

## Economy and Strategy Group

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## Highlights

- It has been a difficult year for the global economy. We see continuing deceleration in 2012. The crisis of public finances in the euro zone has undercut the economy of the region: the fiscal austerity forced on virtually all of its governments has made a recession practically inevitable. Despite an anticipated rebound in the U.S., the advanced economies as a group are likely to grow less in 2012 than in any of the last 30 years outside the recent recession. The emerging economies, however, with their ever-growing weight in the world, can be expected to pull global growth to 3.4% in 2012.
- It is now clear that the U.S. economy not just avoided recession in 2011 but in fact accelerated as the year progressed. GDP in Q4 is tracking well above 2% annualized, the best quarterly performance of 2011. Momentum should carry through to 2012, with the U.S. achieving above-potential growth for the first time in six years, helped by resilient domestic demand and inventory rebuilding. The big caveat, however, is that a European-triggered global financial crisis is averted by policymakers who would, presumably, have learnt about the devastating costs of inaction *à la* 2008.
- Facing challenges both at home and abroad in 2012, Canada stands to underperform the U.S. for the first time in six years. Domestic demand will be under siege from a likely softening in housing, and a more moderate pace to consumption spending. Trade will be vulnerable to the lagged impacts of a strong Canadian dollar although there will be some offset in the form of increasing demand from an accelerating U.S. economy. With domestic demand trading water and European inertia threatening to trigger a global financial crisis, the Bank of Canada is likely to delay interest rate hikes to 2013.
- In all provinces, economic growth in 2012 will feel the effects of declining government fixed investment and budget austerity. Growth will exceed the national average in each of the Western provinces, since natural resource development will not be impaired by the darkening of the global outlook. Conversely, growth will be sub-par in each of the Atlantic Provinces and in Ontario and Quebec.

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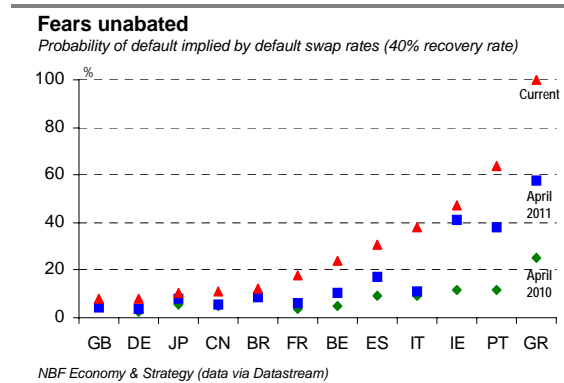
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# International

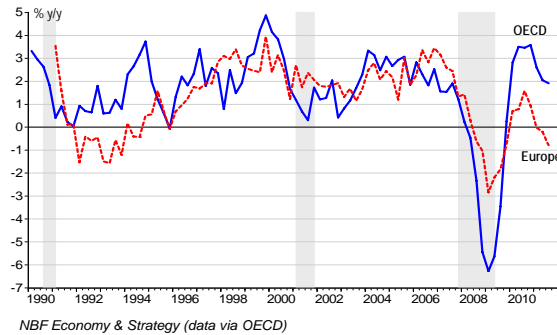
## Recession in Europe: the need to avoid a credit crisis

The cyclical rebound from the economic and financial crisis of 2008-09 turned out to be short-lived. We estimate 2011 global economic growth at 3.9%, the lowest since 2003, excluding the last recession. A number of headwinds arose in the first half of the year. Strong inflationary pressures, notably in energy and food, crimped consumer purchasing power around the world. In many countries, mainly those whose labour markets have been slow to recover, income gains have barely matched inflation. Consumer spending has slowed accordingly. Then Japan was struck by a tsunami that destroyed much of its industrial plant and disabled global supply chains for months. Though these factors are unlikely to affect growth in 2012, euro-zone public finances will remain the focus of investor attention.

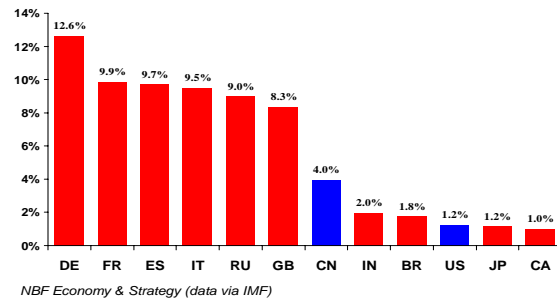


In Europe, the crisis that began in the spring of 2010 with worries about the solvency of Greece has ended up spreading throughout the zone. European leaders have been unable to agree on action that would limit investor apprehensions to the worst-off of the euro countries. The default swap market registers fears about Italy greater than those about Greece in April 2010. The soaring cost of Italy's borrowing is made especially perilous by the country's high debt load. The upshot is that stabilizing its debt-to-GDP ratio will take measures much more drastic than initially foreseen.

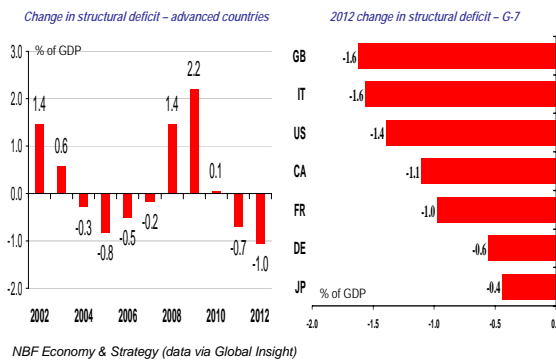
In our view, the size of Italy's debt and its importance in the European banking system require that the authorities keep its financing costs sustainable, especially since Italy, unlike Greece and Portugal, is generally regarded as solvent. Things would probably not have reached this pass had European leaders not done too little, too late as investor apprehension mounted. Economists have long insisted that monetary union is not viable without fiscal union. There has been real progress recently, not least in a plan to improve the Stability and Growth Pact that would entail a loss of fiscal sovereignty for member countries whose deficits or debt exceed set limits. To survive, however, we think the euro zone must ultimately go further, harmonizing its economic and social policies on a model more favourable to growth and more sustainable in the long term. In the meantime, further short-term measures will also be necessary to limit the financing costs of Spain and Italy. Since insufficient funds are available to bail out these countries, it seems increasingly clear that the rescue of the euro zone will require issuance of eurobonds, ECB purchases of new bond issues, or both.

**Shrinking European consumption**
*Volume retail sales*


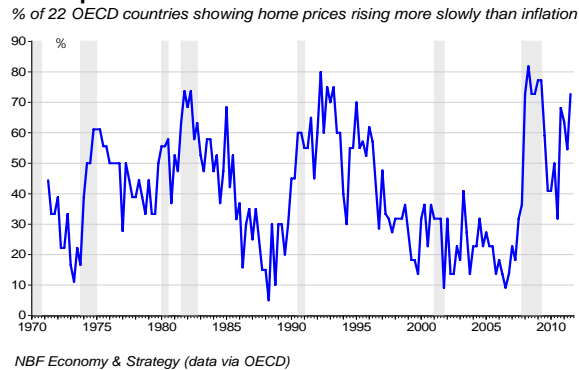
For the euro economies, the damage has been done. Most countries of the zone are being forced to eliminate their deficits much faster than they had planned. The resulting across-the-board fiscal austerity is likely to plunge the zone into its second recession in less than four years, especially since the climate of uncertainty has undermined household and business confidence. Industrial production has been in decline for two months now and retail sales are down from a year ago. These conditions could exacerbate pressures on governments and financial institutions as they wrestle with their heavy indebtedness. In our view, however, the central banks have the tools in place to move quickly to prevent the economic downturn from becoming a financial crisis.

**The U.S. and China in the lee of the storm?**
*Exports to euro countries as % of GDP (2010)*


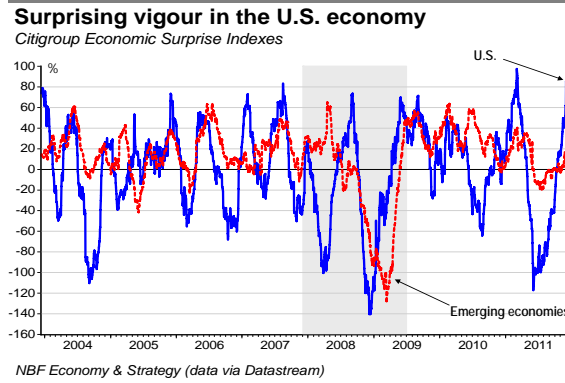
Even Germany, whose austerity measures need not be as sweeping as those of other euro countries, is unlikely to come through unscathed. Germany exports a hefty 12.6% of its GDP to other euro countries. The euro zone's neighbours may also feel the shock waves. The U.K., already facing an outlook of slow growth in its domestic economy, will grow hardly at all if its major trading partners stumble. The Chinese and U.S. economies, on the other hand, are much less exposed. Their exports to the euro zone amount to only 4.0% and 1.2% of GDP respectively. So if European governments and central banks can stop their recession from turning into a credit crunch, the two heavyweights of the global economy will pull through.

**Advanced countries: Fiscal policy will brake growth**


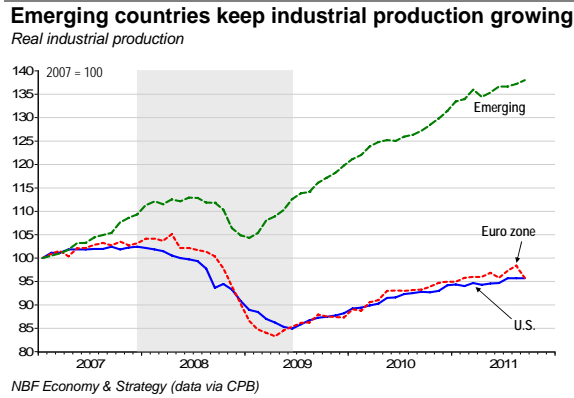
The scope of the austerity that will grip the advanced economies in 2012 can be seen in IMF projections of changes in structural deficits, illustrating the effect of discretionary changes to government budgets as of September. At that time the IMF considered that the braking effect of fiscal policy in the advanced countries would be the sharpest since it began compiling the data in 2002 – 40% sharper than in 2011. And it is quite possible that the fiscal braking will be even more severe than expected, since countries including France and Italy have adopted additional austerity measures since September.

**Home prices slow to stabilize**


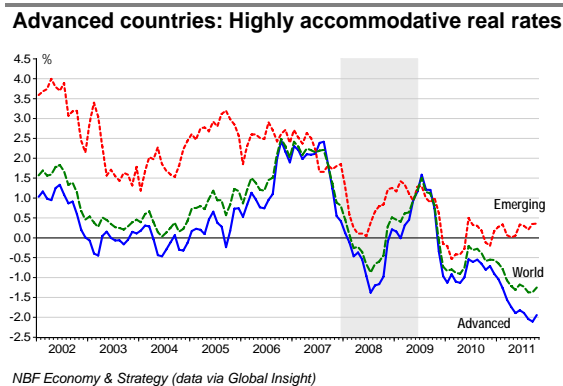
The watch list includes, besides governments, the real estate sectors of the advanced economies. The housing market is exposed to additional risk as a number of countries go into recession. We are especially surprised to see 16 of the 22 OECD countries for which data are available reporting deflation of real home prices in the most recent quarter for which data are available. One reason is that the demographics of European countries including Germany, Spain and Italy are unfavourable to real estate – the ranks of their first-time homebuyers are depleting sharply. This trend, combined with a euro-zone labour market that is especially hard on young people, suggests to us that the housing sector in some advanced countries may remain under pressure over the coming quarters.



