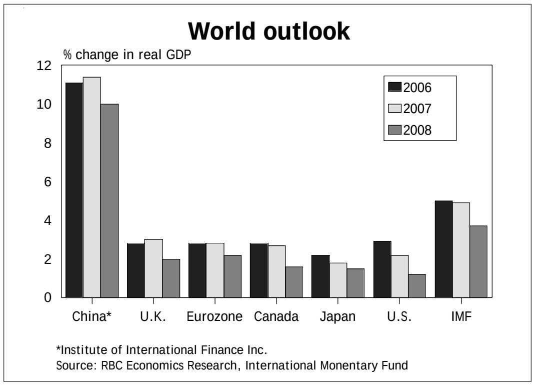
ECONOMICS | RESEARCH



Craig Wright
Chief Economist (416) 974-7457
craig.wright@rbc.com

Paul Ferley
Assistant Chief Economist (416) 974-7231
paul.ferley@rbc.com

Dawn Desjardins
Senior Economist (416) 974-6919
dawn.desjardins@rbc.com

ECONOMIC & FINANCIAL MARKET OUTLOOK

July 2008

Fears of U.S. recession fading; Canada's terms of trade boost continues

▲ U.S. economy to remain weak, but market forecasters see reduced odds of a recession despite higher-than-expected energy prices.

▲ Economy continued to expand in the first quarter, but posted the weakest six-month growth rate since 2003.

▲ Consumer and business spending slowed as credit conditions tightened, but the cost of credit is starting to ease as greater stability is emerging in financial markets.

▲ Risks of a second-quarter contraction are lessening as the early wave of fiscal stimulus cheques may give consumer spending a boost and keep the economic growth numbers positive.

▲ The elevated inflation rate as a result of high energy and food prices threatens to boost inflation expectations.

▲ Oil prices are expected to trend lower through the forecast period.

▲ The Fed is likely the hold the policy rate steady for the remainder of this year.

▲ Canada's economy contracted in first quarter as special factors and inventories dragged the growth rate down, but domestic demand is holding up and will more than offset the significant drag from net exports this year.

▲ Import growth will remain robust, but flagging U.S. demand will weigh on export volumes.

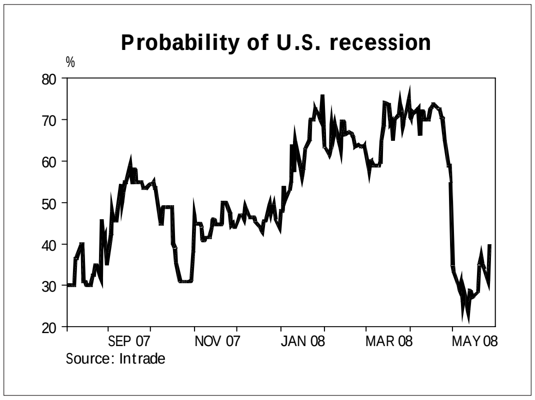
▲ High commodity prices and the attendant rise in terms of trade will support real income growth and jobs.

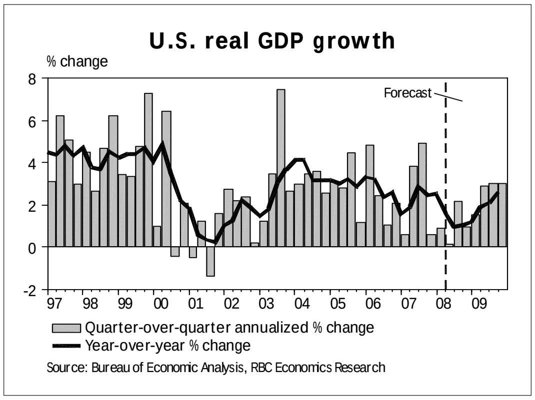
▲ Consumer spending has slowed from its robust 2007 fourth-quarter pace but will still remain a key support for the economy in 2008.

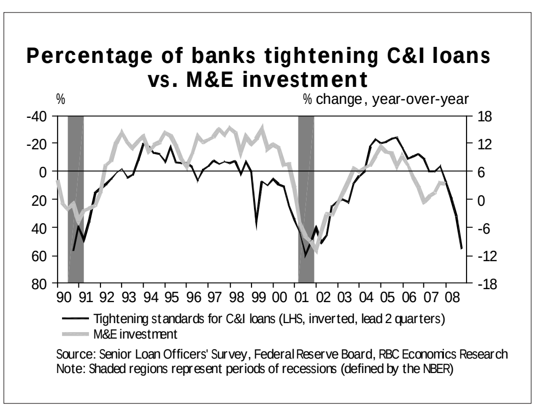
▲ Business investment will continue to be a strong support to the economy as the high Canadian dollar lowers prices of imported machinery and equipment, and high commodity prices will warrant an increase in capacity.

▲ Canada's housing market is losing steam but is not headed for U.S.-style crash.

▲ The Bank of Canada is refocusing on the inflation outlook after easing 150 basis points since December 2007.







U.S. economic gloom lightening up a bit

The economic landscape started to look a bit brighter early in the spring as data releases indicated that the U.S. economy had avoided a decline at the start of the year and the tone in financial markets started to improve. First-quarter GDP growth was firmer than expected, rising at a 1% pace, up from the fourth quarter's 0.6% gain. But, these two quarters were the slowest six months for the U.S. economy since 2003 and early second-quarter data are pointing to flat growth in the quarter.

