

Global Economic Research
Market Trends

NEW REPORTS RELEASED THIS WEEK:

- Global Outlook (October 20, 2004)
 - Forecast Update & Provincial Forecast Update (October 20, 2004)
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October 22, 2004

Reshaping & Rebalancing Global Growth

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The global economic expansion is being reshaped by shifting currency valuations, soaring energy prices, the ascendance of ultra low-cost producers in international markets and the transition to less stimulative policy settings in the United States. The balance of growth is tilting slightly in favour of energy-abundant countries, though prospects for Canada and Mexico will be tempered by a moderation in the overall pace of U.S. activity.

NAFTA will lead the G7 by a wide margin in 2005, with Canadian and U.S. growth converging around 3%. Neither country will match Mexico, which is on track to win the NAFTA growth sweepstakes after a prolonged period of weakness. Among the overseas G7 nations, activity is beginning to take a breather in Japan, and U.K. domestic demand will likely cool in the months ahead. Euro zone growth has very limited upside potential against a background of rising energy prices, the prospect of further currency appreciation, ongoing fiscal constraints and mounting auto sector layoffs.

There may be some loss in altitude among high-flying international growth leaders such as China and India, though output gains will still be more than double the average of the G7 nations. Asia is already the global trendsetter in industrial activity, driving developments in many manufacturing and commodity markets. As the region's exchange reserves and financial resources continue to accumulate, it will eventually reshape the balance in international financial markets as well.

For Canada, exports hold the key to achieving 3% growth in 2005 because domestic demand is unlikely to accelerate. External sales will be supported by robust demand for commodities, which now account for 40% of export receipts compared with 32% in 2002, when resource prices hit a cyclical low. Manufacturing exports, on the other hand, will likely soften next year

as U.S. households rein in purchases and the Canadian dollar moves decisively above 80 cents(US). Sales of motor vehicles and parts have dropped to 21% of merchandise exports — down from a peak of 26% in 1999 — as price discounting in the mature and highly competitive U.S. market muted the growth in overall receipts.

Despite intense global competition, cost-push pressures are beginning to percolate through the production chain. While the bias is shifting to slightly higher inflation, absolute rates will remain very low by historical standards — just above zero in Japan, under 2% in Europe, and slightly above 2% in Canada and the United States. In this environment, the Federal Reserve will tighten monetary policy only gradually. By late 2005, the bellwether funds rate is expected to climb to 2.75% — 1¾ percentage points above its cycle low.

While economic growth in Canada, buoyed by the strength in the resource sector, may be slightly better than in the United States, a higher exchange rate will help keep domestic price trends below U.S. levels. This will provide the central bank with latitude to tighten policy gradually as well, with the overnight rate expected to end next year at 3¼%, three-quarters of a percentage point above the current level.

Currency markets will remain volatile as economic and geopolitical uncertainties interact with the enormous liquidity overhanging global markets. U.S. dollar weakness, punctuated by brief rallies, will be the dominant trend through 2005, as hefty U.S. trade and fiscal deficits encourage global investors to diversify their portfolios. Canadian dollar strength will be reinforced by solid trade surpluses, buoyant commodity markets and G7 fiscal leadership. Accordingly, the Canadian dollar is likely to fluctuate in an 80-83 cent(US) range in 2005.

The full report, [Global Outlook](#), and a webcast of the Chief Economist discussing the economic outlook is available on our website at www.scotiabank.com.

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ECONOMIC AND FINANCIAL FORECASTS

UPDATED

Economic Performance (annual % change unless otherwise indicated)

| | 1990-02 | 2003 | 2004f | 2005f | 1990-02 | 2003 | 2004f | 2005f |
|----------------------------------|-------------------------------------|-------|-------|-------|----------------------|-------|-------|-------|
| | Canada | | | | United States | | | |
| Real GDP | 2.7 | 2.0 | 2.9 | 3.1 | 2.9 | 3.0 | 4.4 | 3.0 |
| Consumer Prices | 2.3 | 2.8 | 2.1 | 2.2 | 2.9 | 2.3 | 2.7 | 2.4 |
| Pre-tax Profits | 6.4 | 10.0 | 17.0 | 8.0 | 5.4 | 15.4 | 15.0 | 9.0 |
| Federal Budget Balance (\$bn) | -12.8 | 9.1 | 4.5 | 4.5 | -87 | -374 | -413 | -375 |
| Current Account Balance (\$bn) | -4.7 | 23.8 | 39.0 | 30.0 | -189 | -531 | -635 | -625 |
| Merchandise Trade Balance (\$bn) | 32.8 | 58.2 | 76.0 | 69.0 | -239 | -548 | -635 | -635 |
| Motor Vehicle Sales (000s)* | 1,349 | 1,596 | 1,530 | 1,565 | 15.1 | 16.6 | 16.7 | 16.7 |
| Motor Vehicle Production (000s)* | 2,422 | 2,550 | 2,650 | 2,700 | 11.5 | 12.1 | 12.0 | 12.1 |
| Housing Starts (000s)* | 154 | 218 | 228 | 200 | 1.43 | 1.85 | 1.92 | 1.76 |
| Employment | 1.3 | 2.2 | 1.7 | 1.2 | 1.5 | -0.3 | 1.0 | 1.6 |
| Jobs Created (000s, Q4/Q4)* | 196 | 271 | 220 | 185 | 1.67 | -0.24 | 1.95 | 2.20 |
| Unemployment Rate (%) | 9.0 | 7.6 | 7.2 | 7.0 | 5.6 | 6.0 | 5.5 | 5.2 |
| | Mexico | | | | Euro zone | | | |
| Real GDP | 3.4 | 1.3 | 4.0 | 4.0 | 2.2 | 0.4 | 1.6 | 2.0 |
| Consumer Prices | 18.2 | 4.0 | 4.5 | 4.0 | 2.3 | 1.9 | 2.1 | 1.6 |
| | Latin America (Excl. Mexico) | | | | Asia | | | |
| Real GDP | 2.9 | 1.4 | 5.2 | 4.1 | 4.0 | 4.2 | 5.3 | 4.1 |
| Consumer Prices | 22.3 | 8.5 | 8.0 | 7.1 | 3.2 | 1.2 | 2.0 | 1.6 |

*In the United States, millions.