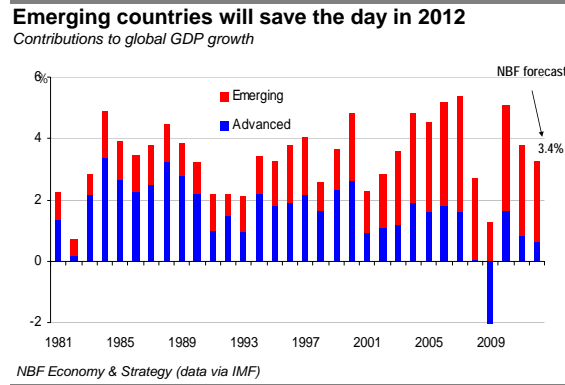
As the euro economy deteriorates, the U.S. economy has been gaining strength. The Citigroup Economic Surprise Index for the U.S. recently approached its most positive reading ever. We are especially comforted by improvements in the labour market at a time when an unusually divided political landscape has generated high uncertainty about fiscal policy. Despite these risks, we see the U.S. economy accelerating to growth of 2.5% in 2012 after a difficult 2011 (see U.S. section for details). As for the emerging economies, which bulk ever larger in the world economy, current indicators are essentially in line with the consensus expectation.



World industrial production, meanwhile, is still trending up, mainly as a result of a surge in the emerging economies. However, recession in Europe is likely to slow imports from Asia. A recent deceleration of China's economy aroused apprehension, though the 9.1% growth rate of its third quarter would be the envy of almost any other country. It should be kept in mind that to counter inflation, Beijing has considerably reduced its monetary accommodation in an attempt to cool its economic growth rate to about 8%. However, the anticipated sluggishness of the advanced economies in 2012 is likely to slow China's growth to a rate below that threshold.



In that event, Beijing can be expected to offset export softness by stimulating domestic demand, especially since recent reports show a sharp deceleration of consumer prices. The recent decline of commodity prices, in response to a decline of physical and financial demand and to the rise of the U.S. dollar, will ultimately show up as disinflation. If the economic picture deteriorates further, inflation fears will completely dissipate and a number of central banks, especially in emerging countries, could put their shoulders to the wheel. In the advanced countries, real short rates are now more stimulative than in 2008 besides several central banks use unconventional monetary stimulus currently.



All these factors considered, we see the advanced economies taken together as likely to expand 1.3% in 2012. Outside the great recession of 2008-09, that would be the weakest annual growth of the last 30 years. Yet the emerging economies, given their growing share of world output, are likely to push global growth to 3.4% in 2012.

From 1980 to 2000, the advanced economies accounted for 63% of global growth. Since 2000 they have accounted for 28%. This new reality justifies optimism in the face of old-world difficulties.

# United States

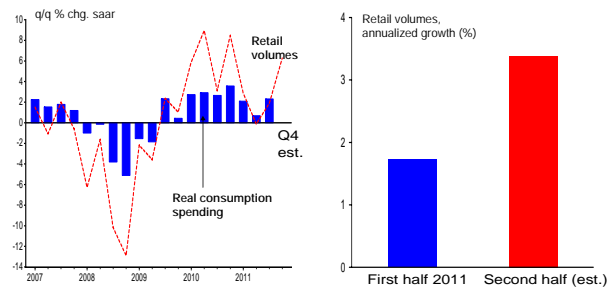
## Accelerating growth in 2012

It is now clear that the U.S. economy not just avoided recession in 2011 but in fact accelerated as the year progressed. GDP in Q4 is tracking well above 2% annualized, the best quarterly performance of 2011. Momentum should carry through to 2012, with the U.S. achieving above-potential growth for the first time in six years, helped by resilient domestic demand and inventory rebuilding. The big caveat, however, is that a European-triggered global financial crisis is averted by policymakers who would, presumably, have learnt about the devastating costs of inaction *à la* 2008.

### Consumers finding support

The U.S. economy has rarely done badly when its consumers have been in a spending mood. Its acceleration in the second half of 2011 was largely a result of consumers getting their mojo back. With two months in, Q4 real retail spending is tracking + 6.3% annualized, the highest since Q4 of 2010. Retail volumes in the second half of 2011 are on track to grow at twice the pace of the first half.

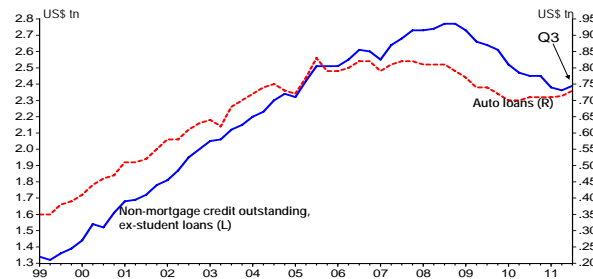
**U.S.: Consumers back in the mood in second half of 2011**  
H2 retail volumes on track to grow at twice H1 pace



NBF Economy & Strategy (data via Global Insight) 2011-12-13

The outlook for 2012 consumer spending seems positive, partly because of a slower pace of deleveraging. Mortgage credit outstanding continues to drop, but more slowly than before. In Q3, moreover, non-mortgage credit (even excluding student loans), led by auto loans, showed the first quarterly increase in three years. Together with a stabilization of the savings rate, these are signs that the worst of the deleveraging process may be over.

**U.S.: Is consumer deleveraging over?**  
Q3 sees first quarterly increase in non-mortgage credit in three years



NBF Economy & Strategy (data via New York Fed) 2011-12-07

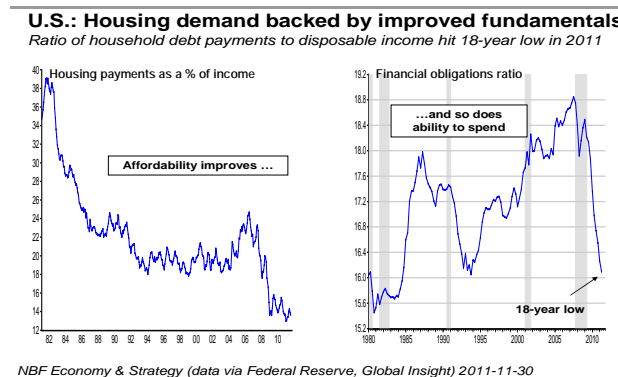
Another plus for consumer spending is the recovery now under way in employment. Non farm payrolls rose 681,000 from June through November, with all gains coming from the private sector. The household survey also shows a clear improvement in the labour market – full-time employment up 759,000 over the same period. In November more than 113 million Americans were employed full-time, the most since April 2009. Odds are that the uptrend will extend into next year, particularly given the strength of help-wanted listings, which tend to lead the household employment survey.



Complementing the improvement in credit and the labour market in 2012 will be a diminished drag on consumer spending from the negative wealth effect of home prices.

### Has housing finally hit bottom?

While it is too early to say whether the double-dip housing recession is definitely over, there are signs suggesting some stabilization ahead. Residential investment grew in both Q2 and Q3, the first back-to-back quarterly increases since 2005. The pace of home-price deflation seems to be moderating as supply and demand come into better balance. Thanks to lower mortgage rates and depressed home prices, affordability is the best in a generation. That, coupled with an 18-year low in the financial obligations ratio, makes borrowing more likely.



Moreover, higher rental demand has driven rents high enough as to give renters incentives to become home owners. On the supply side, while inventory remains large, the drop in foreclosure rates is also helping somewhat in keeping supply growth under control. The overall improving market conditions explain perhaps why builder confidence in December was the second highest since 2007, according to the National Association of Home Builders. That being said, do not expect a significant turnaround in the housing market just yet. A flattish trend is more likely for home prices in 2012, with improving demand likely to be offset by supply increases from both new construction and foreclosures that have yet to hit the market. But importantly, the reduced drag from housing should be supportive of consumption spending in 2012.

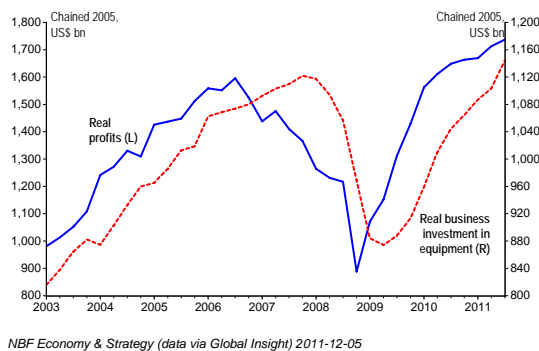
### U.S.: Record occupancy rates giving incentives to buyers



### Business investment to remain solid

Domestic demand is likely to gain further support in 2012 from investment spending as businesses seek to maintain the growth of productivity and profits. Though U.S. output is now back to pre-recession levels, employment remains 5% or so below the pre-recession peak. In short, the U.S. is doing more with less. This productivity boost has come from massive capital outlays over the last couple of years, with investment in equipment and machinery now back to pre-recession levels after growing 15% in 2010 and roughly 10% in 2011. Given the solid corporate profits of 2011 and the usual lag between profits and investment, there is reason to expect capital spending to continue at a healthy pace in 2012, particularly if global economic uncertainty dissipates somewhat.

### U.S.: Business investment seems to lag profits

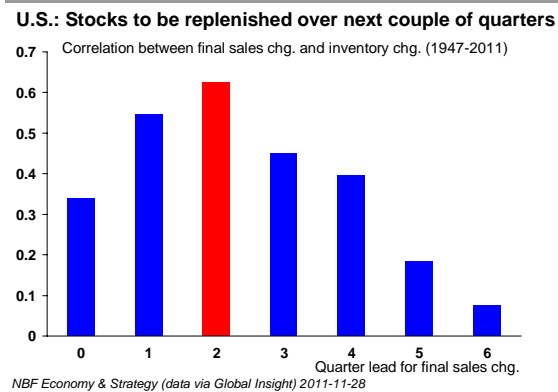


### Fiscal policy: Kicking the can down the road, again

The past year has been eventful for U.S. fiscal policy. The economy was subjected to a near government shutdown in April, a debt-ceiling drama and the ensuing U.S. credit downgrade by S&P in July/August, and the failure of the Super Committee in November. December saw further debates and footdragging by Congress on what ought to be a straightforward decision on the extension of payroll tax cuts. The fiscal outlook remains unclear. Assuming nothing else changes on Capitol Hill (and the current political impasse suggests just that outcome) the U.S. economy will face \$2.1 tn in spending cuts over ten years. Add to that the end of the Bush-era tax cuts and the potential fiscal drag rises to over 2% of GDP in 2013. Facing the prospect of a recession-inducing fiscal drag, a new Congress after the 2012 Presidential elections will very likely kick the can down the road.

### The inventory cycle to boost 2012 GDP

Having braked growth in 2011, inventories are set to contribute to it in 2012. Destocking has chopped 3.3% off GDP in the last four quarters alone (Q410 to Q311), the largest 4-quarter cumulative drag outside of a recession in 25 years. Now, unless we are in a recession or heading precipitously towards one, such inventory cuts are unsustainable. In our view, with domestic demand seemingly still resilient, it is a question of time before the restocking process kicks back into gear. History suggests there tends to be a couple of quarters lag in the inventory response to changes in final sales.



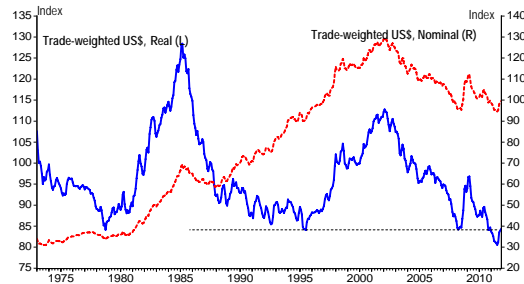
So, the surge in final sales in Q3 bodes well for inventory rebuilding over the next few quarters, assuming of course that the global economic picture does not darken any further.



