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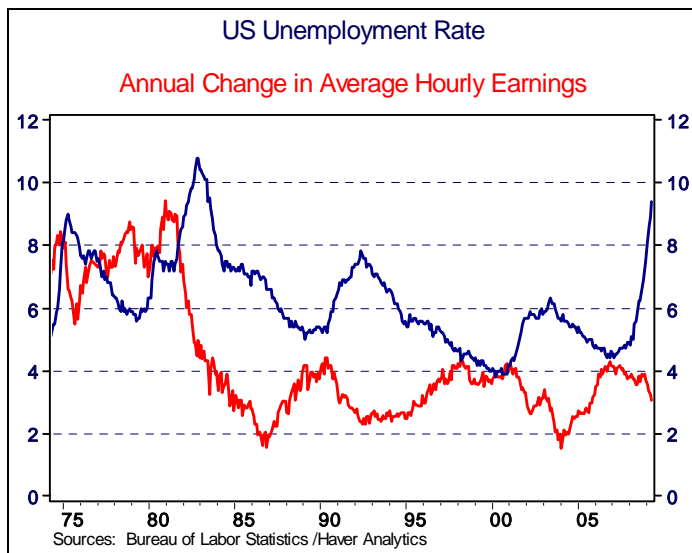


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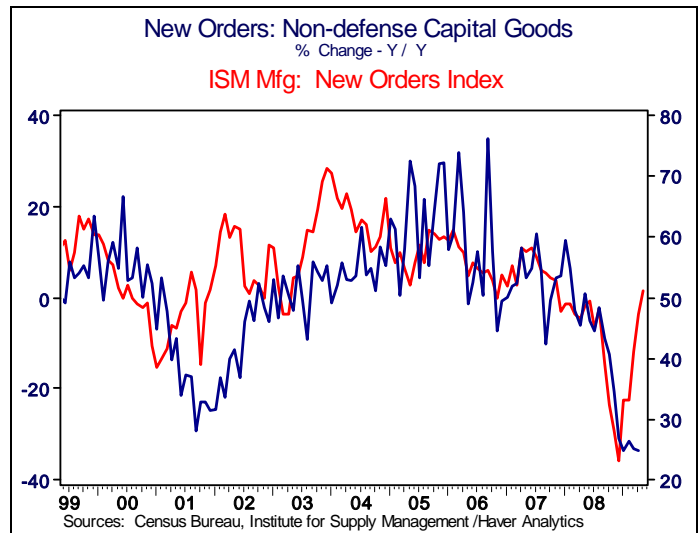
Recent U.S. Indicators Suggest the *Great Recession* Will End ... Eventually!

Recovery, however, will be slow and uneven

Employment declined by “only” 345,000 jobs in May, compared to estimates of about half-a-million jobs lost and an average monthly decline of 642,000 in the previous 6 months. This significant moderation in the pace of layoffs reflects fewer losses in construction, business services and retail trade. Unfortunately, unemployment is still climbing with the rate of unemployment jumping half a percentage point to 9.4%. In fact, since the beginning of this recession in January 2008, 7 million jobs have been lost and the rate of unemployment rate has increased by a massive 4.5 percentage points. Moreover, the annual increase in average hourly earnings slowed yet again for a 6th consecutive month to 3.1% (Chart 1).



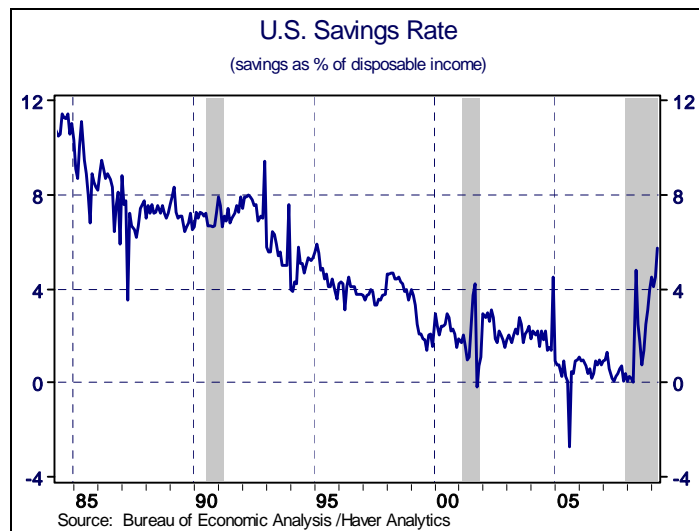
The ISM-Manufacturing index rose to 42.8 in May from 40.1 in April. What was particularly encouraging in that report was the continued rebound in the “New Orders” component: up almost 4 points to 51.1 and a stunning reversal from the depths of the recession in February (Chart 2).



