

Global Forecast Update



Fall Back

For many, the fall means it's back to work. For others, it's back to school. For some, it's back to forecasting, with forecasts falling back.

Overall, our estimate for global growth this year remains at 4.4%, with next year's advance revised down a notch to 3.7%. But this year's projected economic gains mask some important changes in regional performances. Downward revisions to growth expectations for the United States, Canada, and some other countries, for example, have been offset by upward revisions to growth in a few other nations such as Germany and India.

While the recovery continues to move forward, global growth is moving to a weaker, rather than a stronger, performance profile. For the better part of a year now, Scotia Economics believed that the policy-induced rebound in economic activity — even in the countries hardest hit by the housing bust and associated credit crisis — would eventually give way to a prolonged period of economic convalescence, particularly in some of the advanced economies where households, financial institutions and governments are reducing their debt-heavy balance sheets. This transition appears to be happening quicker, and apparently is bumpier, than had been envisaged.

As temporary stimulus initiatives aimed at bolstering domestic spending around the world are withdrawn, there has been a predictable falloff in the pace of expenditures and manufacturing activity. In the United States, in particular, the slowdown has been more pronounced, since the underlying economic fundamentals — the greater need to reduce massive debt burdens, chronically weak housing markets, and an exceptionally soft job market — are less supportive. Despite Canada's comparatively better domestic performance, the trade repercussions associated with the renewed sluggishness in the United States are contributing to a further drag on growth.

Internationally, pockets of economic strength persist, especially among the emerging nations where domestic conditions remain quite robust. Piggybacking on this performance and with the added assist from a sharply weaker euro in the spring, preliminary reports indicate that surging German exports propelled overall growth to over a 9% annualized rate in the April to June period.

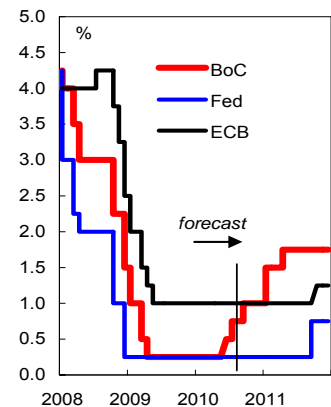
Nevertheless, investors have become increasingly risk adverse over the summer — with the downgrading of the globe's economic and inflation prospects coming quickly on the heels of the European sovereign debt crisis — reducing corporate profit expectations and stock market holdings and favouring the safety of high-quality government securities.

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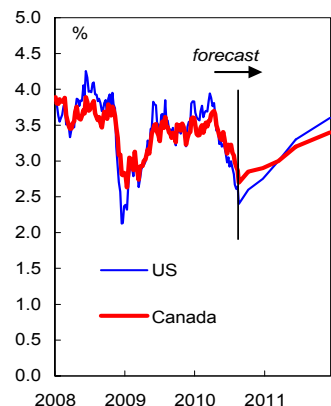
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Low Borrowing Costs Support Continued Growth

Central Bank Rates



10-Year Government Bond





Confidence and spending intentions, particularly in the developed economies, have clearly sagged alongside the increased economic uncertainty and heightened volatility in financial markets. Accordingly, we have adjusted our U.S. funds rate forecast, and now expect the Fed to keep its overnight rate unchanged at 0.25% through the end of the third quarter of 2011. (A similar pattern is expected for the European Central Bank, with its benchmark rate held at 1.0% through the end of 2011Q3.) We have also flattened the trajectory of the cyclical upswing in U.S. government bond yields, reflecting the extended period of Fed accommodation and muted inflation, as well as a slower revival in private sector credit demands. With these factors likely to persist well into next year, we now expect the yield on the 10-year U.S. Treasury bond to end 2011 at 3.60%.

