

## DAILY GLOBAL COMMENTARY

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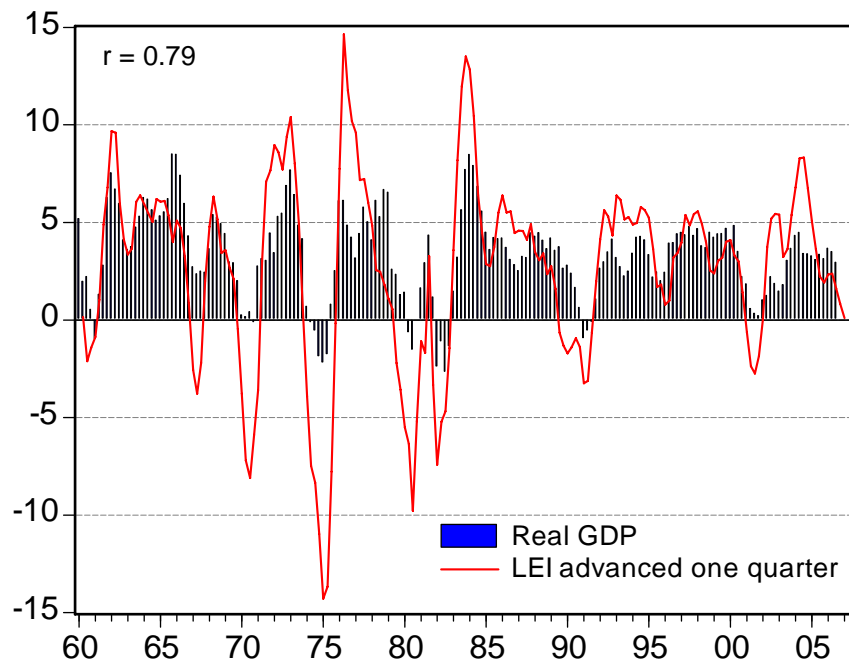
### Leading Indicator Confirms Expectations of Soft Growth

January 23, 2007

The Index of Leading Economic Indicators (LEI) rose 0.3% in December after downward revisions to estimates of each of the prior two months. The LEI fell 0.1% in October and was unchanged in November vs. the prior estimate of 0.1% gains in each of these two months. On a year-to-year basis, the LEI declined 0.1% in December following a 0.2% drop in November. This is the first back-to-back negative readings since a string of negative year-to-year changes were posted during November 2000 – November 2001. On a quarterly basis, the year-to-year change in the fourth quarter was 0.1%, the smallest gain since the fourth quarter of 2001. As chart 1 illustrates, these readings are warning about a marked slowing of economic activity in near term.

Chart 1

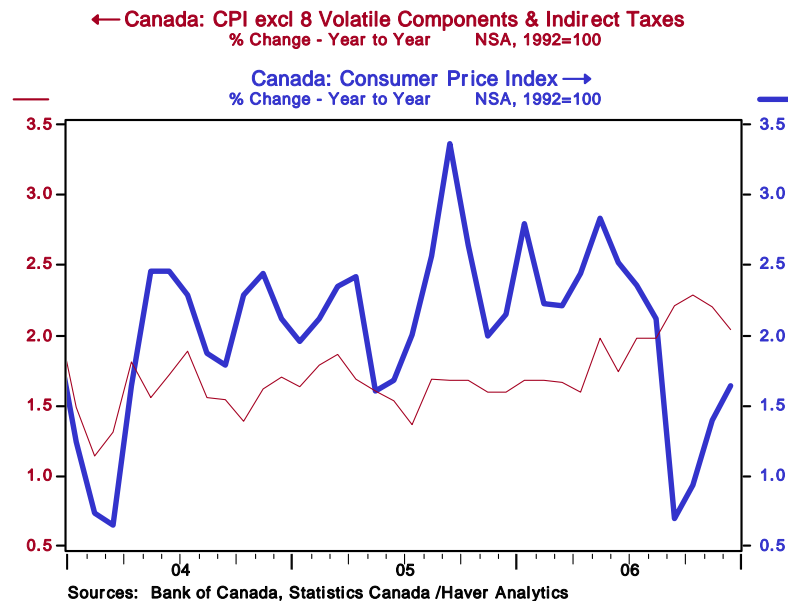
Index of Leading Economic Indicators (LEI) vs. Real GDP  
year-to-year percent change