We forecast that the U.S. economy will grow at a 1.5% pace this year, with a lacklustre first half followed up by stronger growth in the third quarter as the combination of fiscal and monetary policy stimulus supports real GDP gains. The impact of the fiscal stimulus package will likely wane late in the year and the growth rate is expected to drop back down to about 1% in the fourth quarter. This slowing could be even greater if oil prices were to remain high, although our forecast assumes that the price of WTI drops back to US$90 a barrel next year.

Fed's policy actions getting some traction

The combination of the 325 basis points of Fed rate cuts from a recent peak reached mid-2007, plus a plethora of other measures used to inject liquidity into the U.S. financial system, started to reap gains in the second quarter, with markets showing signs of stability compared to the frenzied activity earlier in the year. Funding rate and corporate bond spreads narrowed compared to mid-March. The spread narrowing means that financial companies are once again able to raise funds, albeit at more expensive levels compared to those prevailing prior to the onset of credit market turmoil last August. Our forecast assumes that this improving tone continues.

U.S. rate policy outlook shifts

Market expectations for future central bank policy also shifted significantly early in the second quarter. The combination of the Fed's liquidity-enhancing measures and rate cuts alleviated some pressure in financial markets and stronger-than-expected economic data allayed fears of an impending recession. After a period when markets expected the Fed to continue to ease the policy rate throughout 2008, the Fed funds futures market now looks for the next Fed move to be a rate hike. This is a marked change from the middle of March when the futures contract on the Fed funds rate at year-end was priced at 1.5% — 50 basis points lower than today's rate — just prior to the Fed's actions in direct support of the brokerage industry and the increasing access to the discount window

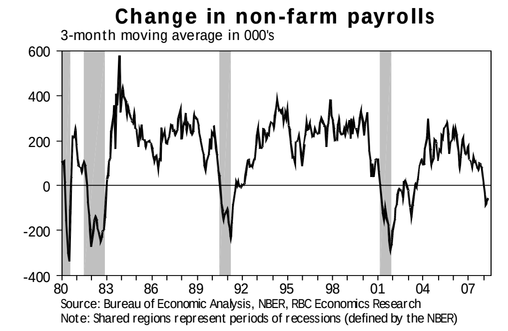
Not out of the woods yet!

Most news about the U.S. economy has tended to be on the strong side of expectations, but one key item suggests that the economy is not out of the woods yet. The April survey of senior loan officers at 56 domestic banks and 21 U.S. branches of foreign banks showed that lending standards continued to tighten early in the second quarter. Fifty-five percent of respondents at domestic banks indicated that their institutions had tightened lending standards for commercial and industrial loans, up from 30% in January. This, historically, has presaged a significant slowing in industrial production, spending on machinery and equipment, and cuts to payrolls.

Payrolls already showing signs of contracting

The survey was in line with the steady decline in employment in early 2008, with an average of 65,000 job losses per month reported from January through May. The goods sector continued to bear the brunt of the layoffs with 396,000 jobs lost, mainly in construction and manufacturing, while service sector employment grew by a relatively subdued 14,000 jobs per month.

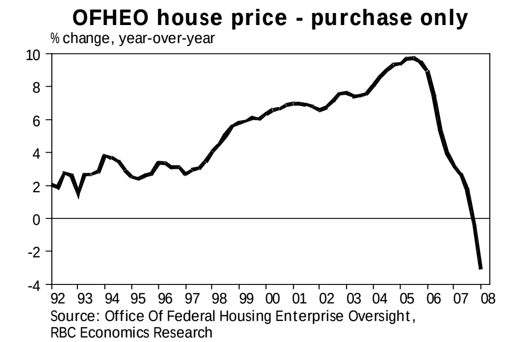
We expect that the U.S. labour market will continue to weaken, although the slower pace of decline in April and May (payrolls fell at an average 38,000 monthly rate) hints that this slowdown will do significantly less damage than in recent full-fledged recessions when job losses averaged 113,000 a month. The unemployment rate spurted to 5.5% in May, above the recent cyclical low of 4.4%, and will likely rise gradually as the economy grows at a sub-par pace. Wages are also showing signs of moderating — the annual increase in average hourly earnings slackened in April to its slowest pace since January 2006.



Weakening labour market, still-tight credit conditions and rising gas prices weigh on confidence

Lending standards for consumer loans also tightened early in the second quarter, with residential mortgage credit remaining under pressure and credit card and other consumer loans facing stricter conditions. The weakening tone in the labour market and tightening in credit conditions have taken a toll on U.S. consumer confidence, which has fallen to the lowest level since the last recession.

Adding to the consumer funk is the continued deterioration of household balance sheets, with real estate net worth continuing to be cut back and the equity market weakness of late 2007 and early 2008 hurting as well. Consumer spending was slightly stronger than expected in the first quarter but still posted only a 1% increase at an annual rate, the slowest pace since 2001. Indicators point to a modest pick-up in consumption in the second quarter, with the volume of personal consumer expenditures rising in both April and May.