Canada's diversified economy should continue to gain support from the ongoing global demand for resources and firm commodity prices. However, less favourable trade prospects with the United States, and a slowing housing market, will likely reinforce a more cautious Bank of Canada policy. We now expect that the overnight rate will end 2011 at 1.75%, 50 basis points lower than our prior outlook. As risk aversion dissipates, we continue to expect that the Canadian dollar will appreciate vis-à-vis its U.S. counterpart, with the currency again challenging parity in the second half of 2011. For a more comprehensive view of foreign exchange developments, please see the September release of the *Foreign Exchange Outlook* at http://www.scotiacapital.com/English/bns_econ/fxout.pdf. ■

North America	2000-08	2009	2010f	2011f
	(annual % change)			
Canada				
Real GDP	2.6	-2.5	3.0	2.3
Consumer Spending	3.5	0.4	3.4	2.8
Residential Investment	5.1	-8.2	10.4	-0.3
Business Investment	4.9	-19.9	1.5	7.3
Government	3.3	5.1	4.8	1.8
Exports	0.9	-14.2	7.2	5.3
Imports	3.9	-13.9	12.9	6.2
Nominal GDP	5.6	-4.5	5.8	4.1
GDP Deflator	2.9	-2.1	2.7	1.8
Consumer Price Index	2.3	0.3	1.8	2.1
Core CPI	1.9	1.8	1.8	1.8
Pre-Tax Corporate Profits	7.8	-32.3	20.0	11.0
Employment	1.9	-1.6	1.7	1.3
thousands of jobs	301	-272	280	230
thousands of jobs (Q4/Q4)	285	-253	375	173
Unemployment Rate (%)	6.9	8.3	8.0	7.8
Current Account Balance (C\$ bn.)	20.5	-43.5	-42.5	-44.5
per cent of GDP	1.6	-2.8	-2.6	-2.6
Merchandise Trade Balance (C\$ bn.)	58.1	-4.6	-3.8	-6.6
Federal Budget Balance (C\$ bn.)	8.4	-48	-43	-28
per cent of GDP	0.7	-3.1	-2.7	-1.7
Housing Starts (thousands)	207	149	190	175
Motor Vehicle Sales (thousands)	1,605	1,461	1,565	1,590
Motor Vehicle Production (thousands)	2,590	1,425	2,200	2,300
Industrial Production	0.5	-10.0	4.9	4.1
United States				
Real GDP	2.3	-2.6	2.6	2.1
Consumer Spending	2.8	-1.2	1.5	2.2
Residential Investment	-2.8	-22.9	-0.4	2.2
Business Investment	2.9	-17.1	4.3	4.9
Government	2.2	1.6	1.2	1.2
Exports	4.7	-9.5	11.5	7.0
Imports	4.5	-13.8	12.5	6.8
Nominal GDP	4.9	-1.7	3.5	3.7
GDP Deflator	2.5	0.9	0.9	1.5
Consumer Price Index	2.9	-0.3	1.6	1.4
Core CPI	2.2	1.7	1.0	1.2
Pre-Tax Corporate Profits	4.4	-0.4	30.0	7.0
Employment	0.7	-4.3	-0.5	1.3
millions of jobs	0.86	-5.87	-0.68	1.71
millions of jobs (Q4/Q4)	0.53	-5.38	0.93	2.28
Unemployment Rate (%)	5.1	9.3	9.6	9.1
Current Account Balance (US\$ bn.)	-596	-378	-483	-505
per cent of GDP	-4.9	-2.7	-3.3	-3.3
Merchandise Trade Balance (US\$ bn.)	-648	-507	-659	-711
Federal Budget Balance (US\$ bn.)	-197	-1,413	-1,340	-1,220
per cent of GDP	-1.5	-10.0	-9.2	-8.1
Housing Starts (millions)	1.65	0.55	0.58	0.88
Motor Vehicle Sales (millions)	16.4	10.4	11.5	12.2
Motor Vehicle Production (millions)	11.5	5.6	7.8	8.1
Industrial Production	1.0	-9.3	5.2	3.5
Mexico				
Real GDP	2.8	-6.5	4.8	3.5
Industrial Production	1.6	-7.3	5.2	3.8
Consumer Price Index (year-end)	5.1	3.6	4.9	4.6
Current Account Balance (US\$ bn.)	-11.2	-5.6	-12.2	-21.8
per cent of GDP	-1.6	-0.5	-1.3	-2.2

