

The Canadian economy will withstand any temporary weakness in world demand.

In the face of an apparent slowdown in many of the world's economies, Canada's economy has been resilient. The Ivey Purchasing Managers' Index (PMI) was 51.0 for July, the highest level for the month since 1999 and the 12th consecutive month above 50, indicating growth. The economy grew 0.3% in May, accelerating from April's disappointing 0.1% growth. As a net oil and commodity exporter, strong commodity prices will help Canada ride out any temporary weakness while an improving global economy and rising business investment will drive growth over the next few quarters. Real Gross Domestic Product (GDP) growth will be 2.7% this year and 3.5% in 2005. The BoC will begin to raise interest rates at a gradual pace on September 8th and continue through the end of 2005.

The manufacturing sector has improved...

The manufacturing sector has improved recently. In June, manufacturing shipments rose 1.5% to a new record high, despite an appreciating currency. Gains were widespread as autos, aerospace, metals, and machinery all recorded significant gains. Shipments and unfilled orders have risen in each of the past six months, and new orders have risen in six out of the past seven months. In addition, manufacturing employment added 20,700 jobs in July, the biggest gain in two years.

..., and will continue to do so over the next few quarters.

The manufacturing sector's prospects have brightened also. In the Business Conditions Survey of manufacturers, 23% of respondents indicated that production over the next three months will be higher and only 13% said it would be lower. The balance of opinion (+10%) was higher than April's +7%. The balance of opinion on orders received and the backlog of unfilled orders both improved to +6% and +3% respectively. On employment, 5% more respondents indicated that employment will rise than indicated that it will fall. The balance of opinion on employment was the highest in almost four years. In addition, in June, manufacturers increased inventories of raw materials by 1.2%, signifying an intention to raise future production. The inventories-to-shipments ratio reached a new low of 1.21, meaning that new demand will have to be met through increased production. All of these factors signal a very strong manufacturing sector over the next few months.

Job growth disappointed in July.

Employment disappointed in July with an increase of only 8,700 positions versus an expected 28,000. Full-time positions were the most affected, falling by 38,900. Many were quick to take this as a sign of a spillover from a slowdown in the US economy; however, private sector employment actually increased by 38,500 jobs. The job losses were concentrated in the public sector, mostly in the areas of education and health care. In all likelihood, July's employment was simply a reversion to the long-run average monthly job growth of 15,000-20,000 jobs after having averaged 31,600 over the past year, almost twice the average over the past twenty years.