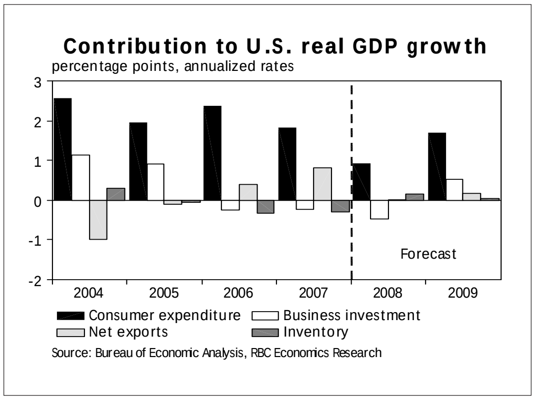


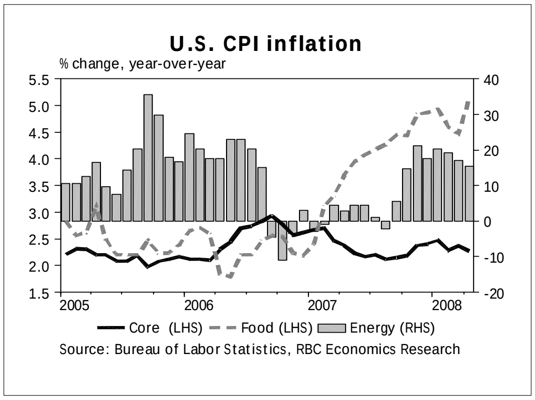
The arrival of the tax rebate cheques in early May as part of the government's large fiscal stimulus package has helped boost consumer spending in recent months, although the lion's share of the support is expected to occur in the third quarter — RBC forecasts that consumption will surge by 4% before slowing again in the fourth quarter. On balance, consumer spending is expected to be slower in 2008 than in 2007, but the fiscal stimulus package and lower interest rates should set up for a recovery in 2009, especially if the tone in financial markets improves as we expect, leading to an easing in credit conditions.

The high price of energy products also poses a downside risk to the outlook for consumer spending. The share of personal disposable income going to purchases of gasoline, fuel oil and other energy goods has doubled since 2002 as oil prices climbed from US$20 a barrel to US$100 a barrel at the end of the first quarter and US$130 a barrel in May. We expect oil prices to fall back to US$90 per barrel in 2009 and moderate the bite from energy-related spending.

Housing market — No relief

The U.S. housing market recession continues in full swing, with home sales running at least 20% slower than a year earlier, prices posting significant year-over-year declines and the stock of homes for sale holding well above historical norms. Residential investment fell at a 24.6% annual rate in the first quarter after plummeting 25.2% in the fourth quarter of 2007 and subtracted a sizeable 1.1





percentage points from economic growth in the first quarter of 2008. Foreclosures were up in April and delinquencies are continuing to rise. Our forecast assumes that the recession in this sector will continue through 2008. In 2009, the combination of lower interest rates and lower house prices is expected to reduce the inventory of homes for sale to more normal levels, which should put a floor beneath new home construction after three years of significant declines.

Businesses to remain tentative in the near-term even as foreign demand bolsters exports

Tighter credit conditions and an uncertain outlook will keep U.S. businesses on the sidelines in the near-term even though corporate balance sheets remain in relatively good shape. The slump in business spending in the first quarter is not expected to let up, with investment in both non-residential structures and equipment likely to remain weak as a result of the tightening in credit conditions. A modest rebound is likely late in the year as the cost of credit comes down and a rebound in consumer demand boosts business confidence. The trade sector is forecast to contribute to the economy's growth rate for the second year running as the weak U.S. dollar keeps foreign demand growing while the soft domestic economy pares back import growth.

Inflation pressures running above Fed's comfort zone

In the three months ended May, the all-items inflation rate rose at a 4.9% compounded seasonally adjusted annual rate, slower than the 5.6% pace in the final three months of 2007. The deceleration was due to slower increases in the energy component and the core index. The core inflation measure, which excludes food and energy, advanced at a 1.8% annualized rate in the period, slower than Q4’s 2.7% annualized gain. Food price inflation, however, picked up pace early this year with the index up at a 5.9% annualized rate, faster than Q4's 2.3% rise. Both the overall and core measures continued to run at the top of the Fed's comfort zone in early 2008 and there have been some tentative indications that inflation expectations are starting to heat up. The University of Michigan's inflation expectations components showed a one-year inflation forecast at an elevated 5.1% in early June, while the five-year inflation forecast rose to 3.4%, the highest since 1996. With commodity prices forecast to stabilize, albeit at their current elevated levels, and capacity pressures easing as the economy grows at a sub-trend rate, we look for price pressures to lessen modestly in the second half of 2008 and curb inflation expectations.

Fed in “wait and see” mode

In its late April press statement, the Fed shifted away from a proactive recession-fighting stance to a “wait-and-see” mode as policymakers assessed the impact of the fiscal stimulus package and earlier rate cuts on the economic outlook. At the same time, policymakers reinforced their commitment to providing liquidity to ensure that financial markets could continue to function efficiently. The temptation to push interest rates even lower in the near-term is being dampened by this elevated level of inflation. In the Fed's statement in June, the upward risks to inflation were acknowledged to have increased, although no imminent response was implied. Going forward, we expect the Fed to hold the policy rate steady through the middle of next year assuming neither the downside risks to growth nor the upside risks to inflation materialize.

Canada's surprise first-quarter economic contraction likely to be short-lived

Canada's economy unexpectedly contracted at a marginal 0.3% annual rate in the first quarter, with slowing inventory accumulation slicing a huge 4.3 percentage points from the quarterly growth rate. Residential construction disappointed as well, taking a one-half percentage point bite out of the quarter's tally. However, the remaining domestic demand components posted decent gains. Even the trade sector boosted the growth rate. Special factors in the auto sector added downward pressure on the economy. However, growth prospects for the remainder of the year are brighter — the inventory correction has passed; financial market pressures appear to be easing; and the high level of commodity prices is expected to produce stronger growth rates during the remaining three quarters of the year.