Forecast Changes

Canada & United States

- We have lowered our forecast for U.S. GDP growth this year and next to 2.6% and 2.1%, respectively, a reduction of 0.4 percentage points in both years. The downgrade reflects revisions to Q2 output as well as a softer growth profile for the second half of the year. The majority of recent indicators have been weaker than expected, including consumer confidence, housing and capital goods orders.
 - For Canada, weaker U.S. growth, combined with more moderate consumer and housing activity, have prompted us to lower GDP growth to 3.0% in 2010 and 2.3% in 2011, a reduction of 0.3 percentage points in both years from our prior forecast. While the nascent economic recovery on both sides of the border is expected to be relatively sluggish, healthier household and fiscal balance sheets give Canada the performance edge.
 - Auto sales in Canada have been stronger than expected over the summer months, buoyed by enhanced incentives. As a result, we have raised our 2010 Canadian sales forecast to 1.565 million units from 1.525 million.
 - Canada's federal deficit for Q1 of fiscal 2010-11(FY11) narrowed to \$7.2 billion from \$12.5 billion a year earlier, due in part to lower stimulus outlays. For the U.S. federal deficit in FY10, the Congressional Budget Office's latest estimate lines up with Scotia Economics'. For FY11 and onward, outstanding tax extension/expiry decisions by Congress accentuate the current uncertainty surrounding the deficit-reduction path.
- ### Mexico
- The Mexican manufacturing-led recovery will continue to be pulled along by industrial performance in the United States. Evidence of a transmission of export gains to the local economy continues to mount, with second-quarter GDP picking up at a solid 3.1% quarterly rate (not annualized). We continue to expect Mexico's GDP to grow by 4.8% in 2010, followed by a 3.5% gain in 2011.

International	2000-08	2009	2010f	2011f
Real GDP (annual % change)				
World	4.0	-0.6	4.4	3.7
United Kingdom	2.4	-4.9	1.4	1.2
Euro zone	1.9	-4.1	1.5	1.1
Germany	1.4	-4.9	3.0	1.5
France	1.9	-2.8	1.5	1.3
Italy	1.0	-5.1	1.0	0.9
Japan	1.4	-5.2	2.5	1.3
Australia	3.2	0.8	3.0	3.0
China	10.1	9.1	10.0	9.0
India	7.3	6.7	8.3	7.0
Korea	4.9	0.2	5.5	4.5
Brazil	3.3	0.5	7.5	5.0
Chile	4.3	-1.5	4.8	5.8
Peru	5.6	0.9	7.0	5.4
Consumer Prices (y/y % change, year-end)				
United Kingdom	2.1	2.9	2.5	2.0
Euro zone	2.2	0.9	1.3	1.6
Germany	1.8	0.8	1.3	1.5
France	2.0	1.0	1.5	1.5
Italy	2.5	1.1	1.5	1.8
Japan	-0.1	-1.7	0.3	0.5
Australia	3.3	2.1	2.5	3.0
China	2.1	1.9	3.0	2.5
India	5.3	9.9	7.0	5.5
Korea	3.2	2.8	3.0	2.5
Brazil	6.9	4.3	5.8	4.8
Chile	4.0	-1.4	3.7	3.5
Peru	2.7	0.3	2.8	3.0
Current Account Balance (% of GDP)				
United Kingdom	-2.1	-1.1	-1.6	-1.3
Euro zone	0.1	-0.6	-0.6	-0.6
Germany	3.5	5.0	5.3	5.5
France	-0.1	-2.0	-2.2	-2.0
Italy	-1.5	-3.1	-2.9	-3.0
Japan	3.3	2.5	3.0	3.0
Australia	-4.9	-2.6	-3.9	-4.6
China	5.5	6.0	5.3	4.0
India	-0.4	-1.6	-2.3	-2.3
Korea	1.5	5.2	2.0	0.4
Brazil	-0.8	-1.2	-3.0	-3.2
Chile	0.6	2.2	-0.5	-2.2
Peru	-0.7	0.2	-0.4	-0.2
Commodities (annual average)				
WTI Oil (US\$/bbl)	49.93	61.78	78	80
Nymex Natural Gas (US\$/mmbtu)	6.15	4.15	4.55	4.55
Copper (US\$/lb)	1.72	2.34	3.20	3.35
Zinc (US\$/lb)	0.73	0.75	0.88	0.85
Nickel (US\$/lb)	7.16	6.50	9.25	9.25
Gold, London PM Fix (US\$/oz)	472	973	1,175	1,200
Pulp (US\$/tonne)	662	720	940	840
Newsprint (US\$/tonne)	574	560	607	680
Lumber (US\$/mfbm)	286	178	240	235-240