Kurt Karl
Chief Economist,
North America
212-317-5564
kurt_karl@swissre.com

Richard Sbaschnig
Associate Economist
212-317-5135
richard_sbaschnig@swissre.com

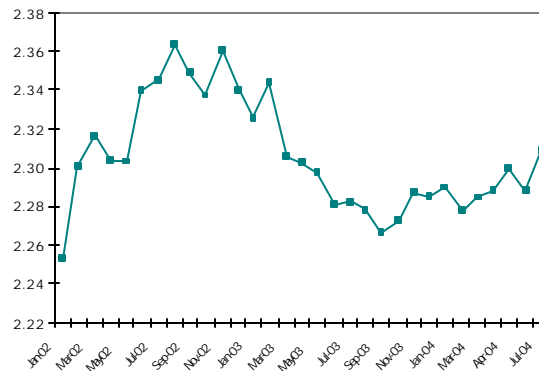
Canadian Forecast Summary

	History		Forecast →					Annual Data			
	03Q4	04Q1	04Q2	04Q3	04Q4	05Q1	05Q2	2002	2003	2004	2005
Real GDP, % Change, SAAR	3.3	2.4	3.8	3.4	3.6	3.7	3.5	3.4	2.0	2.7	3.5
% Change, Year Ago	1.7	1.6	2.7	3.2	3.3	3.6	3.5				
CPI, SA, % Change, Year Ago	1.7	0.8	2.2	2.5	2.5	2.4	1.9	2.2	2.8	2.0	1.9
BoC Core CPI, % Change, Year Ago	1.9	1.3	1.7	1.8	1.7	1.8	1.9	2.4	2.2	1.6	1.9
			End of Period					End of Period			
Bank Target Rate, %	2.75	2.25	2.00	2.25	2.50	2.75	3.25	2.75	2.75	2.50	4.00
5-year Benchmark Bond Yield, %	3.9	3.3	4.1	4.4	4.8	4.9	5.1	4.0	3.9	4.8	5.2
10-Year Benchmark Bond Yield, %	4.7	4.3	4.8	5.0	5.4	5.5	5.5	4.8	4.7	5.4	5.6
CAD/USD Rate	0.77	0.76	0.75	0.74	0.75	0.76	0.76	0.64	0.77	0.75	0.76

Canadian Economic Outlook

Manufacturing employment (SA, mn)

Manufacturing employment has been improving since August 2003.



Sources: Datastream, Statistics Canada, Swiss Re Economic Research & Consulting.

The housing sector will remain strong this year before weakening next year.

The housing sector has remained robust despite upwardly trending mortgage rates. New home prices increased 0.8% in May after rising 0.7% in April. In July, housing starts fell by an annualized 5.8% to 218,700 from 232,100 in June. Despite this shortfall, housing starts are still on track for a record year. According to the Canada Mortgage and Housing Corporation (CMHC), housing starts will reach a 17-year high this year, an increase of 3.3% over 2003, and prices are predicted to rise 9.5% this year. Optimism for the rest of the year was supported by residential building permit issuance, which reached a new record in June after jumping 24.2% in the month. In addition, the percentage of mortgages in arrears for June fell to 0.28%, the lowest level since October 1990. Although the rest of 2004 will be strong, rising interest rates will eat away at demand next year. For 2005, the CMHC predicts starts will fall 9.5% although prices will continue to rise at a rate of 4.6%.

Business investment in construction will start to improve.

Investment in non-residential building construction registered a slight increase of 0.5% in the second quarter of the year. The growth was driven by the government sector, as business investment was flat. There are some indications that business construction investment will improve. According to Royal LePage, a real estate services company, the total office vacancy rate fell to 11.1% in the second quarter, down from 11.5% in the last quarter of 2003. Also, non-residential building permits reached their highest level in fifteen years in June after soaring 32.6% over the previous month.

The BoC will raise rates on September 8th.

The Bank of Canada (BoC) will start to raise rates at their meeting on September 8th. This view is in line with current market expectations which have fully priced-in a 25 basis point (bp) hike at the next meeting. The financial markets have reduced expectations on the number of BoC rate increases this year. The market is now fully pricing-in only two 25 bp rate increases before the end of the year, down from three a month ago. Bank officials have been signaling rate increases over the past few months by stating that the economy is operating slightly closer to full capacity than they expected in April and that "monetary stimulus will have to be removed." The rate of interest rate hikes will be gradual since there are few signs of pressure on core inflation currently.

Canada was upgraded to AAA by Fitch.

On August 12th, Fitch Ratings upgraded Canada's long-term foreign currency sovereign rating to AAA, the last major rating agency to do so. Despite the election result, Fitch did not foresee any Federal budget deficits. In fact, Fitch forecasts improved budget surpluses at the Federal and provincial levels. Fitch forecasts a general budget surplus this year of 0.5% of GDP, up from just 0.2% the previous year. They forecast gross general government debt as a percentage of GDP to fall to 72% by year-end, down from almost 100% in 1994. This rating change will provide a modest boost to Canadian bonds.

This document, prepared by Swiss Re's Economic Research and Consulting, is for information purposes only. It is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The information contained in this document has been obtained from sources believed to be reliable; however, its accuracy and completeness cannot be guaranteed. The views reflected herein are subject to change without notice. They are the views of Swiss Re Economic Research & Consulting and may differ from Swiss Re Asset Management.