

Global Views

Weekly commentary on economic and financial market developments

May 11, 2012

Economics >	Corporate Bond Research	Emerging Markets Strategy >	Fixed Income Research	Fixed Income Strategy >	Foreign Exchange Strategy	Portfolio Strategy
Economic Statistics >	Financial Statistics >	Forecasts >	Contact Us >			

2-10	Economics	
2-3	• Euro Zone GDP, Greek Election Call, And A Full U.S. Schedule Lie Ahead	Derek Holt
4	• Plenty Of Spring Left In Canada's Housing Market.....	Adrienne Warren
5-6	• Would The Fed Be Captive To The Electoral Cycle?	Derek Holt & Dov Zigler
7-8	• Youth Unemployment In Peripheral Europe ... Seriously High & Still Rising	Erika Cain & Mary Webb
9	• BoC Would Need More Than Just Two Strong Job Reports To Justify Hiking	Derek Holt & Dov Zigler
10	• Venezuela's Economic Outlook & Political Uncertainty.....	Daniela Blancas
11-12	Emerging Markets Strategy	
	• Comparing CMPC & Arauco	Joe Kogan & Leonor López
13-21	Fixed Income Strategy	
	• France: The First Year Of President Hollande	Frédéric Prêtet
	• BoE Inflation Report Preview	Alan Clarke
	• The Liquidity & Safety Premia Of US Treasuries Are Set To Rise.....	Guy Haselmann

A1-A10	Forecasts & Data	
	• Key Data Preview	A1-A2
	• Key Indicators.....	A3-A4
	• Global Auctions Calendar	A5
	• Events Calendar	A6
	• Global Central Bank Watch	A7
	• Forecasts.....	A8
	• Latest Economic Statistics.....	A9
	• Latest Financial Statistics	A10



Derek Holt (416) 863-7707
derek.holt@scotiabank.com

Euro Zone GDP, Greek Election Call, And A Full U.S. Schedule Lie Ahead

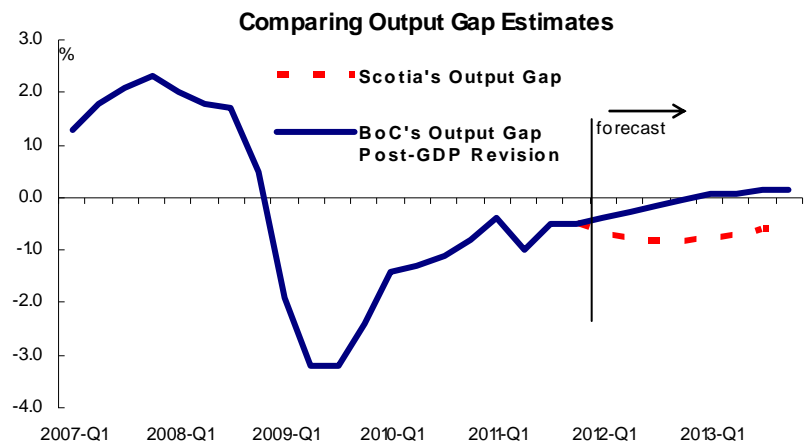
- **Please see our full indicator, central bank, auction and event calendars on pp. A3-A7.**

Europe will carry much of the global tone next week, and principally on two fronts. First will be the risk of an election call in Greece as soon as this weekend. Under Greek election law in the absence of a majority outcome, each of the top three parties is given the opportunity to strike a coalition government. Each of the first-place party (New Democracy), second-place (Syriza) and third place (Pasok) parties have now been given a chance and each failed to do so. Then the President can seek to broker a deal, but that too looks unlikely to occur. Given that New Democracy only garnered 108 seats out of a possible 300, Pasok has 41, and Syriza has 52, a coalition government would require bringing Syriza on side in order to secure a majority. That seems untenable given a very rigid position that the far left party has carved out, including a promise to default on Greek debt, renounce support for the European/IMF bail out, and nationalize banks. The second form of risk posed to markets by European developments will take the form of Q1 GDP growth across the euro zone. The risk here is whether or not several countries slip into technical recession. Expectations for Germany's economy are muted with only 0.1% q/q annualized Q1 growth following a mild Q4 contraction. Similarly, the French economy is expected to post no growth in Q1 following a mild expansion in Q4. After contracting in Q4, Italy's economy is expected to meet the technical definition of recession by posting another contraction in Q1. This is expected to be mirrored for the euro zone as a whole as Q1 GDP is expected to drop for the second consecutive quarter. The UK has already released Q1 GDP which showed the country slipping into technical recession, but next week's BoE Inflation Report, trade and unemployment figures will be closely watched (See Alan Clarke's preview of the inflation report this week).

US markets could chip in and drive much of the global tone in two ways next week: through providing further colour on the stimulus debate at the last FOMC meeting; and via first tier data. The FOMC minutes on Wednesday will shed further light on internal discussions at the FOMC meeting on April 24-25th. Recall that the April 25th statement had a largely maintenance tone by a data-watching Fed that is evaluating the sustainability of the growth picture and inflation risks. Minor changes in that statement flagged that inflation had picked up "somewhat" but that this was temporary, and removed references to how strains in financial markets "have eased" which was an indirect acknowledgement of the risks posed by the euro zone and wavering equity markets. The Fed also issued revised projections, noting that soft GDP growth would "then pick up gradually" and observed that housing had shown "some signs of improvement" but still remained depressed. In all, what the Fed gave with one hand (growth to pick up) it took back with the other (less encouragement toward financial market developments and little inflation concern). The FOMC minutes will reinforce this overall bias that was unwilling to provide any further nod to further stimulus prospects. That disappointed markets which had wrongly anticipated that the Fed might provide just such a signal in contrast to what should be understood to be its tendency to wait to be convinced by a souring tone to growth, inflation and market risks before acting. Thus, expect the FOMC minutes to reinforce the bias that it would be too early to provide additional stimulus, but treat it as a rearview mirror perspective because, since the FOMC meeting, we've been disappointed by another weak nonfarm payroll print and global risk appetite has further soured on euro zone worries. Data risk will be principally represented by Tuesday's CPI report that should provide a further cooling of y/y pressures just as TIPS break-evens continue to march lower — thus providing the Fed with some comfort that its price stability mandate is under no clear threat. Tuesday will be the biggest day of the week for data risk since retail sales are also due out that day and are expected to put in a more subdued gain than the prior month's impressive report. Markets will be sensitive to whether the Philly Fed gauge (Thursday) follows up the latest ISM print by moving higher, given that the ISM print defied the weakness in the last round of the regional manufacturing surveys with the sole exception of the Richmond Fed gauge. Housing starts are expected to rise again on Wednesday, but have been doing so because of multiples construction destined for the rental market as opposed to reflecting buyer confidence. Industrial production should also see a decent gain. The US conducts a ten-year TIPS reopening; this contract has materially richened since mid-March, shedding about 25bps in break-even yield partly because of reduced inflation expectations but also because TIPS benefit less from safehaven flows than nominal Treasuries — thus introducing a liquidity distortion to break-evens. The only Fed speaker on tap is St. Louis Fed President James Bullard (alternate 2012, voting 2013) who speaks on the US economy next week and who is a relative hawk opposed to further stimulus.

Derek Holt (416) 863-7707
derek.holt@scotiabank.com*... continued from previous page*

Apart from global influences, the main risk facing **Canada's** curve is next Friday's CPI report for April. We're anticipating a soft print broadly in line with the BoC's inflation target and that could take some of the steam out of the frothy post-jobs move toward more aggressively pricing summertime rate hikes. Our view remains that the BoC's inflation target will be met even in the absence of tighter monetary policy over 2012-13, in contrast to the BoC's assertion that their 2% range inflation forecast incorporates some modest reduction of monetary stimulus. Given monetary policy lags on inflation readings, even a material tightening in policy over 2012H2 would have most of its impact on yearly inflation readings delayed into next year. One of our reasons for anticipating subdued inflation risk is that we figure the BoC is underestimating the amount of slack in the Canadian economy as shown in the accompanying chart and for two reasons. First, growth is disappointing both our own and BoC expectations so far in 2012. Q1 GDP growth is tracking at a 1.2% annualized q/q pace given what we know about GDP for the first two months of Q1 and the Q4 hand-off. That immediately suggests a weaker starting point for the output gap than what the BoC is forecasting. From that point forward, we retain a somewhat milder profile for growth compared to the BoC and, while using the same potential growth assumption, we derive a milder outlook for the output gap. In fact, we expect that it will take at least a year longer for the gap to close than the BoC's forecast for this to occur by 2013H1. What could further play into this view is our expectation for a subdued print for manufacturing shipments next Wednesday in the wake of a weak export report, and given that we expect a reversal of the large contribution to the prior month from a surge in aircraft shipments. Canada also auctions 2s on Wednesday, the same day as the shipments report but before CPI on Friday. Also see our comment this week on how we think the BoC would have to justify tightening on greater grounds than the strongest back-to-back monthly job gains since 1981. The key is that the BoC looks to trend growth that wouldn't discount the prior softness since last Fall, and is more likely to emphasize very soft wage growth that is not keeping up with inflation at a very advanced point in the consumer cycle.



Asian markets should pose only modest risks to global markets next week. Chinese property prices top the list of risk factors and the April update is slated for release on Thursday. A broadening array of cities have been witnessing falling house prices as China's housing markets cool down. RBA minutes from the May 1st meeting will be parsed for signs of an ongoing easing bias and that could impact the A\$ which has been among the weaker currency crosses against the USD via a 3½% drop since just before the May 1st RBA meeting. Japanese Q1 GDP is expected to post a healthy 0.9% non-annualized rise following the 0.2% contraction in Q4, thus enabling Japan to hopefully avoid a technical recession that threatens Europe.

The annual **G8 Summit** occurs next Friday and Saturday at Camp David in Maryland, USA. Expectations are low for material progress on any market-related matters partly given that little is known of the agenda, and because it is only scheduled to last 24 hours. The G8 Research Group at the University of Toronto expects a five-page communiqué to be issued that will address wide-ranging matters such as the Euro-crisis, tensions in Syria, food supply, and challenges in Afghanistan, North Africa and the Middle East.

Adrienne Warren (416) 866-4315
adrienne.warren@scotiabank.com

Plenty Of Spring Left In Canada's Housing Market

- A round-up of major local real estate board reports for April points to a balanced national market amid some divergent regional performances.

Canada's spring housing season is off to a strong start, buoyed by recent job gains, mild weather and low borrowing costs. Based on reports from 14 regional real estate boards, the volume of resale transactions increased 12% y/y in April (see table). This should translate into a moderate m/m seasonally-adjusted increase for a third consecutive month.

Overall trends in resale housing demand and supply are consistent with a national market that has transitioned to a more sustainable level of activity. The current pace of sales is running about 5% above the average of the past decade, with demand underpinned by historically low interest rates. Meanwhile, an increase in available listings has lowered the temperature on prices in most parts of the country. On average, y/y prices are relatively flat.

Regionally, many of the hottest markets can be found in Saskatchewan and Alberta, where a resurgent resource sector is fuelling relatively stronger employment and income gains, and attracting population inflows internationally as well as from other provinces. The real estate boards of Calgary, Regina and Saskatoon reported sales gains in April of 20-30% y/y. In contrast, Vancouver sales last month were down 13% from a year earlier, and are tracking about 15% below the decade average.

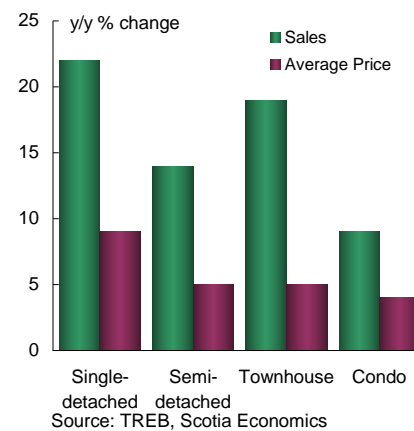
To the East, the red hot Toronto market is a notable standout to the more muted national trend. GTA sales rose 18% y/y in April, and are roughly 15% above the decade average. Strong housing demand alongside a persistent shortage of listings is driving outsized price appreciation, with average prices up almost 9% y/y last month. These sellers' market conditions will likely persist until a better balance returns to the market, either through lower sales, higher listings, or a combination of both.

There is also a notable segmentation underway within the Toronto market itself. The strongest demand and pricing pressure is occurring in the highly sought-after single-detached housing market (see chart). Detached home sales in the GTA soared 22% y/y in April, while average prices were up 9% y/y. In contrast, in the resale condominium market, which faces strong competition from rising new condo supply, sales and average prices increased a more modest 9% y/y and 4% y/y, respectively, last month. A similar trend can be seen in the GTA new home market, where a lack of supply is driving up prices for single-detached homes at a faster rate than for the more amply supplied high-rise segments.

Resale Home Sales - April 2012		
	Units	y/y % chg
Montreal	5,196	16.0
Quebec City	789	8.0
Ottawa	1,568	2.5
Toronto	10,350	17.9
Hamilton	1,394	-0.6
London	880	17.3
Kitchener	672	8.9
Saskatoon	412	20.0
Regina	443	24.4
Edmonton	1,713	5.3
Calgary	2,788	30.7
Fraser Valley	1,435	-5.3
Vancouver	2,799	-13.2
Victoria	565	4.6
TOTAL	31,004	12.0

Source: Regional real estate associations, Scotia Economics

GTA Housing Activity - April 2012



Derek Holt (416) 863-7707
derek.holt@scotiabank.com

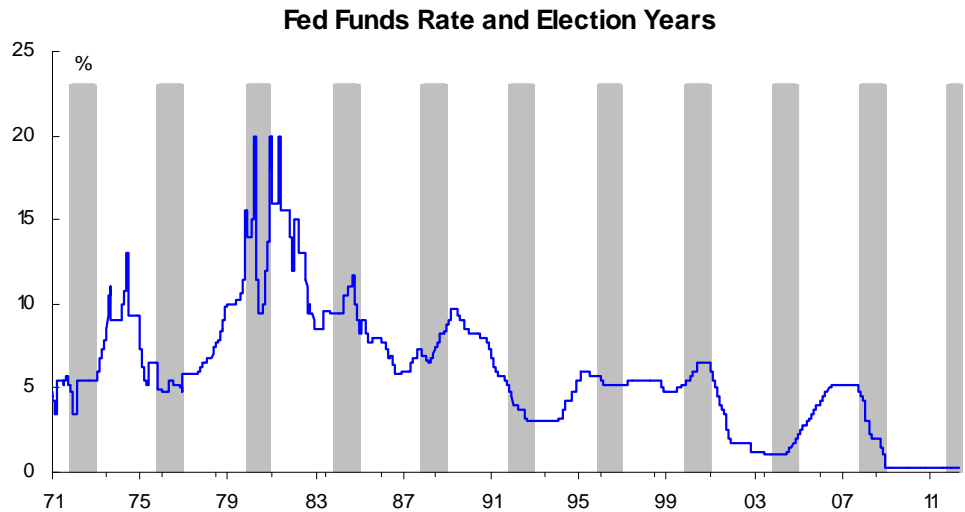
Dov Zigler (416) 862-3080
dov.zigler@scotiabank.com

Would The Fed Be Captive To The Electoral Cycle?