Commodity Prices (US\$ annual average)

| | 1990-02 | 2003 | 2004f | 2005f |
|--------------------------------|---------|-------|-----------|-----------|
| Pulp (tonne) | 602 | 553 | 648 | 720 |
| Newsprint (tonne) | 536 | 493 | 545 | 585 |
| Lumber (mfbm) | 302 | 267 | 380 | 290 |
| Copper (lb) | 0.95 | 0.81 | 1.29 | 1.30 |
| Zinc (lb) | 0.50 | 0.375 | 0.46-0.47 | 0.49-0.50 |
| Nickel (lb) | 3.15 | 4.37 | 6.30 | 5.75-6.25 |
| WTI Oil (bbl) | 21.47 | 31.07 | 43 | 40 |
| Nymex Natural Gas (US\$/mmbtu) | 2.47 | 5.50 | 6.05 | 5.50 |
| Wheat (tonne) | 175 | 177 | 180 | 180-190 |

Financial Markets (end of period, % unless otherwise indicated)

| | 2004Q1 | 04Q2 | 04Q3 | 04Q4f | 2005Q1f | 05Q2f | 05Q3f | 05Q4f |
|----------------------------|--------|------|------|-------|---------|-------|-------|-------|
| CANADA | | | | | | | | |
| 3-month T-bill | 1.99 | 2.17 | 2.47 | 2.75 | 3.10 | 3.10 | 3.20 | 3.20 |
| 5-year Canada | 3.35 | 4.10 | 4.03 | 4.35 | 4.30 | 4.45 | 4.65 | 4.65 |
| 10-year Canada | 4.33 | 4.84 | 4.62 | 4.80 | 4.90 | 5.00 | 5.00 | 5.00 |
| UNITED STATES | | | | | | | | |
| 3-month T-bill (Yield) | 0.95 | 1.27 | 1.71 | 1.95 | 2.00 | 2.10 | 2.40 | 2.70 |
| 5-year Treasury | 2.78 | 3.77 | 3.37 | 3.65 | 3.70 | 3.85 | 4.25 | 4.45 |
| 10-year Treasury | 3.84 | 4.59 | 4.12 | 4.30 | 4.40 | 4.60 | 4.80 | 5.00 |
| CANADIAN-US SPREADS | | | | | | | | |
| 3-month T-bill | 1.04 | 0.90 | 0.76 | 0.80 | 1.10 | 1.00 | 0.80 | 0.50 |
| 5-year | 0.57 | 0.33 | 0.66 | 0.70 | 0.60 | 0.60 | 0.40 | 0.20 |
| 10-year | 0.49 | 0.26 | 0.50 | 0.50 | 0.50 | 0.40 | 0.20 | 0.00 |
| Canadian Dollar (C\$/US\$) | 1.31 | 1.33 | 1.26 | 1.25 | 1.25 | 1.23 | 1.22 | 1.20 |
| Canadian Dollar (US¢/C\$) | 76.4 | 75.0 | 79.4 | 80.0 | 80.0 | 81.3 | 82.0 | 83.3 |
| Yen (¥/US\$) | 104 | 109 | 110 | 105 | 102 | 100 | 98 | 95 |
| Euro (US\$/€) | 1.23 | 1.22 | 1.24 | 1.27 | 1.31 | 1.33 | 1.34 | 1.35 |
| Sterling (US\$/£) | 1.85 | 1.82 | 1.81 | 1.78 | 1.82 | 1.84 | 1.87 | 1.90 |
| Mexican Peso (Peso/US\$) | 11.1 | 11.5 | 11.4 | 11.6 | 11.9 | 12.5 | 12.1 | 12.5 |

Financial Markets

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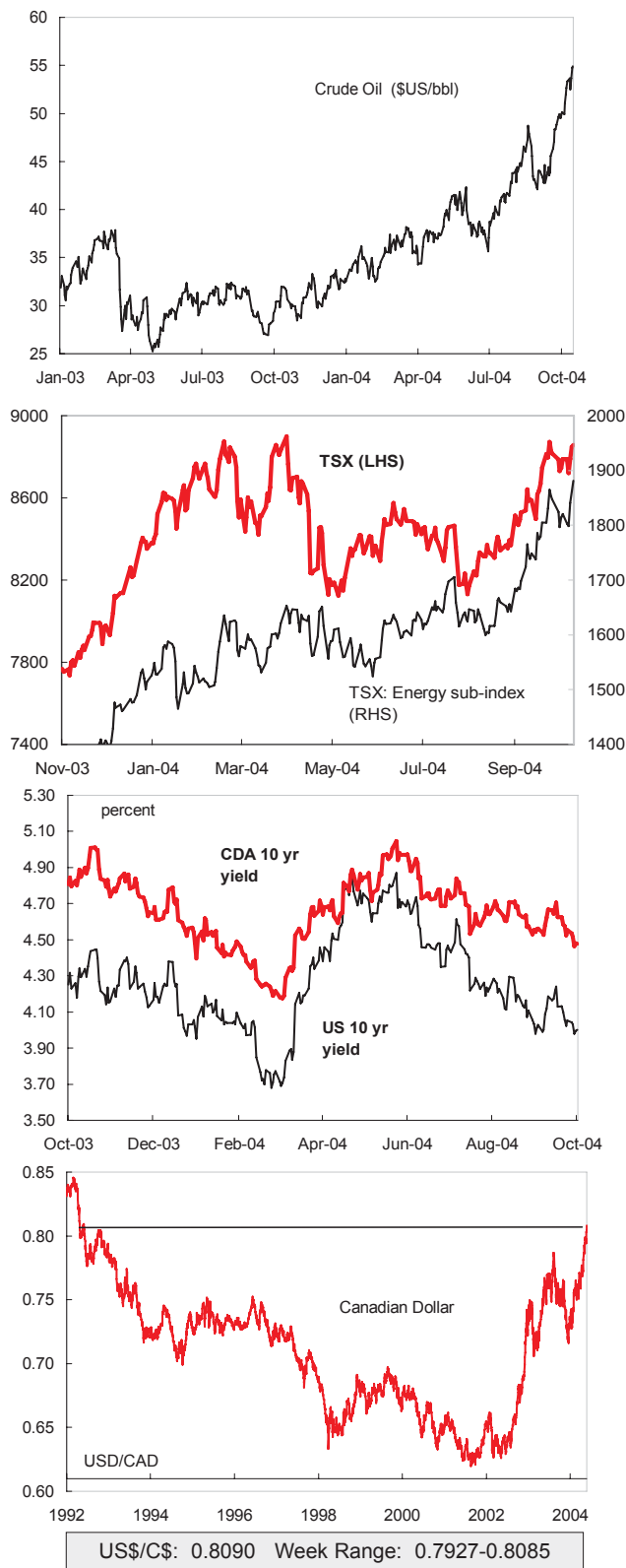
MARKET WATCH

A mixed bag in terms of corporate earnings in the United States this week, aftershocks from the probe by the New York District Attorney's office on the insurance industry and further concerns over the impact of higher energy prices on growth resulted in a net negative week for the major U.S. stock indices and a roller-coaster ride for Canadian equities. At the time of writing, the DJIA was off over 1.5% on the week, compared with a 1.0% loss in the S&P. However, the tech-laden Nasdaq managed to pull off a gain of about 0.4%. In Canada, the TSX outperformed the broader U.S. indices with a 0.3% gain on the week, led by a 2.8% rally in energy. After sliding down to the US\$52/bbl area earlier in the week, crude oil futures rebounded into the weekend, breaking back above US\$55/bbl. The information technology sub-group saw a 2.2% improvement on the week, while more modest gains were seen in telecoms, industrials, materials, consumer staples and utilities. Consumer discretionary, however, came under pressure this week, with the sub-group off more than 1%, slightly ahead of the 1.7% drop in financials.

