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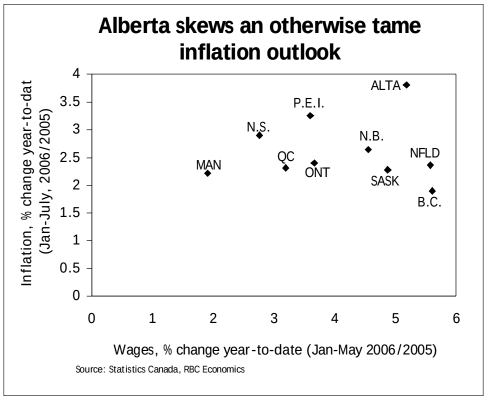

ALBERTA IN LEAGUE OF ITS OWN — INFLATION WELL-CONTAINED IN REST OF CANADA

August 2006

The robust Canadian macroeconomic picture, which is expected to continue through 2006 with only a slight softening next year, has been masking a distinct regional divide — the commodity-rich provinces that have benefited from elevated resource prices in contrast to the export- and manufacturing-oriented economies in central and eastern Canada coping with high commodity prices, a strong dollar, increased competition from offshore producers and weakened U.S. demand for our exports. Despite these pronounced regional differences, the one area of congruence has been on the inflation front. Inflation in almost all provinces has continued to be relatively tame – with the notable exception of Alberta, the only province now showing signs of cost-push inflationary pressures.

The Bank of Canada's measure of core inflation, which excludes the eight most volatile components of the consumer price index (CPI) as well as the effect of changes in indirect taxes on the remaining components, matters to monetary policy in determining underlying inflationary pressures. However, because we want to focus on real wage gains, we are using the all-items CPI to assess the broad-based inflationary pressures affecting the average consumer.

In the past year, inflation has been mostly concentrated in the housing, transportation and energy sectors where price increases have largely been offset by price declines in furniture, clothing, footwear and electronic equipment. The economy's ability to maintain a balanced inflationary picture has allowed most provinces to enjoy substantial real wage gains. Here are the key inflation drivers and offsets that have, on balance, kept inflation across Canada well-contained — except in Alberta.

Inflation drivers

Driver #1: Owned accommodation upkeep costs rising

Owned accommodation accounts for roughly 16% of CPI inflation and is made up of five categories, three of which have significantly contributed to the rising cost of upkeep for our homes. First, mortgage interest costs in all provinces have been on the rise since rate hikes started about a year ago. Second, the replacement cost component, designed to capture ongoing repair costs and measured by the house-only component of new house prices, is up sharply alongside a robust housing market. But, the nationwide pace of replacement costs has been largely skewed by Alberta's market. The June year-over-year pace of the house-only portion of the new housing price index is still high for Canada (up 11%), but largely due to Alberta's eye-popping rate (up 45%). Rising labour and construction materials costs have fuelled Alberta's rapid increases; the rest of the country remains in a high, but healthy, range of growth at about 5-10%. Third, homeowner's insurance premiums have also seen hefty price increases, particularly in the western provinces where house prices are climbing at rapid rates. The Atlantic provinces and Quebec, which have already undergone a substantial cooling in their housing markets, have seen only mild growth in homeowner's premiums.

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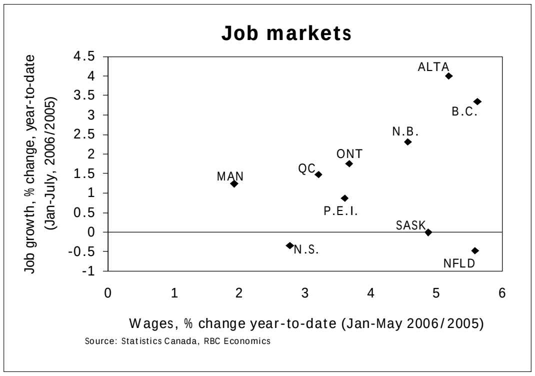
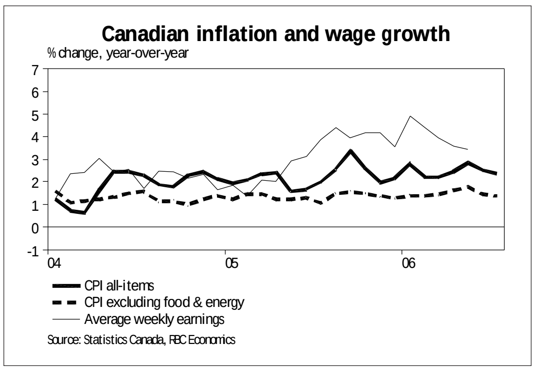
Provincial forecast report:
www.rbc.com/economics/market/pdf/provfcst.pdf

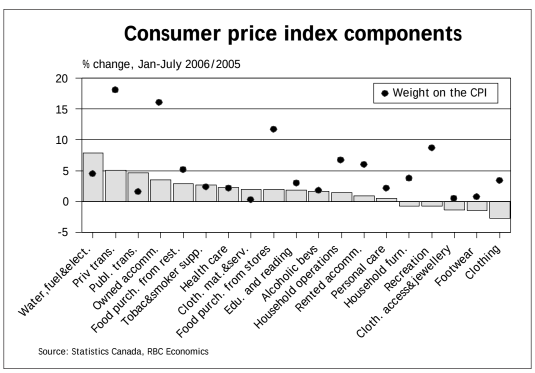
DESPITE SOLID JOB GROWTH AND RISING WAGES...