Forecast Changes

International

- As the euro zone is well entrenched on a better-than-anticipated growth trajectory, we are revising the region's real GDP growth forecast to 1.5% for 2010 and to 1.1% for 2011. While the economic recovery is led by the export sector, domestic demand prospects are brightening as well. However, significant differences in economic performance between the core countries and the euro zone periphery remain in place. In 2011, regional export sector prospects will be adversely affected by slower growth in the U.S. and China.
- India's economy continues to defy expectations. Indian output expanded at an 8.8% yearly rate in the second quarter as a result of an acceleration that took place at the turn of the year. Although inflation is showing signs of receding, the central bank will continue in tightening mode in coming months. We have upgraded our GDP growth estimate for 2010 to 8.3%, from 8.0%.
- The resource-rich Australian economy retained its momentum during the April-June period with GDP expanding at the quickest pace in three years. This reflects not only continued Asian demand for commodities but also solid domestic demand. We have revised up our estimate for 2010 growth to 3%, from 2.8%.

Commodities

- LME copper prices surged today to a lucrative US\$3.46 per pound, following the release of Purchasing Manager Indices (PMIs) in China, pointing to a moderate pick-up in Chinese manufacturing activity in August. While China's growth is still expected to slow in 2010Q3, signs of a manufacturing pick-up have eased concerns over a sharp correction. Chinese steel producers have lifted prices for rebar (used in construction) and wire rod for September. A stronger-than-expected U.S. PMI in August contributed to higher copper prices as did ongoing mine supply constraints. The copper price forecast has been revised up due to tight international supplies.