With the overall drag on stocks, North American fixed income markets again represented an attractive alternative for cautious-minded investors. The U.S. Treasury market saw yields on longer dated issues fall roughly 7 bps, with the 10-year note closing below 4%, while shorter-dated bonds were basically unchanged on the week. The Canadian market outperformed its U.S. counterpart, even with the slightly better tone in equities, mainly on strength in the Canadian dollar. As expected, the Bank lifted the overnight target rate by a quarter point on Tuesday, to 2.50%. The 2-year end of the Canadian curve rallied about 5 bps on the week to 3.15%, but had tested down near 3.10% as of Tuesday. Yields fell about 10 bps on 10-year notes to 4.45% — the lowest level since early April.

All eyes are on the Canadian dollar, in the wake of the sustained break above 80 cents(US) on Wednesday, and then broke 81 cents(US) Friday morning — the highest since September 1992. While the currency flirted with this level a couple of weeks ago, the fact that it has closed above this mark for three sessions in a row has reinforced speculation that the loonie could test significantly higher ground in the months to come, especially if energy and material prices stay strong. Still, much of the move continues to be driven by overall weakness in the U.S. dollar, and for the week, Canada lagged behind other major currencies, like Swiss franc, euro, yen and British pound.

CHART WATCH



Canada

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ECONOMY WATCH

As widely expected, the Bank of Canada raised the overnight rate 25 bps to 2.50% this week. The text of the accompanying statement and Thursday's Monetary Policy Report offered a fairly balanced view. The Bank lowered its Canadian growth forecast for 2005 half a percentage point to 2.9%, citing rising oil prices, a stronger dollar and more moderate U.S. demand, but expects growth to pick up to 3.2% in 2006 — essentially in line with potential throughout the forecast period. However, it left its core inflation outlook unchanged, with underlying price trends expected to move up to the 2% target by the end of 2005 and stay there through 2006. This baseline scenario "assumes further withdrawal of monetary stimulus", and suggests another rate hike is still a good bet for December.

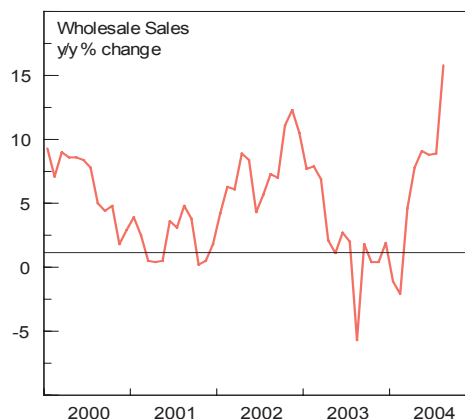
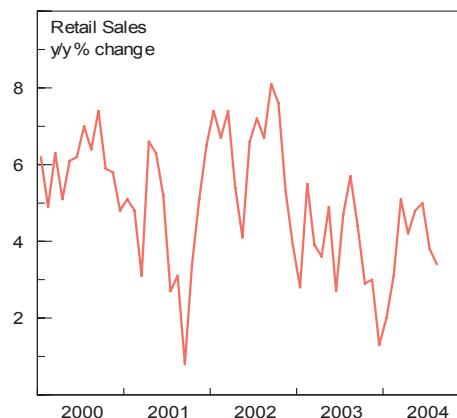
This week's economic reports were largely better-than-expected and suggest the economy continues to move forward at a solid pace. Retail sales rose a strong 0.8% in August and 0.9% excluding autos. Gains were broad based, with five of the eight major categories posting a healthy rise in sales, led by home centres & hardware stores, pharmacies and furniture & electronics dealers. Discounting remained pervasive, with the volume of sales rising by an even stronger 1.1%. Sales have advanced in seven of the past eight months.

August wholesale trade climbed 0.7% (0.5% excluding autos). The advance was the sixth consecutive monthly gain, with most of the increase coming on the back of strong machinery and electronic sales. As with the retail data, the advance was broad, with five of the seven categories posting gains in the month. Wholesale volumes rose 0.8%.

The leading indicator, by contrast, increased by a modest 0.3% last month, continuing a slowing pattern evident since July. Most of the deceleration in the index reflected the slowdown in the U.S. leading indicator and some leveling off in housing-related indicators after hefty gains in the spring. Six of the ten components posted advances, one less than in August.

Looking to next week, we anticipate a benign inflation report for September, with retailers' pricing power still limited and average retail gasoline prices essentially unchanged from August at 85¢/litre. Real GDP data for August should show a strong rebound based on preliminary reports for wholesale and retail trade, manufacturing shipments and housing activity. Thursday's Business Conditions Outlook, conducted in early October, will also be closely watched for signs that Canadian dollar appreciation is hampering the manufacturing sector.

CHART WATCH



LOOKING BACK

| | June | July | Aug | Sept |
|------------------------------------|------|------|-----|------|
| Int'l C\$ Securities Trans., \$ bn | 1.1 | 2.6 | 0.9 | |
| BoC policy announcement | | | | |
| Wage Settlements, % y/y | 2.5 | -0.3 | 2.9 | |
| Leading Indicator, % m/m | 1.0 | 0.7 | 0.5 | 0.3 |
| Wholesale Trade, % m/m | 0.7 | 0.5 | 0.7 | |
| Retail Sales, % m/m | 0.2 | 0.4 | 0.8 | |
| Ex. Autos, % m/m | -0.4 | 0.3 | 0.9 | |
| BoC Monetary Policy Report | | | | |

LOOKING AHEAD

| | June | July | Aug | Sept |
|-----------------------------------------------------------------------------------------------|------|------|------------|-------------|
| CPI, All Items, % m/m (Tue) | 0.1 | -0.1 | -0.2 | <u>0.2</u> |
| CPI, All Items, % y/y | 2.5 | 2.3 | 1.9 | <u>1.9</u> |
| Core CPI, % m/m | 0.1 | 0.2 | -0.2 | <u>0.2</u> |
| Core CPI, % y/y | 1.7 | 1.9 | 1.6 | <u>1.4</u> |
| BoC Dodge and Jenkins appearance before House of Commons Standing Committee on Finance | | | | |
| IPPI, % m/m (Thu) | -0.5 | -0.3 | 0.1 | <u>-0.2</u> |
| Raw Materials PI, % m/m | -1.1 | 1.2 | 3.3 | <u>3.0</u> |
| Business Conditions Survey | | | | |
| Real GDP, % m/m (Fri) | 0.4 | 0.1 | <u>0.4</u> | |

Underlined figures denote Scotia Economics' estimates.