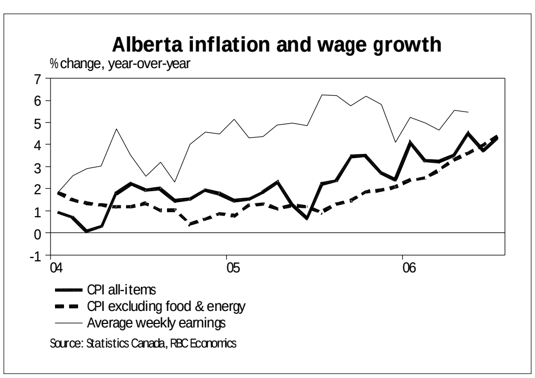
CANADIAN INFLATION REMAINS WELL-CONTAINED...



AS CHEAPER CLOTHING AND FURNITURE OFFSET RISING HOUSING, TRANSPORTATION AND ENERGY PRICES...



EXCEPT IN ALBERTA WHERE COST-PUSH INFLATION IS EMERGING.



Driver #2: Household utility bills squeeze homeowners

Household energy bills, which feed in through the shelter component of the CPI, have been a key driver of inflation during the past year. Water, fuel and electricity account for 4.6% of CPI inflation and are up 8% in the first seven months of 2006 over the same period last year. Fuel oil reported the strongest gains with double-digit price growth in every province. Newfoundland led the 12-month price increase in July with fuel up 9%. Natural gas and electricity prices are extremely volatile across provinces because of varying policies adopted by provincial governments to set price levels. Since the start of the year, Alberta's electricity prices are up the most sharply at 14% compared to a year ago. Deregulation in Alberta’s electricity sector has led to greater price fluctuations. More recently, though, the Ontario Energy Board put in place an electricity price hike that took effect May 1, 2006. The price hike will continue to affect annual price growth in Ontario, which has edged up by 10% year-over-year for three consecutive months. Ontario and Manitoba have experienced the sharpest increases in the price of natural gas so far this year, while Alberta has exhibited the greatest volatility in natural gas prices.

Driver #3: Gas prices drive cost of private transportation

While prices for all types of transportation have been trending upward at an annual pace of roughly 5% in the first seven months of 2006, public transportation (including local and inter-city transportation) has a relatively small weighting on CPI accounting for 1.7% of the index. Instead, the main driver of transportation costs continues to be the heavily weighted private transportation sector, which accounts for 18.1% of Canada’s CPI. Higher gasoline prices remain the primary source of rising costs. Canada’s 12-month gas prices were up 16% in July and all provinces continue to track price increases of roughly 15% (give or take) in the first seven months of 2006 compared to a year ago. The most rapid annual increase in July gasoline prices was found in Saskatchewan (up 18%) and the slowest in Newfoundland (up 11%). Although oil is expected to remain at elevated levels, we expect the price to pull off a little bit from today’s levels, providing some mild relief to consumers.

Inflation offsets

Offset #1: Strong C$ cheapens imported goods

At just beyond the mid-point of 2006, prices for household furnishings, clothing, footwear and computer/home entertainment equipment are down in almost every province compared to a year ago. Some of the sharpest pull-backs in prices this year compared to last occurred in Manitoba’s clothing sector (down 7%), Ontario’s and Newfoundland’s home entertainment equipment (down 5%) and Newfoundland’s footwear segment (down 6%). The combination of a strong dollar, which reduces the cost of imports, rapid technological advancements and heightened foreign competition from offshore producers continues to drive down the cost of many goods. These price declines have significantly helped to curb mounting price pressures coming from other sectors.

Inflation offset #2: Interest rate hikes will help calm rapid economic growth

Last September, the Bank of Canada began aggressively raising the overnight right to ensure that inflation remained on target over the medium-term given the

Provincial current economic indicators

Latest month available, year-over-year % change, not seasonally adjusted unless marked S.A.