- We provide seven reasons why an election year is unlikely to be a constraint for the Fed in applying additional stimulus this year.

It is often surmised that the Fed can't do anything in an election year and will therefore avoid introducing any new stimulus this year. It's my belief that the Fed would pursue what it thinks is the right monetary policy independent of the electoral cycle for a number of reasons that are listed below.

1. The notion that the Fed has been susceptible to election year politics has been malleable in both directions over time as an argument against both tightening and loosening policy, but the evidence is wanting. A chart of the Fed funds rate over the course of past elections since at least the 1970s



Source: Bloomberg, Scotia Economics

- shows that no readily discernible rule of thumb exists that alleges a bias in either direction during an election year. One particular period in which the Fed did the unpopular thing was during the Volcker era and President Reagan's 1980 and 1984 election bids. That said, these are different times and we've never gone through a period of unconventional monetary policy as exists today, so the rest of the reasons are tailored to today's circumstances.
2. It isn't clear that the Fed would face a more welcoming political climate in 2013-14 if it chose to stall stimulus until after the election partly since those are the years in which we are assuming fiscal drag will be a much heavier influence against growth. If the Fed deferred stimulus into next year instead of this year, then it could stand accused of using policy stimulus to monetize debt and cushion the impact of fiscal stimulus at the potential risk of longer-run inflation risk, or of stalling the amount of austerity that would otherwise be needed in order to improve one of the world's worst fiscal positions. That could arguably put the Fed into a much more tenuous position than acting this year.
 3. By contrast, if the Fed didn't apply stimulus this year or next year that was judged to be required then it could come under the sharp criticism of another class of opponents who would allege harmful neglect. Thus, between points 2 and 3, I don't think the Fed can win in any scenario if it allows the electoral and fiscal environment to stand in the way of what it judges to be appropriate monetary policy and that's likely to have them look through such influences.
 4. The Fed has fewer vacancies than they used to and so this makes them somewhat less sensitive to political swings.

Derek Holt (416) 863-7707
derek.holt@scotiabank.com

Dov Zigler (416) 862-3080
dov.zigler@scotiabank.com

... continued from previous page

5. The Fed has already gone through a mandate shift with broader consumer oversight and regulatory powers, so it's not clear this would be further at risk.
6. Chairman Bernanke's term does not expire until January 2014 and so he should be able to provide stewardship through the election and significantly beyond.
7. Political threats to remove Chairman Bernanke from office before the expiration of his term would likely be negatively greeted by markets and opposing politicians as overt political interference and this is likely something that would restrain such talk. Agree with the Fed or not, it could seriously impair the functioning of US and global markets should the independence of the Fed be so overtly threatened. That could also prompt a coordinated outcry of support for Bernanke by other Fed officials and put the entire management apparatus of the Fed in jeopardy — something that no administration would desire as it attempts to impress rating agencies with evidence of sound policy stewardship. Hands off Bernanke should be the clarity provided in the debate if Washington's leaders are truly interested in sustaining a fragile recovery.

Erika Cain (416) 866-4205
erika.cain@scotiabank.com

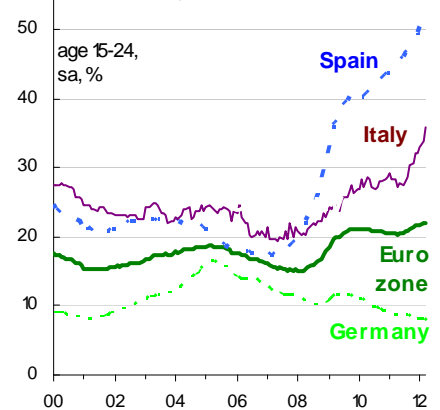
Mary Webb (416) 866-4202
mary.webb@scotiabank.com

Youth Unemployment In Peripheral Europe ... Seriously High & Still Rising

- For euro zone youth, softening labour market prospects are pushing unemployment rates higher.

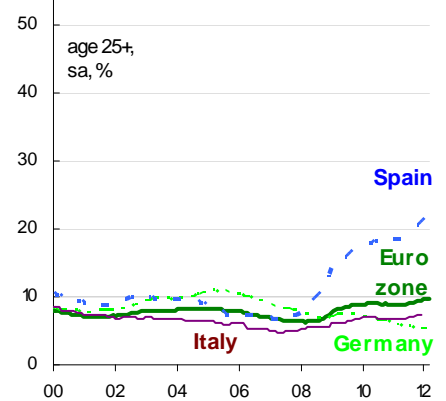
As euro zone voters force a reassessment of austerity, unemployment across the region, particularly for youth aged 15-24, is trending higher, emphasizing the difficult and extended period of restructuring and fiscal repair still ahead. Across all age groups, the euro zone’s seasonally adjusted unemployment rate climbed to 10.9% in March, the highest reading since April 1997. For euro zone youth, the jobless rate in March reached a high of 22.1% (*top chart*). Focusing on Spain, Italy and Portugal, as economies under particular duress, with France and Germany added for comparison, youth unemployment rates in Portugal and France are currently 2½ times the rates of older workers, over four times higher in Italy (*middle chart*), and in Spain, one out of every two youth in the labour force is unemployed. The notable exception is Germany, where youth unemployment has fallen to 7.9% from the March 2005 peak of 16.5%.

Euro Zone Unemployment Rates, For Youth ...



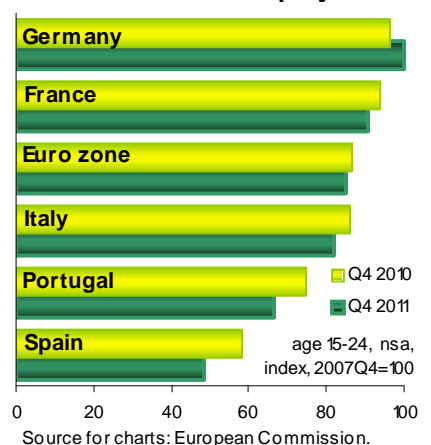
In fact, euro zone youth unemployment was chronically high before the recession, averaging 16.8% from 2000 to 2007, with rates averaging roughly 20% in France and Spain and 23½% in Italy, alongside an outsized share of temporary or contract positions. Employment details for youth (quarterly and not seasonally adjusted with the latest release for Q4 2011) indicate year-over-year employment declines beginning in Q2 2008 and extending, albeit at a moderating pace, through Q4 2011 (*bottom chart*). The fall in total youth employment from Q4 2007 to Q4 2011 was 15.1%, with steeper plunges for Portugal and Spain of 33½% and 51½%, respectively. The loss of full-time jobs for the 15-24 age group was more acute, with a 19.5% decline across the euro zone, relative to the loss of 2.6% experienced by the 25-64 age group from Q4 2007 to Q4 2011. In addition, youths continued to bear the brunt of full-time job declines, accounting for four-fifths of the positions lost in 2011. In contrast, euro zone workers 25-64 witnessed year-over-year job losses for only six quarters, ending in Q2 2010. By Q4 2011, the number of 25-64 employed was just 0.6% less than four years earlier. For youth, Germany stands out for the job creation that emerged in 2011, with an increase averaging just over 3.5% during the second half of the year. These employment gains reflect a stronger economy and less fiscal austerity, with a significant boost from stabilizers such as worksharing¹ and apprenticeship programs.

... and Individuals 25 Years and Older



The rise in euro zone youth unemployment would be even greater over the four years to Q4 2011 were it not for the 3.8% decline in the underlying population, in part due to emigration. As well, widespread joblessness among euro zone youth has dampened their labour force participation. For France and Italy, the drop in their 15-24 populations was modest from Q4 2007 to Q4 2011, but the decrease in Spain and Portugal averaged a material 8.0%. For Germany, the 5.5% decline in

Euro Zone Youth Employment



¹ Global Views, “Work-Sharing Programs - An Important Bridging Function”, November 10, 2011

Source for charts: European Commission.

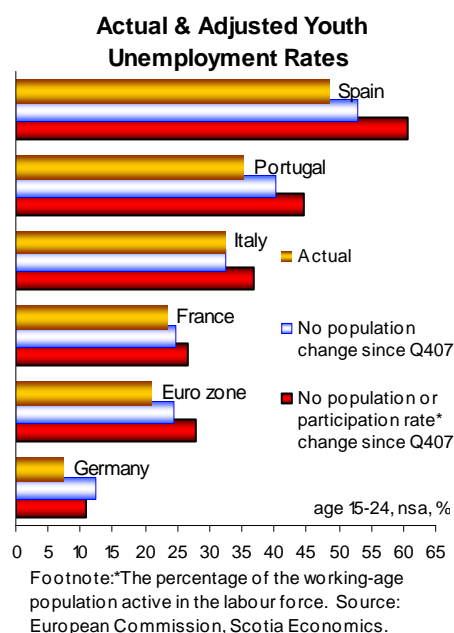
Erika Cain (416) 866-4205
erika.cain@scotiabank.com

Mary Webb (416) 866-4202
mary.webb@scotiabank.com

... continued from previous page

its 15-24 population was a contributing factor to the improvement in their unemployment rate. If the population of euro zone youth since Q4 2007 had levelled out, not declined, their Q4 2011 unemployment rate would have been 24.3%, instead of the reported 21.2%. With no fall-off in labour force participation rates as well as no drop in population since Q4 2007, the youth jobless rate by Q4 2011 would have approached 28% in the euro zone, and in Portugal and Spain, 45% and 61% (side chart).

The failure of youth unemployment in the euro zone to stabilize by 2011, as was widely forecast two years ago, reinforces our outlook that youth joblessness will likely remain above the 2000-07 average of 16.8% past mid-decade. Consequently, many euro zone youth with limited positive workforce experience will be entering the 25-34 age group, which to date has been far less affected by the euro zone's weak economic recovery. Exacerbating the social as well as economic costs of youth unemployment are the limited resources, given fiscal austerity, for expanded income assistance and training as longer-term structural economic and labour market reforms gain traction. Unemployment benefits across Europe are frequently limited without permanent job experience, and social assistance in some instances depends on age. The share of unemployed across all age groups without a job for 12 months or longer averaged 45.2% in 2011 across the euro zone, and a discouraging 52% in Italy.



Examples of significant state intervention to forestall long-term exclusion from the workforce for unemployed youth are programs in the United Kingdom and the Netherlands which offer individuals struggling to find work youth community employment or work-focused training. In the aftermath of the elections in early May in France and Greece, with a second recession stalking a number of euro zone economies, the possible advantages of twinning fiscal restraint with a greater emphasis on economic growth and job creation could spur some adjustments. The benefits of structural labour market reforms, however, are likely to be measured in years, not months, with some costs for individuals currently protected by market rigidities. The list of potential reforms includes reduced restrictions to labour mobility across the euro zone, greater equality between temporary and permanent workers, efforts in Italy and other regions to open up “closed shop” conditions among a number of professions and industries and a shift away from payroll levies and regulations that raise the cost of hiring for private-sector employers. Easing the pressure of the current labour market imbalance, though at a cost of lost resources for the euro zone, is the steady, sizeable emigration expected from nations such as Ireland and Spain, a trend that is likely to accelerate before subsiding.

Derek Holt (416) 863-7707
derek.holt@scotiabank.com

Dov Zigler (416) 862-3080
dov.zigler@scotiabank.com

BoC Would Need More Than Just Two Strong Job Reports To Justify Hiking

Markets clearly became very excited by the April Canadian job print that was marked by the two strongest back-to-back monthly gains since 1981. It's important to note two things which speak to where I think the BoC will put the emphasis in terms of job market developments.

First, the BoC almost always emphasizes trend growth, not being overly swayed by near-term volatility, and often does so by emphasizing y/y figures. To that effect, Canada is up 250k jobs over the past year using the non-seasonally adjusted figures and 104k since last September after which job growth slowed using seasonally adjusted jobs. That's ok, but not out of line with labour force growth which is why the unemployment rate has been relatively steady throughout the past year. As such, the labour force is not experiencing a move toward a steady tightening in the degree of slack.

Second, wages matter far more than jobs. In a country with 17.5 million employed individuals, growing 140,000 jobs in two months is a relatively small 0.8% gain in employment. More important is what is happening to the average wages of the 17.5 million workers. On that note, real wages continue to trend in the opposite direction from jobs. Indeed, Canada faces a conundrum represented by tightening job markets but decelerating wage growth. Wages are what pay the bills, not the body count. To this effect, please see Charts 1 and 2. Both of them show the level of seasonally adjusted employment over time on the left axis, but one shows y/y % growth in real wages using average weekly wages, and the other uses average hourly wages. Weekly wage growth is not keeping up with inflation, and hourly wage growth is only barely doing so. Together, these two measures remain a poor support for a very extended consumer cycle. Why wages are so soft is a point of contention among economists, and I think part of the explanation lies in a still-significant degree of slack in the labour force particularly upon considering part-time workers who would prefer full-time employment as the BoC has also noted.

Further, wage constraints in the public sector are also serving to anchor wage growth in this cycle and going forward.

Overall, the BoC would have to justify an early tightening campaign on far greater grounds than just the past two strong job reports. As we have emphasized, this is particularly true in terms of our view that the BoC is underestimating the amount of slack in the economy as growth disappoints so far this year (see Chart 3), and because of the souring geopolitical back drop.