United States

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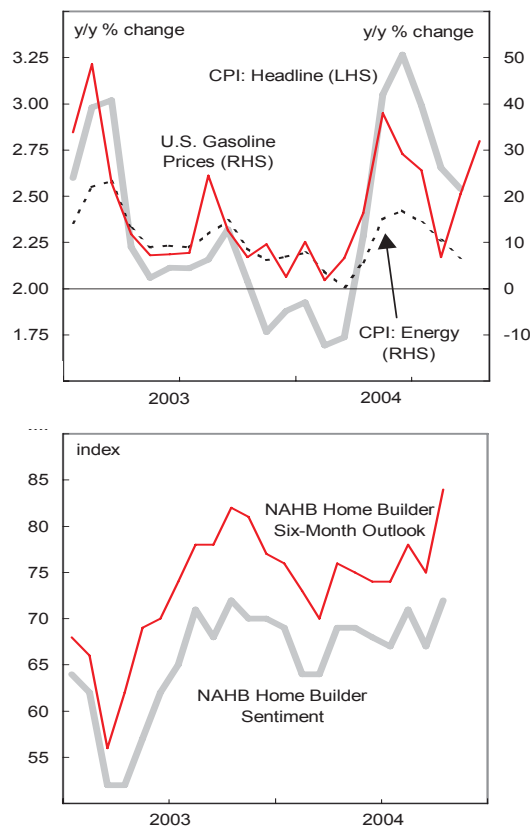
ECONOMY WATCH

Consumer prices remained relatively well behaved in September, with the headline index rising 0.2% month-over-month. Falling energy prices helped lower the year-over-year growth rate in the CPI from 3.3% in June to 2.5% last month. However, with average gasoline prices rising more than 10% since mid September, the dis-inflationary effects of lower energy prices in July and August are likely to reverse in the near term, pressuring headline inflation and threatening the recent improvement in annual real earnings growth. Fed Chairman Greenspan remarked just last week that he expects a tighter relationship between crude oil and gasoline prices in the months ahead — hardly an encouraging prospect with benchmark crude prices surpassing US\$55/bbl this week. Policymakers will therefore remain alert for signs that rising energy prices are spilling over into the costs of final goods and services. However, Governor Ben Bernanke predicted this week that the “second-round” effects of higher oil prices were likely to be small, allowing the withdrawal of policy accommodation to proceed at a “measured” pace.

Housing starts fell 6.0% in September, with wet weather in the Northeast contributing to a 27% drop in activity in the region. With interest rates at such low levels for this stage in the business cycle, new home construction retains a good deal of momentum. Building permits jumped 1.8% and the number of permits that have been authorized but not yet started stood almost 16% above year-ago levels. Homebuilders also reported a large improvement in sentiment in October. The Philly Fed manufacturing index rebounded by 15 points in October to 28.5 — in line with the average seen so far this year. However, expectations surrounding business conditions in six months showed a considerable decline, suggesting manufacturers in the area remain concerned that the U.S. economic ‘soft patch’ might persist.

One longstanding issue that causes concern among many investors is the yawning U.S. trade deficit and the willingness of foreigners to finance U.S. consumers’ spendthrift tendencies. As such, a Treasury Department report showing a decline in net purchases by foreign investors of U.S. securities from \$79 billion in July to \$60 billion in August raised some eyebrows. While still sufficient to finance America’s \$50 billion-plus monthly trade deficit, the data revealed heavy reliance on foreign central bank purchases. Net purchases by private investors fell from \$73 billion to only \$37 billion, the lowest level in ten months. Moreover, private net purchases of U.S. equities fell for the fourth time this year and are up only \$1.8 billion year to date versus a \$23 billion gain over the first eight months of 2003.

CHART WATCH



LOOKING BACK

| | July | Aug | Sept | Oct |
|-----------------------------------------------------|------|------|------|------|
| CPI, % m/m | -0.1 | 0.1 | 0.2 | |
| CPI ex Food & Energy, % m/m | 0.1 | 0.1 | 0.3 | |
| Housing Starts, mn units | 1.99 | 2.02 | 1.90 | |
| Fed's Greenspan, Poole and Olson speak | | | | |
| Leading Indicator, % m/m | -0.3 | -0.3 | -0.1 | |
| Philadelphia Fed Index, level | 36.1 | 28.5 | 13.4 | 28.5 |
| Fed's Poole, Bernanke, Bies and Yellen speak | | | | |

LOOKING AHEAD

| | July | Aug | Sept | Oct |
|------------------------------------------|-----------|-----------|-------------|-------------|
| Existing Home Sales, mn units ann. (Mon) | 6.72 | 6.54 | <u>6.70</u> | |
| Consumer Confidence, index (Tue) | 105.7 | 98.7 | 96.8 | <u>95.0</u> |
| Durable Good Orders, % m/m (Wed) | 1.9 | -0.3 | <u>0.3</u> | |
| New Home Sales, mn units | 1.08 | 1.18 | <u>1.17</u> | |
| Fed's Beige Book | | | | |
| Michigan Sentiment, index (Fri) | 96.7 | 95.9 | 94.2 | <u>88.0</u> |
| Chicago PMI, index | 64.7 | 57.3 | 61.3 | <u>60.0</u> |
| | Q4 | Q1 | Q2 | Q3 |
| Real GDP, % q/q ann. (Fri) | 4.2 | 4.5 | 3.3 | <u>4.0</u> |
| GDP Deflator, % q/q ann. | 1.6 | 2.8 | 3.2 | <u>2.0</u> |
| Employment Cost Index, % q/q | 0.5 | 1.4 | 0.9 | <u>1.0</u> |

Underlined figures denote Scotia Economics' estimates.

Industry & Commodity

AUTO INDUSTRY WATCH

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New car registrations in Western Europe fell 0.6% below a year ago in September – the third consecutive monthly decline. Volumes have weakened steadily since June alongside rising unemployment, weak consumer confidence and record global oil prices.

As in recent months, the slowdown was concentrated in Germany — Europe’s largest auto market — with purchases declining 3.7% below a year earlier due to rising unemployment. Germany’s unemployment rate climbed to 10.7% in September — the highest level since February 1999. Volumes were also weak in the United Kingdom, undercut by rising interest rates. The Bank of England has raised interest rates five times since November to slow economic growth and prevent inflation from accelerating. The central bank rate in England is now 4.75% — the highest in three years — compared with 2% in the euro zone.