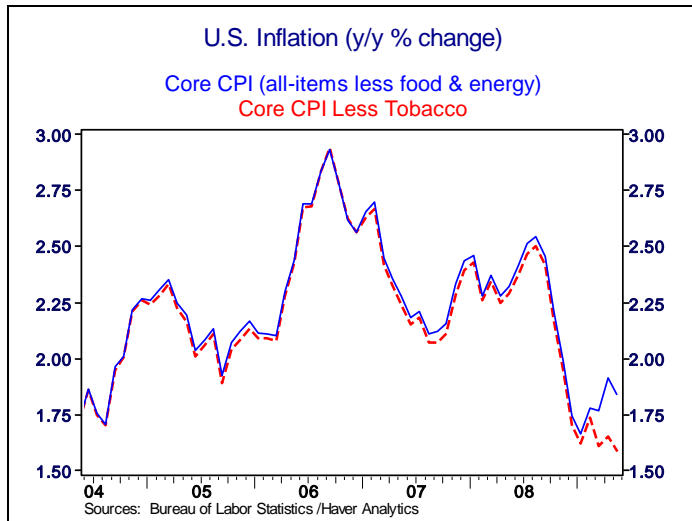
Moreover, inventories continue to be cut (32.9 versus 33.6) and prices paid jumped to 43.5 from 32.0. On the other hand, the broader ISM Non-Manufacturing index inched higher from 43.7 to 44 also in May, a rather disappointing result particularly when one takes into account the fact that the new orders component declined.

Employment, especially hours-worked, and the ISM indices are reasonably good predictors of GDP growth. Based on the results for April and May, our expectation of a 1.9% decline in real GDP in Q2 is still largely on track.

The other important recent indicators were **personal income & spending** for the month of April and the CPI for May. The former revealed large gains in incomes (+0.5%) and a continuing slide in spending (-0.1%). Consequently, the savings rate soared to 5.7%, its highest level since the mid-1990s (Chart 3).

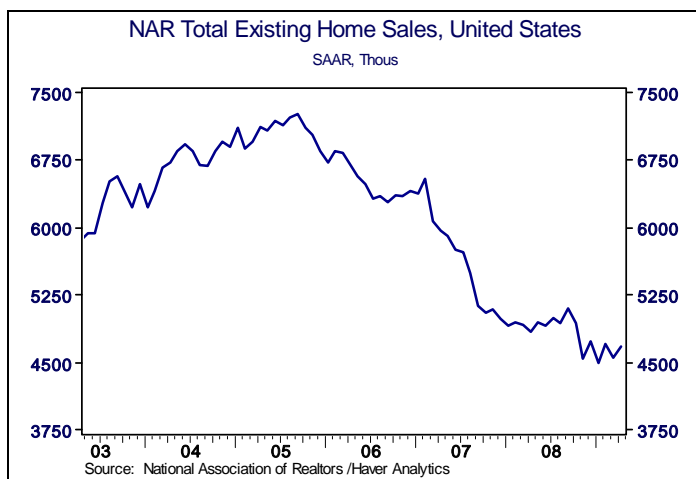


Consumer prices measured by the CPI rose slightly in May and are down 1% from May 2008. Core CPI also rose only slightly in May and, at 1.8%, is still a *safe-way away from zero* on an annual basis. However, excluding volatile tobacco prices, which have been affected by large tax increases, the decelerating trend in core CPI is more pronounced (Chart 4). While we do not believe there is an imminent danger of across the board deflation in the United States, concerns about higher inflation are even less appropriate, particularly in an environment of rising unemployment and slowing wage growth.

