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# Capital Points

— A weekly look ahead at Canadian and U.S. financial markets

## Federal Budget Is Latest Reason To Over-weight Canada

A great week for CAD is likely symbolic of more to come in Scotia's forecast for a return to parity against the USD cross and beyond. That remains a reason for over-weighting Canada in global portfolios. A strong growth report started it all especially given its quality (see page 6). A shift in the Bank of Canada's bias added to CAD momentum on growing market acceptance that the BoC is shifting to a fairly near-term tightening bias (see page 5). But it was the Federal Budget that presented a stay-the-course path that capped it all off. Critics are hardly in short supply in Ottawa, but we think the budget deserves a solid review and that's our prime focus in this article.

## Canada is The Poster-Child of Fiscal Health

How soon we forget. Over a year ago, most were pressuring the federal government to roll out stimulus in order to stem the decline in expectations as global markets and the economy slid with stunning swiftness. Now, some are admonishing policymakers for the resulting deficits. This budget was a good one, plain and simple (see page 10 for Mary Webb's assessment). It avoided the U.S. mistake of rolling out more stimulus before giving the first round a chance to work, thereby only magnifying deficits and treasury issuance. It also escaped the European woes associated with pressured fiscal exits too early in the game.

Why was this possible? Because Canada is the poster child for relative fiscal strengths across the world. There isn't any loaded gun to anyone's head that would justify radical fiscal action. In fact, the country is in a sweet spot, with growth recovering nicely but amid considerable risks that merit the completion of existing fiscal initiatives. It also lacks material market pressures for radical change. Canada's low net debt-to-gdp ratio affords flexibility and as it peaks in the mid-30s in percentage terms, it will remain the envy of much of the industrialized world. It was necessary to leverage that enviable position to bring forth stimulus, and at still-low levels it does not invoke a sense of urgency to pull forth a hasty, radical change in course.

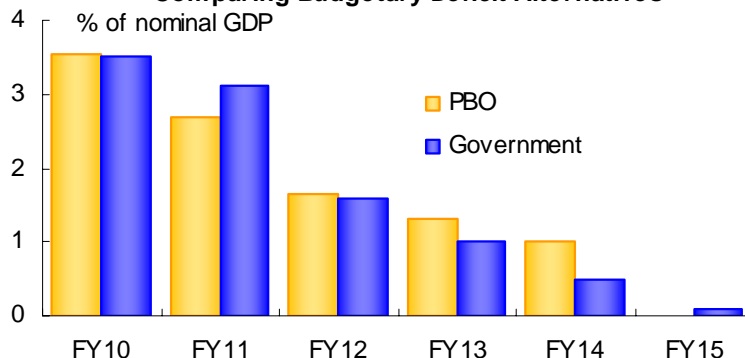
Are there risks to their projections? Sure. For one, it wasn't evident that many were talking upside risks to growth yesterday. There are also downside risks to growth and upside risks to bond yields and hence interest expense. There are risks that economists will be blamed if deficit projections go awry despite material differences of opinion on the growth outlook across economists, but we all know that revenue and expense forecasts are hardly without a plethora of other potential errors and judgement factors well beyond just the underlying macro assumptions. But Canada's fiscal flexibility to address such potential challenges is the envy of most other economies, and its fiscal position continues to give cause for over-weighting CAD in portfolios.

In any event, as the accompanying chart depicts, the gap between the deficit views of the government and the lightning-rod forecasts of its fiscal watch dog, the Parliamentary Budget Officer, amounts to peanuts. Billions in differences between deficit projections years down the road wind up as rounding errors when expressed as a share of the C\$1.5 trillion economy. By FY2014, the gap in opinions is a puny half-point of GDP, and the longer-range doom and gloom views of the PBO are significantly predicated upon questionable

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### Comparing Budgetary Deficit Alternatives



Source: Office of the Parliamentary Budget Officer, Finance Canada, Scotia Capital Economics





demographic views. Long-range population forecasts have always been fraught with substantial error, demographers have always tended to over-emphasize their single factor theories of everything, and macroeconomic inferences based upon demographic change are themselves highly challenging. Indeed, little that demographers predicted over the past twenty years (or all the way back to Malthus over 230 years ago for that matter) has ever come true as witnessed by the fact that demographers twenty years ago often argued we'd never see a housing and consumption boom like the 1980s ever again.

Further, critics who pan the government for not doing enough for the little guy should have another look at the tax loophole features of this budget. It is not kind to stock options (pages 353-57 of the budget), and the disallowance of foreign tax credit generators accompanied by a measure to demand more reporting of such activities is a shot at multinationals (see pages 369-70, 382). I think most analysts missed those measures because like other past sleepers, they were buried in the back pages of the budget in an annex. Those were the sleeper issues in this budget. The stock option hit is a \$300-400 million source of revenue to the government and the biggest feature of the emphasis upon closing so-called tax loopholes, although to repeat, the government says it cannot estimate the revenue gain from the disallowance of foreign tax credit generators because it is uncertain of the scale and scope of such activities.

Lastly, this budget also served as a fitting capper to the BoC's statement on Tuesday. A stay-the-course budget like this one should give the BoC more comfort in taking away the punch bowl. It's the total policy environment that matters. Material additional fiscal cuts would have hampered the BoC's ability to hike. Stimulus already turns toward drag next year, and the effects on the economy don't need further aggravation by aggressive spending cuts amid hopes that the private sector can continue to carry growth forward. By week's end, the ball is back in the BoC's court.



## Next Week's Key Market Risks

With no central bank meetings scheduled for next week in either North America or across the pond, it should be a little quieter for markets. Having said that, several first-tier North American economic reports will be released, including trade in both Canada and the U.S., Canadian housing starts and employment, as well as U.S. retail sales. Bank of Canada Governor Carney will also be speaking in Ottawa next Thursday (details released on Monday) while Treasury supply will return next week. While we aren't expecting any surprises given that the BoC just released its rate announcement this week, we will make sure that there aren't any hints of an earlier hike than the markets are currently pricing in. Europe also gets pounded by industrial production and trade data in France, Germany, Italy and the UK which we elaborate on below. Asia, on the other hand, is faced with five major data releases from China Wednesday night, including CPI, retail sales, industrial production, fixed assets and trade as well as Japanese industrial production and a revision to Q4 Japanese GDP. In Oceania, the Reserve Bank of New Zealand delivers its rate announcement mid-week while Australia releases February employment.

## CANADA

Housing and employment will be the main themes for Canada next week, with housing starts kicking off the week on Monday, followed by the new housing price index on Thursday and employment on Friday. After beating expectations by a long shot in January, **housing starts** are set to climb once more in February, supported by low borrowing costs, relatively strong household finances, lean inventory levels and job growth. Single-family inventories are now at their lowest level since September 2006, spurring on the advancement of building permit volumes, housing construction and new home prices over the past six months. In fact, taking this week's January building permits report into account, single-family building permit volumes have now increased in nine out of the past 10 months which, as illustrated in chart 1, suggests we still have several months of gains in housing construction ahead. This may be true if resale supply remains weak and demand remains strong. However, since October, new resale listings have started to return to the market after over a year and a half of retrenchment, providing a lift to supply. In addition, while we will likely see a spike in short-term buying intentions in the Spring as prospective buyers rush in to purchase a home before the new mortgage rules become effective, the HST hits Ontario and BC and rate hikes kick in, the longer-term demand forecast does not look as promising although increased supply will help provide some relief to record-high home prices facing Canadians right now.

Further improvements in the **job market**, however, may offset some of the expected pull-back in housing demand from higher borrowing costs, the introduction of the HST and the new mortgage rules. While the job gains in January may be explained away given the huge gain in part-time employment and the services sector during the month, there is no doubt that the Canadian labour market is starting to improve, with gains in six of the past 10 months. And, February will likely be no different with our own expected gain of 20,000 workers as economic activity continues to rebound in Canada. In contrast, the U.S. labour market has only posted one monthly gain since December 2007 although we do expect to see the second positive print in March once the winter blizzard effects wear off. Part of the reason behind this difference is that employment has held up relatively well in Canada compared to the U.S., in part due to labour hoarding, which has helped support domestic demand during the recent recession. The flip side of that, however, is that the U.S. was also hit harder by the credit crisis which had firms slashing both bodies and hours worked at a faster pace than in Canada. In addition, U.S. output is recovering faster than hours worked so the distortions to productivity defined as output per hour worked are likely to be short lived. As a result, productivity growth in the U.S. surged to what are now unsustainable levels, while Canadian productivity remained morose (chart 2).