Terms of trade still supporting the economy

The benefits from the boost in Canada's terms of trade continue to accrue to the economy as the prices of Canada's exports outpace imports. For the most part, this reflects the fact that 45% of Canada's exports are commodities that continue to experience strong demand from economies such as China. Our imports are more heavily weighted toward consumer and investment goods, the prices of which have been falling due to global competitive pressures and the elevated level of the Canadian dollar. The result of this terms-of-trade boost is that Canadians have experienced a lift to their incomes on rising export earnings. During the past five years, Canada's gross domestic income has grown faster than gross domestic product by an average of 1.2 percentage points, providing strong support for government revenues, corporate profits and the labour market.

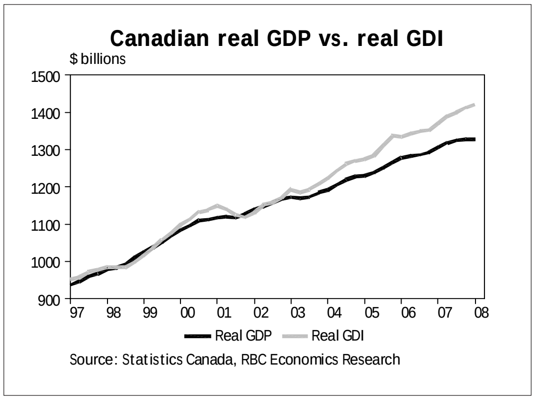
Canada's jobs market still going strong

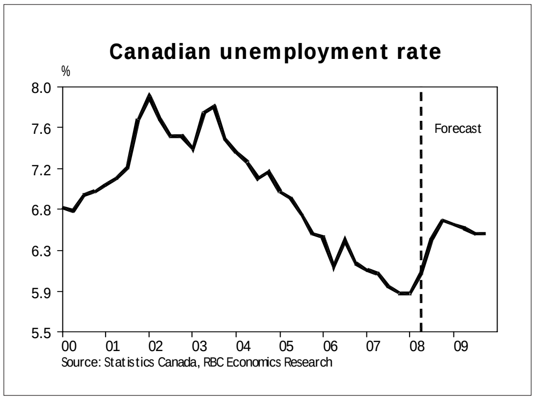
Canada's labour market, unlike its U.S. counterpart, has not shown any signs of weakening so far during the period of financial market turbulence. In the first five months of 2008, employment has increased by an average of 26,000 per month. This is in sharp contrast to the 65,000 monthly average decline in U.S. payrolls during the same period. Canada's unemployment rate recently rose slightly above its recent generational low as the active hiring spree generated a rise in labour market participation. The percentage of the working-age population who are employed stands near its record high, and wage growth remains strong, with earnings up 4.6% in May compared to a year earlier. On balance, the strong labour market plus healthy balance sheet positions should keep Canadian consumers spending in 2008. RBC forecasts that consumer spending will rise by 4.1%, just slightly slower than 2007's 4.5% pace.

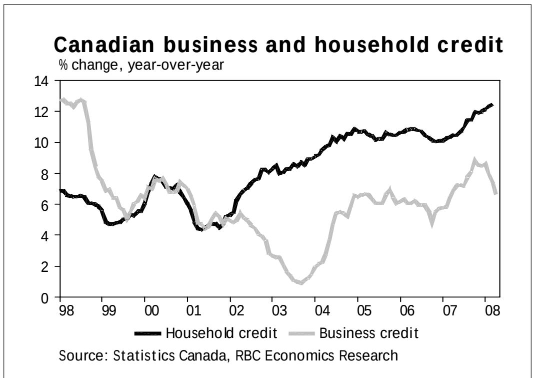
Credit strain — Signs of moderating?

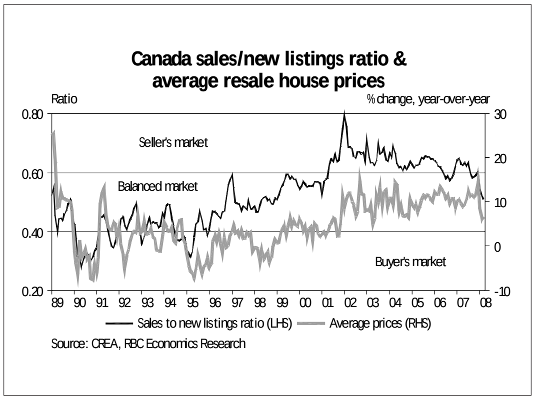
Despite the vibrant domestic economy, Canada did not escape the recent bout of financial market volatility and tightening in credit conditions. Since the crisis broke in mid-August of 2007, household and corporate borrowing rate spreads have widened by as much as 200 basis points. More recently, spreads have started to retrace, although they still remain well above pre-crisis levels. The tightening was also evident in the Bank of Canada's spring Business Outlook Survey, with 41% of respondents indicating that conditions for financing had tightened during the three months to March.