Nissan and Peugeot led the decline in car sales across Western Europe last month, with volumes falling 25% and 8% below a year ago. Customers of both companies are waiting for the arrival of new models. Nissan will introduce five new vehicles in Europe next year, while Peugeot will launch the Peugeot 1007 small van by the end of 2004, and the Citroen C4 compact hatchback in early 2005.

North American automakers outperformed in September, with both Ford and General Motors reporting higher volumes last month. Sales at Ford rose 5.6% above a year earlier alongside higher incentives. Meanwhile, volumes at General Motors advanced 1.2%, boosted by the new Astra compact car. Sales at General Motors surpassed Renault last month, lifting GM’s market share to 10% — the fourth-highest in Europe behind Volkswagen, Peugeot/Citroen and Ford.

NEW CAR REGISTRATIONS — WESTERN EUROPE

| | -2004- Jan-Sept (thousands of units) | -2003- Jan-Sept | -2004- Jan-Sept (y/y% change) | -2004- Sept |
|----------------|--------------------------------------------|--------------------|-------------------------------------|----------------|
| Western Europe | 11,192 | 11,023 | 1.5 | -0.6 |
| France | 1,496 | 1,515 | -1.2 | -0.7 |
| Germany | 2,419 | 2,480 | -2.4 | -3.7 |
| Italy | 1,760 | 1,744 | 0.9 | -0.7 |
| Spain | 1,144 | 1,025 | 11.6 | 6.2 |
| U.K. | 2,080 | 2,073 | 0.3 | -2.0 |
| Others | 2,293 | 2,186 | 4.9 | 3.4 |

INSURANCE WATCH

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Just as the United States and Wall Street were recovering from a series of corporate scandals and malfeasance, a new concern has emerged. This week, the New York Attorney General claimed that the country’s largest insurance brokerage had engaged with some of the United States’ and the world’s largest insurance firms in a scheme that rigged bids and directed business to insurers in an uncompetitive fashion. It is alleged that in a practice that is widespread, insurance brokers hired to find the best bids from competing insurers have been accepting payments from insurance companies to direct business their way — particularly policies deemed low-risk. Victims in the scheme — who paid higher insurance costs than they otherwise would have in a competitive environment — were primarily other large corporations. However, victims also included small and mid-size corporations, municipal governments, school districts and individual consumers. Product lines primarily affected include property and casualty (P&C) — including large construction projects — and employee health and life. However, it has emerged that similar “steering business to and from” insurers may have occurred in mass market consumer lines like auto and home.

Insurance brokers act as middlemen in the industry, helping clients obtain the best coverage for their needs at the best price for a fee. However, decades ago the brokers also began collecting fees — called contingency commissions — from the insurance companies and the practice became generally accepted. The Attorney General’s civil suit against America’s largest broker alleges the company steered business to insurers in return for contingency commission pay-offs. Last year, the broker’s contingency commissions of US\$800 million accounted for 4.5% of total commissions. Other leading brokers also gain 2-4.5% of revenues from contingency commissions. The suit also names four major insurers and highlights close family connections in the top echelons of the U.S. insurance industry. The leading broker’s chief executive is the son of an insurance company chief executive and brother of another insurance company chief executive — companies also named in the suit.

Meanwhile, two insurance company executives have pleaded guilty to criminal charges of rigging bids with the broker. The Attorney General may be hoping the executives testify in the case, as he has refused to negotiate a settlement with the brokerage, citing attempts to interfere with his investigation. Perhaps an outcome other than the usual “neither admit nor deny” wrongdoing and payment of financial settlement may result in this case.

International

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EUROPEAN WATCH

United Kingdom — Third-quarter national accounts provide final confirmation of the U.K.'s economic slowdown. GDP rose 0.4% q/q, according to preliminary estimates, the most subdued gain since the first quarter of 2003. It is, however, important to view this deceleration in perspective; in all likelihood, even this moderate advance will match or exceed those soon to be reported by the major continental economies. Details in the first release are scanty. The figures show a 0.8% q/q rise in services (which account for more than 70% of GDP) — only a marginal slowdown from the previous quarter. This growth was partially offset by a 1.1% decline in industrial activity. While these figures reveal the ongoing structural shifts away from goods production (a characteristic of all advanced economies), the extent of the contraction in industrial output may foreshadow a renewed period of sterling weakness. Depreciation does not appear imminent, but the combination of a slowdown in U.K. economic growth, widening current account deficits and escalating budget shortfalls points to increased pressure on the pound vis-à-vis the euro in 2005.

The minutes of the Monetary Policy Committee's October meeting, together with the most recent economic data, reinforce our view that another rate hike is not imminent. The committee voted unanimously to hold the benchmark rate steady at 4.75% alongside evidence of a slowdown in economic activity and an easing in housing price pressures. Moreover, members noted that consumer inflation (as measured by the Harmonized Index of Consumer Prices) remained below previous expectations. Gross residential mortgage issuance declined from year-earlier levels for the first time in more than three years in September, according to the Council of Mortgage Lenders, a further indication that monetary policy tightening is taking hold. Although retail sales were surprisingly strong, increasing 1.0% m/m, the credit and national accounts data should be sufficient to allay any central bank concerns regarding potentially inflationary demand pressures.

Euro zone — Manufacturing activity in the euro zone is still tentative and the outlook is not encouraging. Industrial production fell for the second time in three months in August, slipping 0.6% m/m; the retreat pulled the year-over-year gain down to just 1.5%, the most subdued advance since February 2004. Moreover, new orders declined for a third consecutive month, slipping 0.6% m/m. Output of durable consumer goods (most notably automobiles) slumped 2.6%, in part a result of the sluggishness in consumer spending — in France consumer outlays on manufactured goods fell 0.7% q/q in the third quarter, while Italian retailers reported a drop in sales for the third time in four months in August — and a loss of market share among European-based auto manufacturers.

ASIA/OCEANIA WATCH

Japan — Household spending in Japan may recover some of its lost momentum, as confidence continues to improve. Consumer optimism is at its highest level in 3½ years, according to a Bank of Japan survey. Moreover, the major Japanese banks, which have seen a protracted decline in commercial/corporate credit, appear ready to push the pace of consumer lending. However, gains will be constrained by the employment outlook. The process of economic restructuring in the services sector is still under way, and dwindling orders reported by the major construction companies suggest that the contraction in this labour-intensive industry is not yet over. Japanese authorities are quickly reviving warnings of possible intervention in reaction to this week's moderate appreciation in the value of the yen to a 4-month high of 107.4/US\$. These comments come alongside reports that exports had declined for the third time in four months in September, dipping 2.3% m/m (though they were still up 12.5% y/y). In the wake of increasing uncertainties regarding the vigour of the global economic expansion, officials remain determined to defend the competitiveness of local manufacturers.