Chart #1

Wages versus jobs - Canada Weekly

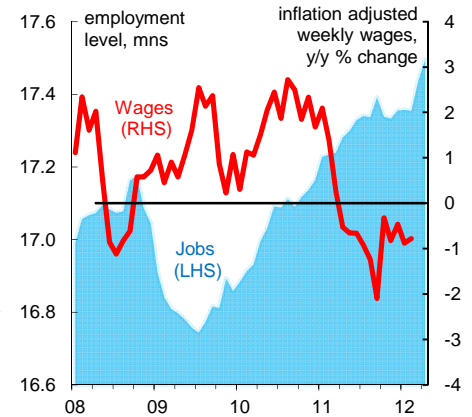
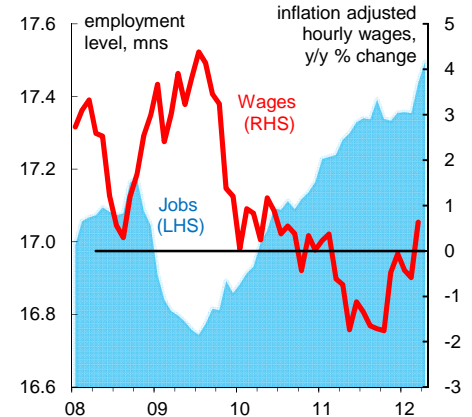


Chart #2

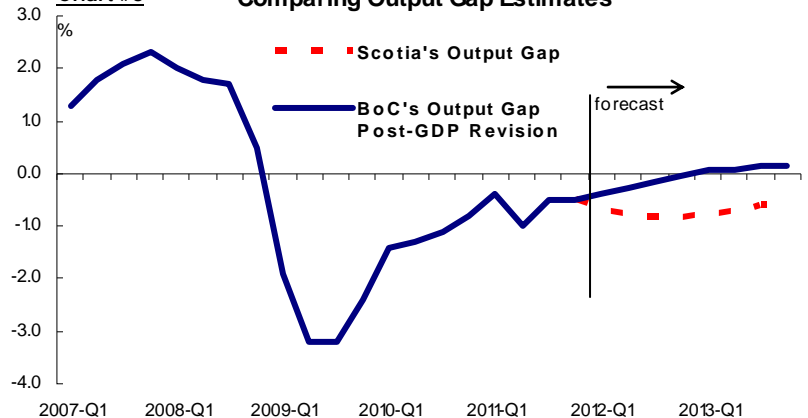
Hourly



Source: Statistics Canada, Scotia Economics.

Chart #3

Comparing Output Gap Estimates



Source: Bank of Canada, Statistics Canada, Scotia Economics.

Daniela Blancas (416) 862-3908
daniela.blancas@scotiabank.com

Venezuela's Economic Outlook & Political Uncertainty

- **Hugo Chávez's health clouds the country's future.**

The Venezuelan economic outlook remains surrounded by political uncertainty. In recent weeks, President Hugo Chávez travelled to Cuba for another round of medical treatment after announcing that his cancer has returned. The severity of his medical condition remains unknown, prompting speculation over the future of his political career and his campaign for the October presidential ballot. So far, Chávez has confirmed that he will seek re-election; however, the chances for a change in government — either through Chávez's successor or the opposition's triumph — have increased. Both scenarios suggest a difficult transition period for Venezuela.

Venezuela remains vulnerable to shifts in oil prices and sluggish production, strong capital flows, low diversification in non-oil exports, an elevated debt burden and economic distortions, either with Chávez, his successor or the opposition party taking office in 2013. Even if the opposition's candidate Henrique Capriles wins the presidential election, friendlier investment and countercyclical policies as well as fiscal consolidation will take time to be implemented. Additionally, Chávez's party, Partido Socialista Unido de Venezuela (PSUV) has majority in the National Assembly, which will complicate an immediate advance in the needed reforms.

In the case that Hugo Chávez leaves office before October's elections, the vice-president will be named as Head of State until a new president is elected. However, if Chávez is re-elected and is unable to run the country during the first four years of his mandate, new elections would be called. After 13 years as the president of Venezuela, any political change will imply significant economic changes; however, this will likely be slow.

We expect a slightly higher growth rate of 4.4% in 2012, supported by high oil prices and the government's persistent increase in social program spending before the elections — which has and will continue to accelerate local consumption. In 2011, the country's GDP expanded by 4.2% y/y. The challenge for the authorities will come in the years ahead as current imbalances, economic distortions and the high dependency on oil exports will be unsustainable.

Inflationary pressures might constrain consumption growth, despite government subsidies and price controls. Based on the central bank's official numbers, inflation has been decelerating in recent months from 26.0% y/y in January to 23.8% in April; however, supply shortages will persist in the near term. Moreover, the informal market for some goods suggests even higher inflationary pressures.

With significant economic distortions and an increase in local liquidity due to government expenditure, we anticipate that after the elections currency devaluations will be implemented. Additionally, the current account surplus is expected to decrease in the coming years as oil revenue could decelerate (both in volume and prices), private investment will remain subdued (capital controls and difficult access to foreign currency) and the country remains dependant on imported goods (local productive capacity remains weak and almost all goods consumed are imported).

The economic outlook for the current year looks challenging for Venezuelan authorities with or without a government transition, which could increase political and social unrest.

Joe Kogan (212) 225-6541
joe.kogan@scotiabank.com

Leonor López (5255) 5229-2202
leonor.lopez@scotiabank.com

Comparing CMPC & Arauco

Both CMPC and Arauco are conservatively managed firms benefitting from their low cost position in the forestry and pulp industry. Planned growth has impacted cash flow, with the rate of growth at CMPC slightly more aggressive so far. The primary difference between the two firms is CMPC's significant presence in end-products like tissue and paper, which adds diversification benefits to earnings but also exposes the firm to different competitive threats.

CMPC and Celulosa Arauco (Celara), two Chilean firms operating in the forestry industry currently trade at around the same yield of 4.5% for recently issued 10-year bonds. Looking over the history of yields on the 2019s over the last two-and-a-half years, we find that yields move closely together with an average difference between the two bonds of 8bp and a standard deviation of the difference at only 16bp.

The obvious similarities between the two firms justify the relationship. The core business for both firms is the sale and export of pulp, made largely from wood derived from the firms' own plantations and located near their mills in South America. Gross margins are high, usually in the range of 30% to 40% and leverage is low, with Debt-to-Ebitda ratios at around 2.2x and management of both firms pledging to manage finances conservatively going forwards. By far the most important similarity is the firms' low cost position in the industry. While we explored in detail the cost advantages in land, wood, energy, and labor, and the sustainability of those advantages in a recent article ("Arauco's cost advantage for bondholders," March 23, 2012), we would like to point out one additional factor—the synergy between the various sources of cost advantage. The fact that trees in South America grow faster and denser not only means that land costs and plantation costs are smaller, but also that a mill can be larger, since mills must be located in geographic proximity to plantations in order to reduce transportation costs; that may yield certain economies of scale at the mill. Similarly, freight costs of pulp may be lower because of the larger volumes of pulp leaving from the same port. In our opinion, the fact that the average cost of these firms is actually lower than the marginal cost of some higher cost competitors ensures that they will always be profitable.

Both firms are pursuing growth opportunities in their core businesses, with the number of acres harvested exceeding those planted by 16% to 52%. That ratio is generally higher for CMPC in all recent years except for 2011, suggesting perhaps that CMPC is pursuing forestry growth more aggressively. They would need to be more aggressive, if the goal were to catch up to Arauco, which has 50% more hectares planted overall. Both firms maintain a significant land reserve of unplanted land, allowing significant room for future growth. Those land reserves are mostly in Chile, but they also maintain significant acreage in Brazil and Argentina, and, in Arauco's case, in Uruguay. Despite gross margins at both firms in the range of 30% to 40%, cash flow is weak as a result of the investments and acquisitions necessary to sustain growth. That problem is particularly noteworthy at CMPC where net cash flow used in investing has exceeded cash flow generated by operating activities in each one of the past three years.

The primary difference between the two firms is CMPC's relatively greater focus on end products in contrast to Arauco's focus on the pulp market. For 2011, CMPC had 27% of revenues from pulp in contrast to 47% from Arauco. For Arauco, the remainder comes from its timber and wood panels businesses. While perhaps less commoditized than pulp, we understand these businesses as competing in a global marketplace. In contrast, CMPC has 35% of its revenues coming from the tissue business (paper towels, toilet paper, diapers). Management explained to us that the large amount of air in tissue products makes shipping them long distances impractical. As a result, this is a local business, and one where brands and distribution matter. CMPC also has 18% of its revenue in paper and 9% in paper products like cardboard.

The presence of these end-product businesses can add diversification benefits to the firm's earnings profile, as pulp price changes are not immediately passed along to final prices. As demonstrated by the historical data in Figure 1, margins increase on tissue and, surprisingly, even on paper, when pulp margins decrease. While Arauco does not publish similar figures on margins by product, Figure 2 shows that prices on Arauco's

Joe Kogan (212) 225-6541
joe.kogan@scotiabank.com

Leonor López (5255) 5229-2202
leonor.lopez@scotiabank.com

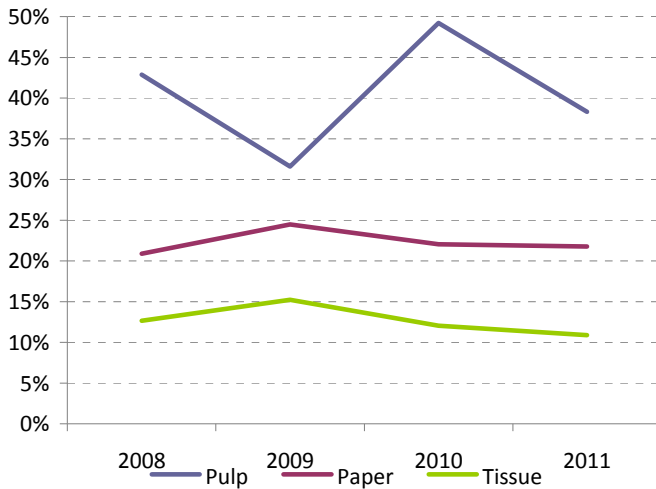
... continued from previous page

products like panels and timber move closely with pulp prices, suggesting that margins on all products move together. When we looked at quarterly price data for CMPC, the correlations were weaker.

On the other hand, these end-product businesses have margins that are only one-half to one-fourth those of pulp; that is not a problem in itself since these businesses may also require less capital with a faster return on investment relative to forestry. Rather, our concern is about the sustainability of competitive advantage in these markets in relation to the robust advantages Chilean firms have enjoyed in forestry and pulp. CMPC is the dominant player in the tissue markets in some countries like Chile, Peru, Uruguay, and Argentina, which should help. In other countries, however, like Mexico and Colombia, CMPC is still small. CMPC sees more potential for growth in tissue than in paper and is investing accordingly.

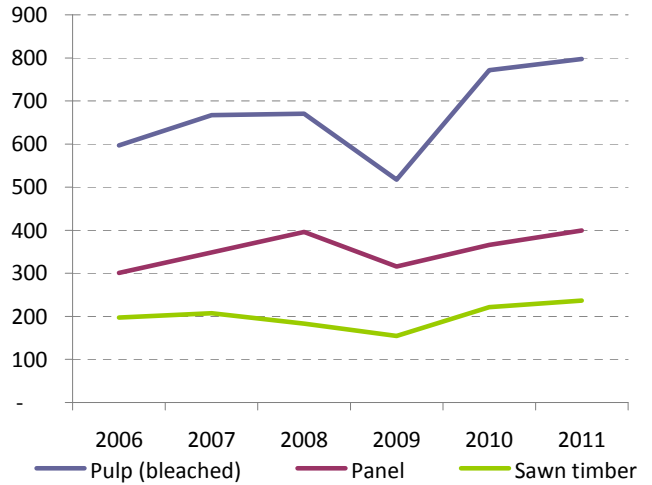
Thus, selecting between bonds of the two firms involves comparing two very different industries. In the end, it comes down to whether one believes more in the strength of brands or the importance of cost structure.

Figure 1. CMPC margins by product



Source: Company annual reports

Figure 2. Arauco prices by product



Source: Company annual reports

France: The First Year Of President Hollande

Key Points

- The immediate agenda of the new French president will be focused on securing a majority at the June Deputy election. This raises the risk of the German/French axis to be silent in the short term at a time of renewing tensions in the EMU debt crisis;
- The pressure from the market suggests that, beyond this, the priority for Mr. Hollande might not be the domestic but the international agenda. On this front, there is also the risk of some tensions with Germany.
- On the domestic side, the coming decisions on the budget policy and restoring French competitiveness will be also closely watched.

The immediate agenda

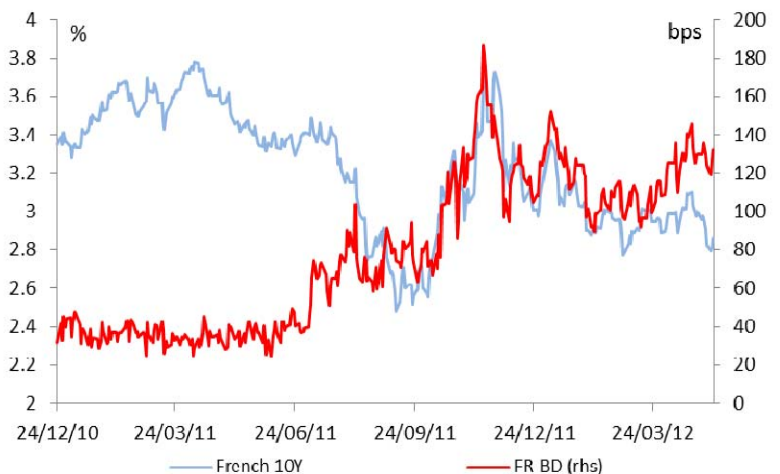
This Tuesday, Mr. Hollande will officially become the next French president. He will then announce his government. While it will only be a temporary government for up to one month until the French Deputy elections (June 10th and 17th), it will nonetheless send a message regarding the direction of French economic policy and its relationship with the European project for the coming five years. It is worth remembering that being in the opposition over the past ten years, there are numerous influences inside the socialist party, from the left wing to the centre.

Mr. Hollande is by nature more toward the centre but the names of the Prime and Finance Ministers will be closely watched. As we already wrote in various previous publications, for the Prime Minister, the two main candidates according to the French press would be Mr. Ayrault, the current leader of the socialist party at the French Deputy assembly, and Mrs. Aubry, the current leader of the socialist party itself. Mr. Ayrault is like Mr. Hollande, more on the centre side of the party, while Mrs Aubry is seen more on the left wing. For the Finance Minister, Mr. Sapin also appears to be the frontrunner. He was already in charge of French budget policy in the socialist government in the early 1990's and was also a member of the Monetary Policy Committee of the Banque de France in the mid-1990's. So, his possible nomination should help to give some guarantee to financial markets.

This coming month, the focus will be for Mr. Hollande to secure a clear majority at the Deputy assembly in the June election. So, do not expect any strong actions or negotiations with Germany regarding the current debt crisis in the short term, a situation which will not be very helpful to ease the current risk aversion.

