

1
2 **Q. Reference: Page 3, Line 36:**
3

4 **Dr. Booth recommends an ROE of 7.75% for NP**
5

6 **Given the discussion in Dr. Booth's testimony with respect to the recovery in the equity**
7 **markets, the improvement in credit markets, and the current stage of the economic**
8 **recovery, please explain why the cost of equity is higher in July 2009 than it was in**
9 **March 2009.**

10
11
12 **A.** Dr. Booth has consistently stated that the only objective basis for changes in the ROE are
13 changes in the LTC yield, which are determined by the state of the economy. The Bank of
14 Canada is now forecasting that inflation will return to the middle of its operating band in
15 2010/11 and the Bank is only committed to keeping the overnight rate at 0.25% until the end
16 of 2010Q2. As a result the expectation is that interest rates will rise with the economic
17 recovery and get back to where they were consistent with 2% long run inflation.
18

19 Of importance is that if the Bank of Canada is effective in maintaining the ongoing rate of
20 inflation at 2.0%, then LTC yields will be about 4.5% and the market return about 9.5%;
21 deviations from these averages will then only come about by changes in the business cycle
22 as we go through from boom to bust and then back to boom.
23
24
25
26