### Trade supported by a competitive U.S. dollar

The resilience of domestic demand will be especially welcome in 2012 as global growth slows. Trade may face some headwinds as a European recession translates into sluggish demand for American exports. That said, the overall impact on U.S. growth is not likely to be significant, particularly given that only 20% or so of U.S. exports go to Europe, and exports account for less than 14% of the overall U.S. economy. Moreover, the highly competitive U.S. dollar, which in real terms is still near historic lows, will provide some offset, especially in markets of buoyant demand such as Asia and South America.

**U.S.: Dollar remains highly competitive in real terms**

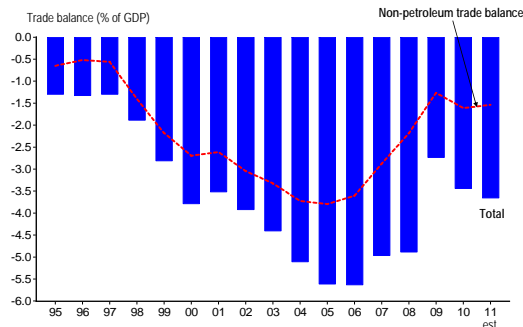


NBF Economy & Strategy (data via Global Insight) 2011-12-13

Further down the road, exports are set to benefit from the long-term trend of depreciation of the U.S. dollar. On trade fundamentals alone, the greenback needs not depreciate much more: the trade deficit excluding petroleum is stabilizing at just 1.5% of GDP. Depreciation pressures will come from elsewhere – the country’s precarious fiscal position, the Fed’s easy money policy, China’s reduction of its foreign exchange reserves. We see the U.S.D losing ground against most currencies, primarily the yuan and the OPEC currencies if the latter are allowed to come off the peg.

**U.S.: Non-petroleum goods trade balance stabilizes**

Excluding petroleum, trade deficit is now half what it was in 2007 (as a % of GDP)



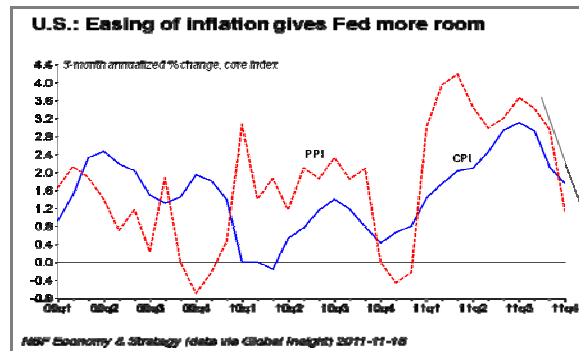
NBF Economy & Strategy (data via Global Insight) 2011-12-09

While trade is unlikely to derail the U.S. recovery, that is not to say that America will remain unscathed by the European situation. European pain would still filter through to America via the financial channel if the debt crisis evolves into a full-blown global financial crisis, perhaps via sovereign defaults. According to data from the Bank of International Settlements, U.S. exposure to European banks stood at U.S.\$3.8 bn at the end of Q2. Taking into account derivative contracts, guarantees and credit commitments, the exposure rises to roughly U.S.\$5.9 tn. Although the bulk of that is being held by the non-bank private sector, the banking sector also has significant exposure (over U.S.\$700 bn). No wonder that CDS spreads for American

financials have risen in tandem with European ones as the debt crisis intensified on the old continent. Should European debt turn sour, expect U.S. banks to take write-downs triggering balance sheet repairs via recapitalizations and asset sales. That eventuality – a credit crunch – is the major channel through which Europe could affect the United States.

### QE3 in 2012?

Fortunately, the U.S. has a more proactive central bank than Europeans do. While an improving U.S. economy and better credit flow make a third round of unsterilized bond purchases (QE3) less necessary at this point, a European-triggered credit crunch would have the Fed take prompt action. The recent easing in inflationary pressures, with both the CPI and PPI on a declining path, and stable inflationary expectations, give the Fed more room to act if necessary. Note that even with the currently well-functioning financial markets, FOMC members continue to talk about the possibility of unleashing QE3 as a way of stimulating the economy. Should credit markets freeze *à la* 2008, expect talk to translate into action.



All told, barring a European-triggered global financial crisis and subsequent world recession, U.S. economic growth should accelerate to an above-potential 2.5% in 2012 thanks to a combination of resilient domestic demand and inventory rebuilding. Fiscal drag will continue to impose a speed limit on the economy in 2012, although that will pale in comparison to the impacts seen in 2013 and beyond.

# Canada

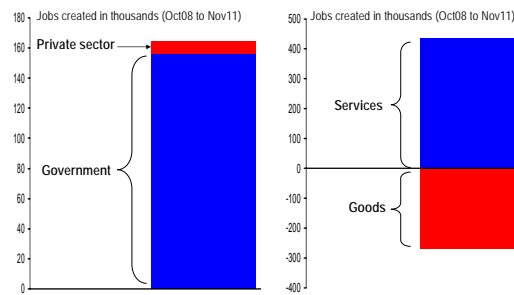
## Headwinds from several fronts in 2012

Facing challenges both at home and abroad in 2012, Canada stands to underperform the U.S. for the first time in six years. Domestic demand will be under siege from a likely softening in housing, and a more moderate pace to consumption spending. Trade will be vulnerable to the lagged impacts of a strong Canadian dollar although there will be some offset in the form of increasing demand from an accelerating U.S. economy. With domestic demand treading water and European inertia threatening to trigger a global financial crisis, the Bank of Canada is likely to delay interest rate hikes to 2013.

### Labour market deceleration in 2012

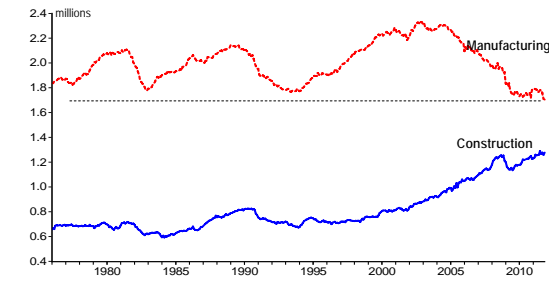
Canada's labour market recovery has been much stronger than that of the U.S., with employment here now above the pre-recession peak compared to American payrolls still languishing 5% below pre-recession levels. The difference between the two countries has, of course, been the relatively better economic growth in Canada. But government payrolls have also been a big driver in boosting Canadian employment. Over the last three years (Oct08 to Nov11), Canada has added roughly 164,000 jobs, 95% of which came from government. Contrast this with the U.S. where the purge in public sector payrolls has been unprecedented. The increase in hiring by government together with the 278,000 job gains in private sector service-producing industries lifted total services employment enough as to offset the purge in the goods sector payrolls.

**Canada: Bulk of jobs created over last 3 years due to Govt.**



*NBF Economy & Strategy (data from Global Insight) 2011-12-15*

The employment slump in the goods sector was driven by the manufacturing sector whose payrolls are at a record low. This avalanche of pink slips from factories was partially offset by the uptrend in construction employment which reached new highs in 2011.

**Canada: Manufacturing employment at record low,  
Construction jobs near all-time high**


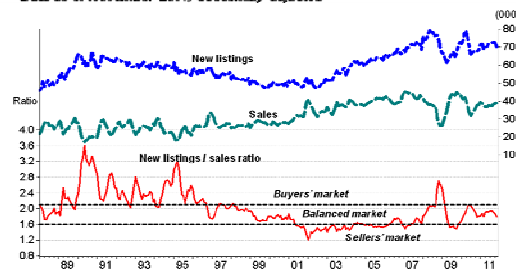
NBF Economy & Strategy (data from Global Insight) 2011-12-15

What do those patterns suggest for the 2012 employment? Simply put, those trends are not bullish. The destruction of manufacturing jobs is symptomatic of a structural problem that is not going away anytime soon (C\$ impacts are described further on). And the gains in construction jobs which have been fed by stimulus programs and the expansion of housing, are likely to reverse as both of those boosters fade in 2012. Hiring in the resources sector may provide some support, although the expected softening in commodity prices should limit employment gains there. In any case, any job gains in the resources sector, which accounts for less than 10% of overall goods sector employment, are unlikely to have a significant positive impact. So expect the goods sector payrolls to remain weak.

This time, however, there will not be as much of an offset from services payrolls. Government hiring at the pace seen over the last three years is not sustainable, nor likely to be permitted to continue particularly with deficit-cutting plans underway. The saving grace for Canadian employment in 2012 may be from private sector service-providing sectors, but even there we are not expecting miracles given the anticipated softening of the overall economy. All told, employment growth should be modest at just under 1% in 2012, contrasting with a roughly 1.5% increase in the prior year. That should leave the unemployment rate averaging north of 7% in 2012.

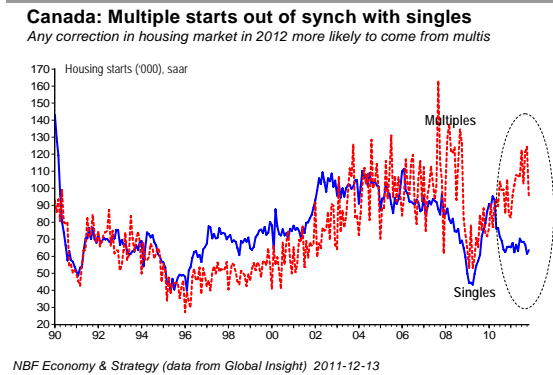
**Consumers under stress**

A tepid labour market will evidently weigh on consumption spending in 2012. However, a slower global economy should cap gasoline prices which will offer Canadians some relief. That is pretty much the reverse of the scenario that played out in 2011 when the benefits of a relatively strong labour market on consumption spending was offset by high gasoline prices. Another difference will be the impact of the housing market on consumers. For now the Canadian housing market is being described as “balanced” with the listings-to-sales ratio remaining low enough as to allow home prices to rise at a modest pace.

**Canada: Conditions on the existing home market**  
 Data as of November 2011, seasonally adjusted


NBF Economy & Strategy (data from CREA) 2011-12-16

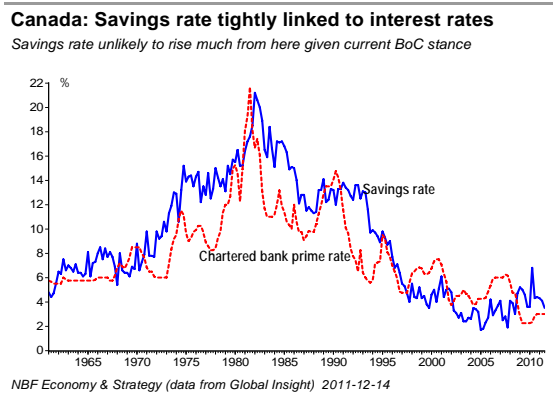
But with the labour market likely to decelerate, the resulting weakness in household incomes should work as to bring the existing home market closer to buyers' market territory, hence limiting price increases or even prompting price declines in some cases. The market for multiple units e.g. condos, apartments, seem more prone for a price correction given how far new supply has strayed from that of singles.