The victory at the presidential election offers in general a good dynamic going into this election. The French, by nature, are legitimist and appreciate clarity, meaning that they are tempted to give all the power to the men they just freshly chose. Early polls for the first round of the deputy election appear to confirm this view. Indeed, it seems that the socialists would garner around 30% of the vote and be the only party on the left to qualify for the second round while, the right will again be split between the conservative and the far-right. Also, the threat of Mr. Hollande being forced to adopt more left wing positions because of the pressure from the communist

Chart 1: French 10Y nominal yields & spread vs. Germany



... continued from previous page

party appears low for the moment with this party gathering less than 10% of the vote. To sum up, this appears to be a best-case scenario for Mr. Hollande. However, any changes in this balance of power will be worth watching over the coming weeks. Given that the participation rate for the deputy election is much lower than for the presidential election, it tends indeed to favour smaller party organisations.

So far, the prospect that Mr. Hollande will be able to deliver a centre-left economic policy and a pragmatic position with Germany appears to be backed by the market. Indeed, while the uncertainties surrounding Greece have refuelled risk aversion in equity markets and pushed the euro back below the 1.30 per USD mark in particular, French 10-year nominal yields have remained close to a two-month low, below 2.90%. However, it is true that there remains some underlying nervousness in financial markets and the next moves from France are on the radar. Indeed, the spread with Germany has widened to above 130 bps. While it is still around its past month average, it is higher than in early February at around 100 bps at the time of the agreement on the fiscal pact with Germany.

The European agenda

The pressure from the market suggests that the priority for Mr. Hollande might not be the domestic but the international agenda and in particular getting an agreement with Germany to move forward on the fiscal pact and possibly, once again, on the Greek issue.

Unfortunately, as we mentioned above, we don't look for significant decisions to be agreed on over the coming month, implying a risk of political deadlock in the short term. Regarding the fiscal pact, in theory, it would be much easier for Mr. Hollande than it was for Mr. Sarkozy to ratify it. Indeed, assuming Mr. Hollande will get the majority at the Deputy Chamber, the socialist party will have a majority in both chambers of parliament, meaning a much more comfortable position to change the constitution.

However, the new French president already indicated that, while he will support the delivery of a clear fiscal program for the coming five years to show his commitment toward budget deficit control, he is against implementing a so-called "golden rule" in the French constitution. He also indicated the need to add to the fiscal pact a deeper commitment in favour of growth policies. So, in a sense, he is already asking for some compromises from Germany, meaning tighter budget control in exchange for stronger solidarity right now!

The risk of rising tensions with Germany cannot be discounted and Mr. Hollande is well aware of this. While he will meet Mrs. Merkel as soon as this Wednesday, he also mentioned that the French/German axis seen over the past years has been too exclusive and that he will seek to broaden it. This is a polite way of suggesting that he might turn around on it! Regarding specific issues of boosting growth in the EMU area, his call for strengthening EU structural funds or the capacity of lending of the European Investment Bank is something which is already agreed on by almost everyone. So, this will be not be a source of conflict. However, this is unlikely to be strong enough. Beyond this, there is, on one side, the position of Germany and the ECB that stronger growth will come through structural reforms, and on the other, the stance of the new French president which calls for a complete rethinking of the current EU institutions, in particular the ECB. For him, it means either common bond issuance policy or stronger and direct interventions by the ECB in the bond market, two issues which so far have remained taboo in Germany. So, we will have to wait until after the Deputy elections in June to see how the positions of Mr. Hollande, and/or Mrs. Merkel herself, could shift on these issues.

In the meantime, Greece could once again be the first test for this possible changing game. The victory of the French president and his speech regarding "less austerity" and "stronger growth" illustrates that the German/French axis could move or weaken, raising sentiments in this country of some renegotiation. The fact that following the victory of Mr. Hollande, there are signs of rising sentiment among the SPD German opposition favouring more growth-orientated EMU policy before the ratification of the fiscal pact, which was planned for the end of the month, will also likely fuel this feeling.

Frédéric Prêtet (00 33) 17037-7705
frederic.pretet@scotiabank.com

... continued from previous page

The budget policy agenda

Mr. Hollande made it clear that budget responsibility and control was one of the key facets of his economic policy, something which is by nature reassuring for the markets. It is true nonetheless that in comparison with his predecessor, a balanced budget situation is only to be reached in 2017 vs. 2016 for Mr. Sarkozy.

Beyond this, it is also true that there is less focus on spending control than announced by his predecessor. While Mr. Sarkozy's policy was in particular dedicated to reducing the number of civil servants, Mr. Hollande indicated that this will no longer be the case and rather plans to stabilize the civil service employment. Given that he wants to increase the number of jobs in the education and security sectors (with a cost of €2 billion), this means at least some downward adjustments elsewhere but, so far, there have been no indications as to which categories this will affect. Also, higher spending growth reflects some readjustments on the pension reform (€5 bn), various youth job programmes (€4 bn) and support for small- and medium-sized corporates (€5 bn). All in all, it is €20 bn in extra spending which is targeted, with total spending projected to rise by around 1% yoy in volume terms over the coming five years. While this is lower than the 2.4% yoy rise seen during the period of 1999-2007, it is higher than in 2010/2011 (around 0.6% yoy), and Mr. Sarkozy promised a 0% growth. At a time when the general government total spending is around 57% of GDP (7% higher than the EMU average), this could raise some nervousness.

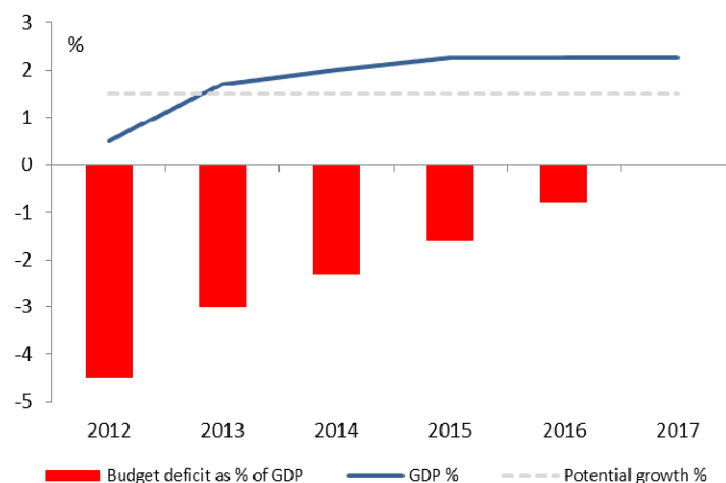
Higher taxes will be raised to finance both this extra spending and the deficit reduction. They will mainly impact corporates by around €13 bn and households by around €12 bn (mainly the wealthier through the introduction of a new income tax tranche at 45% and higher taxes on capital revenue). Also, there will be higher taxes on labour costs (€10 bn) and less potential to reduce the cost of financial participation (€4 bn). Growth expectations are optimistic, with assumptions of 1.75% GDP growth next year, 2% in 2014 and 2.25% beyond this, a situation which could also raise nervousness regarding the risk of slippage. Given that French potential growth is seen by the OECD at around 1.5%, this means that over the coming five years, cyclical factors are expected to contribute one third of the budget deficit reduction. Assuming a more conservative assumption with French GDP rising in line with its potential growth rate (this was the assumption made by the leader of the Center party, Mr. Bayrou), achieving the planned fiscal consolidation would require around €30 bn of austerity measures, which might be difficult to adopt for a candidate who has campaigned against too much austerity.

In the short term, Mr. Hollande indicated that he will make a decision on the budget policy in the view of a complete reassessment of current government finances in France to be released by the High Court at the end of June. Last year, the budget deficit was much better than expected at 5.2% of GDP vs. a 5.7% initial target. For this year, the target is 4.5%. However, markets could be nervous as the recent history across the EMU area has shown that changing governments have coincided with worse-than-expected figures.

The competitiveness agenda

While it has not been a key element in the electoral campaign, the question of competitiveness is now seen as key to addressing the capacity and the

Chart 2: Expected Budget deficit and growth in the socialist program



Frédéric Prêtet (00 33) 17037-7705
frederic.pretet@scotiabank.com

... continued from previous page

sustainability of any economy dealing with rising financing constraints. On this issue, the German model has become the benchmark for the market as well as for many politicians across the euro area.

On this issue, the fact that the French trade account moved from a balanced situation in the early 2000's to around a €60 bn deficit last year is playing favourably. It could be argued that higher oil prices explain a big part of this deficit. However, excluding the impact of energy, France nonetheless moved from a €30 bn trade surplus to a €10 bn deficit over the period. Also over the same period, the share of exports in total nominal GDP moved down from close to 30% to less than 25%.

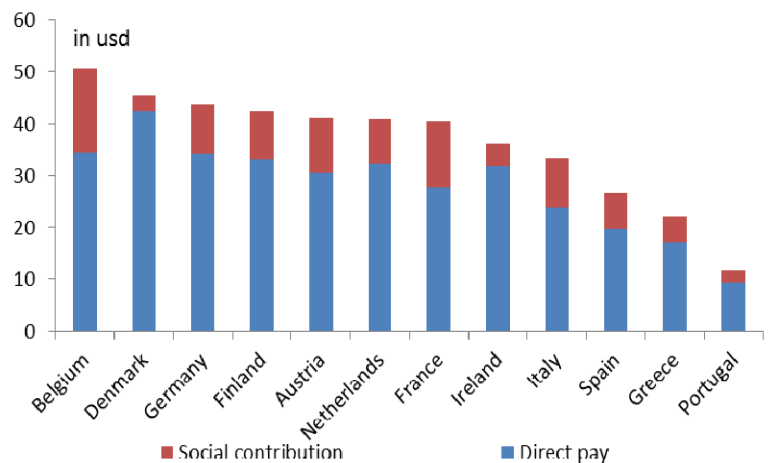
This loss in terms of competitiveness is usually seen through the deterioration of French labour costs vs. the nation's main trading partner, Germany. According to OECD data, labour costs increased more than 10% vs. Germany since the formation of the euro area in 1999. Though not the sole element, part of this loss in competitiveness is often linked to the impact of the introduction of the 35-hour work week by Mrs. Aubry during the time of the last socialist government in 1997-2002. In this regard, her nomination to the job of Prime Minister could be a sensitive issue.

Reducing labour costs has been one of the arguments brought forward by Mr. Sarkozy to justify the introduction of the social VAT in October. The idea was to finance French social contributions partly through higher indirect taxes and no longer only through labour contributions. Actually, it was a way to replicate what has been done by Germany since 2007. Indeed, looking to US labour data, while in 2010, French wages were 20% lower than in Germany, total labour costs were only 8% lower given the impact of higher social contributions.

Mr. Hollande has already indicated that this social VAT will be abolished. In the meantime, as we have previously

mentioned, his economic program has been targeting households more than corporates. Also, his last-minute proposition to boost the minimum wage (although by a very limited amount, 1% in case French GDP growth is at least 2%), does not signal favourability for French corporate competitiveness. We might have to wait for a broad reassessment of French fiscal policy, but the question of finding a way to broaden the tax base away from the labour cost in order to finance the French social security system is likely to come sooner rather than later.

Chart 3: Total hourly compensation cost in the manufacturing sector



BoE Inflation Report Preview

- **The Bank of England's quarterly *Inflation Report* provides the best clues to the likely future moves on monetary policy. While the MPC resisted the urge to loosen policy any further at the May meeting, we expect the thrust of the Bank's updated projections to still be dovish and keep the door open to further policy easing.**

Policy on hold in May

As expected, the Bank of England announced a pause in its asset purchase programme at the May MPC meeting. The committee faced the dilemma of disappointing growth data (which argued for further stimulus), set against stubbornly high inflation (arguing for no further policy ease). In the event, it was the latter that appears to have dominated.

Although the Bank refrained from further policy easing, the last thing the BoE wants to see now is a sharp sell-off in gilts — negating part of the loosening that was injected into the economy over the last 3-4 months. Hence, we believe that the thrust of the *Inflation Report* and the Governor's delivery will be dove-friendly.

The key themes in next week's *Inflation Report* are likely to be:

- Downward revision to GDP growth projection — though probably not down enough;
- Near-term inflation projection revised higher;
- Medium-term inflation projection pushed slightly lower.
- Ribbon chart to show risk of inflation above target close to 50%.

Growth

Despite expressing some scepticism about the reliability of the ONS GDP data, the Bank has continued to be hopelessly optimistic with regards to the growth outlook. In February, the Bank projected full year growth of 1¼% y/y during 2012. Although we started the year with a glass half full, even we struggled to envisage growth as fast as that.

Furthermore, even if the surprisingly weak Q1 GDP reading (-0.2% q/q against the Bank's original estimate of 0.5% q/q) is revised up slightly, it will be hard for growth to be even half the 1¼% y/y pace that the Bank previously projected.

Our forecast is for growth of ½% y/y and we are probably at the optimistic end of the spectrum. We suspect that the Bank will nudge its projection down to around ¾% y/y.

The less said about the Bank's projection of 2¾% y/y growth on average during 2013 the better. Our forecast of 1.7% y/y on average assumes a solid quarterly pace of expansion through next year. The Bank's forecast assumes a miracle. It will probably nudge its forecast lower, but not much.

Inflation

The Bank's near-term inflation projection has once again proved to be too low. During Q1 CPI inflation was 0.15% points higher than the Bank's 3.35% y/y projection. The first year of the profile is likely to be shifted up by at least this margin, if not more. The biggest upward revision is likely to be the end-2012 projection. In February, the Bank expected 1.87% y/y inflation at that point. Our latest forecast for Q4 2012 is around a percentage point higher than that. As with the Bank's growth projection, we suspect the updated projection will move towards our call, but will probably still fall a little short.

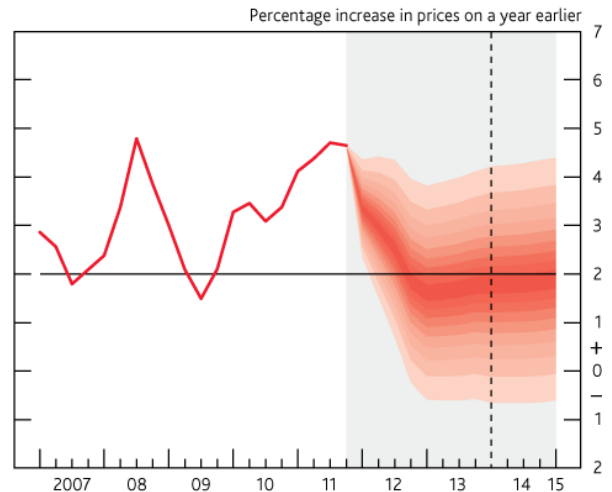
Alan Clarke (44 207) 826-5986
alan.clarke@scotiabank.com

... continued from previous page

The Bank's medium-term inflation projection is the best starting point for gauging the next move on monetary policy. If the 2-year-ahead inflation projection is above 2% y/y then the BoE is more likely than not to tighten monetary policy and vice versa. In February the 2-year-ahead inflation projection was 1.8% y/y (Chart 1). Since February, the key influences on the medium-term inflation projection have been:

- The effective GBP exchange rate is 3% stronger (likely dragging 0.3% points from the Bank's inflation projection);
- GDP growth has been much weaker than the Bank's projection (implying a drag on the inflation projection of up to 0.1% point);
- Inflation over the first 3 quarters of the projection is likely to be around 0.2% points higher than the Bank expected. This should typically add up to 0.1% points to the 2-year-ahead projection;
- The price of oil in USD is 4.5% higher, though around 5% lower when denominated in GBP (effect on BoE projection ambiguous).