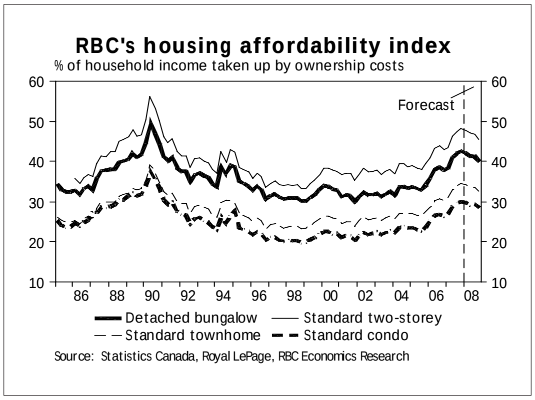
Despite the tightening in credit conditions, loan growth in both the business

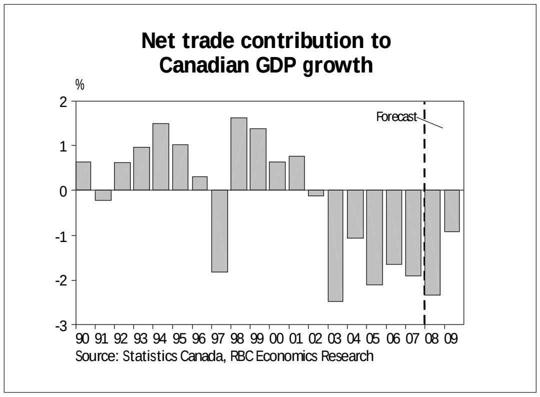












and household sectors continued to grow at a rapid pace in the first three months of this year. The strength in business loan growth likely represents a return to more traditional financing methods as capital markets financing became more difficult. Households are continuing to purchase homes — a driving force in the growth in total household credit balances. In the 12 months to April, residential mortgage demand, which makes up 68% of total household credit, was running at a 13.1% rate.

Housing market losing its edge but not headed for a crash

Canada's resale housing market showed signs of slowing early in the second quarter with sales off 1% from the first quarter of 2008 following three consecutive quarterly declines. However, sales continue to run well above the average pace of the past 20 years. While strong demand boosted prices, with gains of at least 10% in the past six years, the pace slowed to 3.2% in April. In contrast, new listings picked up in the first quarter and this trend continued into April, with listings in the major markets up 17.7% compared to a year earlier. Slowing in the housing market was expected and, to some degree, desired because affordability had been increasingly strained through 2007, with most major markets seeing affordability deteriorate to its worst levels since the early 1990s. On the supply side, the high level of demand continues to support construction activity with housing starts running at an historically fast rate. The structural backdrop to Canada's housing market remains solid, with very limited sub-prime mortgage activity, a relatively small speculative sector and no significant supply overhang despite robust construction activity. Affordability is also forecast to improve this year, with the Bank of Canada having cut the overnight rate by 150 basis points since last December, mortgage rate spreads showing some signs of narrowing and the pace of house price gains slowing.

Businesses ready to invest

Another channel through which the rise in commodity prices has affected Canada's economy is the boost it has given the Canadian dollar. Since the start of the commodity bull run, Canada's currency has gained more than 60% against its U.S. counterpart. For Canadian businesses, this means that the prices of U.S.-made machinery and equipment have plunged, with the most recent data showing a 25% drop in prices since 2002. The price decline is perpetuating the business investment cycle, with private and public companies planning to increase spending by another 5.2% this year. Attempts to increase capacity by commodity-producing sectors are likely to keep non-residential construction activity rising again this year. However, the weakening in building permits signals a slowing pace after the 13% surge in 2006 and 4% rise in 2007.

Trade drag not letting up

Burgeoning demand for imported machinery and consumer goods is expected to result in another year when Canada imports more than it exports on a volumes basis, meaning that net exports will restrain GDP growth this year. The weakening in the U.S. economy, with real growth expected to average about 1.5% in 2008, will weigh on Canada's exports, which are forecast to fall by 2.8%. Imports are forecast to rise by 2.9%, resulting in the drag from the trade sector widening to 2.3 percentage points. As the U.S. economy grows at a firmer 2% next year, demand for Canada's exports is expected to pick up, which will curb the size of the trade drag.

Are upward price pressures starting to percolate?

In April, Canada's inflation rate posted its first year-over-year rate increase since November 2007 as food and energy prices gapped higher, sending the annual rate to 1.7% from 1.4% in March. In May, the rate rose further to 2.2%. The Bank of Canada's core measure also perked up, rising to 1.5% in April and remained there in May. These increases ignited concerns that Canada's benign inflation backdrop might be changing. Still, at 1.5%, the Bank of Canada's core measure sits comfortably below the Bank's 2% target and is below the readings in most major industrialized countries except Japan. Going forward, the transitory factors that pushed the core inflation rate lower, including the impact of the Canadian dollar's 17% rise in 2007 and retail discounting as Canadian companies competed for market share, will start to unwind, resulting in rates moving up closer to the Bank of Canada's 2% target. The persistence of high energy prices has prompted us to raise our near-term inflation forecast for the overall CPI closer to 2.5% during the remainder of this year. However, as oil prices trend lower through next year, CPI inflation is expected to drop below 2% in 2009 on an average annual basis.

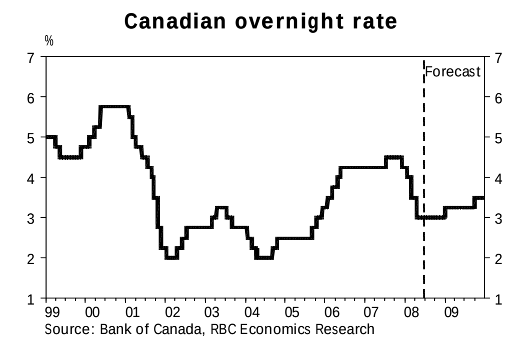
Bank of Canada shifts focus to inflation

The Bank of Canada has lowered the overnight rate by 150 basis points since December 2007, taking aim at the downside risks to the economic outlook coming from the impact of a slowing U.S. economy on export demand and tightening credit conditions on consumer and business spending. With Canada's core inflation rate at the lower end of the 1% to 3% target band, policymakers had the leeway to scale the policy rate to a level that would keep domestic demand on a firm upward track. Successive quarters of sub-potential growth in late 2007 and early 2008, as well as inflation largely tracking the Bank's projections, saw policymakers adjust the policy rate to a relatively accommodative level of 3%.