China — Third-quarter national accounts figures indicate that the restrictive measures introduced earlier this year are proving to be moderately effective. GDP rose 9.1% y/y, according to preliminary data, down from 9.7% in the previous quarter. The relatively subdued deceleration reinforces our view that credit curbs and other initiatives aimed at slowing the pace of investment in a number of sectors deemed to suffer from over-capacity will not be reversed soon. Moreover, the public debate continues to focus largely on whether more measures may be required. We do not believe that this trend foreshadows an early rate hike, particularly in view of the fact that one of the official news agencies subsequently focused on the adverse implications of higher interest rates.

Australia — Recent business and household surveys indicate that Australia's domestic economy is still on a firm footing. Business confidence is at a decade-plus high, according to the Australian Chamber of Commerce and Industry. The upbeat tone among respondents was not severely affected by expectations of further rate hikes over the next year. A separate survey found that consumer confidence weakened slightly in October, though overall sentiment remains positive. The monetary authorities are unlikely to take preemptive action on the basis of these positive survey results. It is clear that the central bank is currently more focused on the potential adverse effects of higher oil prices on economic growth than on inflation. As a result, there is a growing inclination within the central bank to maintain a 'wait and see' stance through the balance of 2004.

LATEST ECONOMIC STATISTICS
(% change from a year earlier unless otherwise noted)

| Canada | 2003 | 04Q1 | 04Q2 | Latest |
|------------------------------|-------------|-------------|-------------|---------------|
| Real GDP (annual rates) | 2.0 | 3.0 | 4.3 | |
| Current Acc. Bal. (C\$B, ar) | 23.8 | 33.0 | 41.7 | |
| Merch. Trade Bal. (C\$B, ar) | 58.2 | 64.5 | 78.4 | 89.1 (Aug) |
| Industrial Production | 0.7 | 1.0 | 3.9 | 4.1 (Jul) |
| Housing Starts (000s) | 220 | 226 | 233 | 238 (Sep) |
| Employment | 2.2 | 1.6 | 1.9 | 2.0 (Sep) |
| Unemployment Rate (%) | 7.6 | 7.4 | 7.3 | 7.1 (Sep) |
| Retail Sales | 3.8 | 3.4 | 4.7 | 3.4 (Aug) |
| Auto Sales (000s) | 865 | 799 | 833 | 829 (Aug) |
| CPI | 2.8 | 0.9 | 2.2 | 1.9 (Aug) |
| IPPI | -1.4 | -2.0 | 5.2 | 4.9 (Aug) |
| Pre-tax Corp. Profits | 10.0 | 4.2 | 24.6 | |

| United States | 2003 | 04Q1 | 04Q2 | Latest |
|-------------------------------|-------------|-------------|-------------|---------------|
| Real GDP (annual rates) | 3.0 | 4.5 | 3.3 | |
| Current Acc. Bal. (US\$B, ar) | -531 | -589 | -665 | |
| Merch. Trade Bal. (US\$B, ar) | -548 | -603 | -654 | -689 (Aug) |
| Industrial Production | 0.2 | 2.9 | 5.2 | 4.4 (Sep) |
| Housing Starts (millions) | 1.85 | 1.94 | 1.92 | 1.90 (Sep) |
| Employment | -0.3 | 0.2 | 1.0 | 1.4 (Sep) |
| Unemployment Rate (%) | 6.0 | 5.6 | 5.6 | 5.4 (Sep) |
| Retail Sales | 5.2 | 7.4 | 7.7 | 7.5 (Sep) |
| Auto Sales (millions) | 7.6 | 7.4 | 7.5 | 7.3 (Sep) |
| CPI | 2.3 | 1.8 | 2.9 | 2.5 (Sep) |
| PPI | 3.2 | 2.3 | 4.2 | 3.3 (Sep) |
| Pre-tax Corp. Profits | 15.4 | 16.5 | 19.9 | |

| Mexico | 2003 | 04Q1 | 04Q2 | Latest |
|-------------------------------|-------------|-------------|-------------|---------------|
| Real GDP | 1.3 | 3.7 | 3.9 | |
| Current Acc. Bal. (US\$B, ar) | -8.9 | -7.1 | -2.0 | |
| Merch. Trade Bal. (US\$B, ar) | -5.6 | -1.7 | -3.7 | -7.7 (Aug) |
| Industrial Production | -0.8 | 3.2 | 3.8 | 5.2 (Aug) |
| CPI | 4.5 | 4.3 | 4.3 | 5.1 (Sep) |

| Brazil | 2003 | 04Q1 | 04Q2 | Latest |
|-------------------------------|-------------|-------------|-------------|---------------|
| Real GDP | 0.0 | 2.5 | 5.3 | |
| Current Acc. Bal. (US\$B, ar) | 4.0 | 6.4 | 10.8 | |
| Merch. Trade Bal. (US\$B, ar) | 24.8 | 24.7 | 35.5 | 38.1 (Sep) |
| Industrial Production | -0.1 | 5.0 | 9.4 | 12.1 (Aug) |
| CPI | 14.8 | 6.8 | 5.2 | 6.9 (Sep) |

| Argentina | 2003 | 04Q1 | 04Q2 | Latest |
|-------------------------------|-------------|-------------|-------------|---------------|
| Real GDP | 8.8 | 11.3 | 7.0 | |
| Current Acc. Bal. (US\$B, ar) | 7.5 | 1.1 | 6.7 | |
| Merch. Trade Bal. (US\$B, ar) | 15.6 | 10.6 | 15.4 | 10.8 (Aug) |
| Industrial Production | 13.0 | 9.9 | 6.5 | 6.0 (Sep) |
| CPI | 13.4 | 2.4 | 4.1 | 5.9 (Sep) |

| Italy | 2003 | 04Q1 | 04Q2 | Latest |
|-------------------------------|-------------|-------------|-------------|---------------|
| Real GDP | 0.4 | 0.8 | 1.2 | |
| Current Acc. Bal. (US\$B, ar) | -20.7 | -20.7 | -27.4 | 18.6 (Aug) |
| Merch. Trade Bal. (US\$B, ar) | 2.1 | -12.4 | -4.6 | 16.2 (Aug) |
| Industrial Production | -0.6 | -0.1 | 1.2 | -1.5 (Aug) |
| CPI | 2.6 | 2.3 | 2.3 | 2.1 (Sep) |