Lastly, Canada's **trade deficit** will likely shift to a trade surplus once again in January after strong crude oil prices and increased demand from the U.S. and Europe lift export growth at a faster pace than imports. That's not to say that we won't likely observe a decent pace of import growth, especially since the Canadian dollar has strengthened over the past two months. However, business investment continues to disappoint as firms pull back on M&E spending, another culprit behind Canada's abysmal productivity record. Nonetheless, hopefully the federal government's plan to make Canada a tariff-free zone for industrial manufacturers, as put forth in the recent 2010 Budget, will provide a much-needed lift to productivity.

Moving away from data releases, Scotiabank reports Q1 2010 results on Tuesday, Canada sells C\$3bn in 2-year notes on Wednesday, while Bank of Canada Governor Mark Carney speaks at Carleton University next Thursday.

Chart 1

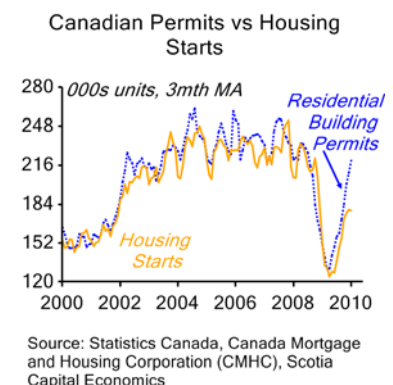
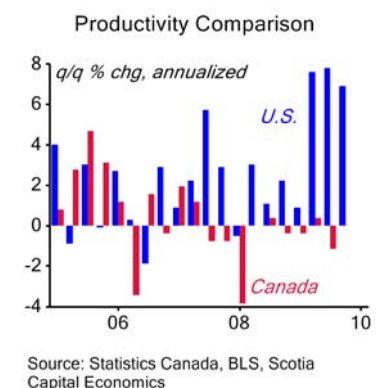
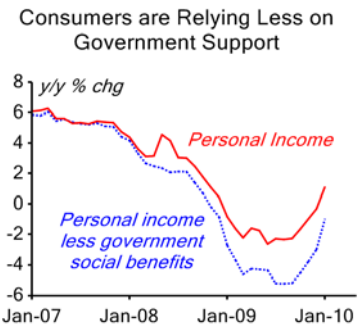


Chart 2



**UNITED STATES**

Should be a pretty quiet week in the U.S. with only two major data reports on tap: **retail sales and trade**. While the U.S. consumer returned in January, turning out a strong print for both headline and core retail sales, severe winter weather in early February through much of the northeast likely kept U.S. consumers out of the malls, leading to a decline on retail sales during the month. While it is difficult to quantify the impact precisely, add to this picture a decline in gasoline prices as well as autos during the month and we are looking at a contraction in sales on the order of 0.3% m/m for the headline and 0.1% m/m on core. This will likely result in a strong positive print in March as the distortion is corrected the following month. In addition, income gains are returning, with wages and salaries up 0.4% m/m in January, the strongest monthly gain since April 2009, as firms begin to hire once again. This also reduces consumers' dependence on government support which increased sharply through the recession, as illustrated by the narrowing in the gap in chart 3. In fact, without the winter weather distortion, February's nonfarm payrolls report likely would have shown a positive print as job growth gets underway. Thus, look to April for a better guide of the underlying trend in retail sales and consumption in general.

**Chart 3**

Source: Bureau Of Economic Analysis, Scotia Capital Economics

On the **trade front**, stronger consumer demand in January, an over 5% gain in crude oil prices and a 2% strengthening in the U.S. dollar will likely lead to a surge in imports once again during the month. This will mark the fifth consecutive monthly increase in imports as the U.S. consumer returns after retreating during the recession. Export growth will also likely continue, although at a weaker pace than imports, to lead to a further widening in the trade deficit.

**US supply returns** next week with three bond auctions: US\$40 billion 3-year notes on Tuesday, US\$21 billion 10-year reopening on Wednesday and US\$13 billion 30-year reopening on Thursday.

The **Fed heads into blackout period** next week ahead of the next FOMC meeting on March 16. This means we will get a lighter than usual speech roster for the week although Chicago Fed President Evans (non-voting) and New York Fed President Dudley (voting) are still set to speak.

**INTERNATIONAL**

Germany, France, Italy, Euro zone, Japan and China all release their January **industrial production** reports next week. See page 9 for a more detailed discussion of the current global production upturn.

In addition to industrial production, **China** will also release consumer prices, retail sales, fixed assets and trade Wednesday night.

Lastly, **Australia** provides an update on employment while the **Reserve Bank of New Zealand** releases its rate announcement mid-week. While we aren't expecting a move in March, the central bank has already announced that they will hike rates in April, noting that "We continue to expect the Reserve Bank to start removing the stimulus in April: the medium-term inflation outlook will appear less comfortable over time." In addition, they noted that they "now expect the pace of rate increases to be of 25 basis points instead of 50 points in the initial meetings." No surprises expected here.

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[derek\\_holt@scotiacapital.com](mailto:derek_holt@scotiacapital.com)**BoC Shifts Toward More Hawkish Bias**

It's what was *not* in the BoC statement on March 2nd that counts at least as much as what *was* in there, with two points that can be made in this regard. First, there is zero mention of when the BoC now thinks the Canadian economy closes off excess capacity nor any chatter about excess supply. Prior statements had consistently emphasized 2011Q3 as the magic balancing point between aggregate demand and supply. And, while we had thought the risk was in terms of advancing the point of balance one quarter closer at hand, the BoC avoided the issue entirely in the end by removing that statement, sending a hawkish message. The second omission was that the BoC deleted the statement made in the January announcement that "In its conduct of monetary policy at low interest rates, the Bank retains considerable flexibility, consistent with the framework outlined in the April 2009 MPR." That's a clear signal that the quantitative easing debate has been thoroughly abandoned in favour of more optimism and clearer exit signals.

Nonetheless, one thing that seems to be clear is that the minority opinion that rates are on hold until next year has even fewer participants now, and makes even less sense than it did before. But, inflation readings are sometimes misinterpreted in their potential effects on the BoC's actions. Current inflation readings are usually misreported as being at target only because of weak year-ago base effects. That's simply not correct as the monthly annualized and seasonally adjusted gain in the latest report had the BoC's core inflation up 2.4% and gains were fairly broadly based. It may well be short-lived, but so what. Monetary policy is forward looking and the bigger issue is that one has a strong reason for expecting the BoC to materially lower its output gap forecast. This could be done via both upward revisions to demand resilience as growth has come in stronger than the BoC anticipated, and/or perhaps even through fewer supply excesses partly as tech obsolescence burns off the capital stock at a faster than expected pace. It may downplay the role of output gaps entirely given concern that inflation and wage readings have proved to be stickier than the real-side decline in activity over the past couple of years may have been expected to achieve. On net though it's the forward-looking inflation expectations that matter the most. As excess capacity is wound down earlier than anticipated, inflation can be reasonably expected to sustainably hit the BoC's 2% target earlier, and hence expectations for when withdrawing the punch bowl will occur have to be advanced. We have yet to hear a convincing argument as to why the BoC cannot hike in Q2 at either the April 20th meeting which will give the BoC full opportunity to update its forecasts through the associated MPR in a package of revised views, or the June 1st meeting after releasing that updated set of forecasts. What makes us nervous is the very consensus view that the BoC is on hold until Q3 which is often based upon a total misreading of its conditional commitment. It's not a promise; it is a commitment based on the outlook for inflation which could change at any point.

*Bottom line:* Although the print forecast from Scotia Economics is for a Q3 hike, a Q2 rate hike on April 20th or June 1st is shaping up in our opinion. The bias shift is somewhat in line with what we thought could be the signals but the comprehensive nature of omissions and changed wording is on balance more material than expected. Why do it all in the March statement instead of March and April, unless one is rapidly shifting toward priming markets for a Q2 hike?

**Details from the Statement:**

\* The BoC noted that inflation risks "are roughly balanced" which deletes the prior reference to risks being "tilted slightly to the downside." The general upside and downside risks to inflation remain unchanged. It also acknowledged that "core inflation has been slightly firmer than projected" and weighed in on whether or not this is temporary by walking the line between pointing to both transitory factors and higher level of economic activity. That too dismisses the segment of market opinion that thinks upsides to core inflation are only one-offs and year-ago base effects, something we've dismissed in pointing to strong m/m core inflation as well.

\* The BoC acknowledged that growth has been "slightly" higher than it had projected in its January MPR which may be a tad charitable. 5% Q4 growth sharply surpassed private sector consensus expectations set back in January, and the BoC's January MPR that had forecast 3.3%. The recovery is frankly coming in stronger than most including the BoC had anticipated.

\* Interestingly, the BoC retained a CAD reference noting that "persistent strength of the Canadian dollar and the low absolute level of U.S. demand continue to act as significant drags on economic activity in Canada." That's despite the fact that net trade contributed positively to Q4 GDP growth, and despite the view that a strong CAD stimulates core elements of the Canadian economy given high import propensities to domestic consumer spending and business investment.

