2.5	-3.0	3.5
Brazil	3.0	5.1	-1.0	3.0
Argentina	3.5	7.0	-2.0	0.5
Chile	4.4	3.2	-1.0	3.0
Consumer Prices (y/y % change, year-end)				
United Kingdom	2.0	3.1	1.2	2.0
Euro zone	2.3	1.6	1.0	1.3
Germany	1.8	1.1	0.3	0.8
France	2.0	1.2	0.5	1.5
Italy	2.5	2.4	0.6	1.7
Japan	-0.2	0.4	-0.3	-0.2
Australia	3.3	3.7	2.3	2.5
China	2.2	1.2	1.0	2.5
India	5.1	5.9	3.5	6.0
Korea	3.1	4.1	1.5	2.5
Brazil	7.0	5.9	4.3	4.3
Argentina	10.1	25.0	15.0	12.0
Chile	3.6	7.1	1.0	2.5
Current Account Balance (% of GDP)				
United Kingdom	-2.1	-1.7	-1.1	-1.4
Euro zone	0.3	-0.7	-0.6	-0.6
Germany	3.3	6.6	4.5	4.9
France	0.3	-1.8	-1.1	-1.2
Italy	-1.3	-3.4	-1.8	-2.1
Japan	3.4	4.1	3.5	3.3
Australia	-4.9	-4.5	-3.7	-4.5
China	5.0	10.8	9.8	7.0
India	-0.1	-2.8	-2.4	-3.1
Korea	1.8	-0.7	0.7	-0.6
Brazil	-0.6	-2.1	-1.2	-1.2
Argentina	2.7	2.3	1.0	1.3
Chile	0.8	-2.1	-1.9	0.6
Commodities (annual average)				
WTI Oil (US\$/bbl)	43.72	99.62	58	75
Nymex Natural Gas (US\$/mmbtu)	5.81	8.90	4.50	6.00
Copper (US\$/lb)	1.54	3.15	1.85	1.95
Zinc (US\$/lb)	0.71	0.85	0.59	0.68
Nickel (US\$/lb)	6.86	9.57	5.00	5.50
Gold, London PM Fix (US\$/oz)	422	872	940	925
Pulp (US\$/tonne)	638	856	660	725
Newsprint (US\$/tonne)	559	695	615	585
Lumber (US\$/mfbm)	294	215	170	215

Forecast Changes

International

- Despite signs of a turnaround in the global economy, 2009 growth forecasts for euro zone countries and Japan have been pulled lower as a result of the marked weakness in the first quarter national accounts data. China's prospects have improved in light of the rapid expansion in credit through the early months of the year. Government spending and inventory rebuilding are key elements supporting recovery in the latter part of 2009, which should provide some additional impetus for growth in 2010.
- Broadly based currency appreciation vis-à-vis the U.S. dollar will help to limit the inflationary impact of rising petroleum prices.
- Global payments imbalances will persist, with little significant shift evident among surplus and deficit countries.

Commodities

- WTI oil prices climbed over US\$65 per barrel following the OPEC meeting on May 28, and have rallied further in recent days to about \$67. While OPEC held its quotas unchanged and global oil inventories remain more-than-ample, oil prices rallied on comments from Saudi Arabia's oil minister that demand is starting to improve in the United States, Asia and the Middle East. China's consumption recovered in April, climbing 3.9% y/y, though actual statistics in the United States do not yet show an improvement. WTI oil prices should climb to US\$75 in 2010 on a resumption of world economic growth and last year's incomplete supply response to tight market conditions, prior to the 'credit collapse'.
- LME copper prices surged to a quite lucrative US\$2.28 per pound in early June, 81% above the low on December 24. After restocking in recent months, China's copper imports may wane over the late summer, before picking up again towards the end of 2009. Greater scrap availability may limit further price gains in 2010.