| Germany | 2003 | 04Q1 | 04Q2 | Latest |
|-------------------------------|-------------|-------------|-------------|---------------|
| Real GDP | -0.1 | 0.8 | 1.5 | |
| Current Acc. Bal. (US\$B, ar) | 55.0 | 105.6 | 126.2 | 13.2 (Aug) |
| Merch. Trade Bal. (US\$B, ar) | 151.1 | 201.5 | 203.2 | 173.7 (Aug) |
| Industrial Production | 0.1 | 1.1 | 3.0 | 3.7 (Aug) |
| Unemployment Rate (%) | 10.5 | 10.3 | 10.5 | 10.7 (Sep) |
| CPI | 1.0 | 1.0 | 1.8 | 1.8 (Sep) |

| France | 2003 | 04Q1 | 04Q2 | Latest |
|-------------------------------|-------------|-------------|-------------|---------------|
| Real GDP | 0.5 | 1.6 | 2.8 | |
| Current Acc. Bal. (US\$B, ar) | 8.2 | 8.9 | -25.9 | -14.6 (Aug) |
| Merch. Trade Bal. (US\$B, ar) | 1.9 | 9.0 | -6.5 | -35.9 (Aug) |
| Industrial Production | -0.3 | 0.5 | 2.4 | 0.7 (Aug) |
| Unemployment Rate (%) | 9.7 | 9.8 | 9.8 | 9.9 (Aug) |
| CPI | 2.1 | 1.8 | 2.4 | 2.1 (Sep) |

| Euro Zone | 2003 | 04Q1 | 04Q2 | Latest |
|-------------------------------|-------------|-------------|-------------|---------------|
| Real GDP | 0.5 | 1.4 | 2.0 | |
| Current Acc. Bal. (US\$B, ar) | 28.0 | 66.0 | 43.8 | 45.6 (Jul) |
| Merch. Trade Bal. (US\$B, ar) | 122.5 | 140.6 | 163.8 | 201.7 (Jul) |
| Industrial Production | 0.3 | 1.0 | 2.8 | 1.6 (Aug) |
| Unemployment Rate (%) | 8.9 | 8.9 | 9.0 | 9.0 (Jul) |
| CPI | 2.1 | 1.7 | 2.3 | 2.1 (Sep) |

| United Kingdom | 2003 | 04Q1 | 04Q2 | Latest |
|-------------------------------|-------------|-------------|-------------|---------------|
| Real GDP | 2.2 | 3.4 | 3.6 | |
| Current Acc. Bal. (US\$B, ar) | -33.5 | -25.3 | -61.2 | |
| Merch. Trade Bal. (US\$B, ar) | -77.5 | -105.1 | -105.1 | -114.0 (Aug) |
| Industrial Production | -0.1 | 0.0 | 1.3 | -0.1 (Aug) |
| Unemployment Rate (%) | 5.0 | 4.8 | 4.8 | 4.7 (Jul) |
| CPI | 2.9 | 2.6 | 2.8 | 3.1 (Sep) |

| Japan | 2003 | 04Q1 | 04Q2 | Latest |
|-------------------------------|-------------|-------------|-------------|---------------|
| Real GDP | 2.5 | 5.1 | 4.3 | |
| Current Acc. Bal. (US\$B, ar) | 136.3 | 189.0 | 165.4 | 157.5 (Aug) |
| Merch. Trade Bal. (US\$B, ar) | 88.6 | 120.4 | 116.5 | 89.0 (Sep) |
| Industrial Production | 3.3 | 5.0 | 8.3 | 8.4 (Aug) |
| Unemployment Rate (%) | 5.3 | 4.9 | 4.6 | 4.8 (Aug) |
| CPI | -0.3 | -0.1 | -0.3 | -0.2 (Aug) |

| Australia | 2003 | 04Q1 | 04Q2 | Latest |
|-------------------------------|-------------|-------------|-------------|---------------|
| Real GDP | 3.0 | 3.6 | 4.1 | |
| Current Acc. Bal. (US\$B, ar) | -30.2 | -31.5 | -34.3 | |
| Merch. Trade Bal. (US\$B, ar) | -15.3 | -17.5 | -14.9 | -15.4 (Aug) |
| Industrial Production | 1.0 | -0.8 | 1.0 | |
| Unemployment Rate (%) | 6.1 | 5.7 | 5.6 | 5.6 (Sep) |
| CPI | 2.8 | 2.0 | 2.5 | |

| China | 2003 | 04Q1 | 04Q2 | Latest |
|-------------------------------|-------------|-------------|-------------|---------------|
| Real GDP | 9.9 | 9.8 | 9.6 | |
| Current Acc. Bal. (US\$B, ar) | 45.9 | | | |
| Merch. Trade Bal. (US\$B, ar) | 25.4 | -34.6 | 6.8 | 59.9 (Sep) |
| Industrial Production | 18.1 | 19.4 | 16.2 | 15.9 (Aug) |
| CPI | 3.2 | 3.0 | 5.0 | 5.2 (Sep) |

| South Korea | 2003 | 04Q1 | 04Q2 | Latest |
|-------------------------------|-------------|-------------|-------------|---------------|
| Real GDP | 3.1 | 5.3 | 5.5 | |
| Current Acc. Bal. (US\$B, ar) | 12.3 | 24.6 | 28.1 | 13.1 (Aug) |
| Merch. Trade Bal. (US\$B, ar) | 15.0 | 26.0 | 34.7 | 33.8 (Sep) |
| Industrial Production | 5.0 | 11.0 | 12.4 | 9.2 (Aug) |
| CPI | 3.5 | 3.2 | 3.4 | 3.9 (Sep) |

LATEST FINANCIAL STATISTICS

Interest Rates (% , end of period)

| Canada | 04Q2 | 04Q3 | Oct/15 | Oct/22 |
|---------------------|------|------|------------|--------|
| BoC Overnight Rate | 2.00 | 2.25 | 2.25 | 2.50 |
| 3-mo. T-bill | 2.06 | 2.50 | 2.56 | 2.63 |
| 10-yr Gov't Bond | 4.84 | 4.62 | 4.56 | 4.48 |
| 30-yr Gov't Bond | 5.34 | 5.10 | 5.06 | 4.98 |
| Prime | 3.75 | 4.00 | 4.00 | 4.25 |
| FX Reserves (US\$B) | 36.4 | | 35.9 (May) | |

| United States | 04Q2 | 04Q3 | Oct/15 | Oct/22 |
|-----------------------|------|------|------------|--------|
| Fed Funds Target Rate | 1.25 | 1.75 | 1.75 | 1.75 |
| 3-mo. T-bill | 1.26 | 1.70 | 1.74 | 1.83 |
| 10-yr Gov't Bond | 4.58 | 4.12 | 4.05 | 4.01 |
| 30-yr Gov't Bond | 5.29 | 4.89 | 4.85 | 4.77 |
| Prime | 4.25 | 4.75 | 4.75 | 4.75 |
| FX Reserves (US\$B) | 70.6 | | 71.8 (May) | |