\* The BoC retained its conditional commitment reference to leave rates unchanged until the end of 2010Q2. They frankly had little choice on this count. Deleting that would have thoroughly lit up the short-end in a heart beat and contradicted the goal of gradually

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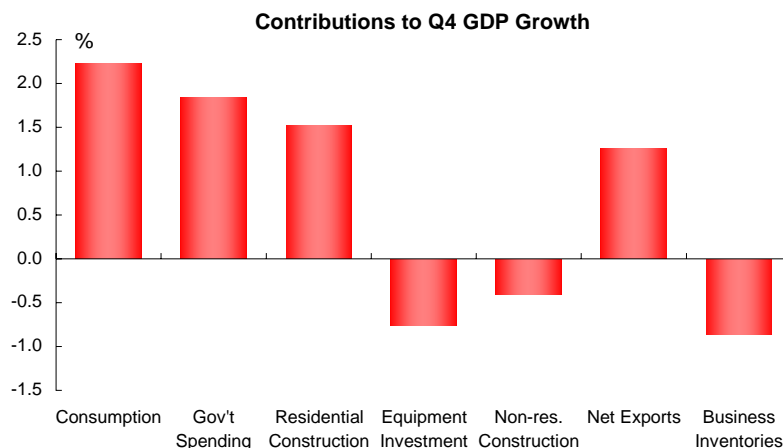
signaling a bias change in order to prime markets for rate hikes. But before, the BoC had stated “conditional on the outlook for inflation” and this is now expressed as being “conditional upon the current outlook for inflation.” That’s a gentle wording shift that may also signal revised inflation BoC expectations.

\* Another tone shift came in the second paragraph of the statement as the BoC noted the substantial improvements in domestic demand in both emerging-market and advanced economies. Not only did the wording shift from “continued improvements in financial conditions and stronger domestic demand growth in many emerging-market economies” to “strong domestic demand growth in many emerging-market economies” but the statement also added that the global economic recovery is also being “supported in advanced economies”.

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[derek\\_holt@scotiacapital.com](mailto:derek_holt@scotiacapital.com)**Canada’s Recovery Over-Shoots BoC’S Expectations**

Canada landed a fifteenth gold medal on Monday morning with recovery evidence that exceeded expectations. At 5% annualized, the pace of the recovery is now materially stronger than the BoC’s expectations, and inflation is proving stickier than the BoC had anticipated. This was the strongest quarterly gain since 2000Q4. Sustainability into Q1 at these growth rates is questionable, but it’s difficult to still defend the need for emergency levels of monetary stimulus at the zero lower bound on rates if growth and inflation are exceeding expectations and funding concerns are all but gone. Therefore, the flattener’s timing is on solid ground now.

What is most impressive about Q4 growth is that unlike the U.S., there is no knocking holes in Canadian growth through inventory effects. That’s because inventories continued to detract from Q4 Canadian growth in contrast to the US where inventories positively contributed about two-thirds of the US GDP lift. Indeed, Canadian inventories fell by over \$4 billion in a marked acceleration from the \$1.5 billion reduction in Q3. Thus, Canada’s Q4 growth is broadly based across final demand components and stands up very solidly (see accompanying chart).



The BoC’s January Monetary Policy Report had expected 3.3% Q4 growth after 0.4% Q3 growth, such that a 5% actual Q4 and a half-point upward revision to Q3 are materially in excess of the BoC’s expectations. With growth being stronger than expected and inflation sticky at target on year-ago comparisons and above target on month-over-month readings, we remain of the view that the BoC has the full green light to hike as emergency conditions have passed and with it justification for sticking to the zero lower bound on rates. Scotia Economics’ official forecast is for the BoC to hike in Q3, and we think there is the strong risk of going in Q2. That would not be a violation of the conditional commitment since inflation is higher than the BoC anticipated to this point.

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[derek\\_holt@scotiacapital.com](mailto:derek_holt@scotiacapital.com)**Canada On Verge of Inventory-Led Growth**

While inventories were a main contributor to U.S. Q4 growth of 5.9%, inventories subtracted almost a full point from Canadian growth and yet it still came in at 5%. As a result, inventories have become a key issue for the sustainability of Canadian growth, especially since Canada has consistently lagged the inventory adjustment cycle that is more advanced in the United States (Flash Points, August 31st 2009 “Canada’s Bloated Inventories Will Mute Recovery”). However, we think Canada may be near the end of its inventory disinvestment period. This effect could well combine with other areas of strength in order to sustain GDP growth at rates above the Bank of Canada’s 2010Q1 expectations from the January MPR. This is a positive development in any cycle that feeds on itself to drive other improvements in the economy, and would add to the case for moving away from the emergency rate setting earlier than the Q3 expiration of the BoC’s conditional commitment.

At the economy-wide level, inventories are being aggressively wound downward while sales are now coming back, leading to a whopping five percentage point decline in the inventory-to-sales ratio in just two quarters since its peak in 2009Q2 (chart 1). About one-third of that move has been due to falling inventories (chart 2) and two-thirds to rising sales (chart 3). We think the ratio will fall in 2010H1 to the low-70s on stabilizing inventories and further sales growth. All figures are in real terms, and conditions by major business sector are reviewed below with manufacturers completing the largest adjustments.

**Manufacturers**

Manufacturing inventories are at their lowest levels since 2004Q3 in absolute terms after a little over a year’s worth of massive inventory shedding (chart 4). That has brought the inventory-to-sales ratio to its lowest level since 2008Q3. The I:S ratio has not corrected as rapidly as the stock of inventories because sales dropped 26% from the 2006Q1 peak until the 2009Q2 trough before starting to recover over the back half of last year.

**Wholesalers**

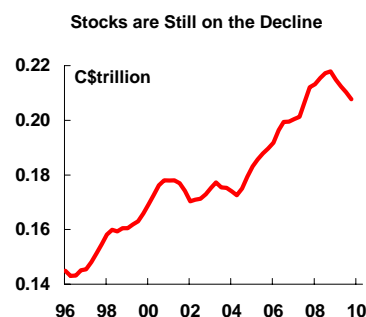
Wholesalers have dropped their inventories back to 2007Q2 levels, and their inventory-to-sales ratio back to 2008Q3 levels (chart 5). Wholesalers haven’t had as much of a need to shed inventories because sales have been more resilient, in part fed by the CAD influenced lift to importers.

**Retailers**

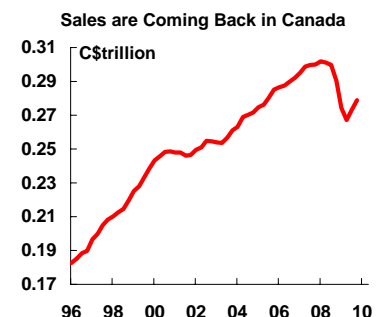
Total retail inventories are at their lowest since 2007Q2, and so is the inventory-to-sales ratio as sales have also rebounded to a new record high (chart 6). Within the retail segment, the largest swing has been at auto dealers as experienced by anyone who has tried to buy a car or truck recently. In fact, inventories at auto dealers are at their lowest since 2005Q4 while the ratio of inventories to sales is at its lowest since 2002Q1 (chart 7).

**Chart 1**

\*Sales and inventories in C\$2002.  
Source: Statistics Canada, Scotia Capital Economics

**Chart 2**

\*Inventories in C\$2002.  
Source: Statistics Canada, Scotia Capital Economics

**Chart 3**

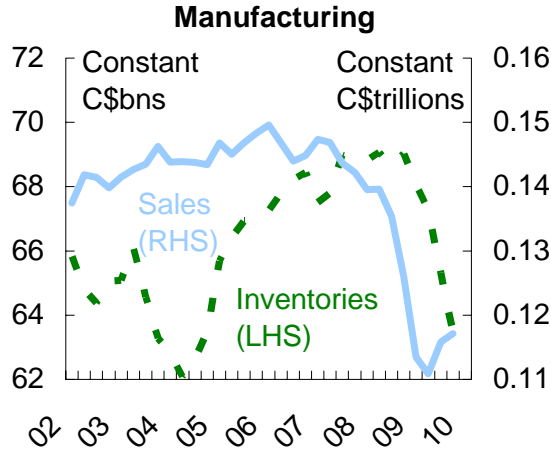
\*Sales in C\$2002.  
Source: Statistics Canada, Scotia Capital Economics

**Canadian Macro Comment (continued)**

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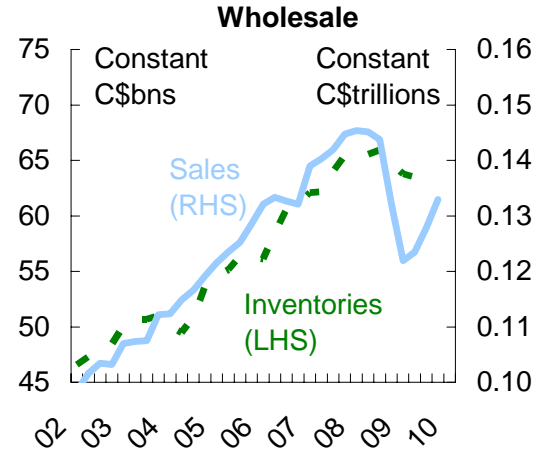
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**Chart 4**