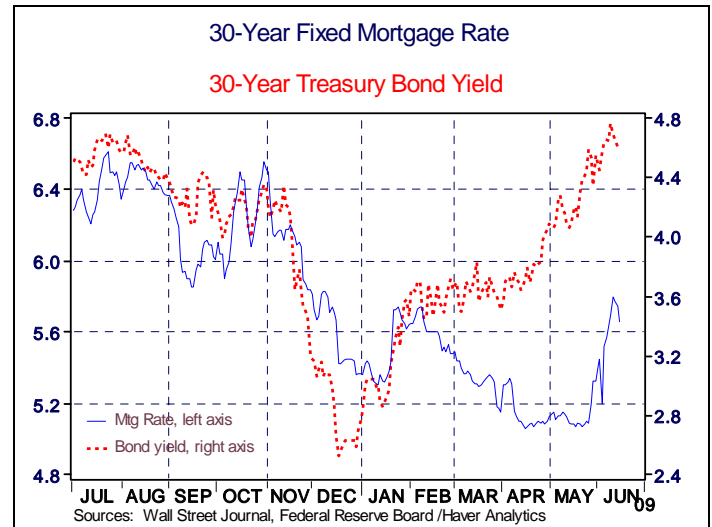


The **bottom line** is that there is now undisputable evidence of a clear break away from economic collapse and Japanese-style deflation. **Having said that, this recession is still far from over.** What remains largely unknown at this stage is the extent of the negative feedback onto consumer spending and the financial system from the massive job losses of the past six months. These are expected to abate somewhat in Q3 but, at about 300,000 per month, should remain large and imply a rate of unemployment in the 10 percent range later this year.

These negative feedback risks are also crucial to the housing market. **Existing home sales** increased slightly in April to 4.68 million units (+2.9%) but that is still some 6.4% below the recession levels of one year ago (about 5 million units) and 33% below the top of the cycle (7 million units) (chart 5).



Moreover, inventories of unsold properties are still rising and, hence, prices continue to fall. In fact, the year-over-year price decline accelerated in April to -15.4%, from -12.4% in March; the inventories of available houses measured in terms of months' supply rose to 10.2 in April from 9.8 in March and 9.7 at the start of the year. The fact is that the U.S. housing market is still searching for a bottom. And, until excess inventories are cleared, prices cannot stabilize and unless prices stabilize, the housing market will remain depressed, consumer confidence fragile and financial institutions vulnerable. The one recent glimmer of hope had been the relative stability in mortgage rates despite the sharp rise in long bond yields. Should that now also fail, the outlook would darken considerably (Chart 6).



Our **forecast** now calls for real GDP growth in the U.S. to turn positive in Q3-2009 (+1.1%) but to average -2.7% for the year as whole; this should be followed by an uncharacteristically moderate rate of growth in 2010 of 2.2%. Unemployment will likely hit 10% in Q4-2009 and peak at about 10 ½ percent in Q1-2010. Inflation (as measured by the annual percent change in total CPI) remains in negative territory throughout 2009 and is expected to average 1.8% in 2010. Core inflation will trend towards 1% by mid-2010.


Moreover, the risks are still clearly tilted to the downside. With access to credit still constrained, businesses and households find it difficult to take on new debt even if they so desired, which is not yet a wise assumption at this stage. On the supply of credit side, tighter capital requirements and more stringent credit risk management by financial institutions will continue to curb credit growth. Into the medium-term, slower private credit growth and an inevitably tighter fiscal policy will temper overall economic growth. In the near term, rising public expenditures partly offset some of the impact from private sector de-leveraging but this process still implies rather painful balance sheet adjustments for both businesses and households. This is not only a net negative factor for the economy as a whole, but also constitutes a powerful disinflationary force. In summary, the *Great Recession* is still not over and even when it does end, the ensuing recovery will be much slower than usual, with all the downside risks this entails.