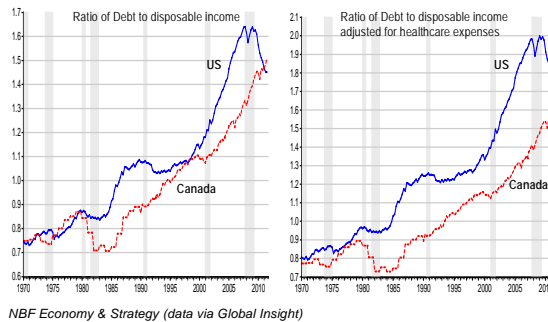
So the housing wealth effect which has helped boost consumption spending over the last several years is likely to be less of a factor going forward.

### How serious is the deleveraging threat to consumption spending?

We are less concerned about the negative impacts of deleveraging on consumption because we do not expect the savings rate to rise significantly given that interest rates are set to remain low for a while. Rock bottom interest rates are clearly discouraging savings and encouraging debt accumulation.



The Bank of Canada is in a bind because it is being forced by global events to keep interest rates low, hence fueling the debt accumulation spree of Canadians. In fact, the longer the BoC delays interest rate increases, the harder it will be for it to raise rates without triggering a housing-led recession. Which is why the BoC felt that it had to, repeatedly, warn Canadians against over-leverage, going so far as to say that “Canadians are now more indebted than the Americans”. While the latter statement may be true if one looks at an unadjusted ratio of household debt to disposable income which is indeed higher in Canada, the comparison is arguably unfair. Disposable incomes of Americans are not exactly comparable to Canadian ones since the former get a lot less bang for the buck having to assume more significant expenses like health care outlays. An adjusted ratio, which removes health care expenses from the calculations, shows that Canadians are not quite as levered as Americans.

**Canadian debt elevated, but not worse than the US**


That said, there is no denying that the Canadian debt picture is not pretty. Canadians will find it harder to service their debt once interest rates resume their ascendancy. But rates are set to remain low over the next several years, meaning that debt servicing costs should remain manageable over the near to medium term. Deleveraging would become a more serious problem for consumption spending if interest rates rise quickly or if the housing market collapses. We are not expecting either of those to materialize. Still, consumers will face enough challenges as to limit spending growth to less than 2% in 2012.

Providing a partial offset in 2012 to a flatlining housing market and the anemic growth in consumption and government spending, will be business investment spending. Buoyed by strong corporate profits, low interest rates and a strong Canadian dollar, business outlays have decent fundamentals for expansion. Planned outlays relating to projects in energy, namely hydro and the oil sands will also help support investment. That, however, will not prevent overall domestic demand to ramp down to a sub-2% performance in 2012.

**Canada: Corporate profits highest since 2008**

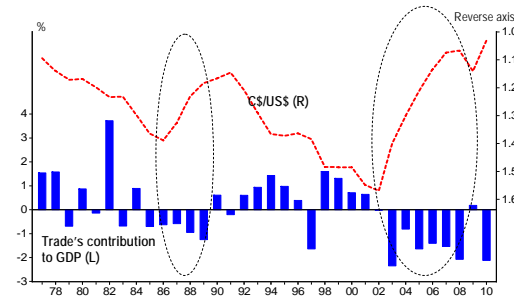
*A source of support for business investment spending*



*NBF Economy & Strategy (data from Global Insight) 2011-12-15*

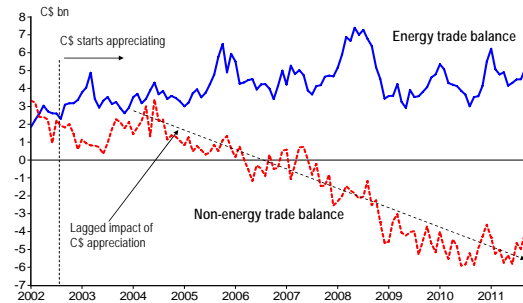
**Canadian Trade: Currency impacts offset by accelerating U.S. economy**

With the U.S. economy going up one gear in 2012, demand for Canadian exports should improve somewhat. However, it is not going to be smooth sailing for our exporters. With only 5% or so of their products going to Europe, Canadian exporters are lucky to not have significant direct exposure to waning demand from the old continent. However, exporters of resources, will feel an indirect hit as the European recession weighs enough on global growth as to bring down commodity prices. Non-resource exporters may get some lift from an accelerating U.S. economy but will be hampered by the lagged impacts of a strong Canadian dollar. Note that the merchandise trade balance remained in deficit territory for the third year in a row in 2011. And, as has been the case for seven of the eight preceding years, trade was likely again a drag on the economy in 2011. So the currency's impacts can be significant.

**Canada: Currency appreciation turns trade into drag**


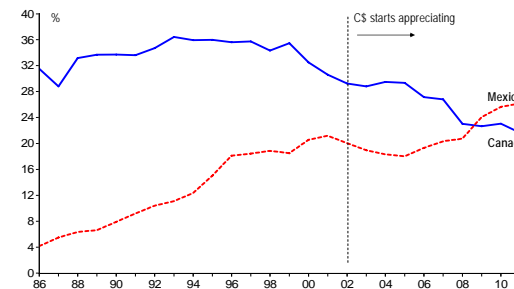
NBF Economy &amp; Strategy (data from Global Insight) 2011-12-14

Commodity prices, which are largely determined on global markets, have been on the rise over the past several years courtesy of the growing clout of emerging markets in the world economy, fuelling the Canadian dollar's ascent. While higher prices have allowed our resource exporters to cushion the blow of the stronger currency, non-resource exporters have not been so lucky. In fact, excluding resources, Canada's trade performance has been largely disappointing, with the non-energy trade balance on a steady decline in recent years.

**Canada: C\$ appreciation hits non-energy trade**


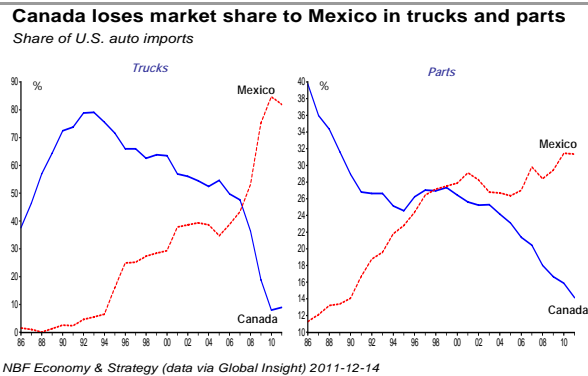
NBF Economy &amp; Strategy (data via Global Insight) 2011-12-09

The erosion of Canada's manufacturing base is one explanation for that alarming trend which is likely to extend into 2012. The poster child for this sad reality is the auto sector. After rebounding strongly in the preceding year, the Canadian auto sector struggled in 2011. Of course, supply chain disruptions related to the Japanese tsunami played a role there, but the negative impact of the strong currency cannot be ignored. In 2011, Canada's share of the U.S. auto market fell under 22% for the first time on record.

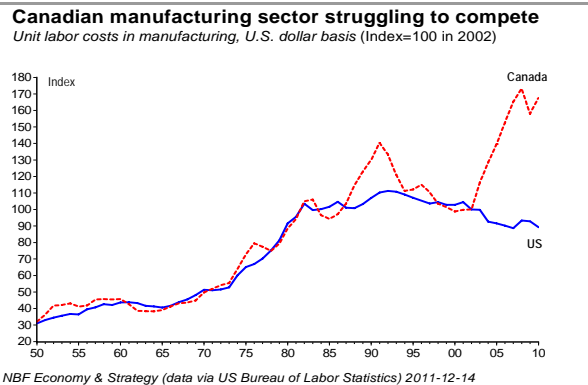
**Canadian share of U.S. auto imports at all-time low**


NBF Economy &amp; Strategy (data via Global Insight) 2011-12-14

Low-cost competitors with highly competitive currencies, like Mexico, have grabbed market share particularly in high margin segments like trucks and parts. While over half of overall U.S. truck imports came from Canada in 2002, our market share in that segment has shrunk to just 10% today. Mexico's share, in contrast has soared past 80%. The contrast is less dramatic for the auto parts business, although the trend is similarly depressing from a Canadian standpoint.



The only segment where Canadian exporters have been able to maintain market share was in the passenger car segment, although that too could change for the worse sooner rather than later. For instance, note a recent comment from Chrysler's CEO Sergio Marchionne: "you cannot have an uncompetitive wage rate and then expect Chrysler or all the other car makers to keep on making cars in this country and be disadvantaged". He has a valid point. While Canadian manufacturing costs have tracked U.S. ones closely up to 2002, the gap has widened significantly since then, due to the Canadian dollar's ascent.



And with the U.S. dollar expected to remain weak over the next several years, and commodities continuing to inflate the loonie, salvation for Canada's auto sector can only come via higher productivity. In fact, such a prescription applies to pretty much all of the non-resource sector. Canada is on track to improve its productivity record if recent trends in business investment are any guide, but productivity improvements will not happen overnight. So expect non-resource exporters to remain under pressure over the near to medium term as they compete with lower-cost competitors. That said, the acceleration of the U.S. economy should be enough as to allow trade to turn into a contributor to growth in 2012. Indeed, a rising tide tends to lift all boats, even those that are listing badly.

The contribution from trade will be offset by a weakened domestic demand resulting in tepid GDP growth of just 2% for Canada in 2012, taking away our bragging rights of having outperformed the U.S. economy since 2006. With domestic demand under pressure and the European debt crisis having the potential to spiral into a full-blown global financial crisis, the Bank of Canada is likely to play safe and delay interest rate hikes to 2013.

# Provincial economies

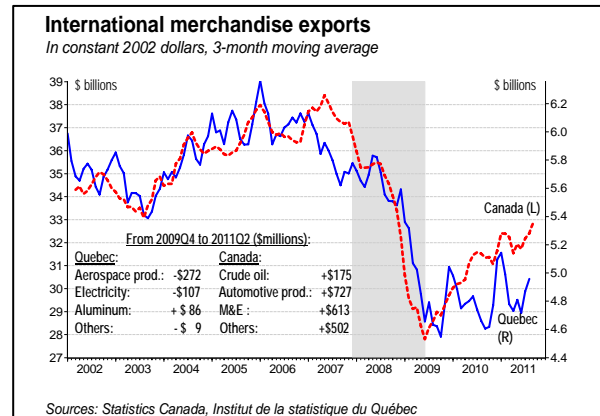
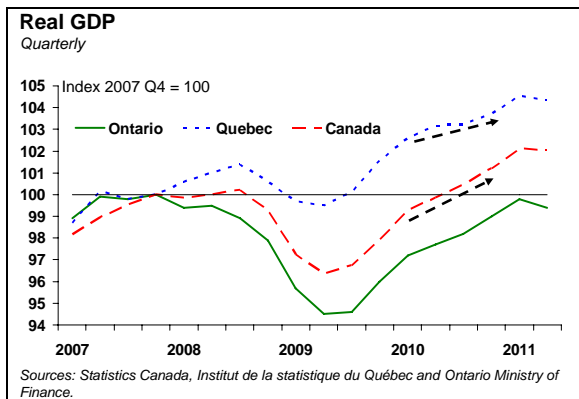
## Quebec exports slow to recover

The Quebec economy emerged from the recession relatively unscathed. However, throughout 2010, the recovery was slower than in Canada as a whole, mainly because of sluggish growth in the volume of international merchandise exports.

Exports started to recover in the second half of 2009. In 2010, Canadian exports continued to expand, but this was not the case in Quebec until the second quarter of 2011. It may be thought that in volume terms, Canadian exports were fuelled mainly by products that Quebec produces little or none of. However, during this period, crude oil and automobiles and automotive parts accounted for only 45% of the increase in Canadian exports. The remainder came mostly from machinery and equipment and industrial products. A significant portion of Quebec's exports fall into these last two categories, including its two main export goods, aerospace products and aluminum. However, aerospace product exports felt the delayed effect of the recession, while electricity exports declined. The increase in aluminum exports was not enough to compensate.