| Germany | 04Q2 | 04Q3 | Oct/15 | Oct/22 |
|---------------------|------|------|------------|--------|
| 3-mo. Interbank | 2.10 | 2.13 | 2.13 | 2.09 |
| 10-yr Gov't Bond | 4.32 | 3.99 | 3.90 | 3.87 |
| FX Reserves (US\$B) | 51.4 | | 49.8 (May) | |

| France | 04Q2 | 04Q3 | Oct/15 | Oct/22 |
|---------------------|------|------|------------|--------|
| 3-mo. T-bill | 2.01 | 2.02 | 2.02 | 2.02 |
| 10-yr Gov't Bond | 4.34 | 4.06 | 3.96 | 3.93 |
| FX Reserves (US\$B) | 29.5 | | 29.0 (May) | |

| Euro-Zone | 04Q2 | 04Q3 | Oct/15 | Oct/22 |
|---------------------|-------|------|-------------|--------|
| Refinancing Rate | 2.00 | 2.00 | 2.00 | 2.00 |
| Overnight Rate | 2.13 | 2.09 | 2.05 | 2.05 |
| FX Reserves (US\$B) | 235.3 | | 210.2 (May) | |

| United Kingdom | 04Q2 | 04Q3 | Oct/15 | Oct/22 |
|---------------------|------|------|------------|--------|
| Repo Rate | 4.50 | 4.75 | 4.75 | 4.75 |
| 3-mo. T-bill | 4.66 | 4.84 | 4.79 | 4.79 |
| 10-yr Gov't Bond | 5.01 | 4.83 | 4.74 | 4.71 |
| FX Reserves (US\$B) | 38.1 | | 41.6 (May) | |

| Japan | 04Q2 | 04Q3 | Oct/15 | Oct/22 |
|---------------------|-------|-------|-------------|--------|
| Discount Rate | 0.10 | 0.10 | 0.10 | 0.10 |
| 3-mo. Libor | -0.01 | -0.01 | -0.01 | -0.01 |
| 10-yr Gov't Bond | 1.79 | 1.45 | 1.46 | 1.49 |
| FX Reserves (US\$B) | 537.1 | | 807.2 (May) | |

| Australia | 04Q2 | 04Q3 | Oct/15 | Oct/22 |
|---------------------|------|------|------------|--------|
| Cash Rate | 5.25 | 5.25 | 5.25 | 5.25 |
| 10-yr Gov't Bond | 5.93 | 5.47 | 5.32 | 5.37 |
| FX Reserves (US\$B) | 26.3 | | 37.0 (May) | |

Exchange Rates (end of period)

| | 04Q2 | 04Q3 | Oct/15 | Oct/22 |
|------------------|--------|--------|--------|--------|
| US\$/C\$ | 75.03 | 79.29 | 79.82 | 80.60 |
| C\$/US\$ | 1.33 | 1.26 | 1.25 | 1.24 |
| US\$/£ | 1.820 | 1.812 | 1.804 | 1.826 |
| US\$/EUR | 1.220 | 1.244 | 1.247 | 1.263 |
| ¥/EUR | 132.67 | 136.85 | 136.30 | 135.72 |
| Swiss Franc/US\$ | 1.25 | 1.25 | 1.23 | 1.22 |

| | 04Q2 | 04Q3 | Oct/15 | Oct/22 |
|-----------------------|--------|--------|--------|--------|
| ¥/US\$ | 108.77 | 110.05 | 109.33 | 107.48 |
| US\$/Australian\$ | 69.93 | 72.77 | 73.12 | 73.84 |
| Chinese Yuan/US\$ | 8.28 | 8.28 | 8.28 | 8.28 |
| South Korean Won/US\$ | 1155 | 1152 | 1145 | 1141 |
| Mexican Peso/US\$ | 11.487 | 11.382 | 11.454 | 11.430 |
| Brazilian Real/US\$ | 3.085 | 2.861 | 2.857 | 2.848 |

Equity Markets (index, end of period) *

| | 04Q2 | 04Q3 | Oct/15 | Oct/22 |
|------------------------|-------|-------|--------|--------|
| United States (DJIA) | 10435 | 10080 | 9933 | 9852 |
| United States (S&P500) | 1141 | 1115 | 1108 | 1105 |
| Canada (S&P/TSX) | 8546 | 8668 | 8789 | 8849 |
| Mexico (Bolsa) | 10282 | 10957 | 10991 | 11217 |
| Brazil (Bovespa) | 21149 | 23245 | 23368 | 23190 |
| Italy (BCI) | 1326 | 1326 | 1346 | 1345 |

| | 04Q2 | 04Q3 | Oct/15 | Oct/22 |
|-------------------------|-------|-------|--------|--------|
| U.K. (FT100) | 4464 | 4571 | 4623 | 4624 |
| Germany (Dax) | 4053 | 3893 | 3922 | 3949 |
| France (CAC40) | 3733 | 3641 | 3671 | 3697 |
| Japan (Nikkei) | 11859 | 10824 | 10983 | 10857 |
| Hong Kong (Hang Seng) | 12286 | 13120 | 13035 | 13015 |
| South Korea (Composite) | 670 | 698 | 842 | 828 |

Commodity Prices (end of period)

| | 04Q2 | 04Q3 | Oct/15 | Oct/22 |
|--------------------------|-------|-------|--------|--------|
| Pulp (US\$/tonne) | 620 | 650 | 650 | 650 |
| Newsprint (US\$/tonne) | 530 | 545 | 550 | 550 |
| Lumber (US\$/mfbm) | 371 | 419 | 328 | 312 |
| WTI Oil (US\$/bbl) | 32.52 | 49.64 | 54.93 | 54.92 |
| Natural Gas (US\$/mmbtu) | 6.19 | 6.80 | 6.71 | 7.84 |

| | 04Q2 | 04Q3 | Oct/15 | Oct/22 |
|------------------|-------|-------|--------|--------|
| Copper (US\$/lb) | 1.04 | 1.36 | 1.28 | 1.27 |
| Zinc (US\$/lb) | 0.46 | 0.50 | 0.48 | 0.47 |
| Gold (US\$/oz) | 395.8 | 415.7 | 420.4 | 422.8 |
| Silver (US\$/oz) | 5.9 | 6.7 | 7.1 | 7.2 |
| CRB | 255.3 | 285.0 | 285.6 | 287.0 |

* stock indices are not end of day quotes

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