Chart 1: BoE Inflation Projection (February)



Taking the sum of these influences, the 2-year-ahead projection could easily be pushed down by as much as 0.3% points. The effect of the price of oil is ambiguous. In USD terms the price of oil is almost 5% higher. However, when taking account of the stronger GBP versus the USD, the price of oil is actually lower. Our judgement is that the USD price is more important.

Last but not least, it can't have escaped the Bank's attention that inflation keeps surprising on the upside. Other things equal, this should encourage the committee to aim a little higher than it might otherwise have done. Our best judgement is that the 2-year-ahead projection will be somewhere in the region of 1.6-1.7% y/y. That is around a full percentage point below our own forecast — though by our own admission we are unashamedly in the high inflation camp.

However, as Mervyn King has stressed time and again, the Bank's projection is about more than just the 2-year-ahead mid-point. The risk distribution and the profile over the full 3 years of the projection are equally important. The Bank's 'ribbon chart' which takes account of the risk distribution has become a more important part of the Bank's signalling mechanisms. Even if the mid-point of the Bank's projection is nudged lower next week, we would expect the ribbon chart to show that the risks are skewed to the upside and there is only a very small chance that inflation will undershoot target.

What does this imply for BoE Policy?

Throughout 2010 the Bank left monetary policy on hold and didn't expand its asset purchases despite having a 2-year-ahead inflation projection that was 1.45% y/y or lower. So even if next week's projection is nudged lower, it does not automatically signal that more QE is nailed on. Nonetheless, the Bank would be signalling that the door is open to further policy easing.

What could push the door even wider open? Q2 GDP data are going to be riddled with noise related to the extra Bank holiday, volatile weather and some correction of Q1 distortions. Q3 is key. If growth does not

... continued from previous page

surge on the back of the unwind of the extra bank holiday and an Olympics boost, then it is perfectly plausible that the economy registers zero or negative growth this year. If this is coupled with a correction lower in inflation (i.e. to well below 3% y/y) then there is a chance that the Bank re-engages in more asset purchases. However, our view is that inflation will remain stubbornly high, growth will improve and further policy ease is unlikely.

Old habits die hard

We believe that the Bank will continue to aim too high on growth and too low on inflation. With regards to growth, aiming too high now is a subtle, but nonetheless tactical weapon within the Bank's projections.

The debate on when the first interest rate hike will be delivered was already in full flow, even before the Bank had announced this pause in QE. With the Bank's inflation projection within close proximity to the 2% target, it will not be long before that projection rises above 2%. This has typically been a signal that monetary policy tightening is fairly imminent. On the basis of this it is reasonable that the debate on the timing of the first hike has begun. However, we believe that it is far too soon for the Bank to even contemplate raising the Bank Rate.

By aiming too high on the growth outlook, the Bank will afford itself some leeway to delay the timing of the first rate hike. In other words, if growth turns out weaker than the Bank's (overly optimistic) projection, it gives the Bank the excuse to refrain from pushing its medium-term inflation projection higher and in turn delaying the first rate hike.

Conclusion

The Bank will use the *Inflation Report* to present this week's pause in QE as a pause – not game over. The economy hasn't grown for six months, and the headline Q2 GDP data are unlikely to stray much above zero (even if the underlying picture is more robust). Nonetheless, inflation is the primary focus of the Bank's mandate. Persistent upward surprises on inflation and the prospect of more to come suggest that it will be difficult to restart asset purchases anytime soon. If growth improves over the remainder of the year (as we expect) then the timing of the first interest rate hike will become a hot topic of discussion. We believe it will be at least a year before a rate hike becomes plausible.

Guy Haselmann (212) 225-6686
guy.haselmann@scotiabank.com

The Liquidity & Safety Premia Of U.S. Treasuries Are Set To Rise

- **Flight from risk assets has just begun and opens up the potential for a “left-tail black swan” event.**

Since early March, Treasuries have been slowly grinding to lower yields, but traders have been reluctant to embrace the rally as sustainable. Not only have many seasoned traders missed the up-trade, but they have set shorts on several occasions, only to be stopped out on each occasion. One trader summed it up best when he said, “there are 3 types of trading positions: short, wanting to be short, and being stopped out”.

For almost two years now, Treasury prices have not been about valuations, but rather about a highly-liquid parking place for cash when levels of global uncertainties increase. We are in an era of extreme global imbalances and great geo-economic and geo-political risk. Furthermore, Globalization has increased the fallout from any crises, due to greater inter-linkages between countries and markets. Positive carry can be earned while waiting for global uncertainties to subside, and waiting for the Fed to take the punchbowl away.

The all-time low in 10-year notes is 1.67%, reached on September 23, 2011. I believe we will test this level by the end of the month. The all-time low in 30-year bonds was 2.52%. Having supply from the May refunding out of the way helps open the upside. Treasuries are entering the best seasonal period of the year. For example, Treasuries rallied 100 bps over the period from the May refunding to the August refunding in both 2011 and 2010. Extraordinarily low yields will prevent a move of similar magnitude; however, despite short term overbought conditions, the power of the seasonals should be respected.

Due to massive liquidity and loans provided by central banks (primarily to the large banks) LIBOR rates do not accurately reflect the true stress in the banking system. Nonetheless, 2-year US swap spreads have widened from the mid-20's to the 34 bps resistance level. The risk in swap spreads is significantly skewed to the upside.

In the current environment in particular, Treasuries should command a liquidity premium that rises when risk assets are under pressure. At present, portfolios have too much exposure to risk assets and so re-balancing should increase Treasury premiums going forward. Economic and political uncertainties and chaos, particularly in Europe, has opened up “left-tail” probabilities which merit greater emphasis on capital preservation strategies. The global environment is such that desire for return of principal is beginning to trump desire for (what amounts to) marginal increases in return on capital from a compressed capital structure.

Recent movements in commodities, equities, currencies and safe-haven bonds are the first signs of this paradigm shift. For over three years, equities and other risk assets have had the benefits of piggy-backing off of government intervention purchases, printing of money, and ZIRP. Additional stimulus going forward will be increasingly more difficult to sell politically and arguably less effective.

ZIRP has chased investors down the capital structure and into riskier assets. QE and LTRO money has a tendency to find its way into all asset classes, distorting prices away from fundamental value and toward bubble territory. The belief that the “government put” will come to the rescue should equities falter is too firmly ingrained in the market's thinking. Markets have failed to realize that officials have less desire, fewer bullets, and growing opposition to implementing any new bailout programs — unless, of course, markets or the economy deteriorate significantly.

It seems markets have entered a phase where they will only tolerate real solutions and problem fixes. Acceptance of further short-term band-aids may not be well-received by capital markets. It is disheartening that the massive and unprecedented amounts of government stimuli have resulted in only modest-to-below-average growth, as well as (possibly) a risk asset bubble not justified by the fundamentals. Such a condition is fragile at best and makes capital markets highly susceptible to any kind of derailment or shock.

Guy Haselmann (212) 225-6686
guy.haselmann@scotiabank.com

... continued from previous page

Bundesbank President Jens Weidmann published an editorial in the Financial Times this week entitled, “Monetary Policy is no panacea for Europe’s ills”. He said, “We have to make sure by putting out the fire now, we are not unwittingly preparing the ground for the next one. The medicine of near-zero interest rate policy combined with large-scale intervention in financial markets does not come without side-effects which are all the more severe, the longer the drug is administered”. He sums up the sentiment of markets well, and even issues advice and warnings to his fellow central bankers.

Markets have enjoyed a liquidity-induced “right-tail” event that has been based primarily on easy money. However, high monetary accommodation has camouflaged underlying problems, thereby making risk-takers oblivious or at least complacent to fundamental value. Over-confident in the “government put”, is leading to complacency; a potential “Minsky trap” in the making. Weidmann also said, “Research suggests that the asymmetric policy of unconditional monetary accommodation, to counter a correction of financial sector excess, encourages more aggressive risk-taking.”

Dodd-Frank, Basel, the Volcker Rule and other regulatory actions are beginning to have a negative impact on liquidity. Liquidity is a moving target that will get significantly worse when risk-takers decide to “head for the door”. Running to the opposite side of a boat all at the same time usually does not end well. There are currently not enough outlets to pare risk as the number of market makers has declined, as has the willingness to take on new risk.

The magnitude of the “left-tail” event has been growing over time due to government efforts to “kick the can down the road” and the offering of cheap money, none of which have been accompanied by real solutions. Price action in capital markets over the past week or so seems to be indicating that we are entering the first inning of a new investment shift with “left tail” risk potential.

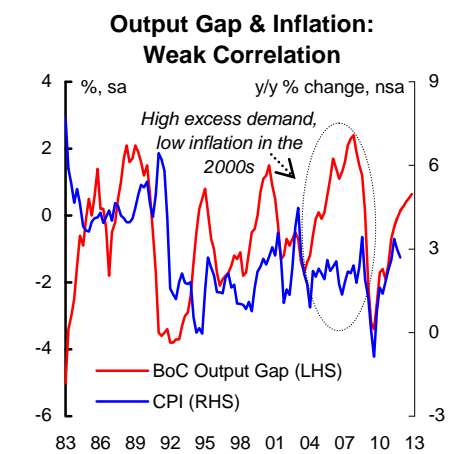
Derek Holt (416) 863-7707
derek.holt@scotiabank.com

Dov Zigler (416) 862-3080
dov.zigler@scotiabank.com

Key Data Preview

CANADA

Canada April CPI will be released on May 18, and Scotia is anticipating a mild headline gain and a largely muted core print in month-over-month terms. This should result in yearly headline inflation of 2% and core inflation of 1.9%. We are expecting slightly higher gasoline prices and various seasonal bounces including pick-ups in food costs and in household-related expenses. Strong declines in natural gas prices (-9%) and seasonal patterns in the volatile recreation, education and reading category should pull on prices. The April CPI report is a pretty significant data point as markets are torn as to how to forecast Bank of Canada policy. The BoC has said that “in light of the reduced slack in the economy and firmer underlying inflation, some modest withdrawal of the present considerable monetary policy stimulus may become appropriate.” While underlying inflation is indeed firmer than anticipated last Fall 2011 because oil prices unexpectedly resumed an upward march following last Fall’s weakness, it is still well under control. The year-over-year headline number may well fall further in the May CPI report in light of the pull-back in global crude prices (spot WTI fell 7.5% during the first six trading days in May). If so, that would leave a fairly dovish backdrop for inflation risk right after the Bank of Canada sent a hawkish signal to markets in the most recent statement and MPR. That leaves a more academic argument about the effect that a possibly narrowing output gap might have for the wider Canadian economy. While the output gap is a useful conceptual tool for looking at the broad relationship of prices and the economy, it does not have very much utility as an inflation targeting tool (see chart). That could be in part due to the success of targeting low and stable rates of inflation such that expectations have become well anchored over time, and/or it could reflect the role of other forces such as the rise of China and the concomitant flood of cheaper consumer goods. In any event, we do not see the output gap closing as rapidly as the BoC, and we think the BoC is under-estimating the amount of current slack.



The other major release in Canada next week will be **manufacturing shipments** on May 16. Scotia forecasts that manufacturing shipments will follow up February’s report with another small decline in March. One factor that might swing the headline into negative territory is the volatile aerospace segment, which surged 32% m/m in February and is unlikely to repeat a gain in March. On a weighted basis, this category added 0.8% to the headline shipments number that fell 0.3% in February. Further, export figures for March point to weakness in categories related to manufacturing shipments such as energy exports (-8.9%), auto product exports (-0.7%), and forestry products (-0.3%). Canadian **wholesale sales** will be released on May 17.

UNITED STATES

It will be a data-heavy week in the US. **CPI for April** will be among the more important releases, and Scotia is anticipating a flat headline print. Gasoline will be a neutral contributor to inflation, since the average retail gasoline price was \$4.01 per gallon in March vs. \$4.05 per gallon in February. Our forecast for the year-on-year seasonally unadjusted data is for a tailing off from last month’s 2.7% growth to 2.5%. That would remain consistent with waning market expectations for inflation risk such as a sharp drop in one-year break-evens on Treasury Inflation Protection Securities from 2.8% in mid-March to 1.3% today. Some of this decline also naturally reflects distortions owing to the safe haven flows into nominal bonds, but the Fed should be comforted by the fact that inflation is cooling and thus providing greater flexibility to counter growth downsides.

The more muted pace of gasoline price growth will filter through in April **retail sales** as well. Retail sales expanded at a very robust 0.8% m/m in March, and it is improbable that the rapid pace will be maintained. Not only are sales at gasoline stations expected to be fairly muted, but other categories that accelerated very rapidly last month — in particular new car sales — will be hard pressed to keep up the pace. Scotia is forecasting flat overall retail sales with a 0.1% m/m pace of growth ex-automobiles. In addition, April housing starts and the NAHB housing index are on tap for release next week.

Daniela Blancas (416) 862-3908
daniela.blancas@scotiabank.com

Sarah Howcroft (416) 863-2859
sarah.howcroft@scotiabank.com

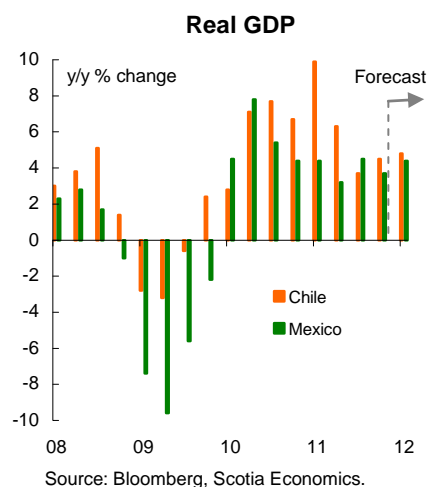
... continued from previous page

EUROPE

Next week's highlight in Europe will be the preliminary first-quarter GDP estimates for the euro zone. Germany, the economic engine of the currency union, is expected to have registered a modest advance of 0.1% q/q in the first three months of the year, following the 0.2% q/q decline in the final quarter of 2011. Elsewhere in the core, France avoided a contraction in the fourth quarter but likely lost around 0.1% q/q in January-March, with a risk that the downturn will extend through the second quarter, implying a technical recession. Italy is already in the midst of a double-dip recession, with output having contracted in both the third and fourth quarters of last year. We expect the downtrend to continue through the current year, with a first-quarter forecast of -0.8% q/q. Faced with aggressive fiscal consolidation, a severely weakened housing market and a damaged banking sector, Spain is set to experience a prolonged period of decline. The economy lost 0.3% q/q in the last three months of 2011, and the preliminary first-quarter GDP report confirmed a technical recession with a second decline of the same magnitude. We see a possibility that this estimate will be revised downward to -0.4% q/q. Finally, for the euro area as a whole, a loss in the range of 0.2%-0.3% q/q will corroborate the mild recession projected by the European Central Bank for the last several months. Though the first-quarter weakness may prove less acute than at one point anticipated, a renewed deterioration in survey indicators and rising unemployment indicate that the slump could be more protracted than previously envisioned. We continue to expect a contraction in the aggregate euro zone of 0.5% this year to be followed by a 0.9% expansion in 2013. The latest IMF projection calls for a contraction of 0.3% this year and growth matching our own expectation for next year.