The year 2011 could be a milestone for Quebec exports. In the first nine months of the year, China replaced the United Kingdom as the second destination for Quebec's international merchandise exports in terms of value. This phenomenon was due mainly to strong growth in shipments to China of iron ore and to a lesser degree, aerospace products, while shipments of aerospace products to the UK fell. The growth in exports of aerospace products to emerging countries should continue. There is a revival of demand in developed countries, so that this sector should lead Quebec's export growth in 2012.

In 2010, the 4.2% increase in final domestic demand made up for lacklustre external demand. In 2011, domestic demand has been transitioning toward a slower growth track. In real terms, consumer spending fell during the first and second quarters. In the first quarter, a one percentage point hike in the Quebec sales tax (QST) took effect. In the second quarter, there was barely any increase in wages and salaries, which posted the smallest growth of all 10 provinces. Fortunately, wages and salaries started to grow again in the third quarter, stimulating households' expenses as witnessed by the behaviour of retail sales. For the year as a whole, consumer spending should be up 1.4%, compared to 3.3% in 2010.



In 2011, current government expenditure should increase 1.1% in real terms. In its recent Economic and Financial Update, the provincial government reiterated its objective of balancing the budget by 2013-2014. For this to happen, growth in the government's consolidated expenditure (program spending, spending by organizations and that of special funds) is forecasted at an average of 3.0% between 2010-2011 and 2013-2014, compared to 5.5% during the previous four years.

Government investment, which was running high even before the recession struck, is likely to have levelled off towards the end of the year. For 2011 as a whole, it will increase by 4.8%, versus 8.6% in 2010. In real terms, business investment in machinery and equipment will grow by 14%, still remaining below its pre-recession high.

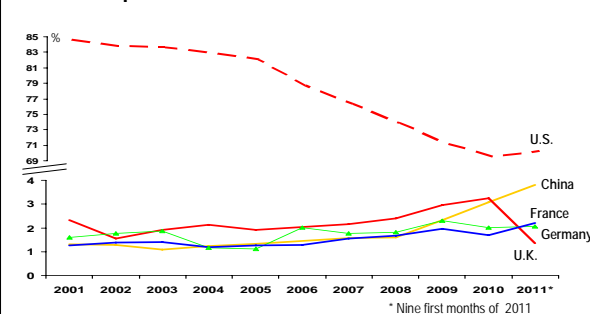
The year may close with a quarter in which employment is down slightly from the third quarter. However, the jobs lost are part-time. Once again, the manufacturing sector reduced its workforce in 2011, this time by 2%. The losses may be proportionally higher in the finance, insurance, real estate and leasing sector, as well as in information, culture and recreation. The construction sector was still hiring, but this is unlikely to continue. The transportation and warehousing sector performed well, in the sense that it maintained the jobs created during 2010. Trade and education were vectors of job creation in 2011, more than offsetting losses in public administrations and health care and social services. Toward the end of the year, there was a strong upsurge in employment in the primary sector (agriculture, forestry and mining) and in professional, scientific and technical services.

For 2011 as a whole, employment should grow by 1.1%. Because of the jobs lost at the end of the year that will need to be recouped, growth should only be 0.6% in 2012. This growth rate will not be enough to prevent the unemployment rate to edge up from 7.6% in 2011 to 7.7% in 2012. Under these conditions, and considering the next hike in the QST coming up at the beginning of 2012, the \$100 increase per adult in the health contribution and the growth in real estate taxes, it would be surprising if consumer spending growth exceeded 2.0% in real terms next year.

In Quebec, and particularly in Greater Montreal, condominium housing starts reached a record level in 2010, which is going to be broken in 2011. The result is a large number of units under construction at a time when the number of existing units listed for sale has risen. This suggests that housing starts will decline in Quebec, from 46,700 in 2011 to 40,000 in 2012. It would be surprising if renovation spending, which was frontloaded due to the Home Renovation Tax Credit, provided a counterweight. We are therefore expecting residential construction to decrease by almost 5% in 2012.

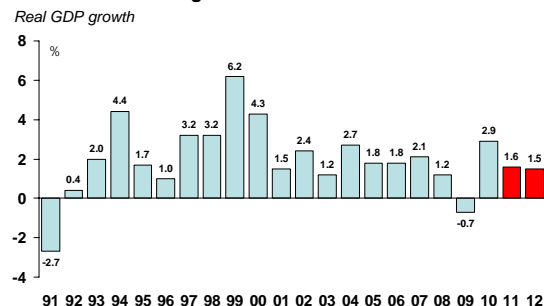
On the other hand, business investment will continue to expand, but at a more moderate pace than in 2011. But a 10% reduction in government fixed investment in real terms is expected. This is why, all things considered, domestic demand should increase by a modest 1.6% in 2012.

**Quebec: Export value breakdown for selected countries**



Source: Industry Canada

**Quebec: Economic growth and 2011-2012 forecasts**



Sources: Statistics Canada, National Bank forecasts.

Therefore, even with forecasted growth of 4.0% in international exports, economic growth should remain moderate in 2012, at 1.5%.

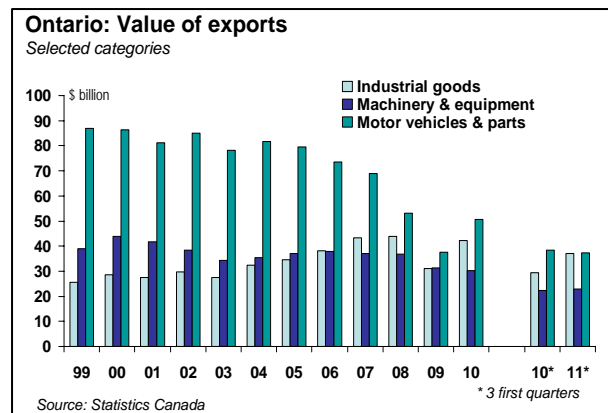
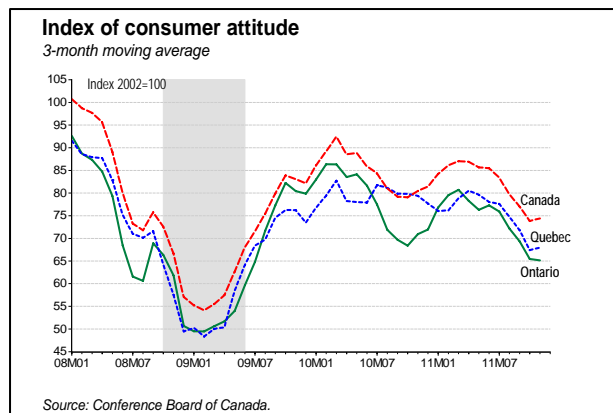
## Ontario: Heading for moderate economic growth

In the second quarter of 2011, the breakdown in the global supply chain caused an annualized drop of 8.4%, in real terms, in automotive industry production. The economy as a whole shrank 1.3%. In value terms, international exports were down 7.0%. The second quarter drop prevented the economy from regaining the same level of activity as in the last quarter of 2007, its pre-recession peak.

Economic growth no doubt resumed in the third quarter. Nonetheless, the value of automotive product exports was 4.9% lower than in the same quarter of 2010. The value of other international exports as a whole rose by more than 15%, obviously in large part because of the higher price of gold, since the value of gold exports shot up 60%. Non-ferrous metals also made an important contribution due to higher prices as well as the resumption of normal activity at the Vale nickel and cobalt processing plant in Sudbury. During the first three quarters of 2011, the value of industrial good exports was almost the same as exports of motor vehicles and parts. In real terms, Ontario's mining production could grow by 15% in 2011, and should continue to post a strong performance over the entire forecast horizon.

The seasonally-adjusted value of manufacturing sales increased by 6% in the third quarter of 2011 compared to the second, notably due to transportation equipment and petroleum products.

The second quarter was marked by very low annualized growth in wages and salaries, at 0.7%, no doubt related to the loss of 20,000 manufacturing jobs and a shift in employment toward part-time jobs. In any case, real personal disposable income per capita dipped slightly, after stagnating in the previous quarter. It is therefore not surprising that consumer spending did not make much headway, in real terms, in the first half of the year. As in Quebec, wages and salaries started to increase again in the third quarter, which had an impact on retail sales. Nonetheless, judging from the Conference Board's confidence index, Ontario consumers are still the most downbeat in Canada. Moreover, the 1.8% employment carry-over until this point in 2011 reflects gains in the first half of the year. During the second half, the labour market seemed to lose steam. The weakness was obvious in the finance, insurance, real estate and leasing sector, and to a lesser degree in commerce, manufacturing, information, culture and recreation and in education. In addition, in contrast to Quebec, the jobs lost toward year-end were full-time ones.

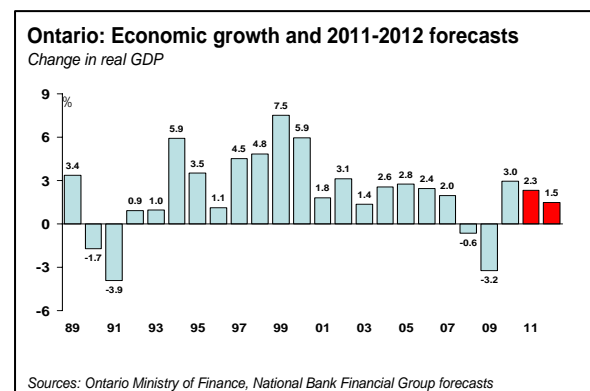
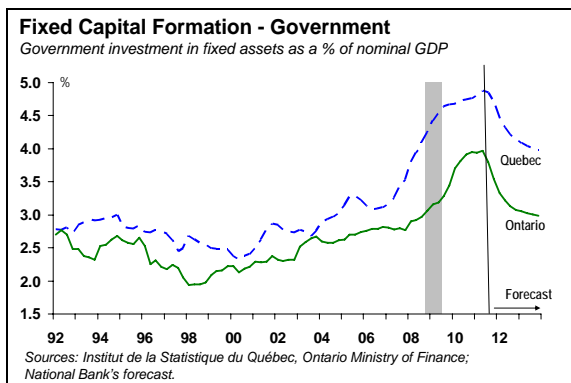


As in Quebec, 2011 was a transitional year in terms of domestic demand. In real terms, consumer spending should advance 2.1%. Public administrations must control their spending. In this regard, in order to eliminate the Ontario government's budget deficit by 2017-2018, the budget presented last spring called for limiting program expenditure growth to 1.4% annually. Given the uncertainty hanging over global economic growth, the Commission on the Reform of Ontario's Public Services is expected to recommend setting the spending growth target at 1%. The government says it will take this recommendation into consideration when preparing the 2012 budget. In this context, growth in government expenditure on goods and services will slow during the forecast period. In addition, government investment likely peaked in the second quarter of 2011. In 2012, a 14% decline is expected in real terms.

Business investment growth is expected to slow in real terms in 2012. Furthermore, as anticipated, housing starts were up in 2011 for a second consecutive year. However, we expect a 9% decrease in 2012.

In other words, there will be slower growth in 2012 in every component of domestic demand. Employment growth should not exceed that of Quebec, that is, 0.7%. The unemployment rate, at 7.9% on average in 2011, should edge up to 8.0% in 2012. It was not until April 2011 that employment returned to its pre-recession level. The labour market still has a long way to go before the jobless rate gets back to its pre-recession level, namely 6.5%. The result should be 2.4% growth in real terms in household spending in 2012. Given the gradual reduction in government investment until then, growth in final domestic demand should be about 2.0% in 2012, compared to 3.2% in 2011.