Provincial	2000-07	2008	2009f	2010f	2000-07	2008	2009f	2010f
	Real GDP (annual % change)				Budget Balance, FY March 31* (\$millions)			
Canada	2.9	0.4	-2.2	2.5	10,799	9,597	-4,500	-54,000
Newfoundland & Labrador	5.0	-0.1	-2.6	2.4	-347	1,437	2,434	-750
Prince Edward Island	2.1	0.9	-1.5	1.9	-28	-4	-41	-85
Nova Scotia	2.1	2.0	-1.4	2.3	15	419	22	na
New Brunswick	2.4	0.0	-1.3	2.5	77	87	-265	-741
Quebec	2.2	1.0	-2.2	2.4	-171	0	0	-3,946
Ontario	2.8	-0.4	-2.8	2.2	-176	600	-3,890	-18,500
Manitoba	2.5	2.4	-0.6	2.5	n.a.	576	316	48
Saskatchewan	2.0	4.4	0.8	2.9	153	641	2,318	425
Alberta	4.0	-0.2	-2.3	2.8	4,869	4,581	0	0
British Columbia	3.3	-0.3	-2.0	2.7	769	2,886	50	-495
	* FY09 & FY10 prov. balances: Budget documents.							
	Employment (annual % change)				Unemployment Rate (annual average, %)			
Canada	2.0	1.5	-1.9	0.8	6.9	6.1	8.5	8.9
Newfoundland and Labrador	1.0	1.5	-2.2	0.7	15.6	13.2	15.9	16.3
Prince Edward Island	1.8	1.3	-1.9	0.7	11.3	10.8	13.1	13.3
Nova Scotia	1.3	1.3	-1.5	0.8	8.9	7.7	9.9	10.3
New Brunswick	1.4	0.9	-1.6	0.8	9.7	8.6	10.2	10.6
Quebec	1.8	0.8	-1.9	0.5	8.4	7.2	9.0	9.5
Ontario	2.0	1.4	-2.4	0.5	6.5	6.5	9.4	9.9
Manitoba	1.2	1.7	-0.2	0.8	4.9	4.2	5.2	5.2
Saskatchewan	0.8	2.2	0.6	1.2	5.2	4.1	5.0	5.0
Alberta	3.0	2.8	-1.7	1.3	4.4	3.6	6.4	6.5
British Columbia	2.3	2.1	-2.2	1.5	6.7	4.6	7.3	7.2
	Housing Starts (annual, thousands of units)				Motor Vehicle Sales (annual, thousands of units)			
Canada	207	211	135	150	1,600	1,642	1,420	1,500
Atlantic	12	12	11	10	111	127	111	118
Quebec	44	48	41	40	402	430	372	386
Ontario	77	75	50	52	619	580	500	519
Manitoba	4	6	3	5	44	46	41	45
Saskatchewan	4	7	3	5	39	48	46	52
Alberta	38	29	13	18	204	232	195	210
British Columbia	28	34	14	20	181	179	155	170

Forecast Changes

Provincial

- We have made a number of adjustments to our provincial economic forecast, in line with our revised national view. Regional growth rankings, however, are little changed. Ontario is still expected to post the largest output decline this year, at 2.8%, as the ongoing restructuring in its large motor vehicle sector has cut first-half assemblies more than 50% below a year ago. However, conditions should begin to stabilize as idle auto assembly plants once again begin production. Saskatchewan remains the only province expected to record positive growth, albeit at less than 1%.
- While we are projecting a better economic performance for all provinces in 2010, the combination of a stronger Canadian dollar and higher commodity prices will continue to tilt overall activity in favour of Canada's resource-rich regions in the West and the East, while adding an additional burden to the fledgling recoveries in Central Canada's manufacturing-heavy economies. In particular, stronger oil prices alongside declining construction costs could bring forward deferred oil sands investments sooner than previously anticipated.
- Over the next two quarters, wider deficit expectations for FY10 in several jurisdictions are expected to broaden the aggregate provincial shortfall to more than C\$25 billion this year, reflecting in part lower GDP expectations since many of the Budgets were prepared early in 2009. Specific events also are contributing, notably the revision of Ontario's projected FY10 shortfall from C\$14.1 billion to C\$18.5 billion given recent aid for the automotive sector.