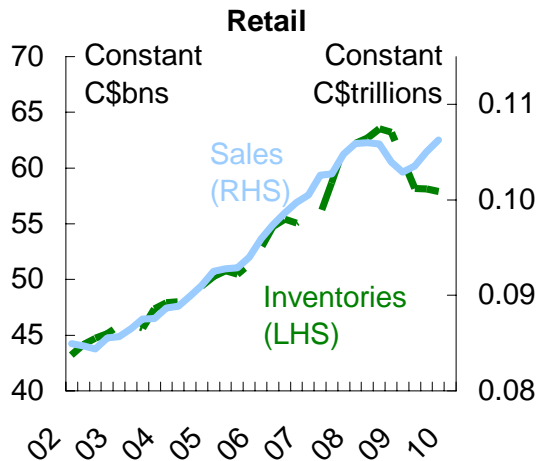
Source: Statistics Canada, Scotia Capital Economics

**Chart 5**



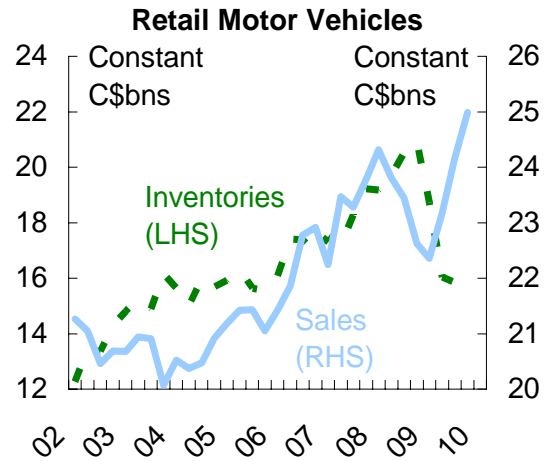
Source: Statistics Canada, Scotia Capital Economics

**Chart 6**



Source: Statistics Canada, Scotia Capital Economics

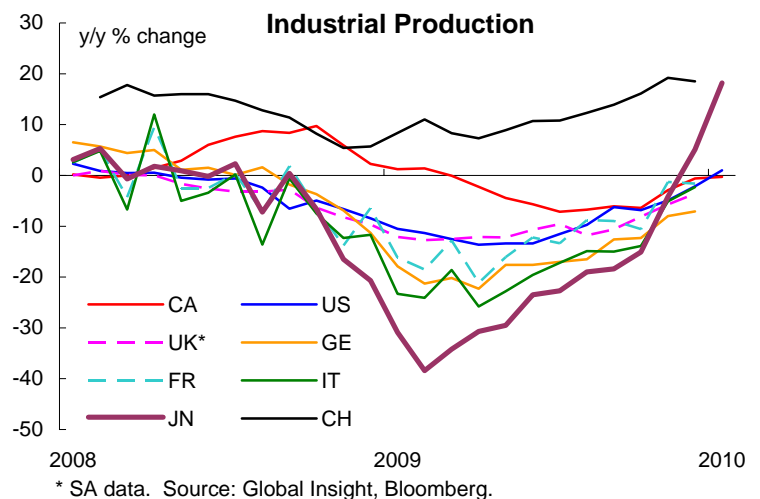
**Chart 7**



Source: Statistics Canada, Scotia Capital Economics

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[derek\\_holt@scotiacapital.com](mailto:derek_holt@scotiacapital.com)**Synchronized Global Production Upturn**

Expect further improvement in **industrial production (IP)** numbers across the board next week as Germany, France, Italy, Eurozone, Japan and China all release their January IP reports (or revisions to the preliminary report as is the case for Japan). As the accompanying chart illustrates, while we are currently in a synchronous global production upturn as global supply chains recover, the speed and timing of the production rebound differs by region with Asia leading the way. China stands out among the countries mentioned above given that industrial production never turned negative on a year-over-year basis through the recent recession although the growth rate did fall remarkably close to zero before rebounding back up to 19.2% in November 2009. While December experienced a slight decline to 18.5% as stimulus starts to be reduced, January is expected to see another 19% growth number as China's economy remains red-hot. Perhaps somewhat surprisingly, Japan is not far behind China, registering a growth rate of 18.2% y/y in the preliminary January IP report. Unlike China though, Japan did experience a huge collapse in production through the recession, with IP bottoming at 38.4% y/y in February of last year. In fact, Japan experienced the largest decline in IP amongst the G7, providing Japan with the chance to also lead those same countries on the production upturn. The Eurozone, Canada and the U.S. all seem to be clumped together, with a positive IP print already registered for the U.S. in January, while Germany and France are both set to publish their first positive IP print - also for January - since 2006. What is most interesting, however, is that France, Germany and Italy all experienced an earlier and deeper bottoming in IP compared to the U.S. and Canada. Thus, it looks like the UK and Canada lag the G7 pack having not published a positive year-over-year print yet.



What does this mean for policy? While all of the countries have been affected by the coordinated production upswing, each country is facing different political and economic challenges that lead to uneven policy effects. In the U.S. and Canada, the production recovery is a big impetus behind the unwinding of non-standard measures but in Japan, monetary authorities remain shackled by the current deflationary environment despite leading the way on production. In fact, the BoJ is currently considering further quantitative easing to help fight the current deflation situation. In the Eurozone, while industrial production may be strong, growth in Germany especially has been morose while inflation remains quite tame. In addition, the fiscal problems in several other European nations remain uncertain, leaving the ECB with room to sit on the sidelines for a while longer before pulling the stimulus chains back. Lastly, China has already started to tighten monetary and fiscal policy to lower the risk of overheating as it remains the fastest growing major economy, with an expected 9.5% gain in economic activity in 2010, helping to fuel trade and thus growth around the world.

## Canadian Fiscal Policy

### Canada's 2010-11 Federal Transition Budget

#### Highlights

Ottawa's near-term deficit reduction path is only slightly altered from its September forecast. The deficit for fiscal 2009-10 (FY10, ending March 31) is expected to be \$54 billion versus the \$56 billion September estimate. Sticking to its game plan of fully implementing the second year of its stimulus package, a \$49 billion shortfall is projected for FY11, \$4 billion higher than the September estimate. After deficits of \$28 billion, \$18 billion and \$9 billion in the following three fiscal years, a very minor \$2 billion shortfall is forecast for FY15, with balanced books assumed in FY16, just beyond Ottawa's forecast horizon.

As previously committed, the deficit reduction strategy involves no tax increases, Defence spending rises albeit at a slower pace after FY12 and, the growth tracks of major transfers to individuals and other governments remain intact. In addition, the federal plan to trim the general corporate income tax rate to 15% by 2012 is still in place.

The FY11 deficit, at 3.0% of GDP, will remain the envy of our G7 partners, as will Ottawa's net debt, rising to just over 35% of GDP in FY11 and FY12 before edging lower. Relative to revenues, the debt service peaks at 14.6¢ of each revenue dollar in FY13. Yet in absolute terms, interest charges are forecast to climb from just less than \$30 billion this year to almost \$41 billion in FY15, reducing Ottawa's flexibility.

Ottawa's financial requirement will drop from an estimated \$71 billion in FY10 to \$45 billion in FY11. To lengthen term with the anticipation of rising rates, Ottawa plans gross bond issuance of \$95 billion for FY11, only slightly lower than the \$102 billion issuance in FY10.

A centre-piece of the *Budget* is making Canada a tariff-free zone for industrial manufacturers, a first among the G-20. All remaining tariffs on manufacturing inputs and machinery & equipment will be eliminated by January 1, 2015, with the majority removed immediately.

Ottawa expects its saving measures to total \$0.8 billion in FY11, climbing to \$2.0 billion in FY12 and eventually to almost \$6 billion by FY15. Part of this saving involves closing tax loopholes, with a number of measures affecting businesses and households, such as changes to the tax treatment of stock options.

The risk in the Budget estimates is the ability to sharply cut the deficit from \$49 billion in FY11 to \$28 billion in FY12, and accomplish a further \$10 billion cut in red ink in each of the two following fiscal years. This dramatic deficit reduction occurs during 2011 and 2012 when Finance Canada assumes real growth averaging over 3% annually, a forecast that could prove optimistic, requiring Ottawa to undertake additional saving.