Again in real terms, international exports should increase by 6.0%. If they do, and given that import growth should decrease along with domestic demand, then international trade could contribute to economic growth in 2012, for the first time since 2001. In spite of all this, economic growth should lose steam, dropping from 2.3% in 2011 to 1.5% in 2012.



## Atlantic Provinces

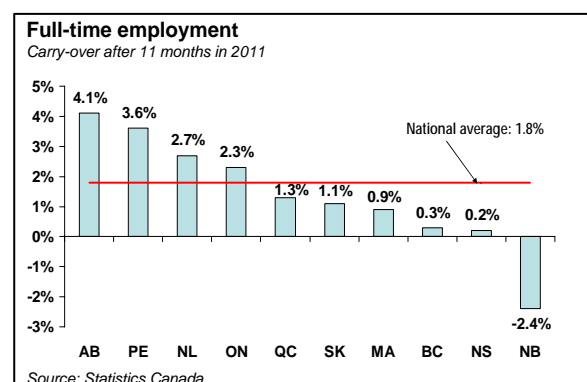
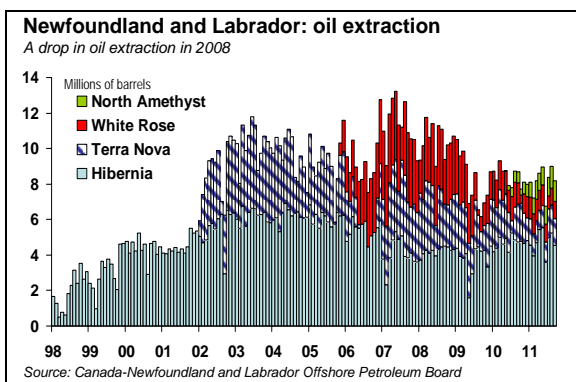
After posting 6.1% economic growth in 2010, **Newfoundland and Labrador** could experience a surge of close to 5.0% in 2011. However, crude oil extraction, which accounts for almost 20% of the economy, is on the decline as a result of the natural depletion of off-shore sites. This activity will trim some 0.4% off growth in 2011, and about 1.5% during the following two years. In 2011, the decline will be very largely offset by a jump of more than 40% in real terms in ore extraction (which nonetheless accounts for 7% of the province's economy). The construction industry will not be far behind, with growth of over 20%. Mining, energy and government investment are all

recording strong growth. Construction has, to this point in 2011, provided half the growth in employment over 2010, which is close to 2.8%. Other than in the residential sector, the construction industry will step up activity in 2012, and then lose steam thereafter. New housing construction should continue the decline that began in 2011. Only mining will continue to experience a vigorous expansion in the next two years, although at a more moderate pace than in 2011. Economic growth should therefore be 0.7% in 2012. This modest growth will have an impact on the province's finances. The government will enjoy a surplus that has been revised upward this year due to higher-than-expected oil production. In the next two fiscal years, the drop in oil extraction will produce budget deficits that the government expects to absorb in 2014-2015 by maintaining slow growth in program spending. That being said, the financial picture is still favourable, with net debt forecasted at \$7.7 billion as at March 31, 2012, its lowest level in 13 years.

In order to reduce its deficit, the government of **Prince Edward Island** compressed program expenditure growth to 1% during the current fiscal year. A return to a balanced budget is expected in 2013-2014. Furthermore, after adopting in 2008 a five-year, \$510 million investment plan in order to stimulate the economy, the new five-year plan that will apply as of fiscal 2012-2013 calls for a more normal level of investment spending, with a total of \$371 million over five years. In 2012-2013, investments of \$101 million will be made, versus \$138 million during the current fiscal year. Efforts to balance the budget will lead to modest economic growth, estimated at 2.0% in 2011 and 1.7% in 2012.

After the first three quarters of 2011, P.E.I. is the province with the slowest growth in the value of exports, namely 1.0% on a year-over-year basis. This is due to reductions of 12% and 8%, respectively, in the province's two main export categories, frozen potatoes and processed seafood. The potato harvest was hurt by bad weather. Even so, the province's economy provided jobs for its inhabitants in 2011. After Alberta, P.E.I. had the strongest growth in full-time employment. The unemployment rate, at slightly over 11%, has settled at its typical level before the recession. In addition, the province's labour force participation rate is the highest among the Maritime Provinces, and that is why its jobless rate is the highest as well. In fact, P.E.I.'s employment rate is the highest of the three Maritime Provinces. Let's mention that the P.E.I. is the province with the fastest population increase in 2011. Indeed, Immigration Services succeeded in attracting a large number of migrants, coming mostly from China.

In 2010, output by utilities was up 15% because of the commissioning of wind farms. The expansion of renewable energy production should continue.



In **Nova Scotia**, a Cape Breton paper mill had to close its doors in September because of high energy costs, the strong loonie and a drop in demand. A thousand jobs were lost as a result. In the third quarter of 2011, manufacturing sales plunged an annualized 10.7%. Wages and salaries in the economy increased by only 0.7%, the smallest growth of all the provinces. Furthermore, the province's employment is having a hard time getting back to where it was before the

recession. The non-agricultural primary sector, business services including services related to buildings and other support services and the manufacturing sector are lagging the most. What is more, the average hourly wage will likely increase by only 1.6% in 2011. As a consequence, consumption expenses growth has been moderate.

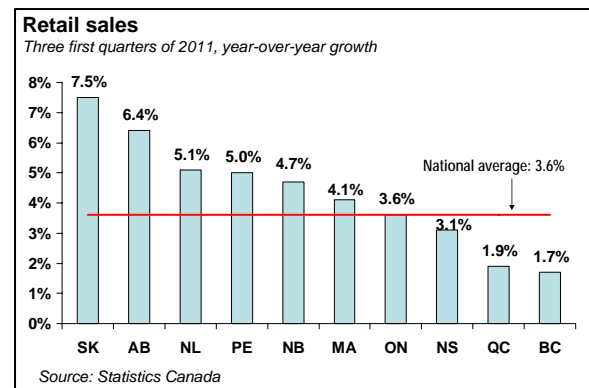
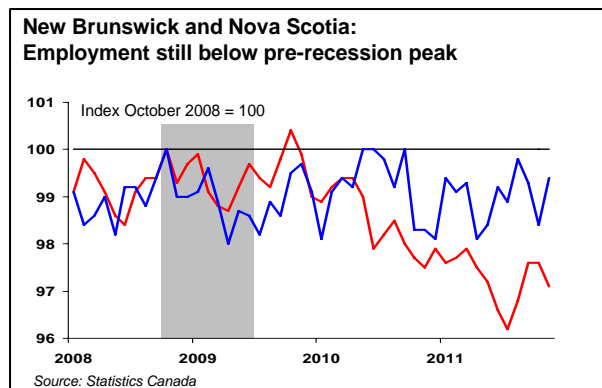
Government fixed investment, which was boosted in 2009 to support the economy, probably culminated at the end of 2010 and began to decrease in 2011. In addition, by 2012-2014, the government wants to wipe out a budget deficit estimated at \$319 million for the current fiscal year. Budget austerity has been chosen to reach this objective, with the result that in 2013-2014, total expenditure is expected to be about the same level as in 2011-2012.

Over the forecast horizon, economic conditions will nonetheless improve as a result of the awarding of a large naval construction contract in Halifax. The contract is expected to be a major source of growth in the manufacturing sector. In addition, natural gas extraction at the Deep Panuke site should begin early in 2012. Natural gas extraction will contribute to economic growth next year, while it reduced it in 2009 and 2010 because of the gradual depletion of the Sable Island deposit. It is true that once the operating infrastructure for Deep Panuke is completed, construction will decline in 2012. Economic growth, estimated at 1.5% in 2011, will therefore not be uniform next year. It should accelerate only slightly, to 1.7%.

Out of all the provinces, the labour market in **New Brunswick** has turned in the worst performance since the start of the recession. And yet it was relatively unaffected by the recession itself. Paradoxically, it was during the recovery, specifically as of mid-2010, that it went off the rails. What is more, the jobs lost since then have been full-time ones. Jobs lost in the past 18 months have been concentrated primarily in construction, transportation and warehousing, and trade. On the other hand, growth in average weekly earnings has exceeded the national average. So has growth in retail sales to this point in 2011, no doubt for that reason.

The continued weakness of the labour market is affecting public finances. In the government's last financial report, it revised receipts from personal income taxes downward for the current fiscal year. This, combined with higher-than-expected contributions to public service pension and employee benefit plans, means that the reduction in the budget deficit should be smaller than forecasted in last March's budget. This budget, it should be remembered, called for a continuing freeze on hiring in the public service this year. The government has to develop a fiscal plan with the aim of balancing the budget by 2014-2015. Until then, austerity should prevail.

New Brunswick is undoubtedly the province with the most lacklustre private and public non-residential investment in 2011. Incidentally, the government has substantially reduced its capital expenditure budget for fiscal 2011-2012. In addition, residential construction has declined, with housing starts down almost 30% in 2011. As a result, construction industry activity was down in 2011, a scenario that will be repeated throughout the forecast horizon,



causing more job losses in this sector.

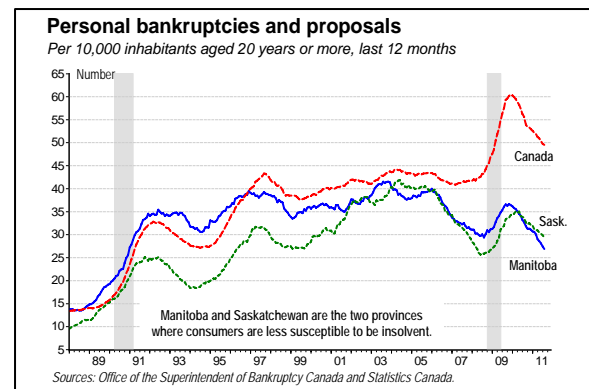
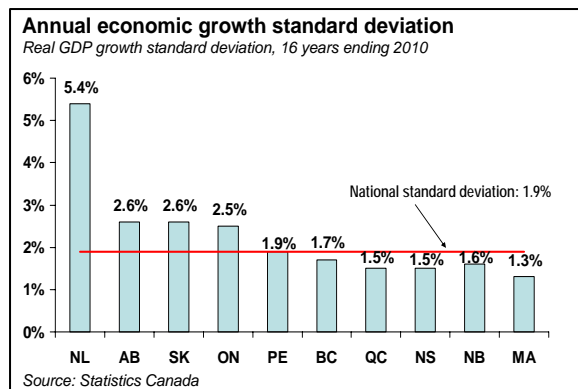
Overall, the labour market is nonetheless expected to resume a positive trajectory in 2012 as industrial output expands. Next year, economic growth should be 1.5%. At the beginning of 2012, the Brunswick mine, once the biggest underground zinc mine in the world, will be depleted. Metal ore production, specifically zinc, lead, copper and silver, will resume during the year with the opening of a new mine. In 2013, another larger molybdenum and tungsten mine will be opened, while the Sussex potash mine will go into production. The increase in mining activity will then make a strong contribution to accelerating the province's economic growth. But for the time being, economic growth will be 1.2% in 2011 and 1.5% in 2012.