Interest-Rate and Exchange-Rate Forecasts

	Historical Data						Forecasts*					
	2007	2008	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3
Canada												
Overnight Rate	4.35	3.03	3.00	3.00	1.50	0.50	0.25	0.25	0.25	0.25	0.25	0.75
3-Month Treasury Bills	4.14	2.33	2.48	1.89	0.83	0.39	0.20	0.20	0.20	0.25	0.35	0.80
2-Year Bond	4.18	2.66	3.22	2.78	1.09	1.07	1.25	1.00	0.90	0.95	1.00	1.20
10-Year Bond	4.27	3.61	3.74	3.75	2.69	2.79	3.50	3.00	2.75	2.75	2.75	2.95
30-Year Bond	4.31	4.06	4.06	4.13	3.45	3.57	4.35	3.75	3.45	3.35	3.35	3.45
United States												
Federal Funds Rate	5.05	2.08	2.00	2.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50
3-Month Treasury Bills	4.48	1.40	1.89	1.15	0.03	0.21	0.15	0.15	0.20	0.25	0.25	0.50
2-Year Bond	4.36	2.01	2.75	2.08	0.82	0.81	0.90	0.80	0.80	0.80	0.80	0.95
10-Year Bond	4.63	3.66	4.05	3.69	2.42	2.71	3.60	3.25	3.05	3.05	3.10	3.25
30-Year Bond	4.84	4.29	4.70	4.27	2.90	3.56	4.50	4.05	3.85	3.85	3.90	4.05
Canadian Dollar (US\$/C\$)	0.930	0.938	0.982	0.943	0.813	0.794	0.925	0.900	0.875	0.850	0.875	0.900
Canadian Dollar (Euro/C\$)	0.679	0.637	0.622	0.669	0.602	0.599	0.651	0.643	0.625	0.599	0.603	0.629
Euro (US\$/Euro)	1.371	1.473	1.578	1.410	1.350	1.326	1.420	1.400	1.400	1.420	1.450	1.430
Yen (Yen/US\$)	118	103	107	106	91	99	96	95	93	91	90	93

Quarter-end data and annual averages
June 2nd 2009

June 2009 - Main Economic Indicators - United States

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
												Forecast
Gross Domestic Product (1996 \$B)	9817	9867	10049	10301	10676	10990	11295	11524	11652	11343	11597	11916
Change (%)	3.7	0.5	1.6	2.5	3.6	2.9	2.8	2.0	1.1	-2.7	2.2	2.8
Real Personal Disposable Income - Change (%)	4.8	1.9	3.1	2.2	3.6	1.4	3.5	2.8	1.3	2.0	1.0	1.0
Average Weekly Earnings - Change (%)	3.9	3.8	2.9	1.6	3.2	2.3	4.3	4.0	3.8	2.8	1.9	2.4
Employment - Change (%)	2.2	0.0	-1.1	-0.3	1.1	1.7	1.8	1.1	-0.4	-3.3	-0.9	0.8
Unemployment Rate (%)	4.0	4.7	5.8	6.0	5.5	5.1	4.6	4.6	5.8	9.1	10.3	9.4
Housing Starts (thousand units)	1573	1601	1710	1854	1950	2073	1812	1342	900	545	579	650
Before Tax Profits - Change (%)	-3.9	-6.2	14.0	13.6	24.0	17.6	15.2	-1.6	-10.1	-2.6	8.1	8.1
Inflation Rate (%)	3.4	2.8	1.6	2.3	2.7	3.4	3.2	2.9	3.8	-0.9	1.8	2.3
Surplus (deficit) Federal Gov. - National Accounts (\$B)	189	47	-248	-372	-371	-318	-220	-221	-596	-1413	-1000	-1000
Current Account Balance (\$B)	-417	-385	-461	-523	-625	-729	-788	-731	-673	-500	-480	-530
Growth of the main components, in real terms (%)												
Consumption Expenditures	4.7	2.5	2.7	2.8	3.6	3.0	3.0	2.8	0.2	-0.8	1.6	1.9
Residential Construction	0.8	0.3	4.8	8.4	10.0	6.3	-7.1	-17.9	-20.8	-20.5	-0.1	2.6
Private Investment	8.8	-4.5	-8.7	1.2	6.0	7.6	7.4	3.9	0.2	-19.4	0.2	8.2
Public Expenditures	2.1	2.8	4.4	2.5	1.4	0.4	1.7	2.1	2.9	1.7	3.7	2.0
Final Domestic Demand	4.5	1.6	1.6	2.8	3.4	3.7	2.8	1.8	-0.1	-3.0	1.8	2.5
Exports	8.7	-5.2	-2.3	1.3	9.7	7.0	9.1	8.4	6.2	-14.6	0.1	4.2
Imports	13.1	-2.6	3.4	4.1	11.3	5.9	6.0	2.2	-3.5	-15.5	1.2	3.3
Change in Inventories (1996 \$B)	56.5	-36.0	12.5	14.3	54.3	39.0	42.3	-2.5	-29.1	-60.1	-1.5	14.0
Output Gap (CBO definition, year-end)								-1.0	-4.4	-8.0	-6.7	-5.7

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* Subject to approval by the regulatory authorities.