		Canada	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta.	B.C.
Labour market												
Employment	Jul-06	2.0	-2.0	-0.5	-1.2	1.3	1.3	1.9	0.7	1.5	4.6	3.1
Labour force	Jul-06	1.7	-2.2	-0.2	-0.9	0.5	1.1	1.7	0.8	1.2	4.6	1.8
Unemployment rate (% level, S.A.)	Jul-06	6.4	14.6	11.2	8.3	8.9	8.1	6.5	3.6	4.7	3.6	4.7
Average weekly earnings	May-06	3.5	6.1	3.6	2.8	4.5	2.4	2.9	1.4	4.4	5.5	4.8
Consumers and business												
Retail sales	Jun-06	6.7	2.5	2.6	4.1	5.5	3.5	4.5	8.0	6.3	18.2	8.1
Retal sales excl. new motor vehicles	Jun-06	8.3	3.1	2.8	6.0	6.0	6.1	6.1	10.8	6.7	19.3	9.6
New motor vehicle sales	Jun-06	-1.9	-1.0	1.5	-6.4	2.5	-9.6	-3.1	-9.3	3.8	13.3	-0.3
Wholesale trade	Jun-06	5.6	1.1	-28.6	0.5	-2.7	3.6	6.2	-6.2	-7.2	17.4	3.5
Housing starts (S.A.)	Jul-06	-4.8	-17.4	0.0	28.9	13.2	-21.6	-17.6	-21.7	2.6	34.4	11.7
Existing home sales	Jun-06	-2.7	15.8	-21.5	-13.9	-5.7	0.9	-3.8	4.8	8.8	7.4	-9.5
Residential building permits (S.A.)	Jun-06	2.1	-12.5	-12.3	-1.5	-3.1	-19.6	-11.2	15.6	19.0	26.0	28.3
Non-residential building permits (S.	Jun-06	15.6	-53.0	55.2	74.5	38.4	6.2	-3.4	-61.3	109.4	105.8	-8.3
Manufacturing shipments	Jun-06	1.1	-27.5	-13.3	-8.1	-0.6	6.7	-2.7	-3.4	9.9	8.1	6.3
Business bankruptcies	Jun-06	-2.2	100.0	200.0	-45.8	20.0	6.8	16.9	-16.7	3.6	-39.3	-21.3
Consumer bankruptcies	Jun-06	-8.2	-1.7	14.3	-11.9	2.3	-0.5	-7.1	-10.3	-21.5	-32.9	-8.6
Domestic trade												
Merchandise exports (S.A.)	Jun-06	1.2	35.8	-19.0	-12.2	-3.0	3.3	-3.3	3.6	4.1	13.2	0.9
Merchandise imports (S.A.)	Jun-06	1.0	88.8	-96.4	-18.7	-16.8	4.0	0.6	0.0	15.0	-1.1	3.5
Inflation												
CPI	Jul-06	2.4	2.4	3.2	3.0	2.0	2.1	1.9	2.5	2.6	4.3	2.0
CPI ex. food and energy	Jul-06	1.4	1.0	1.4	1.3	1.0	0.8	1.0	1.3	1.3	4.4	1.1
CPI ex. Shelter	Jul-06	1.9	2.0	3.2	2.5	2.2	2.0	1.6	2.5	2.3	2.4	1.9

Source: Statistics Canada, Canada Mortgage and Housing Corporation, Canadian Real Estate Association, RBC Economics Department

robust growth outlook for the economy. This series of rate hikes drove the overnight rate from 2.5% up to 4.25% where rates currently stand. The effects of these rate hikes typically have a 12-18 month lag. As such, the hikes are expected to continue to filter through the economy and should help keep a lid on the threat of inflation expanding in the economy.

Inflation offset #3: GST cut provides discount

Consumers have already begun to enjoy the one-percentage point cut to the GST. Since the price changes measured by the CPI incorporate the value of consumption taxes, this tax cut is estimated to shave roughly 0.5% off the CPI, providing some mild near-term relief. However, this is only a one-off benefit to consumers providing temporary price relief for a year until next July when the prices have fully worked their way through. This tax cut is irrelevant to the Bank of Canada because it is not indicative of underlying inflationary pressures and does not factor into their measure of core inflation.

On balance, except for the inflationary pressures mounting in Alberta, inflation remains well-contained. British Columbia's tight labour market and booming construction sector have yet to reveal broad-based signs of consumer inflation, but meanwhile the province is enjoying solid economic growth accompanied by significant real wage gains. In Saskatchewan, rapid wage growth accompanied by mild inflation continues to provide solid real earnings growth. Recently, Manitoba's economy has lost some of its wage growth momentum, which has temporarily eroded real wage gains, but inflation remains under control. Ontario continues to enjoy small real wage gains, but Quebec has just recently seen an erosion to real wage gains. New Brunswick and Newfoundland are reporting some of the most solid real wage gains in the country. Going forward, mounting inflation in Alberta is emerging as a risk to its economic outlook. As shortages intensify, the cost of materials and labour will continue to escalate and we may continue to observe further