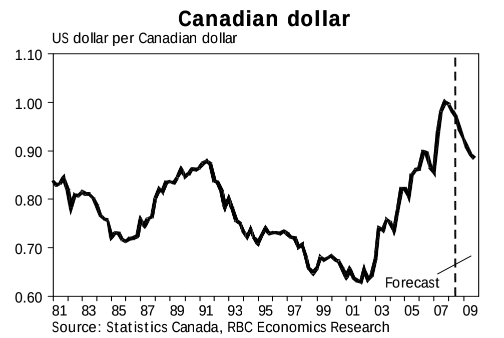
In early June, however, the Bank shifted its focus to inflation, joining the ranks of other central banks fearing that inflation pressures are brewing and will bolster inflation expectations. Signs that credit market strains are easing and data suggesting the U.S. economy might avoid recession dampened the downside risks to the economic outlook, thus supporting the Bank's view that the current policy rate is consistent with keeping the economy in balance and inflation on track in the medium-term. We expect the Bank of Canada to hold the policy rate steady at 3% in the near-term, meaning that market interest rates in Canada will remain low in 2008, although they are likely to move gradually higher in 2009 as the stronger economic outlook for Canada and the United States looks more assured.

Canadian dollar trading around parity

Canada's dollar has traded around parity against the U.S. dollar in the past three months despite a run-up to record oil prices (up 62% from late January's recent low of US$87 a barrel) and natural gas prices gaining 91% from mid-December's slip to US$7.02 per 1000 cubic feet. Against a backdrop of slower global growth, with the IMF having trimmed its global 2008 forecast to 3.7% from 4.1% in January, commodity prices are likely to lose some of their lustre this summer. Commodity price slippage should be enough to edge the C$ below parity with the U.S. dollar, especially if the U.S. economy is on a firmer growth path and the Fed is at the end of its rate-cutting cycle. Our forecast assumes that the Canadian dollar will finish 2008 at around US$0.94 and US$0.89 at the end of 2009.



Source: Bank of Canada, RBC Economics Research



Source: Statistics Canada, RBC Economics Research

Economic forecast detail — Canada

Real growth in the economy

Period-over-period annualized % change unless otherwise indicated

	Actual					Forecast							Act.	Forecast	
	2007				2008				2009				Annual average		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2007	2008	2009
Consumer spending	3.8	5.8	4.2	7.5	3.2	2.7	2.6	2.8	3.1	3.4	3.5	3.3	4.5	4.1	3.1
Durables	4.6	15.0	-1.4	11.5	16.5	1.0	2.4	2.0	2.9	3.5	3.5	3.3	7.1	7.4	2.8
Non-durables	5.1	5.3	2.2	3.9	0.6	2.5	2.3	2.2	3.5	3.0	3.9	3.9	3.3	2.4	3.0
Services	2.2	4.3	5.8	8.8	0.9	2.4	2.8	3.4	3.2	3.8	3.5	3.0	4.3	3.8	3.3
Government spending	3.0	2.7	7.2	5.8	2.6	3.0	2.7	3.1	2.6	2.8	2.8	2.8	3.7	3.9	2.8
Business investment	1.9	3.9	4.5	4.2	-1.2	2.9	4.1	4.2	2.6	2.9	2.6	3.3	3.4	2.6	3.2
Residential construction	11.0	4.7	4.1	1.8	-6.8	1.8	2.0	1.7	-2.0	-1.0	-1.5	-1.0	3.0	0.0	-0.3
Non-residential structures	-3.1	-7.7	-4.3	-3.5	3.5	2.0	4.5	5.0	2.9	2.9	4.5	4.5	-0.4	0.4	3.7
Machinery & equipment	-2.2	14.2	13.2	14.0	1.1	3.8	5.0	5.2	5.2	5.0	4.0	5.0	7.1	6.9	4.9
Final domestic demand	3.3	4.9	5.1	6.3	2.3	2.9	3.0	3.2	3.2	3.2	3.2	3.2	4.2	3.8	3.2
Exports	0.8	2.5	-1.1	-7.4	-4.1	-3.7	2.6	0.7	2.3	3.8	3.8	4.0	1.0	-2.8	2.2
Imports	1.1	4.9	20.6	8.6	-10.0	3.1	4.5	3.7	4.2	4.0	4.0	4.2	5.5	2.9	4.0
Inventories (change in $b)	6.0	5.7	20.5	20.6	3.3	6.6	9.2	9.2	8.9	8.8	8.5	8.5	13.2	7.1	8.7
Real gross domestic product	**4.1**	**3.9**	**2.3**	**0.8**	**-0.3**	**1.5**	**3.0**	**2.0**	**2.0**	**3.0**	**2.9**	**3.0**	**2.7**	**1.4**	**2.5**