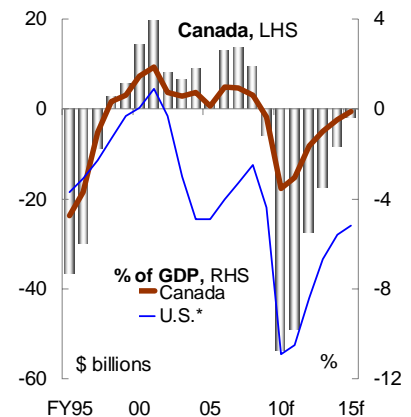
The market reaction to this *Budget* is likely to be muted, with many of the factors driving the near-term deficits already known. Canada's fiscal advantage entering the downturn, relative to most of its trading partners, is well recognized, and proceeding with the second year of stimulus offers some insurance in highly uncertain times. There will, however, be significant impact across industries from the decision to make Canada a tariff-free zone, as well as from the proposed domestic and international tax changes, including the measures to close perceived tax loopholes.

#### Fiscal Details

##### The Second Year of Ottawa's Economic Action Plan Stimulus

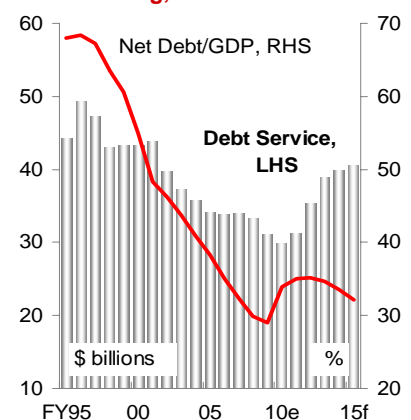
The second year of the two-year stimulus package will be implemented with few changes from last year's Budget and the government's updates. At \$19.2 billion, plus assumed provincial/territorial participation of \$6.0 billion, a \$25.1 billion boost is planned, 31% less than last year's \$36.5 billion assist. With the recovery still at an early, fragile stage, the gradual withdrawal of monetary stimulus, and importantly for Canada's small open economy, the winding down of stimulus around the world, maintaining some economic support for our businesses and households should help private-sector growth regain sustainable traction.

#### Federal Budget Balances



\* Excluding Social Security surplus.  
Source: Finance Canada, OMB;  
U.S. deficits and GDP forecasts:  
Scotia Economics.

#### A Moderate, But Rising, Debt Burden



Source: Finance Canada; GDP  
forecast: Scotia Economics.

**Canadian Fiscal Policy (continued)**

A number of the Plan's measures should have important pay-offs this year. As business sees demand picking up, the measures allowing full expensing of computer equipment purchased before February 2011 and, for manufacturers and processors, the 50% straight-line depreciation allowed on machinery and equipment purchases before January 1, 2012, should become increasingly attractive. Alongside the removal of all tariffs on capital imports, the strength of the Canadian dollar, reducing their effective price, should support productivity growth.

**Positioning Canada for the Future**

The government's key initiative is the removal of tariffs on machinery & equipment and manufacturing inputs for the manufacturing sector. The government estimates that more than \$5 billion in imports will be liberalized, eventually providing Canadian business with \$300 million in annual duty savings. This also reduces custom compliance costs, eliminates the administrative burden of origin and drawback regulations and simplifies Canada's tariff structure.

For the telecommunications sector, the existing restrictions on foreign ownership of Canadian satellites will be removed.

The Budget measures to specifically support growth add to \$900 million in FY11 and \$600 million in FY12. They include an additional \$178 million for education and internships, increased research grants, and funding for a broad array of specific projects such as Genome Canada, a Canadian High Arctic Research Station, developing new avenues for medical isotope production and the RADARSAT Constellation Mission, the next generation of advance radar remote sensing satellites. As a two-year pilot, a Small- and Medium-Sized Enterprise Innovation Commercialization Program will be launched to demonstrate innovative products. The Next Generation Renewable Power Initiative will support the development of green energy technology for the forest sector.

A commitment to reducing regulation includes creating a Red Tape Reduction Commission to review federal regulations and streamlining the Northern Regulatory Regime to facilitate new resource projects in the North.

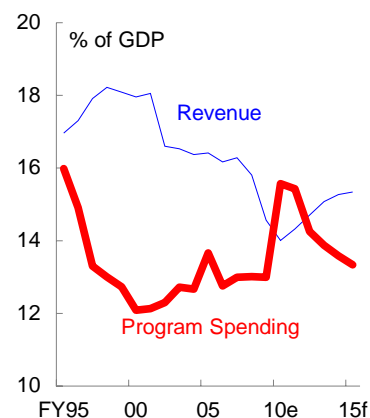
Reflecting the government's incremental approach to improving Canada's international tax rules, proposals in this *Budget* offer estimated tax relief of \$30 million in FY11 and \$25 million in FY12. With the Accounting Standards Board requiring Canadian public companies to adopt International Financial Reporting Standards (IFRS) as of 2011, Ottawa will review the impact of IFRS on the tax system to make adjustments where appropriate.

**A Start on Expenditure Restraint**

Program spending in FY10 is expected to jump 14.4%, less than September's 16.4% estimate, followed by a 4.8% rise in FY11. From FY12 to FY15, the government plans to limit annual program spending growth to just 0.8%, reflecting the successful unwinding of the temporary measures in the stimulus package and Ottawa's saving plan.

In the near-term, the government proposes to freeze politicians' salaries and allow no increase in departmental administration costs from FY11 through FY13. For FY11, this means that Departments, except for Defence, must make cuts to accommodate the 1.5% public service wage increase. Scheduled growth in the Defence department will be slowed, saving \$1 billion by FY15. In addition, International Assistance, slated to rise 8% annually, will be capped after it reaches \$5 billion in FY11. By FY15, this represents a saving of almost \$2 billion.

A number of strategic reviews are expected to trim costs by \$100 million in FY11 and \$250 million by FY12. These reviews include a reassessment of overhead costs, the ongoing Corporate Asset Management Review and a reduction in Governor-in-

**Revenue and Expenditure Paths**

Source: Finance Canada; GDP forecast: Scotia Economics.

**Economic Assumptions\***  
annual % change except where noted

	Scotia Economics		
	2009	2010f	2011f
<b>Canada:</b> Real GDP	-2.6	3.2	2.8
Nominal GDP	-4.5	5.7	4.8
CPI - All Item	0.3	1.8	2.2
Unemploy. Rate,%	8.3	8.2	8.0
Oil Price, US\$/bbl	61.8	83	87
3-Month T-Bills,%	0.4	1.0	2.2
10-Year Bonds,%	3.2	4.0	4.6
Cdn Dollar, US¢/C\$	88	101	104
<b>U.S.:</b> Real GDP	-2.4	3.6	2.6

	Finance Canada**		
	2010f	2011f	2012-14f
<b>Canada:</b> Real GDP	2.6	3.2	2.8
Nominal GDP	4.9	5.4	5.0
CPI - All Item	1.7	2.2	2.1
Unemploy. Rate,%	8.5	7.9	7.0
3-Month T-Bills,%	0.7	2.4	4.2
10-Year Bonds,%	3.7	4.3	5.1
Cdn Dollar, US¢/C\$	95.5	98.3	98.5
<b>U.S.:</b> Real GDP	2.7	3.0	3.1

\* All data: annual averages. \*\* Private-sector survey.

**Canadian Fiscal Policy (continued)**

Council positions, with more effective governance of agencies, boards, commissions and Crown corporations planned. The government will examine ways in which all compensation costs, including benefits, could be better managed.

Of major significance are the government's plans to close tax loopholes, broadly echoing Quebec's actions to limit "aggressive" tax planning. For example, increased reporting is proposed for certain tax avoidance practices. Another measure would deny claims for foreign tax credit generators incurred for the tax years starting after March 4, 2010.

A further measure, as part of its efforts to close tax loopholes, is a range of tax changes for stock options, including repealing the tax deferral election and requiring employers to remit at least part of the tax owing. Increased reporting is proposed for certain tax avoidance practices.

For income trusts transitioning to SIFT trusts owning a corporation, the subsequent use of that corporation's losses is restricted.

**The Downsized Revenue Base**

Ottawa estimates an 8.2% drop in FY10 revenues, dragged down by a 24% plunge in corporate income taxes. For FY11, an optimistic 8.1% rebound in tax receipts is assumed and for the following four years, taxes are expected to advance by a healthy 6.1% annually.

The Budget estimates assume that EI premium rates, beginning in 2011, will be raised to the maximum limit of 15¢ per \$100 of insurable earnings, with the EI account balanced by 2014.

**Financial Sector Measures**

The opportunity to expand Canada's financial services, given this sector's strong performance through recent turmoil, is recognized with federal interest in Toronto's proposed Global Integrative Risk Management Institute. To help federally regulated financial institutions diversify their funding sources, Ottawa will introduce legislation setting out a framework for low-cost source of funds — covered bonds, debt instruments secured by high-quality assets such as residential mortgages.

