



August 2005

Canadian Economic Outlook

Real GDP growth was strong in May.

The Canadian economy continues to be robust, relying on strength in domestic consumption, trade, and the still resilient housing sector. Real GDP was up 0.3% m-o-m in May, and 2.8% y-o-y. Strong GDP growth in the past three months has nudged ER&C's forecast up, and implies a probable rate hike for the Bank of Canada in the near future. Headline inflation crept up 0.2% in June, but core CPI remained flat. Despite the recent strength of the loonie, Canada's exports have remained stable.

The housing market remains robust.

The housing market remains surprisingly strong, although there are some signs of worry. Housing starts surged in June to 237,000 (SAAR) units, but the entire gain came from the volatile multi-family segment. Permit activity has also softened. ER&C expects a modest sag in housing activity in H2 as interest rates rise. However, the decline is likely to be cushioned by a healthy job market.

"Employee discount" incentives boosted car sales in June and July.

Following a weak May, Light Motor Vehicle (LMV) sales rebounded in June and July as the Big-3 automakers incentivized their customers with "employee discounts." Even with the May softening in automotive, overall retail sales year-to-date were 6.9% higher than the same period last year, supporting the positive consumer spending outlook.

Labor market conditions are tight.

Canada gained more than 14,000 jobs in June. Much of the employment growth was in the construction sector, triggered by the ongoing housing boom. The unemployment rate edged down 0.1% to 6.7%, very low by Canadian standards. Even the manufacturing sector, which has been losing jobs, posted a positive month, gaining 6,100 jobs. Wage pressure remains modest, but labor market conditions are tight.

The trade surplus declined due to high oil prices

The trade surplus slipped to CAD 4.0 billion in May. This was mainly due to an increase in energy imports rather than a collapse in exports. Canadian export industries have adjusted well to the reality of a strong currency.

The BoC warned of less stimulative monetary conditions "in the near term".

The BoC continues to remain on the sidelines, although monetary tightening is expected sooner rather than later. In its July report, the bank suggested that less stimulative monetary conditions will be necessary "in the near term." It appears that the BoC is preparing for a September rate hike. ER&C's 2005 year-end forecast for the overnight rate is 3.0%, the 5-year bond yield 4.2%, and the 10-year bond yield 4.8%. The CAD/USD exchange rate is forecast to remain relatively stable in the short run.

Canada Forecast Summary

	History		Forecast →					Annual Data			
	05Q1	05Q2	05Q3	05Q4	06Q1	06Q2	06Q3	2003	2004	2005	2006
Real GDP, % Change, SAAR	3.0	3.1	3.1	3.2	3.2	3.3	3.4	2.0	2.9	3.1	3.2
% Change, Year Ago	3.4	2.9	2.8	3.1	3.1	3.2	3.3				
CPI, SA, % Change, Year Ago	2.2	1.7	1.9	1.7	1.9	1.9	1.9	2.8	1.8	1.9	1.9
BoC Core CPI, % Change, Year Ago	1.8	1.8	2.1	2.2	2.2	2.0	1.9	2.2	1.5	2.0	2.0
			End of Period								
Bank Target Rate	2.50	2.50	2.75	3.00	3.25	3.50	3.75	2.00	2.50	3.00	4.00
3-Month Treasury Bill	2.6	2.5	2.7	3.0	3.2	3.5	3.7	2.6	2.5	3.0	4.0
5-year Benchmark Bond Yield	3.7	3.2	3.7	4.2	4.4	4.7	4.9	3.9	3.7	4.2	5.1
10-Year Benchmark Bond Yield	4.3	3.7	4.5	4.8	5.0	5.2	5.3	4.7	4.3	4.8	5.4
CAD/USD Rate	0.83	0.82	0.83	0.83	0.83	0.83	0.83	0.77	0.83	0.83	0.83

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