Other indicators

Business and labour															
Productivity (y/y %)*	-0.3	0.8	0.8	0.3	-0.4	-0.8	-0.4	0.2	1.0	1.2	1.1	1.3	0.4	-0.4	1.1
Pre-tax corporate profits (y/y %)	4.3	3.7	2.2	3.1	4.6	2.0	0.5	-1.3	-0.1	3.8	4.5	5.0	3.3	1.4	3.3
Unemployment rate (%)	6.1	6.1	6.0	5.9	5.9	6.1	6.4	6.6	6.6	6.6	6.5	6.5	6.0	6.3	6.5
Inflation															
Headline CPI (y/y %)	1.8	2.2	2.1	2.4	1.8	2.3	2.6	2.4	2.1	1.5	1.4	1.6	2.1	2.3	1.6
Core CPI (y/y %)	2.3	2.4	2.2	1.6	1.4	1.5	1.6	1.9	2.1	2.1	2.1	2.1	2.1	1.6	2.1
External trade															
Current account balance ($b)	15.8	28.5	7.0	3.1	22.2	36.8	29.1	23.3	20.0	19.5	19.7	19.8	13.6	27.9	19.8
% of GDP	1.1	1.9	0.5	0.2	1.4	2.3	1.8	1.4	1.2	1.2	1.2	1.2	0.9	1.7	1.2
Housing starts (millions)	0.23	0.23	0.24	0.21	0.23	0.22	0.21	0.21	0.19	0.19	0.18	0.18	0.23	0.22	0.18
Motor vehicle sales (millions)	1.66	1.75	1.70	1.66	1.81	1.76	1.77	1.77	1.77	1.78	1.78	1.78	1.69	1.78	1.78

* Productivity is calculated as total real GDP divided by employment.

Source: Statistics Canada, RBC Economics Research forecasts

Economic forecast detail — United States

Real growth in the economy

Period-over-period annualized % change unless otherwise indicated

	Actual					Forecast							Act.	Forecast	
	2007				2008				2009				Annual average		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2007	2008	2009
Consumer spending	3.7	1.4	2.8	2.3	1.1	1.5	4.0	-0.1	1.1	2.8	2.9	2.8	2.9	1.9	1.9
Durables	8.8	1.7	4.5	2.0	-6.0	-1.6	9.0	-2.5	1.5	2.3	2.9	2.5	4.7	0.0	1.8
Non-durables	3.0	-0.5	2.2	1.2	-0.2	0.4	0.7	-0.2	0.5	2.0	2.4	2.4	2.4	0.5	1.0
Services	3.1	2.3	2.8	2.8	3.1	2.8	4.4	0.5	1.4	3.3	3.1	3.0	2.8	2.9	2.3
Government spending	-0.5	4.1	3.8	2.0	2.1	0.8	2.1	0.7	1.1	0.7	0.8	1.5	2.0	2.0	1.0
Business investment	-4.4	3.1	-0.7	-4.0	-6.9	-6.8	-6.5	-1.0	1.2	3.9	4.6	4.4	-2.9	-4.8	0.3
Residential construction	-16.3	-11.8	-20.5	-25.2	-24.6	-22.5	-11.0	-5.5	0.7	2.0	3.0	1.5	-17.0	-20.5	-3.1
Non-residential structures	6.4	26.2	16.4	12.4	1.2	-8.0	-7.0	-4.0	0.5	3.5	3.0	3.5	12.9	3.0	-0.8
Machinery & equipment	0.3	4.7	6.2	3.1	0.2	1.0	-4.6	1.5	1.4	4.5	5.4	5.5	1.3	1.2	2.0
Final domestic demand	1.7	2.1	2.5	1.3	0.1	0.1	2.1	-0.1	1.1	2.6	2.8	2.8	1.8	0.9	1.5
Exports	1.1	7.5	19.1	6.5	5.4	3.4	7.0	5.2	4.5	3.5	5.5	5.8	8.1	6.9	4.9
Imports	3.9	-2.7	4.3	-1.4	-0.7	3.2	4.0	1.5	2.8	2.0	2.6	3.0	1.9	0.9	2.5
Inventories (change in $b)	0.1	5.8	30.6	-18.3	-19.6	-11.0	-17.5	2.5	9.5	12.0	8.0	5.0	4.6	-12.1	8.6
Real gross domestic product	**0.6**	**3.8**	**4.9**	**0.6**	**1.0**	**0.1**	**2.2**	**1.0**	**1.5**	**2.9**	**3.0**	**3.0**	**2.2**	**1.5**	**2.0**

Other indicators

Business and labour															
Productivity (y/y %)*	0.2	0.7	1.8	1.5	2.0	1.5	1.1	1.5	1.5	1.9	1.7	1.8	1.1	1.5	1.7
Pre-tax corporate profits (y/y %)	4.3	4.8	1.5	5.1	-4.4	-5.0	1.6	0.2	2.0	2.2	3.3	6.0	3.9	-1.8	3.4
Unemployment rate (%)	4.5	4.5	4.7	4.8	4.9	5.3	5.5	5.7	5.8	5.8	5.7	5.7	4.6	5.4	5.8
Inflation															
Headline CPI (y/y %)	2.4	2.7	2.4	4.0	4.1	4.2	4.1	3.7	3.2	2.2	2.2	2.2	2.9	4.0	2.4
Core CPI (y/y %)	2.6	2.3	2.2	2.3	2.4	2.4	2.3	2.3	2.3	2.2	2.2	2.2	2.3	2.3	2.2
External trade															
Current account balance ($b)	-793	-760	-710	-692	-724	-765	-752	-741	-716	-713	-705	-698	-739	-746	-708
% of GDP	-5.9	-5.5	-5.1	-4.9	-5.1	-5.3	-5.2	-5.1	-4.9	-4.8	-4.7	-4.6	-5.3	-5.2	-4.7
Housing starts (millions)	1.45	1.46	1.30	1.15	1.04	0.95	0.90	0.88	0.90	0.95	1.00	1.10	1.34	0.94	0.99
Motor vehicle sales (millions)	16.4	16.0	15.9	16.1	15.2	14.5	15.1	14.8	14.9	15.2	15.4	15.7	16.1	14.9	15.3

* Productivity is calculated as total real GDP divided by employment.