LATIN AMERICA

Mexican and Chilean GDP data for the first quarter of the year will be released next week. In Mexico, leading indicators such as industrial production, retail sales and global economic activity indicator (IGAE) suggest that the economy maintained solid growth through the first quarter, mainly driven by a faster reactivation of domestic demand. We expect GDP to have expanded by 4.4% y/y in the first quarter. In Chile, economic activity has decelerated somewhat, but remains at a solid pace. As suggested by monthly numbers, consumption continues to be strong, despite a recent deceleration, which has been less aggressive than initially anticipated. We expect the Chilean economy grew by 4.8% y/y in the first quarter of the year.



ASIA

On Wednesday Japan will release the preliminary GDP estimate for the first quarter. We anticipate an expansion of 0.8% q/q, a healthy rebound from the 0.2% contraction recorded in the previous quarter. Japan's recovery from the devastating events of last March encountered a number of obstacles in the final months of 2011, including supply chain disruptions caused by excessive flooding in Thailand, persistent currency strength, and the global economic deceleration caused by euro zone debt stress and stalling activity in the US. Available data for the first three months of 2012 point to a revival in economic activity; merchandise exports, household spending and industrial production all advanced strongly in March, while both vehicle sales and production reached multi-year highs. This performance has been underpinned by the general improvement in conditions worldwide, with exporters also receiving a significant boost from the Bank of Japan, which has expanded its asset purchase program in order to weaken the currency (with limited success, as the yen has been strengthening since mid-March). With the BoJ committed to supporting the recovery, we expect GDP growth to rebound to 2% this year, following last year's 0.7% decline.

Key Indicators for the week of May 14 - 18

North America

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
MX	05/14	09:00	Industrial Production (m/m)	MAR	--	--	-1.7
MX	05/14	09:00	Industrial Production (y/y)	MAR	4.7	--	5.9
US	05/15	08:30	CPI (m/m)	APR	0.0	0.1	0.3
US	05/15	08:30	CPI (y/y)	APR	2.5	2.4	2.7
US	05/15	08:30	CPI ex. Food & Energy (m/m)	APR	--	0.2	0.2
US	05/15	08:30	CPI ex. Food & Energy (y/y)	APR	--	2.3	2.3
US	05/15	08:30	Empire State Manufacturing Index	MAY	8.0	9.0	6.6
US	05/15	08:30	Retail Sales (m/m)	APR	0.1	0.2	0.8
US	05/15	08:30	Retail Sales ex. Autos (m/m)	APR	0.1	0.2	0.8
US	05/15	09:00	Total Net TIC Flows (\$ bn)	MAR	--	--	107.7
US	05/15	10:00	Business Inventories (m/m)	MAR	--	0.5	0.6
US	05/15	10:00	NAHB Housing Market Index	MAY	--	26.0	25.0
US	05/16	07:00	MBA Mortgage Applications (w/w)	MAY 11	--	--	1.7
CA	05/16	08:30	Manufacturing Shipments (m/m)	MAR	-0.2	0.3	-0.3
US	05/16	08:30	Building Permits (000s a.r.)	APR	--	730	764
US	05/16	08:30	Housing Starts (000s a.r.)	APR	685	680	654
US	05/16	09:15	Capacity Utilization (%)	APR	--	79.0	78.6
US	05/16	09:15	Industrial Production (m/m)	APR	0.6	0.5	0.0
CA	05/17	08:30	International Securities Transactions (C\$ bn)	MAR	--	8.0	12.5
CA	05/17	08:30	Wholesale Trade (m/m)	MAR	--	0.3	1.6
US	05/17	08:30	Continuing Claims (000s)	MAY 5	3280	3250	3229
US	05/17	08:30	Initial Jobless Claims (000s)	MAY 12	370	365	367
MX	05/17	09:00	GDP (q/q)	1Q	--	--	0.4
MX	05/17	09:00	GDP (y/y)	1Q	4.42	--	3.7
MX	05/17	09:00	Global Economic Indicator IGAE (y/y)	MAR	3.8	--	6.2
US	05/17	10:00	Leading Indicators (m/m)	APR	--	0.1	0.3
US	05/17	10:00	Philadelphia Fed Index	MAY	11.0	10.0	8.5
CA	05/18	08:30	Core X8 CPI (m/m)	APR	0.1	0.1	0.3
CA	05/18	08:30	Core X8 CPI (y/y)	APR	1.9	1.9	1.9
CA	05/18	08:30	CPI, All items (m/m)	APR	0.3	0.3	0.4
CA	05/18	08:30	CPI, All items (y/y)	APR	2.0	1.9	1.9

Europe

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
FR	05/14	02:45	Current Account (€ bn)	MAR	--	--	-5.0
IT	05/14	04:00	CPI (y/y)	APR F	3.3	3.3	3.3
IT	05/14	04:00	CPI - EU Harmonized (y/y)	APR F	3.8	3.8	3.8
EC	05/14	05:00	Industrial Production (m/m)	MAR	--	0.4	0.8
FR	05/15	01:30	CPI (m/m)	APR	0.2	0.2	0.8
FR	05/15	01:30	CPI (y/y)	APR	2.1	2.2	2.3
FR	05/15	01:30	CPI - EU Harmonized (m/m)	APR	0.3	0.2	0.9
FR	05/15	01:30	CPI - EU Harmonized (y/y)	APR	2.5	2.5	2.6
FR	05/15	01:30	GDP (q/q)	1Q P	-0.1	0.0	0.2
GE	05/15	02:00	GDP (q/q)	1Q P	0.1	0.1	-0.2
FR	05/15	02:45	Non-Farm Payrolls (q/q)	1Q P	--	-0.2	-0.1
UK	05/15	04:30	Visible Trade Balance (£ mn)	MAR	-8400	-8400	-8772
EC	05/15	05:00	GDP (q/q)	1Q A	-0.3	-0.2	-0.3
EC	05/15	05:00	ZEW Survey (Economic Sentiment)	MAY	--	--	13.1
GE	05/15	05:00	ZEW Survey (Current Situation)	MAY	--	39.0	40.7
GE	05/15	05:00	ZEW Survey (Economic Sentiment)	MAY	--	19.0	23.4

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Key Indicators for the week of May 14 - 18

Europe (continued from previous page)

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
IT	05/16	04:00	GDP (q/q)	1Q P	-0.8	-0.7	-0.7
UK	05/16	04:30	Jobless Claims Chan(000s)	APR	5.0	5.0	3.6
UK	05/16	04:30	Unemployment Rate (%)	MAR	8.3	8.4	8.3
EC	05/16	05:00	CPI (m/m)	APR	0.5	0.5	1.3
EC	05/16	05:00	CPI (y/y)	APR	2.6	2.6	2.7
EC	05/16	05:00	Trade Balance (€ bn)	MAR	--	4.0	2.8
SP	05/17	03:00	Real GDP (q/q)	1Q P	-0.4	-0.3	-0.3
GE	05/18	02:00	Producer Prices (m/m)	APR	--	0.3	0.6

Asia Pacific

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
AU	05/13	21:30	Home Loans (%)	MAR	--	-2.0	-2.5
IN	05/14	02:30	Monthly Wholesale Prices (y/y)	APR	--	6.7	6.9
JN	05/15	01:00	Consumer Confidence	APR	--	40.8	40.3
JN	05/15	19:50	Machine Orders (m/m)	MAR	--	-3.5	4.8
JN	05/15	19:50	Tertiary Industry Index (m/m)	MAR	--	-0.4	0.0
AU	05/15	21:30	Wage Cost Index (q/q)	1Q	--	0.8	1.0
JN	05/16	19:50	GDP (q/q)	1Q P	0.8	0.9	-0.2
JN	05/16	19:50	GDP Deflator (y/y)	1Q P	--	-1.4	-1.8
SI	05/16	20:30	Exports (y/y)	APR	--	6.6	-4.3
JN	05/17	00:30	Capacity Utilization (m/m)	MAR F	--	--	-1.7
JN	05/17	00:30	Industrial Production (m/m)	MAR F	--	--	1.0
HK	05/17	04:30	Unemployment Rate (%)	APR	--	--	3.4

Latin America

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
PE	05/15	06:59	Economic Activity Index NSA (y/y)	MAR	--	--	7.2
PE	05/15	06:59	Unemployment Rate (%)	APR	--	--	8.7
CO	05/16	17:00	Trade Balance (US\$ mn)	MAR	--	--	537.2
BZ	05/17	08:00	Retail Sales (m/m)	MAR	--	0.2	-0.5
BZ	05/17	08:00	Retail Sales (y/y)	MAR	--	11.0	9.6
CO	05/17	17:00	Retail Sales (y/y)	MAR	--	6.3	9.4
CL	05/17	18:00	Nominal Overnight Rate Target (%)		5.00	5.00	5.00
CL	05/18	08:30	GDP (q/q)	1Q	--	--	2.0
CL	05/18	08:30	GDP (y/y)	1Q	4.8	5.5	4.5

Forecasts at time of publication.

Source: Bloomberg, Scotia Economics.

Global Auctions for the week of May 14 - 18

North America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
US	05/14	11:00	U.S. Fed to Purchase USD4.25-5 Bln Notes
US	05/14	11:30	U.S. to Sell 3-Month Bills
US	05/14	11:30	U.S. to Sell 6-Month Bills
US	05/14	11:30	3M Indirect Accepted %
US	05/14	11:30	3M Bid/Cover Ratio
US	05/14	11:30	3M High Yield Rate
US	05/14	11:30	6M Indirect Accepted %
US	05/14	11:30	6M Bid/Cover Ratio
US	05/14	11:30	6M High Yield Rate
US	05/15	11:00	U.S. Fed to Sell USD8-8.75 Bln Notes
US	05/15	11:30	U.S. to Sell 4-Week Bills
US	05/15	11:30	4W Indirect Accepted %
US	05/15	11:30	4W Bid/Cover Ratio
US	05/15	11:30	4W High Yield Rate
CA	05/16	12:00	Canada to Sell 2-Year Notes
US	05/17	11:00	U.S. Fed to Purchase USD1.5-2 Bln Notes
US	05/17	13:00	U.S. to Sell 10-Year TIPS Reopening
US	05/17	13:00	10Y Tips Bid/Cover Ratio
US	05/17	13:00	10Y Tips High Yield Rate
US	05/17	13:00	10Y Tips Indirect Accepted %
US	05/18	11:00	U.S. Fed to Purchase USD4.5-5.25 Bln Notes

Europe

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
SP	05/14	04:30	Spain to Sell 12-Month and 18-Month Bills
IT	05/14	05:00	Italy to Sell Bonds/Floating/Zero Coupon
GE	05/14	05:30	Germany to Sell EU4 Bln 6-Mth Bills
FR	05/14	09:00	France to Sell Bills (BTF)
GR	05/15	05:00	Greece to Sell Bills
UK	05/15	05:30	U.K. to Sell GBP2.75 Bln 5% 2025 Bonds
SW	05/16	05:10	Sweden to Sell Bonds
GE	05/16	05:30	Germany to Sell Add'l EU5 Bln 10-Year Notes
SP	05/17	04:30	Spain to Sell Bonds
FR	05/17	05:00	France to Sell Bonds/Notes (OAT/BTAN)
UK	05/17	05:30	U.K. to Sell 5% 2014 Bonds
UK	05/18	06:10	U.K. to Sell Bills

Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
JN	05/14	23:45	Japan to Sell 40-Year Bonds
CH	05/15	23:00	China to Sell 50-Year Bonds
JN	05/15	23:35	Japan to Sell 1-Year Bonds
JN	05/16	23:45	Japan to Sell 5-Year Bonds

Latin America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
BZ	05/17	11:00	Brazil to Sell Bills due 4/1/2013 - LTN
BZ	05/17	11:00	Brazil to Sell Bills due 7/1/2014 - LTN
BZ	05/17	11:00	Brazil to Sell Bills due 1/1/2016 - LTN
BZ	05/17	11:00	Brazil to Sell Fixed-rate bonds due 1/1/2018 - NTN-F
BZ	05/17	11:00	Brazil to Sell Fixed-rate bonds due 1/1/2023 - NTN-F

Source: Bloomberg, Scotia Economics.

Events for the week of May 14 - 18

North America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
US	05/15	09:00	U.S. Treasury Secretary Geithner Speaks at Peterson Summit
US	05/15	09:30	Fed's Duke Speaks on Housing Recovery in Washington
CA	05/15	12:00	Privy Council Clerk Wouters Speaks in Ottawa
CA	15-22 MAY		G-8 Summit , Chicago
US	05/16	12:30	Fed's Bullard Speaks on U.S. Economy in Louisville, Kentucky
US	05/16	14:00	Fed Releases Minutes from April 24-25 FOMC Meeting
CA	05/17	10:30	Bank of Canada Publishes Review Collection of Academic Papers
US	05/17	12:35	Fed's Bullard Speaks to Rotary Club of Louisville

Europe

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
EC	05/14	03:30	EU Foreign Ministers Meet in Brussels
EC	05/14	11:00	Euro-Area Finance Ministers Meet in Brussels
GE	05/14		Merkel Visits a Berlin School to Discuss Europe's Future
EC	05/15	03:00	EU Finance Ministers Meet in Brussels
EC	05/15	14:30	EU's Rehn Speaks at Dinner Event in Brussels
FR	05/15		Hollande to be Sworn in as France's President
UK	05/16	05:30	Bank of England Releases Quarterly Inflation Report
EC	05/16		ECB Meeting, Frankfurt

Asia Pacific

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
AU	05/14	21:30	Reserve Bank Board May Minutes

Latin America

<u>Country</u>	<u>Date</u>	<u>Time</u>	<u>Event</u>
CL	05/17	18:00	Nominal Overnight Rate Target

Source: Bloomberg, Scotia Economics.