Most of the measures under the Extraordinary Financing Framework have expired or will expire this March 31. An exception is the Business Credit Availability Program, that in January 2010 reached its target of providing more than \$5 billion in loans and other financing at market rates through private lenders, the Export Development Corporation and the Business Development Bank. As part of this Program, the government will introduce a Vehicle and Equipment Financing Partnership with an initial \$500 million for asset-based financing in partnership with private lenders and investors.

Budget initiatives related to financial services for consumers include: an expanded mandate for the Financial Consumer Agency of Canada to provide the government with timely information; reduction of the maximum cheque hold period; additional financial institution disclosure requirements on items such as mortgage prepayment penalties, and; the Code of Conduct for the Credit and Debit Card Industry will be released shortly with a framework to monitor compliance. The government proposes that banks belong to an approved third-party dispute handling body and an independent Task Force will review the Canadian payments system.

**Ottawa's Budget Arithmetic\***  
\$ billions except where noted

	FY10 Rev.	FY11 Bud.	FY12 Bud.	FY15* Bud.
Personal Income Tax (PIT)	108.2	117.0	124.5	150.6
Corporate Income Tax (CIT)	22.3	25.5	28.9	33.2
Goods & Services Tax (GST)	25.8	27.3	28.8	33.7
Employ. Insurance (EI) Premiums	16.6	17.6	20.0	26.6
Other Revenue	41.0	43.9	46.8	52.4
<b>Total Revenue</b>	<b>213.9</b>	<b>231.3</b>	<b>249.0</b>	<b>296.5</b>
Total Transfers to Persons	69.7	72.0	71.4	77.1
EI Benefits	22.4	22.6	19.6	18.4
Other Transfers to Persons	47.3	49.4	51.8	58.7
Transfers to Other Cdn Gov'ts	51.4	56.8	56.3	62.4
Direct Program Expenditures	116.8	120.4	113.7	118.2
<b>Total Program Spending**</b>	<b>237.8</b>	<b>249.2</b>	<b>241.4</b>	<b>257.7</b>
Debt Service	29.9	31.3	35.3	40.6
<b>Total Expenditure</b>	<b>267.7</b>	<b>280.5</b>	<b>276.7</b>	<b>298.3</b>
<b>Budget Balance</b>	<b>-53.8</b>	<b>-49.2</b>	<b>-27.6</b>	<b>-1.8</b>
Non-Budgetary Transactions	-17.3	4.6	4.6	11.5
<b>Fin.Source(+)/Requirement(-)</b>	<b>-71.1</b>	<b>-44.6</b>	<b>-23.0</b>	<b>9.7</b>
<b>Net Debt</b>	<b>517.5</b>	<b>566.7</b>	<b>594.3</b>	<b>622.1</b>
<b>Annual Change, %</b>				
Personal Income Tax (PIT)	-6.7	8.1	6.4	6.5
Corporate Income Tax (CIT)	-24.3	14.3	13.3	4.7
Goods & Services Tax (GST)	0.4	5.8	5.5	5.4
Total Tax Revenue	-8.8	8.1	6.9	5.8
EI Premiums	-1.7	6.0	13.6	10.0
<b>Total Revenue</b>	<b>-8.2</b>	<b>8.1</b>	<b>7.7</b>	<b>6.0</b>
EI Benefits	37.4	0.9	-13.3	-2.1
Other Transfers to Persons	4.4	4.4	4.9	4.3
Transfers to Other Cdn. Gov'ts	10.5	10.5	-0.9	3.5
Direct Program Expenditures	17.0	3.1	-5.6	1.3
<b>Total Program Spending**</b>	<b>14.4</b>	<b>4.8</b>	<b>-3.1</b>	<b>2.2</b>
<b>Memo Items, %</b>				
Total Revenue / GDP	14.0	14.3	14.7	15.3
Program Spending** / GDP	15.6	15.4	14.3	13.3
Budget Balance / GDP	-3.5	-3.0	-1.6	-0.1
Net Debt / GDP	33.9	35.1	35.1	32.2
Debt Service / Revenue	14.0	13.5	14.2	13.7

\* Average annual growth, FY13-FY15. \*\* Includes *Economic Action Plan*.  
Source: Finance Canada; Nominal GDP forecasts: Scotia Economics.

**Canadian Fiscal Policy (continued)**Mary Webb (416) 866-4202  
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Ottawa will introduce a new legislative framework to enable credit unions to incorporate, continuing their operations as federal entities.

**The Risks That Still Exist**

Canada remains closely linked to the struggling U.S. economy, our strengthening Canadian dollar represents a hurdle for all our producers, and the global unwinding of both fiscal and monetary stimulus may not be smooth. As a small, open economy, Canada depends upon continuing solid global growth. As well, this year and next, longer-term interest rates could be higher than the government assumes and the Canadian dollar could strengthen to parity. The government acknowledges the continuing high levels of uncertainty that could require additional saving measures to stay on track.

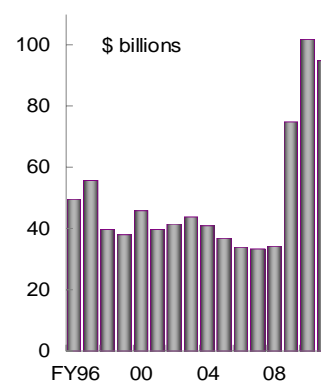
**The Debt Management Strategy**

The government's financial requirement for FY10 is expected to fall to \$71 billion from \$90 billion in FY09. Lowering this requirement below expectations was the diminished borrowing of just \$63 billion for the Insured Mortgage Purchase Program. In total, the financing required for non-budgetary transactions shrinks from \$84 billion in FY09 to \$17 billion in FY10.

In FY11, non-budgetary transactions actually represent a \$4½ billion source of funds, trimming the financial requirement to \$45 billion.

The government will be lengthening the term of its debt. After gross bond issuance in FY10 of \$102 billion, the government, even with its reduced financial requirement, still plans to issue \$95 billion, raising marketable bonds outstanding from \$295 billion in March 2009 to \$428 billion by March 2011. The fixed-rate share of the debt, at 61% in March 2009, is estimated to climb to almost 63% by the end of March 2010 and edge higher by March 2011.

Conversely, Treasury bills outstanding will drop by \$28 billion during FY11 to \$150 billion by year-end, compared with outstanding bills of \$190 billion in March 2009. The average size of bi-weekly Treasury bill auctions will decrease for the 3-month, 6-month and 1-year terms.

**Gross Bond Issuance**

\* Includes Real Return Bonds.  
Source: Finance Canada.

## Emerging Markets

### Pay 2Y TIIE for optionality and a global hedge

Most forecasters think that Mexico will be among the later countries in the region to hike rates and that the hikes will be relatively less aggressive. Forecasters surveyed by Bloomberg are expecting, by the end of the year, 225bp of hikes in Brazil, 225bp in Peru, and 200bp in Chile (prior to the earthquake), but only 50bp of hikes in Mexico. Markets clearly reflect this view. While the 1Y1Y derivative forwards in Brazil, Peru and Chile exceed reference rates by 300 to 400bp, 1Y1Y forwards in Mexico are only 160bp above their current reference rate.

Yet, in our opinion, markets may have taken this idea too far. If we consider the path of Mexican interest rate hikes suggested by the latest Banamex survey, and assume that term premia is zero, we calculate a fair value for the 2Y swap of 5.87%. In comparison, 2Y TIIE was trading at 5.97% earlier this week, implying only 10bp of term premia. Historically, the TIIE curve has incorporated much more risk premia. For example, a recent study by economists at the Mexican Central Bank on term structure found average excess holding-period returns for the 2Y tenor (an imperfect proxy for term premia) to be 70bp(1). In Brazil, we calculate the current term premia in the Jan 11 contract at 74bp based on average forecaster expectations, and that contract is shorter than 1 year whereas the Mexico contract is 2 years. In the current scenario where inflation prints above target, the economy grows above the neutral rate, and countries in the region are already considering rate hikes, at least 50bp in Mexico seems justified.



Furthermore, we think in the current environment that the risks to the Mexico rate forecasts are highly asymmetric. At this time, economists are expecting hikes of 25bps. The first hike of 25 bps is expected in July, continuing in 25bp increments for a total of 200bps. Scotiabank local economists are more hawkish than the median, and expectations of other forecasters can change quickly. As we saw back in September/October 2008, economists can easily justify more hikes, arguing that since Mexico lowered rates in clips of 75bps, they may well hike in amounts of 50bps. Meanwhile, 2y TIIE cannot go much lower than current levels because real rates are close to zero. Thus, the potential for unexpected hikes creates significant asymmetry in the risks.