Provincial	2000-08	2009	2010f	2011f	2000-08	2009	2010f	2011f
	<u>Real GDP*</u> (annual % change)				<u>Budget Balance, FY March 31</u> ((\$millions))			
Canada	2.6	-2.5	3.0	2.3	10,666	-5,755	-48,000	-43,000
Newfoundland & Labrador	4.6	-10.2	2.9	3.1	-151	2,350	-295	-194
Prince Edward Island	1.9	0.6	1.6	1.9	-25	-33	-84	-55
Nova Scotia	2.0	-0.5	1.8	1.9	60	26	-242 *	-222
New Brunswick	2.0	-0.8	1.9	2.0	79	-192	-738 *	-749
Quebec	2.1	-1.0	2.8	1.9	-128	0	-4,257	-4,506
Ontario	2.4	-3.1	3.5	2.0	-90	-6,409	-19,262 *	-19,677
Manitoba	2.4	-0.2	2.5	2.5	n.a.	470	-555	-545
Saskatchewan	2.3	-6.3	2.9	3.3	207	2,389	425 *	20
Alberta	3.5	-5.1	3.0	3.5	4,837	0	0 *	0
British Columbia	2.9	-2.3	3.1	2.8	959	75	-1,779 *	-1,715
	<u>Employment</u> (annual % change)				<u>Unemployment Rate</u> (annual average, %)			
Canada	1.9	-1.6	1.7	1.3	6.9	8.3	8.0	7.8
Newfoundland and Labrador	1.0	-2.5	2.7	1.1	15.4	15.5	14.3	14.2
Prince Edward Island	1.7	-1.1	2.7	0.7	11.3	12.0	10.6	10.8
Nova Scotia	1.3	-0.1	0.5	0.9	8.7	9.2	9.2	9.1
New Brunswick	1.3	0.1	0.3	1.4	9.6	8.9	9.1	8.7
Quebec	1.7	-1.0	1.9	1.2	8.3	8.5	7.9	7.8
Ontario	1.9	-2.4	1.8	1.3	6.5	9.0	8.7	8.5
Manitoba	1.3	0.0	1.9	1.1	4.8	5.2	5.2	5.3
Saskatchewan	0.9	1.5	1.6	1.5	5.1	4.8	4.9	4.8
Alberta	3.0	-1.3	0.8	2.0	4.3	6.6	6.6	6.3
British Columbia	2.2	-2.4	1.9	1.5	6.4	7.6	7.5	7.4
	<u>Housing Starts</u> (annual, thousands of units)				<u>Motor Vehicle Sales</u> (annual, thousands of units)			
Canada	207	149	190	175	1,605	1,461	1,565	1,590
Atlantic	12	11	13	12	113	115	122	123
Quebec	44	43	51	44	405	392	413	420
Ontario	77	50	61	58	615	535	584	592
Manitoba	4	4	5	5	44	43	45	46
Saskatchewan	4	4	5	5	40	44	46	47
Alberta	37	20	29	27	207	182	200	205
British Columbia	29	16	26	24	181	150	155	157

* 2009 provincial GDP are preliminary industry-based estimates from Statistics Canada.

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

Forecast Changes

Provincial

- We have tempered growth prospects across the nation relative to our early-August forecast. For 2010 the revisions are most pronounced for Western Canada; for 2011 the dampening impact is greatest in Central Canada.
- Although increases in energy sector production and investment have provided a significant boost to Alberta's economy, sluggish employment growth to date in 2010 has resulted in weak retail sales. Manitoba continues to be hampered by the weak recovery in its manufacturing shipments. With the U.S. housing market still struggling, a notable recovery for B.C.'s ailing forest products sector lies further out. For Saskatchewan, in addition to the crop losses due to flooding noted last month, the contribution from retail spending remains relatively modest.
- Given its exposure to an increasingly sluggish U.S. market, manufacturing production in Central Canada will likely be constrained in late 2010 and through 2011.
- The commodity-driven rebound in Newfoundland continues to be restrained by the labour dispute at Voisey's Bay. New Brunswick and Nova Scotia have yet to kick into higher gear, with muted employment gains this year.
- Audited results for the three most western Provinces, Ontario, Nova Scotia and New Brunswick for fiscal 2009-10 (FY10) report a hefty improvement of more than \$6 billion in their FY10 aggregate deficit from forecasts last spring, due to stronger-than-anticipated revenues and savings on expected program spending and interest charges. For FY11, however, early reports indicate some caution given the indications of slowing growth, particularly in the United States.