Global Central Bank Watch

North America

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Bank of Canada – Overnight Target Rate	1.00	June 5, 2012	1.00	--
Federal Reserve – Federal Funds Target Rate	0.25	June 20, 2012	0.25	--
Banco de México – Overnight Rate	4.50	June 8, 2012	4.50	--

A sharp fall in inflation breakevens point to subdued market expectations for inflation risk and, when combined with our expectations for a soft CPI print next week, this should comfort the Fed's price stability mandate and enable it to debate additional stimulus in a clearer context. Canada is tracking 1.2% q/q annualized GDP growth in Q1 that is about half the growth pace forecast by the Bank of Canada. As a result, we think the BoC is underestimating the amount of slack in the Canadian economy when combined with subdued expectations for Q2 growth, making it likely that the BoC does not hike rates in 2012. Indeed, it is conceivable that the BoC will have to push out its output gap guidance into the back half of 2013. Over the next two weeks we will obtain more readings to close out Q1 GDP growth estimates, including manufacturing shipments, retail sales and wholesale trade.

Europe

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
European Central Bank – Refinancing Rate	1.00	June 6, 2012	1.00	--
Bank of England – Bank Rate	0.50	June 7, 2012	0.50	0.50
Swiss National Bank – Libor Target Rate	0.00	June 14, 2012	0.00	--
Central Bank of Russia – Refinancing Rate	8.00	June 1, 2012	8.00	--
Hungarian National Bank – Base Rate	7.00	May 29, 2012	7.00	7.00
Central Bank of the Republic of Turkey – 1 Wk Repo Rate	5.75	May 29, 2012	5.75	--
Sweden Riksbank – Repo Rate	1.50	July 4, 2012	1.50	--

Asia Pacific

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Bank of Japan – Target Rate	0.10	May 23, 2012	0.10	--
Reserve Bank of Australia – Cash Target Rate	3.75	June 5, 2012	3.75	3.75
Reserve Bank of New Zealand – Cash Rate	2.50	June 13, 2012	2.50	2.50
People's Bank of China – Lending Rate	6.56	TBA	--	--
Reserve Bank of India – Repo Rate	8.00	June 18, 2012	8.00	--
Bank of Korea – Bank Rate	3.25	June 7, 2012	3.25	--
Bank of Thailand – Repo Rate	3.00	June 13, 2012	3.00	--
Bank Indonesia – Reference Interest Rate	5.75	June 12, 2012	5.75	--

Latin America

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
Banco Central do Brasil – Selic Rate	9.00	May 30, 2012	9.00	--
Banco Central de Chile – Overnight Rate	5.00	May 17, 2012	5.00	5.00
Banco de la República de Colombia – Lending Rate	5.25	May 28, 2012	5.25	--
Banco Central de Reserva del Perú – Reference Rate	4.25	June 7, 2012	4.25	--

The central bank of Chile will likely maintain its monetary policy rate unchanged at 5.0% at its next meeting. Inflationary pressures eased in recent months, decelerating from 4.4% y/y in December to 3.5% in April. Additionally, inflation expectations remained unchanged in the latest survey released by the central bank, at 3.3% y/y, after three months of continued increases. We expect the central bank to maintain a neutral monetary policy stance for now.

Africa

<u>Rate</u>	<u>Current Rate</u>	<u>Next Meeting</u>	<u>Scotia's Forecasts</u>	<u>Consensus Forecasts</u>
South African Reserve Bank – Repo Rate	5.50	May 24, 2012	5.50	--

Forecasts at time of publication.
Source: Bloomberg, Scotia Economics.

Forecasts as at May 4, 2012*	2000-10	2011	2012f	2013f	2000-10	2011	2012f	2013f
Output and Inflation (annual % change)	Real GDP				Consumer Prices²			
World ¹	3.7	4.0	3.4	3.9				
Canada	2.2	2.5	2.1	2.2	2.1	2.9	2.1	2.1
United States	1.8	1.7	2.3	2.4	2.5	3.1	2.6	2.2
Mexico	2.1	3.9	3.6	3.7	4.9	3.8	3.9	4.0
United Kingdom	2.0	0.7	0.5	1.8	2.1	4.2	2.8	2.7
Euro zone	1.4	1.5	-0.5	0.9	2.1	2.7	2.2	1.9
Japan	0.9	-0.7	2.0	1.7	-0.3	-0.2	0.1	0.3
Australia	3.1	2.0	3.3	3.4	3.1	3.1	2.5	2.8
China	9.5	9.3	8.4	8.9	2.3	4.1	4.0	4.4
India	7.6	10.0	7.0	7.4	6.4	7.7	6.5	6.8
Korea	4.6	3.6	3.4	4.2	3.1	4.8	3.3	3.0
Thailand	4.4	5.7	5.0	4.5	2.7	3.5	3.0	2.8
Brazil	3.7	2.7	3.5	4.5	6.6	6.5	5.5	5.0
Chile	4.6	6.1	5.0	5.9	3.4	4.4	3.6	3.2
Peru	5.5	6.8	5.5	5.6	2.4	4.7	3.0	2.5
Central Bank Rates (% end of period)	12Q1	12Q2f	12Q3f	12Q4f	13Q1f	13Q2f	13Q3f	13Q4f
Bank of Canada	1.00	1.00	1.00	1.00	1.00	1.25	1.50	1.75
Federal Reserve	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
European Central Bank	1.00	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Bank of England	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Swiss National Bank	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bank of Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Reserve Bank of Australia	3.75	3.75	3.75	3.75	3.75	3.75	4.00	4.00
Exchange Rates (end of period)								
Canadian Dollar (USDCAD)	1.00	1.00	0.99	0.98	0.97	0.97	0.97	0.96
Canadian Dollar (CADUSD)	1.00	1.00	1.01	1.02	1.03	1.03	1.03	1.04
Euro (EURUSD)	1.33	1.29	1.27	1.25	1.25	1.26	1.28	1.29
Sterling (GBPUSD)	1.60	1.60	1.62	1.63	1.65	1.66	1.67	1.68
Yen (USDJPY)	83	82	83	85	86	86	87	87
Australian Dollar (AUDUSD)	1.03	1.07	1.08	1.09	1.10	1.10	1.11	1.11
Chinese Yuan (USDCNY)	6.3	6.3	6.2	6.2	6.2	6.1	6.1	6.1
Mexican Peso (USDMXN)	12.8	12.8	13.0	13.1	13.2	13.1	13.1	13.3
Brazilian Real (USDBRL)	1.83	1.80	1.83	1.85	1.83	1.85	1.86	1.90
Commodities (annual average)	2000-10	2011	2012f	2013f				
WTI Oil (US\$/bbl)	54	95	105	105				
Brent Oil (US\$/bbl)	52	111	120	120				
Nymex Natural Gas (US\$/mmbtu)	5.81	4.03	2.50	2.75				
Copper (US\$/lb)	1.93	4.00	3.85	3.70				
Zinc (US\$/lb)	0.75	0.99	0.94	1.10				
Nickel (US\$/lb)	7.36	10.38	8.50	8.00				
Gold, London PM Fix (US\$/oz)	586	1,569	1,650	1,600				
Pulp (US\$/tonne)	694	977	875	915				
Newsprint (US\$/tonne)	575	640	650	670				
Lumber (US\$/mfbm)	273	255	265	310				

¹ World GDP for 2000-10 are IMF PPP estimates; 2011-13f are Scotia Economics' estimates based on a 2010 PPP-weighted sample of 38 countries.

² CPI for Canada and the United States are annual averages. For other countries, CPI are year-end rates.

* See Scotia Economics 'Global Forecast Update' (http://www.gbm.scotiabank.com/English/bns_econ/forecast.pdf) for additional forecasts & commentary.

Canada	2011	11Q3	11Q4	Latest	United States	2011	11Q3	11Q4	Latest
Real GDP (annual rates)	2.5	4.2	1.8		Real GDP (annual rates)	1.7	1.8	3.0	2.2 (Q1-A)
Current Acc. Bal. (C\$B, ar)	-48.3	-49.3	-41.3		Current Acc. Bal. (US\$B, ar)	-473	-431	-496	
Merch. Trade Bal. (C\$B, ar)	2.3	3.0	14.9	4.2 (Mar)	Merch. Trade Bal. (US\$B, ar)	-738	-723	-745	-811 (Mar)
Industrial Production	3.5	3.3	3.0	1.3 (Feb)	Industrial Production	4.1	3.4	4.0	3.6 (Mar)
Housing Starts (000s)	193	205	199	245 (Apr)	Housing Starts (millions)	0.61	0.62	0.67	0.65 (Mar)
Employment	1.6	1.5	1.2	1.5 (Apr)	Employment	1.1	1.2	1.3	1.3 (Apr)
Unemployment Rate (%)	7.5	7.3	7.5	7.3 (Apr)	Unemployment Rate (%)	9.0	9.1	8.7	8.1 (Apr)
Retail Sales	4.1	4.6	4.2	4.1 (Feb)	Retail Sales	8.2	8.8	7.5	6.8 (Mar)
Auto Sales (000s)	1588	1604	1603	1711 (Jan)	Auto Sales (millions)	12.7	12.4	13.4	14.4 (Apr)
CPI	2.9	3.0	2.7	1.9 (Mar)	CPI	3.2	3.8	3.3	2.7 (Mar)
IPPI	4.6	5.4	3.9	-0.9 (Mar)	PPI	6.0	6.9	5.4	1.9 (Apr)
Pre-tax Corp. Profits	15.0	18.0	13.3		Pre-tax Corp. Profits	4.2	3.7	9.3	
Mexico					Brazil				
Real GDP	3.9	4.5	3.7		Real GDP	2.5	2.0	1.2	
Current Acc. Bal. (US\$B, ar)	-8.8	-13.7	-14.0		Current Acc. Bal. (US\$B, ar)	-52.5	-42.6	-63.2	
Merch. Trade Bal. (US\$B, ar)	-1.2	-15.3	-2.8	18.9 (Mar)	Merch. Trade Bal. (US\$B, ar)	29.8	40.4	27.0	10.6 (Apr)
Industrial Production	3.8	3.5	3.2	5.9 (Feb)	Industrial Production	0.3	0.2	-1.9	-3.9 (Mar)
CPI	3.4	3.4	3.5	3.4 (Apr)	CPI	6.8	7.1	6.7	6.6 (Jan)
Chile					Italy				
Real GDP	6.0	3.7	4.5		Real GDP	0.5	0.4	-0.4	
Current Acc. Bal. (US\$B, ar)	0.0	-12.0	-5.1		Current Acc. Bal. (US\$B, ar)	-0.07	-0.05	-0.03	-0.08 (Feb)
Merch. Trade Bal. (US\$B, ar)	10.0	1.2	9.4	12.6 (Apr)	Merch. Trade Bal. (US\$B, ar)	-34.2	-18.3	-8.3	-17.7 (Feb)
Industrial Production	6.9	4.4	2.0	0.2 (Mar)	Industrial Production	0.2	-0.3	-3.1	-5.5 (Mar)
CPI	3.3	3.1	4.0	3.5 (Apr)	CPI	2.8	2.9	3.3	3.4 (Mar)
Germany					France				
Real GDP	3.1	2.7	2.0		Real GDP	1.7	1.6	1.3	
Current Acc. Bal. (US\$B, ar)	204.1	188.1	256.1	312.9 (Mar)	Current Acc. Bal. (US\$B, ar)	-60.1	-48.7	-58.2	-92.4 (Feb)
Merch. Trade Bal. (US\$B, ar)	216.1	223.8	220.7	217.5 (Mar)	Merch. Trade Bal. (US\$B, ar)	-51.0	-49.5	-45.9	-52.0 (Mar)
Industrial Production	8.0	8.1	3.5	1.5 (Mar)	Industrial Production	2.5	2.9	0.5	-0.9 (Mar)
Unemployment Rate (%)	7.0	7.0	6.9	6.8 (Apr)	Unemployment Rate (%)	9.7	9.7	9.8	10.0 (Mar)
CPI	2.3	2.5	2.3	2.1 (Apr)	CPI	2.1	2.1	2.4	2.3 (Mar)
Euro Zone					United Kingdom				
Real GDP	1.5	1.3	0.7		Real GDP	0.7	0.3	0.5	
Current Acc. Bal. (US\$B, ar)	-4	15	183	-93 (Feb)	Current Acc. Bal. (US\$B, ar)	-46.4	-83.1	-45.4	
Merch. Trade Bal. (US\$B, ar)	6.4	16.0	76.9	38.6 (Feb)	Merch. Trade Bal. (US\$B, ar)	-159.8	-177.6	-152.5	-166.3 (Feb)
Industrial Production	3.6	3.8	-0.1	-1.5 (Feb)	Industrial Production	-1.2	-1.6	-3.0	-2.6 (Mar)
Unemployment Rate (%)	10.1	10.2	10.5	10.9 (Mar)	Unemployment Rate (%)	8.1	8.2	8.4	8.3 (Jan)
CPI	2.7	2.7	2.9	2.7 (Mar)	CPI	4.5	4.7	4.7	3.5 (Mar)
Japan					Australia				
Real GDP	-0.7	-0.5	-0.6		Real GDP	2.0	2.6	2.3	
Current Acc. Bal. (US\$B, ar)	119.2	159.5	48.0	231.4 (Mar)	Current Acc. Bal. (US\$B, ar)	-33.0	-34.0	-38.0	
Merch. Trade Bal. (US\$B, ar)	-33.7	-20.6	-76.8	-90.4 (Mar)	Merch. Trade Bal. (US\$B, ar)	35.8	42.6	29.3	2.4 (Mar)
Industrial Production	-2.3	-0.6	0.0	15.5 (Mar)	Industrial Production	-0.1	0.9	2.1	
Unemployment Rate (%)	4.6	4.4	4.5	4.5 (Mar)	Unemployment Rate (%)	5.1	5.2	5.2	4.9 (Apr)
CPI	-0.3	0.1	-0.3	0.5 (Mar)	CPI	3.4	3.5	3.1	
China					South Korea				
Real GDP	10.4	9.1	8.9		Real GDP	3.6	3.6	3.3	
Current Acc. Bal. (US\$B, ar)	290.0				Current Acc. Bal. (US\$B, ar)	26.5	27.6	46.0	36.5 (Mar)
Merch. Trade Bal. (US\$B, ar)	155.1	250.3	193.3	221.1 (Apr)	Merch. Trade Bal. (US\$B, ar)	30.8	25.2	36.6	25.8 (Apr)
Industrial Production	12.8	13.8	12.8	9.3 (Apr)	Industrial Production	6.9	5.3	5.2	0.3 (Mar)
CPI	4.1	6.1	4.1	3.4 (Apr)	CPI	4.0	4.3	4.0	2.5 (Apr)

All data expressed as year-over-year % change unless otherwise noted.