The 2-year level is too low relative to other tenors, to the forecasts, and to the asymmetric risks in the current environment. Very rarely will you find a 2yr tenor trading so close to fair value, so much so that few market participants should be willing to receive a 2yr tenor at a rate 100bps above the fix unless there is the possibility of a rate cut, or unless monetary policy is at least expected to remain neutral.

A 2-year payer in Mexico is also a very cheap hedge against potential actions of the Fed and other central banks. Most investors believe that Banxico will start hiking before the Fed since inflation is expected above 5% for 2010 vs. the target of 3%. By paying the carry on this trade, you can reduce the risk related to positive global shocks of having receivers in other countries. Fed funds are already pricing 200bps of hikes by September 2011. The risk on this trade—most likely just the negative carry—is very small; however, the value of the optionality of a payer far exceeds the cost of the carry in our opinion.

We think we are currently in the lower part of the range in 2Y TIIE. The lowest it has been was 5.75% in July 2009, but the market expected more cuts then and the last cut was indeed in July 2009. Levels earlier this week were the lowest we have seen since late summer 2009. We believe the payer position holds value as 2Y rates can easily rise by 40bp.

#### Notes:

(1) Josué Cortés Espada et al, "An empirical analysis of the Mexican term structure of interest rates," Economics Bulletin, Volume 29, Issue 3, September 15, 2009.

**Emerging Markets (continued)**Joe Kogan (212) 225-6541  
[joe\\_kogan@scotiacapital.com](mailto:joe_kogan@scotiacapital.com)**Important Disclosures**

I, Joe Kogan, the primary author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in the research report.

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**International Markets**Tuuli McCully (416) 863-2859  
[tuuli\\_mccully@scotiacapital.com](mailto:tuuli_mccully@scotiacapital.com)***Greece's new fiscal measures welcomed by market participants***

Greece is taking additional steps to restore its weak fiscal situation and to improve the credibility of its consolidation plans. On Wednesday, the government announced a new set of austerity measures — to both decrease spending and increase revenues — worth €4.8 billion (around 2% of GDP) in order to help to bring the fiscal deficit from 12.7% of GDP in 2009 to the 2010 target of 8.7%. The administration is planning to increase the value added tax from 19% to 21% and raise the tax on tobacco, alcohol, fuel and luxury items, while reducing expenditure by cutting public sector wages, freezing pensions and scaling back public investment and education expenses. Both the European Commission and the International Monetary Fund officially expressed satisfaction regarding the Greek authorities' additions to the fiscal package. The statement by European Commission President Barroso that the new measures "provide a strong signal of the readiness of the Greek Government to proceed with courageous decisions" was seemingly shared by market participants, as the Greek government's 10-year bond issue bearing a coupon of 6.25% was three times oversubscribed. The nation's financing needs are around €4 billion in 2010, with approximately €20 billion of debt maturing in April and May; about €18 billion has been raised so far this year. European policymakers maintain their view that Greece is responsible for fixing its own fiscal problems; while offering verbal support, they have not (yet) provided financial assistance to the country. In any event, Greek bonds have been rallying: the spread over the equivalent 10-year German benchmark bund has narrowed by 36 bps on the week to 289 bps and were priced to yield 6.05% at the time of writing

## International Markets

### Rate hikes in Australia and Malaysia, ECB and BoE on hold

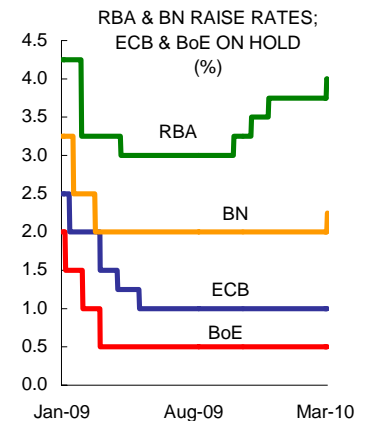
The Reserve Bank of Australia's (RBA) bias towards monetary policy tightening remains intact following its March 2<sup>nd</sup> decision to raise the Cash Rate another 25 basis points to 4.0%. In his official announcement, Governor Glenn Stevens made it clear that the process of interest rate normalization is not yet over: "[With growth likely to be close to trend and inflation close to target over the coming year, it is appropriate for interest rates to be closer to average. Today's decision is a further step in that process." (His complete statement can be found on the RBA's website: <http://www.rba.gov.au/>.) The adjustment - the fourth such decision in the past five policy meetings - followed an array of positive economic indicators, including a solid 1.2% m/m advance in retail sales in January alongside further gains in employment and a strong (9.5% m/m) rebound in private new home sales (though building approvals slumped 7.0% m/m).

Fourth quarter national accounts data released the day following the RBA decision confirmed the strength of the economic recovery, as output rose a solid 0.9% q/q (2.7% y/y), led by a 4.9% q/q rebound in business investment and underpinned by a further 0.7% q/q gain in consumer spending. Yet, as we noted last week, wage pressures were muted through the final three months of 2009, increasing by a modest 0.6% q/q (2.9% y/y). Trade was a heavy drag on economic activity in the fourth quarter, pulling the growth figure down by 1.3 percentage points. The RBA is not concerned by the further widening of the current account shortfall to a 7-quarter high of A\$17.5 billion in Q4. Nevertheless, while currency markets are now focused on fiscal rather than balance of payments deficits, the persistent heavy reliance on foreign savings to sustain domestic spending does pose longer-term risks to chronic current account deficit countries; at the same time, we believe that the period of market support for commodity-sensitive currencies still has some distance to run, setting the stage for a fresh rally in the Australian dollar before a period of stability and subsequent retreat.

Bank Negara Malaysia (BN) Governor Zeti Akhtar Aziz has been signalling the prospect of higher interest rates for several months. As a result, markets were generally indifferent to BN's March 4<sup>th</sup> decision to commence the process of interest rate normalization by nudging its benchmark interest rate up 25 basis points to 2.25%. The benchmark equities index - the KLCI - dipped marginally on the day as did the yield on the benchmark 10-year government bond, and the ringgit appreciated slightly vis-à-vis the US dollar. The monetary authorities expect inflation to "remain moderate" even as growth accelerates; the consumer price index rose by an 8-month high of 1.3% y/y in January. Thus, the rate decision was entirely preemptive and was designed to avoid "the risk of financial imbalances that could undermine the economic recovery process" (the full statement can be found at BN's website: <http://www.bnm.gov.my/>). Although the pace of recovery in industrial output and exports has lagged a number of other emerging Asian economies, Malaysia is on track to grow by at least 4% this year, following a relatively moderate 1.7% contraction in 2009. With interest rates trending higher and economic conditions on the mend (GDP rose 4.5% y/y in the final quarter of 2009, the first advance in a year), we expect the ringgit's moderate appreciating bias to persist through the balance of the year, taking the exchange rate (currently 3.36 per US dollar) to 3.25 by end-2010.

### No change in administered interest rates in the euro zone or the UK

Interest rates remain on hold in the euro zone and the UK. Following their March policy meetings, the European Central Bank (ECB) and the Bank of England's (BoE) Monetary Policy Committee (MPC) opted to leave their benchmark interest rates unchanged at 1.0% and 0.5%, respectively. In announcing the ECB's decision, President Jean-Claude Trichet expressed confidence that inflationary pressures would remain low over the medium term; economic growth - at least in 2010 - will be "moderate" and "uneven" (his complete statement can be found at the ECB's website: <http://www.ecb.int/home/html/index.en.html>). In another step towards the normalization of monetary policy and the phasing out of non-standard measures, the ECB will return to variable rate tender procedures for its 3-month refinancing operations effective April 28<sup>th</sup>. In keeping with normal BoE practices when there is no change in policy, there was no amplification of the decision to maintain the Bank Rate at 0.5% and the asset purchase programme at £200 billion. Clearly, the MPC remains confident that the consumer price inflation rate (3.5% y/y in January) will soon slip back to the medium-term target of 2%. However, pressures further up the distribution chain threaten to slow the correction as the headline producer price index rose 4.1% y/y (0.3% m/m) in February.



## Fixed Income Markets

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### Debt Management Strategy & Likely Bond Issuance Schedule

Canada released its Debt Management Strategy on Thursday, as an appendix to the budget. The main changes are a decline in T-Bill issuance, a possible shift in the size or maturity of some benchmark terms, and an increase in bond buybacks.

Gross fixed-rate bond issuance is expected to be \$95 billion, down \$7 bn from last year (which was a substantial increase due to the various emergency funding programs related to the financial crisis).

The government will be reducing T-Bill issuance, lowering the amount outstanding by \$28 billion, to about \$150 bn by the end of the 2010-11 fiscal year. This means that the percentage of fixed-rate debt will increase further. The fixed rate share of the debt was 61% in 2008-09, is estimated by the government to be 63% in 2009-10, and to rise “slightly further” in 2010-11. This gradual shift toward longer-term term fixed rate borrowing seems a reasonable response to historically low interest rates.