## Western Provinces

**Manitoba's** economy is relatively diversified, which is why Manitoba has had the most stable economic growth out of all the provinces during the past 16 years, a characteristic that should continue across the forecast horizon. Its economic growth may well have reached 2.2% in 2011, in spite of the worst flooding in recent history. The floods caused an estimated 3% drop in agricultural production, after declines of 14% in 2010 and 1% in 2009 (in 2008, agriculture accounted for 5% of the province's economy).

After the first three quarters of 2011, the year-over-year increase in the value of Manitoba's international merchandise exports, at almost 27%, was the second highest in the country, after Newfoundland and Labrador. Crude oil and natural gas generated more than 40% of this increase, even though these raw materials represented less than 5% of the province's exports in 2010. One quarter of the increase came from the inauguration in 2011 of non-ferrous metal ore exports, half of which to China. In 2011, China also became a market for papermaking pulp and once again became a market for plastic products. Incidentally, just like Quebec, China became the second largest market for the province's exports in 2011. This position should be reinforced in future by the fact that China is gradually eliminating restrictions on Canadian beef imports. In spite of reduced production, the value of wheat and oilseed exports was up because of higher prices. With the commissioning of the Wuskwatin generating station in 2012, the outlook for exporting electricity to the United States is positive, and, as in Quebec, so is the outlook for aerospace products.

Like the other two Prairie provinces, Manitoba's labour market is mainly characterized by a very low unemployment rate. Employment will probably grow by only 0.7% in 2011, but this represents a consolidation of the 1.9% gain recorded in 2010. Employment growth should accelerate at 1% in 2012.



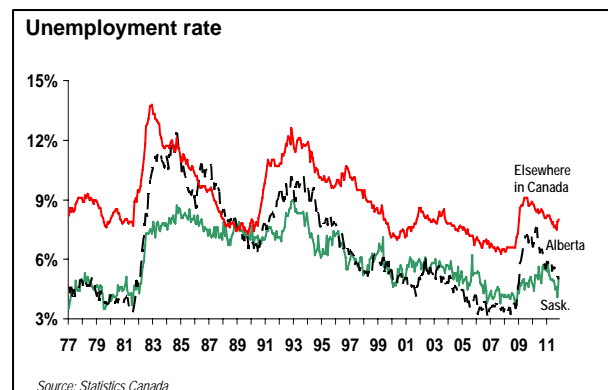
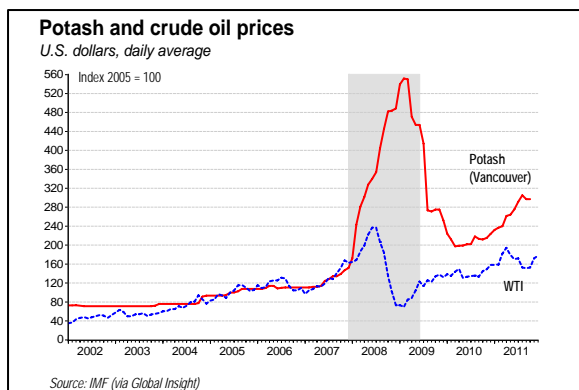
Despite pressure from health care, education and debt service, the government's total expenditure is expected to rise 2.3% for 2011-2012, and 2.0% on average for the following three years. At the end of this time, the budget deficit is expected to be wiped out. The government also plans to reduce the capital expenditure budget in 2012. For this reason, and given, moreover, that private projects are wrapping up and housing starts will decline, the construction industry will contract next year. If agricultural production bounces back, the economy should still expand by 2.5% in 2012.

For **Saskatchewan**, poorer economic conditions in Europe and the U.S. are partly offset by comparatively robust economic growth in Asia and Latin America, which are important markets for its raw materials. Furthermore, after the U.S., China and India have been the top two destinations for its international exports since 2008. That is why economic growth should exceed 3% in 2011 and 2012. This is true even if 2010 economic growth, at 4.0%, was much stronger than estimated, as the impact of bad weather on crops was originally overestimated.

After the first three quarters in 2011, Saskatchewan was the province with the highest year-over-year growth in retail sales. Total employment growth of only 0.3% masks a 1.1% rise in full-time employment. It will be the only province with an unemployment rate of 5% or less in 2011. Consumer spending therefore supported economic growth this year, as did potash production, with a year-over-year increase of 25% for the first nine months of the year. That does not include business investment to increase potash production capacity and a strong rise in the number of wells drilled. In addition, flooding was less extensive than in 2010 and the summer conditions were much better, with the result that the harvest will be better in terms of both quantity and quality. The province is also experiencing the largest advance in housing starts. Wholesale trade as well has been an important contributor to economic growth in 2011. In 2012, the energy and potash sectors should again spearhead economic growth. However, activity in the construction sector should contract as a result of reduced government infrastructure investment and a drop in housing starts. The decline will be only temporary, because mining development will resume with increased vigour in 2013.

Even before the net transfers from the Growth and Financial Security Fund, the government has been able to post a budget surplus. If Crown corporations, agencies and other organizations are included, a deficit is expected this year, but solely due to bad weather conditions and the poor performance of capital markets.

The catalysts of economic growth in **Alberta**, namely fixed investment in oil sands development and crude oil extraction, will not be jeopardized by the darker economic picture. The price of crude oil fell in August and September, but it was nothing compared to the drop at the end of 2008, the start of the recession. In early December 2011, the price of oil had regained the ground it had lost. There are still downside risks, but they are unlikely to be enough to compromise the profitability of the oil sands development projects.



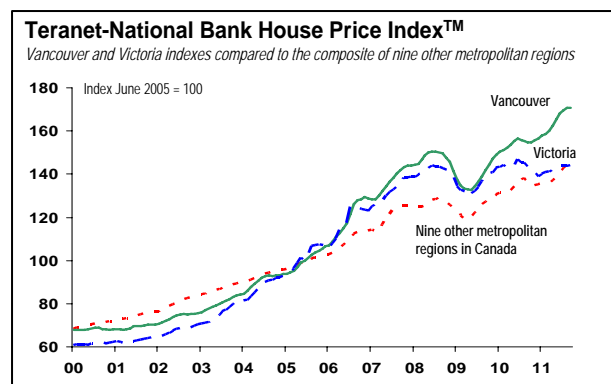
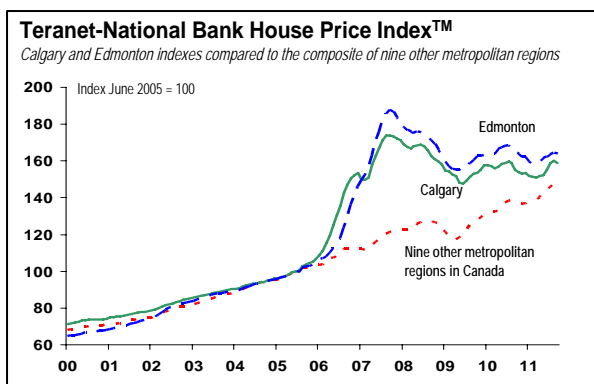
The economy is running at full speed. Employment growth was well above 3.0% in 2011, and should grow at 2.0% in 2012. Toward the end of 2011, the employment rate topped 70%, by far the highest rate in the country. After the first three quarters in 2011, wages and salaries had recorded year-over-year growth of 8.2%, the biggest advance in the country. Such a progression heralds that the household services sector will also experience a strong expansion over the forecast horizon. The labour market is becoming very tight. Salaries, which are already the highest in Canada on average, are set for an accelerated increase. In 2011, Alberta once more became a magnet for workers from other provinces, and should remain so. The need for new housing will therefore remain high over the forecast horizon.

The residential sector has just emerged from the slump that followed the wave of speculation in 2006 and 2007. The Teranet-National Bank house price indexes for Calgary and Edmonton started rising again as of the second quarter of 2011. The reduction in federal infrastructure spending will limit the growth of the construction industry in 2012, but only temporarily. In 2013, because of the U.S. authorities' decision to delay approval of the Keystone XL project, bottlenecks will limit oil exporting capacity to refineries south of the border. Even so, the province's economic growth will be well above 3% across the forecast horizon.

In 2011, **British Columbia's** economic growth should match the national average, and no more than that. Employment is in the process of increasing 0.8% over 2010, and only 0.3% in full-time employment. Strong gains in accommodation and food services and in construction slightly exceeded the heavy losses in trade and agriculture. The lacklustre performance of the labour market seemed to rub off on consumers. As a result, growth in retail sales in third quarter 2011 was 0.9% compared to third quarter 2010 (excluding the first half of the year avoids comparison with the increased sales during the 2010 Winter Olympics).

After a brief correction in second quarter 2010, house prices staged a strong comeback in Vancouver, gaining 10% in the following 11 months, according to the Teranet – National Bank House Price Index. Market conditions were tight until the end of first quarter 2011. Since then, they have gradually been moving in the other direction, which suggests that the September drop in prices heralds a short correction. In Victoria, the correction lasted until December 2010. After that, the rise in prices has been modest, since market conditions favoured buyers. For the province as a whole, a 2.6% reduction in housing starts is expected in 2012. In B.C. as elsewhere, activity in the construction industry will be limited by the implosion of government capital expenditure.

After three quarters in 2011, the value of international merchandise exports rose 16%, but the value of these exports to the U.S. was up a mere 2.6%. Exports to Pacific Rim countries showed an impressive increase. Their level even slightly exceeded exports to the U.S. Forest products were favoured in China, which imported \$2.4 billion of them, versus \$2.7 billion for the U.S. Capacity that had been shut down has been restarted in order to serve the Chinese market. Higher coal prices as a result of the floods in Australia were a major stimulus for exports of the



mineral to South Korea, Taiwan, the Netherlands and Brazil. This effect is only temporary and prices should decrease in 2012. The Chinese residential real estate market has slowed drastically. Despite the fact that 8 million social housing units are planned to be built in China in 2012, the growth of forest product exports to this country will slow.

As of 2013, the manufacturing sector will also be stimulated by the awarding of an \$8 billion ship-building contract by the federal government. Although prices will remain depressed, natural gas extraction should increase vigorously, at least at deposits that are also rich in butane and propane. Prices for these products tend to follow prices for crude oil rather than natural gas, and are thus an incentive for drilling. The commissioning of new mines will stimulate ore extraction in 2012, and even more in 2013.

In August, a referendum vote forced the government to reverse the introduction of the harmonized sales tax, leaving it with a \$700 million shortfall in revenues and additional expenses during the current fiscal year and the next two, in addition to having to repay \$1.6 billion to the federal government in transition payments. The B.C. government will therefore have to come up with a new plan to balance its budget by 2013-2014. The plan will no doubt call for strict expense control, which may slow economic growth somewhat. Economic growth should reach 2.3% in 2011 and 2.1% in 2012.