Source: Bloomberg, Scotia Economics.

Interest Rates (% , end of period)

Canada	11Q4	12Q1	May/04	May/11*	United States	11Q4	12Q1	May/04	May/11*
BoC Overnight Rate	1.00	1.00	1.00	1.00	Fed Funds Target Rate	0.25	0.25	0.25	0.25
3-mo. T-bill	0.84	0.92	1.06	1.03	3-mo. T-bill	0.01	0.07	0.07	0.09
10-yr Gov't Bond	1.94	2.11	2.02	2.00	10-yr Gov't Bond	1.88	2.21	1.88	1.85
30-yr Gov't Bond	2.49	2.66	2.54	2.48	30-yr Gov't Bond	2.89	3.34	3.07	3.03
Prime	3.00	3.00	3.00	3.00	Prime	3.25	3.25	3.25	3.25
FX Reserves (US\$B)	65.7	69.2	69.2	(Mar)	FX Reserves (US\$B)	136.9	138.0	138.0	(Mar)
Germany					France				
3-mo. Interbank	1.35	0.71	0.62	0.61	3-mo. T-bill	-0.06	0.07	0.09	0.09
10-yr Gov't Bond	1.83	1.79	1.58	1.52	10-yr Gov't Bond	3.15	2.89	2.83	2.80
FX Reserves (US\$B)	66.9	67.9	67.9	(Mar)	FX Reserves (US\$B)	48.6	49.2	49.2	(Mar)
Euro-Zone					United Kingdom				
Refinancing Rate	1.00	1.00	1.00	1.00	Repo Rate	0.50	0.50	0.50	0.50
Overnight Rate	0.63	0.39	0.34	0.35	3-mo. T-bill	4.85	4.85	4.85	4.85
FX Reserves (US\$B)	316.7	319.8	319.8	(Mar)	10-yr Gov't Bond	1.98	2.20	2.00	1.96
					FX Reserves (US\$B)	79.3	82.4	82.4	(Mar)
Japan					Australia				
Discount Rate	0.30	0.30	0.30	0.30	Cash Rate	4.25	4.25	4.25	3.75
3-mo. Libor	0.13	0.13	0.13	0.13	10-yr Gov't Bond	3.67	3.98	3.56	3.29
10-yr Gov't Bond	0.99	0.99	0.89	0.85	FX Reserves (US\$B)	42.8	47.7	47.7	(Mar)
FX Reserves (US\$B)	1258.2	1247.8	1247.8	(Mar)					

Exchange Rates (end of period)

USDCAD	1.02	1.00	1.00	1.00	¥/US\$	76.91	82.87	79.85	79.87
CADUSD	0.98	1.00	1.00	1.00	US¢/Australian\$	102.09	103.46	101.82	100.64
GBPUSD	1.554	1.601	1.615	1.608	Chinese Yuan/US\$	6.30	6.30	6.31	6.31
EURUSD	1.296	1.334	1.308	1.294	South Korean Won/US\$	1152	1133	1132	1147
JPYEUR	1.00	0.90	0.96	0.97	Mexican Peso/US\$	13.936	12.811	13.168	13.490
USDCHF	0.94	0.90	0.92	0.93	Brazilian Real/US\$	1.867	1.827	1.928	1.942

Equity Markets (index, end of period)

United States (DJIA)	12218	13212	13038	12893	U.K. (FT100)	5572	5768	5767	5576
United States (S&P500)	1258	1408	1369	1363	Germany (Dax)	5898	6947	6561	6580
Canada (S&P/TSX)	11955	12392	11871	11775	France (CAC40)	3160	3424	3162	3130
Mexico (Bolsa)	37078	39521	39409	39160	Japan (Nikkei)	8455	10084	9380	8953
Brazil (Bovespa)	56754	64511	60821	60108	Hong Kong (Hang Seng)	18434	20556	21086	19965
Italy (BCI)	806	859	786	769	South Korea (Composite)	1826	2014	1989	1917

Commodity Prices (end of period)

Pulp (US\$/tonne)	890	870	900	900	Copper (US\$/lb)	3.43	3.85	3.76	3.67
Newsprint (US\$/tonne)	640	640	640	640	Zinc (US\$/lb)	0.83	0.91	0.91	0.88
Lumber (US\$/mfbm)	261	266	301	304	Gold (US\$/oz)	1531.00	1662.50	1643.75	1583.00
WTI Oil (US\$/bbl)	98.83	103.02	98.49	96.82	Silver (US\$/oz)	28.18	32.43	29.90	28.58
Natural Gas (US\$/mmbtu)	2.99	2.13	2.28	2.47	CRB (index)	305.30	308.46	297.15	293.07

* Latest observation taken at time of writing.
Source: Bloomberg, Scotia Economics.

Emerging Markets Strategy

www.gbm.scotiabank.com

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable. Scotiabank, together with “Global Banking and Markets”, is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including Scotia Capital (USA) Inc.

The fixed income strategy reports contained herein have been prepared for Institutional Investors by Fixed Income Strategists of Scotia Capital (USA) Inc. (“SCUSA”) and may include contributions by strategists who are employees of affiliates of SCUSA. Fixed Income Strategists are employees of SCUSA’s Fixed Income Credit Sales & Trading Desk and support the trading desk through the preparation of market commentary, including specific trading ideas, and other materials, both written and verbal, which may or may not be made publicly available, and which may or may not be made publicly available at the same time it is made available to the Fixed Income Credit Sales & Trading Desk. Fixed Income Strategists are not research analysts, and this report was not reviewed by the Research Departments of SCUSA. Fixed Income Strategist publications are not research reports and the views expressed by Fixed Income Strategists in this and other reports may differ from the views expressed by other departments, including the Research Department, of SCUSA. The securities laws and regulations and the policies of SCUSA that are applicable to Research Analysts may not be applicable to Fixed Income Strategists.

These reports are provided to you for informational purposes only. Prices shown in this publication are indicative and SCUSA is not offering to buy or sell, or soliciting offers to buy or sell any financial instrument. SCUSA may engage in transactions in a manner inconsistent with the views discussed herein. SCUSA may have positions, or be in the process of acquiring or disposing of positions, referred to in this publication. Other than the disclosures related to SCUSA, the information contained in this publication has been obtained from sources that SCUSA knows to be reliable, however we do not represent or warrant that such information is accurate and complete. The views expressed herein are the views of the Fixed Income Strategists of SCUSA and are subject to change, and SCUSA has no obligation to update its opinions or information in this publication. SCUSA and any of its officers, directors and employees, including any persons involved in the preparation or issuance of this document, may from time to time act as managers, co-managers or underwriters of a public offering or act as principals or agents, deal in, own or act as market makers or advisors, brokers or commercial and/or investment bankers in relation to the securities or related derivatives which are the subject of this publication.

Neither SCUSA nor any of its officers, directors, partners, employees or affiliates accepts any liability for any direct or consequential loss arising from this publication or its contents. The securities discussed in this publication may not be suitable for all investors. SCUSA recommends that investors independently evaluate each issuer and security discussed in this publication, and consult with any advisors they deem necessary prior to making any investment.

Fixed Income Strategy (New York)

www.gbm.scotiabank.com

TM Trademark of The Bank of Nova Scotia. Used under license, where applicable. Scotiabank, together with "Global Banking and Markets", is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including Scotia Capital Inc.

This publication has been prepared for Major U.S. Institutional Investors by Fixed Income Strategists of the Bank of Nova Scotia, New York Agency. ("BNS/NYA"). BNS/NYA Fixed Income Strategists are employees of Scotiabank's Fixed Income Credit Sales & Trading Desk and support the trading desk through the preparation of market commentary, including specific trading ideas, and other materials, both written and verbal, which may or may not be made publicly available, and which may or may not be made publicly available at the same time it is made available to the Fixed Income Credit Sales & Trading Desk. Fixed Income Strategists are not research analysts, and this report was not reviewed by the Research Departments of Scotiabank. Fixed Income Strategist publications are not research reports and the views expressed by Fixed Income Strategists in this and other reports may differ from the views expressed by other departments, including the Research Department, of Scotiabank. The securities laws and regulations, and the policies of Scotiabank that are applicable to Research Analysts may not be applicable to Fixed Income Strategists.

This publication is provided to you for informational purposes only. Prices shown in this publication are indicative and Scotiabank is not offering to buy or sell, or soliciting offers to buy or sell any financial instrument. Scotiabank may engage in transactions in a manner inconsistent with the views discussed herein. Scotiabank may have positions, or be in the process of acquiring or disposing of positions, referred to in this publication. Other than the disclosures related to Scotiabank, the information contained in this publication has been obtained from sources that Scotiabank knows to be reliable, however we do not represent or warrant that such information is accurate and complete. The views expressed herein are the views of the Fixed Income Strategists of Scotiabank and are subject to change, and Scotiabank has no obligation to update its opinions or information in this publication. Scotiabank and any of its officers, directors and employees, including any persons involved in the preparation or issuance of this document, may from time to time act as managers, co-managers or underwriters of a public offering or act as principals or agents, deal in, own or act as market-makers or advisors, brokers or commercial and/or investment bankers in relation to the securities or related derivatives which are the subject of this publication.

Neither Scotiabank nor any of its officers, directors, partners, or employees accepts any liability for any direct or consequential loss arising from this publication or its contents. The securities discussed in this publication may not be suitable for all investors. Scotiabank recommends that investors independently evaluate each issuer and security discussed in this publication, and consult with any advisors they deem necessary prior to making any investment.

Fixed Income Strategy (London)

www.gbm.scotiabank.com

© 2012, The Bank of Nova Scotia

This material, its content, or any copy of it, may not be altered in any way, transmitted to, copied or distributed to any other party without the prior express written consent of Scotiabank™. This material has not been prepared by a member of the research department of Scotiabank, it is solely for the use of sophisticated institutional investors, and this material does not constitute investment advice or any personal recommendation to invest in a financial instrument or "investment research" as defined by the Financial Services Authority. This material is provided for information and discussion purposes only. An investment decision should not be made solely on the basis of the contents of this publication. It is not to be construed as a solicitation or an offer to buy or sell any financial instruments and has no regard to the specific investment objectives, financial situation or particular needs of any recipient. It is not intended to provide legal, tax, accounting or other advice and recipients should obtain specific professional advice from their own legal, tax, accounting or other appropriate professional advisers before embarking on any course of action. The information in this material is based on publicly available information and although it has been compiled or obtained from sources believed to be reliable, such information has not been independently verified and no guarantee, representation or warranty, express or implied, is made as to its accuracy, completeness or correctness. Information included in this material related to comparison performance (whether past or future) or simulated performance (whether past or future) is not a reliable indicator of future returns.

This presentation is not directed to or intended for use by any person resident or located in any country where the distribution of such information is contrary to the laws of such country. Scotiabank its directors, officers, employees or clients may currently or from time to time own or hold interests in long or short positions in any securities referred to herein, and may at any time make purchases or sales of these securities as principal or agent. Scotiabank may also have provided or may provide investment banking, capital markets or other services to the companies referred to in this communication.

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable. Scotiabank, together with "Global Banking and Markets", is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including Scotia Capital Inc., Scotia Capital (USA) Inc., Scotiabanc Inc.; Citadel Hill Advisors L.L.C.; The Bank of Nova Scotia Trust Company of New York; Scotiabank Europe plc; Scotia Capital (Europe) Limited; Scotiabank (Ireland) Limited; Scotiabank Inverlat S.A., Institución de Banca Múltiple, Scotia Inverlat Casa de Bolsa S.A. de C.V., Scotia Inverlat Derivados S.A. de C.V. – all members of the Scotiabank Group and authorized users of the mark. The Bank of Nova Scotia is incorporated in Canada with limited liability. Scotia Capital Inc. is a member of CIPF. Scotia Capital (USA) Inc. is a registered broker-dealer with the SEC and is a member of the NASD and SIPC. The Bank of Nova Scotia, Scotiabank Europe plc, Scotia Capital (Europe) Limited and Scotia Capital Inc. are each authorised and regulated by the Financial Services Authority (FSA) in the U.K. Scotiabank Inverlat, S.A., Scotia Inverlat Casa de Bolsa, S.A. de C.V., and Scotia Derivados, S.A. de C.V., are each authorized and regulated by the Mexican financial authorities.

Fixed Income Strategy (Paris)

Disclaimer © 2011, The Bank of Nova Scotia This material, its content, or any copy of it, may not be altered in any way, transmitted to, copied or distributed to any other party without the prior express written consent of Scotiabank™. This material has not been prepared by a member of the research department of Scotiabank, it is solely for the use of sophisticated institutional investors, and this material does not constitute investment advice or any personal recommendation to invest in a financial instrument or "investment research" as defined by the Financial Services Authority. This material is provided for information and discussion purposes only. An investment decision should not be made solely on the basis of the contents of this publication. It is not to be construed as a solicitation or an offer to buy or sell any financial instruments and has no regard to the specific investment objectives, financial situation or particular needs of any recipient. It is not intended to provide legal, tax, accounting or other advice and recipients should obtain specific professional advice from their own legal, tax, accounting or other appropriate professional advisers before embarking on any course of action. The information in this material is based on publicly available information and although it has been compiled or obtained from sources believed to be reliable, such information has not been independently verified and no guarantee, representation or warranty, express or implied, is made as to its accuracy, completeness or correctness. Information included in this material related to comparison performance (whether past or future) or simulated performance (whether past or future) is not a reliable indicator of future returns. This presentation is not directed to or intended for use by any person resident or located in any country where the distribution of such information is contrary to the laws of such country. Scotiabank its directors, officers, employees or clients may currently or from time to time own or hold interests in long or short positions in any securities referred to herein, and may at any time make purchases or sales of these securities as principal or agent. Scotiabank may also have provided or may provide investment banking, capital markets or other services to the companies referred to in this communication.

Scotia Economics

This report has been prepared by Scotia Economics as a resource for the clients of Scotiabank. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Scotiabank nor its affiliates accepts any liability whatsoever for any loss arising from any use of this report or its contents.

TM Trademark of The Bank of Nova Scotia. Used under license, where applicable.

Scotia Economics

Scotia Plaza 40 King Street West, 63rd Floor
Toronto, Ontario Canada M5H 1H1
Tel: (416) 866-6253 Fax: (416) 866-2829
Email: scotia.economics@scotiabank.com

For general and publication-related inquiries, contact us by telephone, email and/or fax.