The government notes that it may adjust the maturity dates of certain benchmarks “to help smooth the cash flow profile of upcoming maturities”, and offers as an example of this adjustment switching from a June/Dec to a Mar/Sep cycle. The government notes that any changes would involve consultation with the market, and would be published “well in advance”.

This means that the government may issue more Sep and March dated benchmarks, and fewer June-Dec dated benchmarks. It could also focus buybacks in the relatively large June maturities, to further “smooth the cash flow profile” of maturities. Currently, the only Sep and March-dated benchmarks are the 2-year and the 3-year. The government would presumably just issue more Mar-Sep dated bonds in these two terms, rather than issue Sep or March-dated bonds in other terms.

Buybacks: the size of buybacks is planned to increase from \$2 to \$5 bn.


Target benchmark sizes are the same. Target sizes take into account both new issuance and the amount outstanding on old fungible bonds. As with last year, the government says it expects that benchmark sizes may be exceeded in some terms.

2-year	\$7 to \$10 billion.
3-year	\$7 to \$10 billion.
5-year	\$9 to \$12 billion.
10-year	\$10 to \$14 billion.
30-year	\$12 to \$15 billion

The planned auction schedule is also the same, with quarterly issuance of all benchmark terms, except there will be no auction of a 30-year bond in the fourth quarter of fiscal 2010-11.

## Estimates for the week of March 8 – 12

 <b>Canada</b>						
Date	ET	Indicator	Period	BNS	Consensus	Latest
03/08	(08:15)	Housing Starts (000s a.r.)	Feb	195.0	190.0	185.6
03/11	(08:30)	Merchandise Trade Balance (C\$ bn)	Jan	0.4	0.1	-0.2
03/11	(08:30)	New Housing Price Index (m/m)	Jan	0.3	0.5	0.4
03/11	(08:30)	Capacity Utilization (%)	Q4	--	70.0	67.5
03/11		<b>BoC's Governor Carney Speaks in Ottawa (13:50)</b>				
03/12	(07:00)	Employment (000s m/m)	Feb	20.0	15.0	43.0
03/12	(07:00)	Unemployment Rate (%)	Feb	8.3	8.4	8.3

 <b>United States</b>						
Date	ET	Indicator	Period	BNS	Consensus	Latest
03/08		<b>ECB's Stark Speaking in Arlington (12:00)</b>				
03/08		<b>Fed's Sack Speaks to Economists in Arlington, Virginia (17:00)</b>				
03/09	(07:45)	ICSC Chain Store Sales - Weekly (w/w)	Mar. 06	--	--	-0.8
03/09	(10:00)	IBD/TIPP Economic Optimism Index	Mar	--	--	47
03/09	(17:00)	ABC Consumer Confidence (index)	Mar. 07	--	-48	-49
03/09		<b>Fed's Evans Speaks to Economists in Arlington, Virginia (09:30)</b>				
03/10	(07:00)	MBA Mortgage Applications (w/w)	Mar. 05	--	--	14.6
03/10	(10:00)	Wholesale Inventories (m/m)	Jan	--	0.2	-0.8
03/10	(14:00)	Treasury Budget (\$ bn)	Feb	--	-202.0	-42.6
03/11	(08:30)	Initial Jobless Claims (000s)	Mar. 06	445.0	450	469
03/11	(08:30)	Continuing Claims (mn)	Feb. 27	4.48	--	4.50
03/11	(08:30)	Trade Balance (\$ bn)	Jan	-42.0	-41.0	-40.2
03/11		<b>New York Fed's Dudley Speaks to London Economists (14:00)</b>				
03/12	(08:30)	Retail Sales (m/m)	Feb	-0.3	-0.2	0.5
03/12	(08:30)	Retail Sales ex. Autos (m/m)	Feb	-0.1	0.1	0.6
03/12	(09:55)	U. of Michigan Consumer Sentiment	Mar-P	--	74.0	73.6
03/12	(10:00)	Business Inventories (m/m)	Jan	0.3	0.1	-0.2
03/12		<b>ECB's Trichet Speaking in Stanford (15:45)</b>				

## Estimates for the week of March 8 – 12

Europe						
Date	ET	Indicator	Period	BNS	Consensus	Latest
03/08	(06:00)	GE Industrial Production (m/m)	Jan	--	1.0	-2.6
03/08	(19:01)	UK RICS House Price Balance (%)	Feb	--	30.0	32.0
03/08		<b>ECB's Stark Speaking in Arlington (12:00)</b>				
03/09	(02:45)	FR Trade Balance (EUR bn)	Jan	--	-4.0	-4.3
03/09	(04:30)	UK Visible Trade Balance (GBP bn)	Jan	--	-7.0	-7.3
03/10	(00:00)	UK NIESR GDP Estimate (q/q)	Feb	--	--	0.4
03/10	(02:00)	GE CPI (m/m)	Feb	--	0.2	0.2
03/10	(02:00)	GE CPI - EU Harmonized (m/m)	Feb	--	0.2	0.2
03/10	(02:00)	GE Trade Balance (EUR bn)	Jan	--	14.5	13.5
03/10	(02:45)	FR Industrial Production (m/m)	Jan	--	--	-0.1
03/10	(02:45)	FR Manufacturing Production (m/m)	Jan	--	0.2	-0.8
03/10	(04:00)	IT Industrial Production (y/y)	Jan	--	-3.40	-5.60
03/10	(04:30)	UK Industrial Production (m/m)	Jan	--	0.3	0.5
03/10	(04:30)	UK Manufacturing Production (m/m)	Jan	--	0.2	0.9
03/10	(05:00)	IT GDP (y/y)	Q4-F	--	-2.8	-2.8
03/10		<b>ECB's Weber Speaks at Event in Dublin (12:15)</b>				
03/10		<b>ECB's Trichet Speaking in Frankfurt (13:00)</b>				
03/11	(02:45)	FR Non-Farm Payrolls (q/q)	Q4-F	--	-0.4	-0.4
03/11		<b>ECB's Mersch Presents BCL's Bulletin (n/a)</b>				
03/12	(02:45)	FR Current Account (EUR bn)	Jan	--	0.0	0.0
03/12	(06:00)	EC Industrial Production (m/m)	Jan	--	0.7	-1.6
03/12		<b>ECB's Trichet Speaking in Stanford (15:45)</b>				

Asia/Oceania						
Date	ET	Indicator	Period	BNS	Consensus	Latest
03/08	(00:00)	JN Eco Watchers Survey (current)	Feb	--	40.1	38.8
03/08	(00:00)	JN Eco Watchers Survey (outlook)	Feb	--	--	41.9
03/08	(03:00)	TAI Exports (%)	Feb	--	32.9	75.8
03/08	(03:00)	TAI Imports (%)	Feb	--	39.1	114.7
03/08	(03:00)	TAI Trade Balance (US\$ bn)	Feb	--	1.4	2.5
03/09	(00:00)	JN New Composite Leading Economic Index	Jan	--	96.6	94.3
03/09	(00:00)	JN Coincident Index CI (index)	Jan	--	99.6	97.4
03/09	(01:00)	JN Machine Tool Orders (y/y)	Feb	--	--	189.4
03/09	(18:50)	JN Machine Orders (m/m)	Jan	--	-3.5	20.1
03/09	(19:30)	AU Home Loans (%)	Jan	--	2.0	-5.5
03/09	(20:00)	PHI Exports (y/y)	Jan	--	35.0	23.8
03/09		<b>RBA Deputy Bank Governor Lowe speaks in Sydney (17:00)</b>				
03/10	(15:00)	<b>NZ RBNZ Official Cash Rate (%)</b>		--	<b>2.50</b>	<b>2.50</b>
03/10	(18:50)	JN GDP (q/q)	Q4-F	--	1.0	1.1
03/10	(18:50)	JN GDP Deflator (y/y)	Q4-F	--	-3.0	-3.0
03/10	(19:30)	AU Employment (000s)	Feb	--	15.0	52.7
03/10	(19:30)	AU Unemployment Rate (%)	Feb	--	5.3	5.3
03/10	(21:00)	CH CPI (%)	Feb	--	2.5	1.5
03/10	(21:00)	CH PPI (%)	Feb	--	5.1	4.3
03/10	(21:00)	CH Purchasing Price (%)	Feb	--	8.5	5.5
03/10	(21:00)	CH Industrial Production (%)	Feb	--	19.0	18.5
03/10	(21:00)	CH Retail Sales (%)	Feb	--	18.1	17.5
03/10		<b>RBNZ Governor at Finance Select Committee (19:15)</b>				
03/11	(23:30)	JN Industrial Production (m/m)	Jan	--	--	2.5
03/11	(23:30)	JN Capacity Utilization (m/m)	Jan	--	--	1.4



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