Source: Bureau of Economic Analysis, RBC Economics Research forecasts

Financial market forecast detail

Interest rates

%, end of period

	Actual						Forecast						Actual	Forecast	
	Q107	Q207	Q307	Q407	Q108	Q208	Q308	Q408	Q109	Q209	Q309	Q409	2007	2008	2009
Canada															
Overnight rate	4.25	4.25	4.50	4.25	3.50	3.00	3.00	3.00	3.25	3.25	3.25	3.50	4.25	3.00	3.50
3-month T-bills	4.17	4.43	3.97	3.84	1.88	2.50	2.70	2.80	2.85	3.50	3.65	3.75	3.84	2.80	3.75
2-Year GoC bonds	3.98	4.61	4.12	3.74	2.55	3.22	3.50	3.60	3.70	3.75	3.80	3.80	3.74	3.60	3.80
5-Year GoC bonds	4.02	4.58	4.24	3.87	2.89	3.43	3.65	3.70	3.75	3.85	4.00	4.10	3.87	3.70	4.10
10-Year GoC bonds	4.13	4.59	4.35	3.99	3.42	3.71	3.90	4.00	4.20	4.25	4.30	4.40	3.99	4.00	4.40
30-Year GoC bonds	4.21	4.51	4.44	4.08	3.94	4.06	4.30	4.40	4.60	4.55	4.55	4.65	4.08	4.40	4.65
Yield Curve (10's-2's)	15	-2	23	25	87	48	40	40	50	50	50	60	25	40	60
United States															
Fed Funds rate	5.25	5.25	4.75	4.25	2.25	2.00	2.00	2.00	2.00	2.00	2.25	2.75	4.25	2.00	2.75
3-month T-bills	4.92	4.69	3.64	3.10	1.30	1.68	2.00	2.10	2.25	2.35	2.50	2.80	3.10	2.10	2.80
2-Year bonds	4.60	4.93	3.94	3.08	1.62	2.64	2.90	2.75	2.65	2.85	3.05	3.50	3.08	2.75	3.50
5-Year bonds	4.55	4.97	4.19	3.46	2.46	3.33	3.60	3.60	3.50	3.60	3.90	4.25	3.46	3.60	4.25
10-Year bonds	4.65	5.06	4.53	4.03	3.42	3.96	4.30	4.50	4.60	4.70	4.50	4.55	4.03	4.50	4.55
30-Year bonds	4.83	5.16	4.79	4.46	4.30	4.51	4.90	5.10	5.20	5.25	5.05	5.05	4.46	5.10	5.05
Yield Curve (10's-2's)	4	14	60	95	180	132	140	175	195	185	145	105	95	175	105
Yield spreads															
3-month T-bills	-0.75	-0.26	0.34	0.75	0.58	0.83	0.70	0.70	0.60	1.15	1.15	0.95	0.75	0.70	0.95
2-Year	-0.62	-0.32	0.18	0.65	0.93	0.58	0.60	0.85	1.05	0.90	0.75	0.30	0.65	0.85	0.30
5-Year	-0.53	-0.39	0.06	0.41	0.42	0.10	0.05	0.10	0.25	0.25	0.10	-0.15	0.41	0.10	-0.15
10-Year	-0.52	-0.47	-0.18	-0.04	0.00	-0.26	-0.40	-0.50	-0.40	-0.45	-0.20	-0.15	-0.04	-0.50	-0.15
30-Year	-0.63	-0.65	-0.35	-0.39	-0.36	-0.45	-0.60	-0.70	-0.60	-0.70	-0.50	-0.40	-0.39	-0.70	-0.40

Exchange rates

%, end of period

	Actual						Forecast						Actual	Forecast	
	Q107	Q207	Q307	Q407	Q108	Q208	Q308	Q408	Q109	Q209	Q309	Q409	2007	2008	2009
Australian dollar	0.81	0.85	0.89	0.88	0.91	0.97	1.02	1.00	0.97	0.96	0.95	0.92	0.88	1.00	0.92
Canadian dollar	1.15	1.07	0.99	1.00	1.03	1.02	1.03	1.06	1.08	1.10	1.12	1.13	1.00	1.06	1.13
Chinese renminbi	7.73	7.61	7.51	7.30	7.01	6.80	6.60	6.50	6.45	6.40	6.35	6.30	7.30	6.50	6.30
Euro	1.34	1.35	1.43	1.46	1.58	1.50	1.50	1.38	1.36	1.34	1.32	1.30	1.46	1.38	1.30
Japanese yen	118	123	115	112	100	107	109	110	111	112	112	112	112	110	112
Mexican peso	11.04	10.81	10.94	10.91	10.64	10.40	10.75	10.85	11.10	11.20	11.35	11.30	10.91	10.85	11.30
New Zealand dollar	0.71	0.77	0.76	0.77	0.79	0.77	0.73	0.69	0.67	0.66	0.66	0.65	0.77	0.69	0.65
U.K. pound sterling	1.97	2.01	2.05	1.98	1.98	1.88	1.84	1.73	1.74	1.74	1.74	1.73	1.98	1.73	1.73

Source: Bank of Canada, Federal Reserve Board, Reuters, RBC Economics Research forecasts