Financial Markets	09Q1	09Q2f	09Q3f	09Q4f	10Q1f	10Q2f	10Q3f	10Q4f
Canada								
BoC Overnight Target Rate	0.50	0.25	0.25	0.25	0.50	0.75	1.25	2.00
3-month T-bill	0.40	0.25	0.25	0.30	0.55	1.05	1.75	2.50
2-year Canada	1.08	1.35	1.15	1.30	1.45	2.00	2.55	3.10
5-year Canada	1.75	2.55	2.40	2.70	3.10	3.55	3.85	4.00
10-year Canada	2.78	3.55	3.35	3.70	4.20	4.45	4.65	4.80
30-year Canada	3.56	4.20	4.05	4.45	4.75	5.00	5.10	5.15
Real GDP (q/q, ann. % change)	-5.4	-2.0	0.5	2.5	3.5	3.5	3.0	3.0
Real GDP (y/y, % change)	-2.1	-2.7	-2.7	-1.1	1.1	2.5	3.1	3.3
Consumer Prices (y/y, % change)	1.2	-0.2	-0.7	1.2	1.8	1.9	1.9	2.1
Core CPI (y/y % change)	1.9	1.6	1.3	1.0	1.2	1.3	1.5	1.7
United States								
Fed Funds Target Rate	0.25	0.25	0.25	0.25	0.75	1.25	1.75	2.50
3-month T-bill	0.20	0.15	0.20	0.35	0.75	1.50	2.25	3.00
2-year Treasury	0.80	1.05	0.95	1.20	1.55	2.20	2.85	3.50
5-year Treasury	1.66	2.65	2.50	2.80	3.20	3.70	4.00	4.15
10-year Treasury	2.66	3.80	3.60	4.00	4.50	4.75	4.95	5.10
30-year Treasury	3.53	4.70	4.55	4.90	5.20	5.40	5.50	5.55
Real GDP (q/q, ann. % change)	-5.7	-2.0	1.0	4.0	3.5	3.5	3.0	2.5
Real GDP (y/y, % change)	-2.5	-3.7	-3.3	-0.7	1.6	3.0	3.5	3.1
Consumer Prices (y/y, % change)	-0.2	-0.8	-1.9	0.7	1.6	1.6	1.8	2.1
Core CPI (y/y % change)	1.7	1.7	1.3	1.4	1.2	1.1	1.4	1.6
Spreads								
Target Rate	0.25	0.00	0.00	0.00	-0.25	-0.50	-0.50	-0.50
3-month T-bill	0.20	0.10	0.05	-0.05	-0.20	-0.45	-0.50	-0.50
2-year	0.28	0.30	0.20	0.10	-0.10	-0.20	-0.30	-0.40
5-year	0.10	-0.10	-0.10	-0.10	-0.10	-0.15	-0.15	-0.15
10-year	0.12	-0.25	-0.25	-0.30	-0.30	-0.30	-0.30	-0.30
30-year	0.03	-0.50	-0.50	-0.45	-0.45	-0.40	-0.40	-0.40
Central Bank Rates								
Bank of England	0.50	0.50	0.50	0.50	0.50	0.75	1.25	1.75
European Central Bank	1.50	1.00	1.00	1.00	1.25	1.50	1.75	2.00
Bank of Japan	0.10	0.10	0.10	0.10	0.10	0.25	0.25	0.25
Reserve Bank of Australia	3.25	2.75	2.75	3.00	3.25	3.50	3.75	4.00
Swiss National Bank	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.25
Exchange Rates								
Canadian Dollar (USD/CAD)	1.26	1.11	1.09	1.06	1.05	1.04	1.02	1.00
Canadian Dollar (CAD/USD)	0.79	0.90	0.92	0.94	0.95	0.96	0.98	1.00
Yen (USD/JPY)	99	98	98	95	92	90	88	85
Euro (EUR/USD)	1.33	1.42	1.45	1.50	1.53	1.56	1.58	1.60
Euro (EUR/GBP)	0.93	0.88	0.89	0.91	0.91	0.91	0.91	0.91
Sterling (GBP/USD)	1.43	1.62	1.63	1.65	1.69	1.72	1.74	1.75
Australian Dollar (AUD/USD)	0.69	0.80	0.82	0.85	0.87	0.89	0.91	0.94
Mexican Peso (USD/MXN)	14.2	13.9	14.2	13.9	13.9	13.8	13.9	14.0
Chinese Yuan (USD/CNY)	6.8	6.8	6.8	6.8	6.6	6.5	6.4	6.3

Forecast Changes

Financial

- The U.S. yield curve is expected to steepen further through the remainder of this year, with bond yields moving higher in response to the improving outlook for growth, and renewed inflation concerns that are being aggravated by a rapidly increasing debt burden and a sharply weaker dollar.
- We expect the Fed to begin raising the funds rate early in 2010, with the cumulative increase pegged at 225 bps. Following the Fed's lead, the Bank of Canada will also begin tightening policy later in 2010Q1, with the total increase in the overnight rate projected at 175 bps next year.
- Canadian interest rates across the yield curve are expected to move below those in the United States, reflecting comparatively better longer-term fiscal, debt, and inflation prospects than in the United States.
- The U.S. dollar is expected to continue to lose ground against most of its global trading partners, as many investors increasingly favour a diversified asset strategy with the global economy on a firmer economic foundation. Longer-term risks for the greenback have been exacerbated by the massive jump in foreign indebtedness used to help stabilize the hard-hit U.S. economy. In this environment, currencies in commodity-rich countries such as Canada and Australia should outperform.

Scotia Economics

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