**World Economic Outlook**

	<u>Forecast</u>		
	<b>2010</b>	<b>2011</b>	<b>2012</b>
<b>Advanced countries</b>	<b>3.1</b>	<b>1.6</b>	<b>1.3</b>
<i>United states</i>	3.0	1.8	2.5
<i>Euroland</i>	1.8	1.4	-1.5
<i>Japan</i>	4.0	-0.6	2.0
<i>UK</i>	1.4	1.0	0.5
<i>Canada</i>	3.2	2.3	2.0
<i>Australia</i>	2.7	1.9	2.5
<i>New Zealand</i>	1.7	1.2	2.1
<i>Hong Kong</i>	7.0	5.2	4.0
<i>Korea</i>	6.2	4.0	3.9
<i>Taiwan</i>	10.9	5.1	4.4
<i>Singapore</i>	14.5	5.0	4.2
<b>Emerging Asia</b>	<b>9.5</b>	<b>7.9</b>	<b>7.0</b>
<i>China</i>	10.3	9.0	7.7
<i>India</i>	10.1	7.8	7.0
<i>Indonesia</i>	6.1	6.2	5.0
<i>Malaysia</i>	7.2	5.0	4.5
<i>Philippines</i>	7.6	4.5	4.5
<i>Thailand</i>	7.8	3.5	4.2
<b>Latin Amer. and Caribbean</b>	<b>6.1</b>	<b>4.6</b>	<b>3.6</b>
<i>Mexico</i>	5.4	3.8	3.2
<i>Brazil</i>	7.5	4.0	3.3
<i>Argentina</i>	9.2	8.0	4.0
<i>Venezuela</i>	-1.5	2.5	2.7
<i>Colombia</i>	4.3	4.9	3.9
<b>Eastern Europe and CIS</b>	<b>4.5</b>	<b>4.3</b>	<b>3.2</b>
<i>Russia</i>	4.0	4.2	3.2
<i>Czech Rep.</i>	2.3	2.0	1.0
<i>Poland</i>	3.8	3.7	2.8
<i>Turkey</i>	8.9	6.2	2.5
<b>Middle East and N. Africa</b>	<b>4.4</b>	<b>4.0</b>	<b>3.6</b>
<b>Sub-Saharan Africa</b>	<b>5.4</b>	<b>5.2</b>	<b>5.8</b>
<b>Advanced economies</b>	<b>3.1</b>	<b>1.6</b>	<b>1.3</b>
<b>Emerging economies</b>	<b>7.3</b>	<b>6.2</b>	<b>5.4</b>
<b>World</b>	<b>5.1</b>	<b>3.9</b>	<b>3.4</b>

Source : NBF Economy &amp; Strategy, Consensus Economics, IMF

**Canada  
Economic Forecast**

<i>(Annual % change)*</i>	2008	2009	2010	2011	2012	Q4/Q4	
						2011	2012
Gross domestic product (2002 \$)	0.7	(2.8)	3.2	2.4	2.0	2.1	2.1
Consumption	3.0	0.4	3.3	1.9	1.9	1.4	1.8
Residential construction	(3.2)	(8.0)	10.2	2.7	0.6	5.8	(1.9)
Business investment	3.7	(20.8)	7.3	11.7	4.9	6.2	6.5
Government expenditures	4.8	4.3	4.7	1.3	0.3	0.1	0.3
Exports	(4.7)	(13.8)	6.4	4.4	5.8	4.3	6.0
Imports	1.5	(13.4)	13.1	6.5	3.4	5.3	3.9
Change in inventories (millions \$)	9,683	(539)	8,899	12,505	7,063	9,052	5,893
Domestic demand	3.0	(2.1)	4.5	2.9	1.7	1.9	1.7
Real disposable income	4.1	0.8	3.6	1.0	1.6	0.4	2.1
Employment	1.7	(1.6)	1.4	1.5	0.9	1.3	1.1
Unemployment rate	6.2	8.3	8.0	7.4	7.2	7.3	7.1
Inflation	(0.7)	0.3	1.8	3.0	2.2	2.3	2.9
Before-tax profits	8.0	(32.3)	20.9	15.3	5.8	8.3	5.2
Federal balance (Public Acc., bil. \$)	9.6	(5.8)	(55.6)	(33.4)	(30.1)	....	....
Current account (bil. \$)	5.3	(45.2)	(50.9)	(51.3)	(46.5)	(48.0)	(40.0)

\* or as noted

**Financial Forecast\***

	Current 12/16/11	Q1/12	Q2	Q3	Q4	2012	2013
Overnight rate	1.00	1.00	1.00	1.00	1.00	1.00	2.00
Prime rate	3.00	3.00	3.00	3.00	3.00	3.00	4.00
3 month T-Bills	0.83	0.86	0.90	0.92	1.17	1.17	1.92
Treasury yield curve							
2-Year	0.85	0.94	1.01	1.13	1.38	1.38	2.49
5-Year	1.19	1.46	1.57	1.76	1.97	1.97	2.91
10-Year	1.88	2.24	2.37	2.58	2.73	2.73	3.40
30-Year	2.46	2.79	2.88	3.04	3.15	3.15	3.63
Exchange rates*							
USD per CAD	0.96	0.99	0.97	0.96	0.98	0.98**	....
Oil price (WTI), U.S.\$	93	90	85	87	89	88**	....

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\* end of period

\*\* annual average

**United States  
Economic Forecast**

<i>(Annual % change)*</i>	2008	2009	2010	2011	2012	Q4/Q4	
						2011	2012
Gross domestic product (2005 \$)	(0.3)	(3.5)	3.0	1.8	2.5	1.7	2.5
Consumption	(0.6)	(1.9)	2.0	2.3	2.5	1.9	2.7
Residential construction	(23.9)	(22.2)	(4.3)	(1.7)	13.9	2.0	20.3
Business investment	(0.8)	(17.9)	4.4	8.7	9.3	8.1	9.2
Government expenditures	2.6	1.7	0.7	(1.9)	(1.1)	(1.7)	(1.6)
Exports	6.1	(9.4)	11.3	6.8	4.3	5.2	4.1
Imports	(2.7)	(13.6)	12.5	4.8	5.1	3.3	7.0
Change in inventories (bil. \$)	(36.3)	(145.0)	58.8	19.9	23.8	0.0	30.0
Domestic demand	(1.0)	(3.6)	1.8	2.0	2.7	1.8	2.8
Real disposable income	2.4	(2.3)	1.8	1.0	2.0	0.4	2.8
Household employment	(0.5)	(3.8)	(0.6)	0.5	1.2	0.8	1.4
Unemployment rate	5.8	9.3	9.6	9.0	8.5	8.9	8.4
Inflation	(1.3)	(0.3)	1.7	3.1	1.8	1.2	3.3
Before-tax profits	(17.4)	9.1	32.2	8.3	5.7	8.0	4.2
Federal balance (unified budget, bil. \$)	(1,800.0)	(1,800.0)	(1,300.0)	(1,350.0)	(1,100.0)	...	...
Current account (bil. \$)	(410.0)	(410.0)	(500.0)	(480.0)	(490.0)	(510.0)	0.0

\* or as noted

**Financial Forecast**

	Current	Q1/12	Q2	Q3	Q4	2012	2013
	12/16/11						
Fed Fund Target Rate	0.07	0.12	0.12	0.12	0.12	0.12	0.50
3 month Treasury bills	0.01	0.05	0.06	0.05	0.05	0.05	0.29
Treasury yield curve							
2-Year	0.23	0.27	0.29	0.33	0.35	0.35	1.46
5-Year	0.81	0.99	1.04	1.18	1.30	1.30	2.25
10-Year	1.86	2.18	2.25	2.43	2.62	2.62	3.32
30-Year	2.86	3.22	3.28	3.45	3.62	3.62	4.09
Exchange rates*							
U.S.\$/Euro	1.30	1.38	1.35	1.30	1.25	1.32**	....
YEN/U.S.\$	78	78	77	77	76	77**	....

National Bank Financial

\* end of period

\*\* annual average

**Main economic indicators - Provinces**

	2007	2008	2009	2010e	2011f	2012f
<b>Real GDP (% growth)</b>						
Newfoundland & Labrador	9.2	-0.4	-9.0	6.1	4.9	0.7
Prince Edward Island	1.8	0.7	0.2	2.6	2.0	1.7
Nova Scotia	1.6	2.7	0.0	1.9	1.5	1.7
New Brunswick	1.1	0.6	-0.4	3.1	1.2	1.5
Quebec	2.1	1.3	-0.7	2.5	1.6	1.5
Ontario	2.0	-0.6	-3.2	3.0	2.3	1.5
Manitoba	2.7	3.8	-0.3	2.4	2.2	2.5
Saskatchewan	3.6	4.6	-3.8	4.0	3.6	3.1
Alberta	1.7	0.9	-4.5	3.3	3.4	3.6
British Columbia	3.0	0.7	-2.1	3.0	2.3	2.1
Canada	2.2	0.7	-2.8	3.2	2.4	2.0
<b>Employment (% growth)</b>						
Newfoundland & Labrador	0.7	1.0	-2.9	3.5	2.7	0.4
Prince Edward Island	0.8	1.2	-1.4	3.1	1.6	1.2
Nova Scotia	1.6	0.9	-0.1	0.2	-0.1	0.8
New Brunswick	1.9	0.6	0.1	-0.9	-1.3	0.8
Quebec	2.4	1.2	-0.8	1.8	1.1	0.6
Ontario	1.8	1.5	-2.4	1.6	1.8	0.7
Manitoba	1.7	1.7	0.0	1.9	0.7	1.0
Saskatchewan	2.4	1.7	1.3	0.9	0.2	0.9
Alberta	3.8	3.1	-1.3	-0.4	3.8	2.0
British Columbia	3.5	2.0	-2.1	1.8	0.8	1.0
Canada	2.4	1.7	-1.6	1.4	1.5	0.9
<b>Unemployment rate (%)</b>						
Newfoundland & Labrador	13.5	13.3	15.6	14.3	12.6	12.2
Prince Edward Island	10.3	10.7	12.0	11.3	11.4	11.0
Nova Scotia	8.0	7.6	9.1	9.3	9.1	8.4
New Brunswick	7.6	8.5	8.7	9.3	9.6	9.1
Quebec	7.2	7.3	8.5	7.9	7.6	7.7
Ontario	6.4	6.5	9.0	8.6	7.9	8.0
Manitoba	4.5	4.2	5.3	5.4	5.4	5.6
Saskatchewan	4.2	4.1	4.8	5.2	5.0	4.9
Alberta	3.5	3.6	6.6	6.5	5.5	5.4
British Columbia	4.3	4.6	7.7	7.6	7.5	7.4
Canada	6.0	6.1	8.3	8.0	7.4	7.2
<b>Housing starts (000)</b>						
Newfoundland & Labrador	2.6	3.3	3.1	3.6	3.5	2.9
Prince Edward Island	0.8	0.7	0.9	0.8	0.9	0.6
Nova Scotia	4.8	4.0	3.4	4.3	4.2	3.8
New Brunswick	4.2	4.3	3.5	4.1	3.2	2.8
Quebec	48.6	47.9	43.4	51.4	47.5	40.0
Ontario	68.1	75.1	50.4	60.4	66.7	62.0
Manitoba	5.7	5.5	4.2	5.9	5.9	5.5
Saskatchewan	6.0	6.8	3.9	5.9	7.3	5.7
Alberta	48.3	29.2	20.3	27.1	25.3	26.1
British Columbia	39.2	34.3	16.1	26.5	26.7	26.0
Canada	228.3	211.1	149.1	189.9	191.1	175.4
<b>Consumer Price Index (% growth)</b>						
Newfoundland & Labrador	1.4	2.9	0.3	2.4	3.3	1.9
Prince Edward Island	1.8	3.4	-0.1	1.8	2.9	1.8
Nova Scotia	1.9	3.0	-0.1	2.2	3.9	1.9
New Brunswick	1.9	1.7	0.3	2.1	3.4	1.8
Quebec	1.6	2.1	0.6	1.3	3.1	2.3
Ontario	1.8	2.3	0.4	2.4	3.2	2.1
Manitoba	2.1	2.2	0.6	0.8	3.0	1.7
Saskatchewan	2.9	3.2	1.1	1.3	2.8	1.8
Alberta	4.9	3.2	-0.1	1.0	2.3	2.0
British Columbia	1.7	2.1	0.0	1.4	2.4	1.9
Canada	2.1	2.4	0.3	1.8	3.0	2.2

f: forecast National Bank, Economy and Strategy Group

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