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Canadian Economic Outlook

Recent indicators have generally disappointed in July, but still point toward moderate growth.

This past month has been the first time since March that the economic indicators would be untainted by the Severe Acute Respiratory Syndrome (SARS) outbreak or the onset of the Bovine Spongiform Encephalopathy (BSE) export ban. Better-than-expected indicators from the US raised hopes of similar indications of rebound in the Canadian economy. The indicators mostly disappointed, however, signifying very restrained growth in the third quarter. Increases in the leading indicators over the past few months (up 0.4% in July versus 0.2% expected) indicate that the economy continues to grow. Stronger business investment and improved exports will steer the economy towards growth of about 3.5% through the second half of 2003. In addition, the recent easing of the BSE-related export ban will provide a short-term boost.

The Ivey index indicated positive growth compared to a year earlier in July.

The Ivey Purchasing Managers' Index (PMI) came in below expectations at 47.3, lower than the key 50 level, signifying contraction. This index is not seasonally-adjusted, and July is usually the weakest month. This reading was still generally positive in that it was 1.7%

The trend of the economy adding full-time jobs while cutting part-time employment continued in July.

The housing market has stayed strong, but rising rates will cool demand beginning in the fourth quarter.

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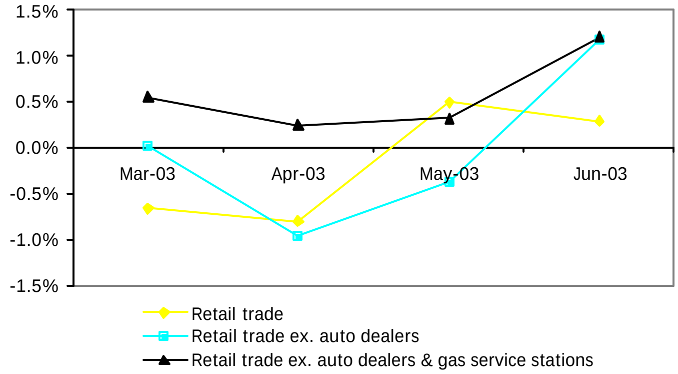
Growth in retail sales excluding auto dealers & gas stations has stayed positive during some difficult months.

Retail trade, month-over-month percent change (seasonally-adjusted)



Retail spending, recently unusually volatile, will continue to grow at a healthy pace.

Retail sales in June jumped by 0.3%, well ahead of an expected fall of 0.6%. Retail sales have been unusually volatile over the past few months due to increasingly volatile motor vehicle sales and oil-price driven gas station sales. While headline retail sales fell in March and April, retail sales excluding motor vehicle dealers and gas stations have been growing steadily, despite a number of impediments such as SARS. The sharp rise of sales in June demonstrates that much of the drag on sales over the past few months was temporary. According to a recent Ipsos-Reid poll, 73% of consumers still think the economy is good, and the percentage of consumers that expect it to improve is twice as large as those who expect it to get worse. This confidence will mean that underlying sales (excluding autos and gas stations) will continue on a steady path of growth.

Recent below-expected inflation will likely lead the Bank of Canada to cut rates on September 3rd by 25 basis points.

The Bank of Canada (BoC) will next meet on September 3rd. The Bank has had a rate-cutting bias ever since it surprised markets with a cut on July 15th. Recent inflation has come in below the Bank's already low expectations. The BoC core CPI, which excludes the eight most volatile components, fell -0.1% over the previous month in June and was flat in July versus expected increases. The Industrial Product Price Index (IPPI) fell -1% over the previous month in June versus an expected increase of 0.3%. These readings give the Bank enough reason to cut rates by 25 basis points (bp). However, inflation will rise above what the Bank had forecast. Much of the fall in prices is due to the stronger Canadian dollar, and it has stabilized. Excluding the stronger currency, the growth in the IPPI would have been higher by 0.9% in June and 3.9% over the previous year. Also, an improving Canadian economy, above-expected growth in the US, and strong commodity prices will mean inflation will rise above what the Bank expected in mid-July. After a likely cut of 25 bp, this higher inflation and stronger signals of growth are expected to keep the Bank on hold until the middle of next year.

Canadian long-term interest rates will continue to trend higher throughout the year.

Optimism about the US economy and sharply higher US long-term rates have driven up the yield on the Canadian ten-year government bond. Stronger signals of recovery and firming prices will push rates up to around 5% by year-end. Stronger economic growth in Canada will drive the spread between the two economies higher by about 30 bp, to 70 bp, at year-end before dropping throughout 2004 as the US economy begins to outperform the Canadian economy.

The recent power outage will have a small impact on the economy.

The recent power outage in Ontario is unlikely to have a major impact on the economy, assuming no further disruptions after August. Even though Ontario accounts for 42% of the economy, the power outage itself was short-lived, and August is a slow month anyway. Much of the retail sales and production that did not occur due to the disruptions in power can be made up later. Overall, the economic impact will be a reduction of about 0.3% off of the third quarter's annualized gross domestic product (GDP) growth rate.