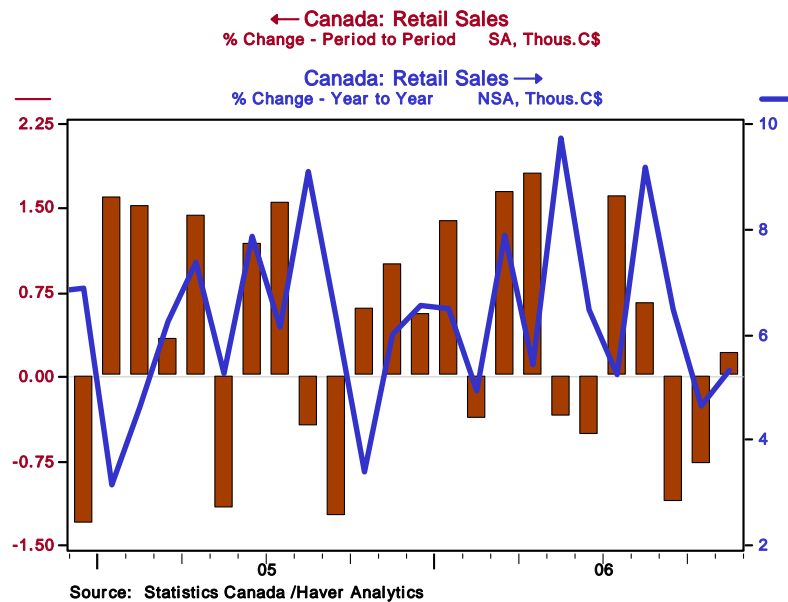
In December, six of the ten indicators that make up the composite index advanced – building permits, average weekly jobless claims, real money supply, stock prices, vendor performance and new orders for non-defense capital goods. The interest rate spread and consumer expectations components fell in December. The manufacturing workweek and new orders for durable consumer goods held steady. This estimate is subject to revision after inflation and factory orders reports are published. It is noteworthy that there is an upward bias to economic data from the warmer-than-typical weather in December.

## Canada: Data Support Additional Rate Pause at March Policy Meeting

Despite the fact that core inflation eased to the 2.0% target midpoint faster than the Bank of Canada (BOC) expected, today's data were largely in line with the revised *Monetary Policy Report Update* published last week. Annual headline inflation rose by 1.6% versus a year ago (up from 1.4% in November); core inflation slowed to 2.0% year-over-year following three months of above mid-point target growth; retail sales posted a rebound in November 2006 following two months of declines; and the leading indicators index grew by 0.3% in December after a 0.5% surge in the previous month. All told, we expect the central bank to hold the overnight interest rate target steady at 4.25% at the upcoming March 6<sup>th</sup> monetary policy committee meeting.



On a monthly basis, consumer prices rose 0.2% in December following a slight increase in gas prices (4.1%), as well as increases for cigarettes (1.7%), household maintenance and repair (1.7%) and mortgage interest costs (0.4%). The rebound in gas prices followed several months of declines and should support an additional expansion in retail sales data for December (released on February 21<sup>st</sup>). Price changes strongly influence sales at gasoline stations, which account for approximately 10% of total retail trade. Retail sales posted a 0.2% gain in November 2006 on the back of a 4.5% expansion of gasoline station sales.



If December's retail sales data are stronger than expected, the base-case projections set by the BOC could underestimate fourth quarter growth. Growth rates in the US have remained surprisingly robust (a boon to Canadian exporters) and domestic demand continues to be supported by expansion in the western provinces, a still-strong housing sector, and a favorable employment situation. Current projections put quarter-to-quarter growth at 1.5% (down from October's forecast of 2.8%), following a 1.7% (2.0%) expansion in the third quarter.

	2006		2007			2008
	Q3	Q4	Q1	Q2	H2	
Real GDP (quarter-to-quarter percentage change at annual rates) <sup>b</sup>	1.7 (2.0)	1.5 (2.8)	2.4 (2.4)	2.6 (2.5)	2.8 (2.7)	2.9 (2.8)
Real GDP (year-over-year percentage change)	2.5 (2.5)	2.3 (2.6)	1.9 (2.3)	2.1 (2.4)	2.5 (2.6)	2.8 (2.8)
Core inflation (year-over-year percentage change)	2.1 (2.0)	2.2 (2.1)	2.1 (2.2)	2.0 (2.2)	2.0 (2.0)	2.0 (2.0)
Total CPI (year-over-year percentage change)	1.7 (1.7)	1.3 (1.5)	1.2 (1.4)	1.0 (1.4)	1.7 (2.0)	2.0 (2.0)
Total CPI excluding the effect of changes in indirect taxes (year-over-year percentage change)	2.2 (2.2)	1.8 (2.0)	1.7 (1.9)	1.5 (1.9)	1.7 (2.0)	2.0 (2.0)
WTI <sup>c</sup> (level)	71 (71)	60 (60)	56 (63)	58 (65)	61 (66)	63 (67)


a. Figures in parentheses are from the October *Monetary Policy Report*.

b. For half and full years, the number reported is the average of the respective quarter-to-quarter percentage growth at annual rates.

c. Assumption for the price of West Texas Intermediate crude oil (US\$ per barrel), based on an average of futures contracts over the two weeks ending 12 January 2007.

\*\* Source Bank of Canada January Monetary Policy Report

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A milder than anticipated fourth quarter slowdown together with steady growth in 2007 could raise concerns over capacity-related price pressures – adding to existing wage- and housing-related pressures (homeowners’ replacement costs growth exceeded 8.0% for the fifth straight month in December and mortgage interest costs rose by 4.9%, the largest monthly increase on record since March 2001) – leading to cautious monetary policy throughout 2007 and even into 2008.

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