Financial Markets	09Q4	10Q1	10Q2	10Q3f	10Q4f	11Q1f	11Q2f	11Q3f	11Q4f
(% , end of period)									
Canada									
BoC Overnight Target Rate	0.25	0.25	0.50	1.00	1.00	1.50	1.75	1.75	1.75
3-month T-bill	0.31	0.30	0.61	1.05	1.10	1.60	1.85	1.80	1.95
2-year Canada	1.47	1.74	1.39	1.40	1.50	1.65	1.90	2.00	2.20
5-year Canada	2.76	2.90	2.33	2.25	2.30	2.40	2.60	2.65	2.90
10-year Canada	3.61	3.57	3.08	2.90	2.85	2.95	3.00	3.15	3.40
30-year Canada	4.08	4.07	3.65	3.35	3.40	3.50	3.60	3.75	4.05
Real GDP (q/q, ann. % change)	4.9	5.8	2.0	1.5	2.0	2.4	2.5	2.6	2.9
Real GDP (y/y, % change)	-1.1	2.2	3.4	3.5	2.8	2.0	2.1	2.4	2.6
Consumer Prices (y/y, % change)	0.8	1.6	1.4	1.9	2.1	2.2	2.1	2.0	2.1
Core CPI (y/y % change)	1.6	1.9	1.8	1.7	1.7	1.7	1.6	1.8	1.9
United States									
Fed Funds Target Rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.75
3-month T-bill	0.08	0.15	0.17	0.20	0.25	0.30	0.30	0.40	1.00
2-year Treasury	1.14	1.02	0.60	0.50	0.60	0.65	0.85	1.10	1.50
5-year Treasury	2.68	2.54	1.77	1.50	1.60	1.65	1.80	1.95	2.25
10-year Treasury	3.84	3.83	2.93	2.65	2.60	2.75	3.00	3.30	3.60
30-year Treasury	4.64	4.71	3.89	3.50	3.55	3.65	3.85	4.05	4.30
Real GDP (q/q, ann. % change)	5.0	3.7	1.6	1.2	1.8	2.4	2.3	2.6	2.5
Real GDP (y/y, % change)	0.2	2.4	3.0	2.9	2.1	1.8	1.9	2.3	2.4
Consumer Prices (y/y, % change)	1.5	2.4	1.9	1.2	0.9	0.9	1.5	1.6	1.6
Core CPI (y/y % change)	1.7	1.3	1.0	0.8	0.7	1.0	1.1	1.2	1.3
Spreads									
Target Rate	0.00	0.00	0.25	0.75	0.75	1.25	1.50	1.50	1.00
3-month T-bill	0.23	0.15	0.44	0.85	0.85	1.30	1.55	1.40	0.95
2-year	0.33	0.72	0.79	0.90	0.90	1.00	1.05	0.90	0.70
5-year	0.08	0.36	0.56	0.75	0.70	0.75	0.80	0.70	0.65
10-year	-0.23	-0.26	0.15	0.25	0.25	0.20	0.00	-0.15	-0.20
30-year	-0.56	-0.64	-0.24	-0.15	-0.15	-0.15	-0.25	-0.30	-0.25
Central Bank Rates									
European Central Bank	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.25
Bank of England	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25
Swiss National Bank	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.25
Bank of Japan	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Reserve Bank of Australia	3.75	4.00	4.50	4.50	4.75	4.75	4.75	4.75	4.75
Exchange Rates									
Canadian Dollar (USDCAD)	1.05	1.02	1.06	1.06	1.05	1.04	1.02	1.00	0.98
Canadian Dollar (CADUSD)	0.95	0.98	0.94	0.94	0.95	0.96	0.98	1.00	1.02
Euro (EURUSD)	1.43	1.35	1.22	1.25	1.29	1.32	1.34	1.36	1.38
Euro (EURGBP)	0.89	0.89	0.82	0.81	0.82	0.83	0.83	0.82	0.82
Sterling (GBPUSD)	1.62	1.52	1.49	1.55	1.57	1.60	1.62	1.65	1.69
Yen (USDJPY)	93	93	88	84	85	88	92	94	95
Australian Dollar (AUDUSD)	0.90	0.92	0.84	0.88	0.90	0.91	0.92	0.93	0.94
Chinese Yuan (USDCNY)	6.8	6.8	6.8	6.8	6.8	6.7	6.6	6.6	6.5
Mexican Peso (USDMXN)	13.1	12.4	12.9	12.7	12.9	12.9	13.0	13.1	13.3
Brazilian Real (USDBRL)	1.74	1.78	1.80	1.77	1.80	1.81	1.82	1.84	1.85

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