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Q: Reference: Page 58, Lines 4-6

With reference to NP-CA-66, please comment on the likelihood of Canada experiencing a recession of the depth and length of the recession experienced in the early 1990s in the foreseeable future. Please provide independent support for any conclusion.

A: Dr. Cannon views the overall Canadian economy as being relatively strong at the present time. However, the current turmoil in the U.S. sub-prime mortgage market and its effects on credit availability in the U.S., and possibly in Canada as well, may, it is feared, cause a slowdown in U.S. consumer spending which, if it were to happen, would (a) impact Canadian economic activity directly by reducing the U.S. demand for products exported from Canada and (b) impact the volume and value of Canadian exports of resource-based and manufactured goods negatively by its effects on the pace of growth in such countries as China, India, Taiwan, South Korea, etc. These developments, in turn, would affect Canadian employment and income levels, which would impact the level of Canadian consumption expenditures. There is a chance that such a scenario could create in Canada "a recession of the depth and length of the recession experienced in the early 1990s" over the next 2-3 years. Dr. Cannon estimates that the probability of this starting or occurring during the next 3 years is between 5% and 25%.

Independent support for the possibility of the above scenario unfolding is referenced in lines 1-11 on page 8 of Dr. Cannon's prefiled evidence and is found frequently on the pages of recent business newspapers. An example of the latter is an article copied from page B5 of *The Globe and Mail's* August 15th, 2007 "Report on Business", entitled "Economist Warns of Consumer-Led Recession", which is attached as pages 2 and 3 of this response.

LIQUIDITY CRISIS

U.S. ECONOMY

Economist warns of consumer-led recession

Tightening credit, slumping auto sales, retailers missing sales and profit targets has analysts ringing alarm bells

BY BARRIE MCKENNA WASHINGTON

The U.S. economy may be on the brink of its first consumer-led recession in nearly two decades, according to Merrill Lynch economist David Rosenberg.

"There are plenty of signs now suggesting that we may be in the early stages of a consumer-led recession for the first time in 17 years," Mr. Rosenberg warned in a report to clients.

"The future is very likely in the hands of the consumer on Main Street, USA, and the latest signposts are not encouraging."

He and other economists point to several alarm bells for the world's largest economy: Banks are tightening consumer lending standards, auto sales have slumped to a nine-year low and key retailers keep missing their sales and profit targets.

Wal-Mart Stores Inc., a bellwether of the U.S. consumer, cut its profit forecast for the year yesterday, citing economic pressures on shoppers in the United States, Canada and Mexico.

"It is no secret that many customers are running out of money toward the end of the month," said Wal-Mart chief executive officer Lee Scott.

Wal-Mart posted a profit of \$3.1-billion (U.S.) or 76 cents a share in the second quarter ended July 31, up from \$2.08-billion or 50 cents a year earlier.

The housing slump also hammered Home Depot Inc., the largest U.S. home improvement chain.

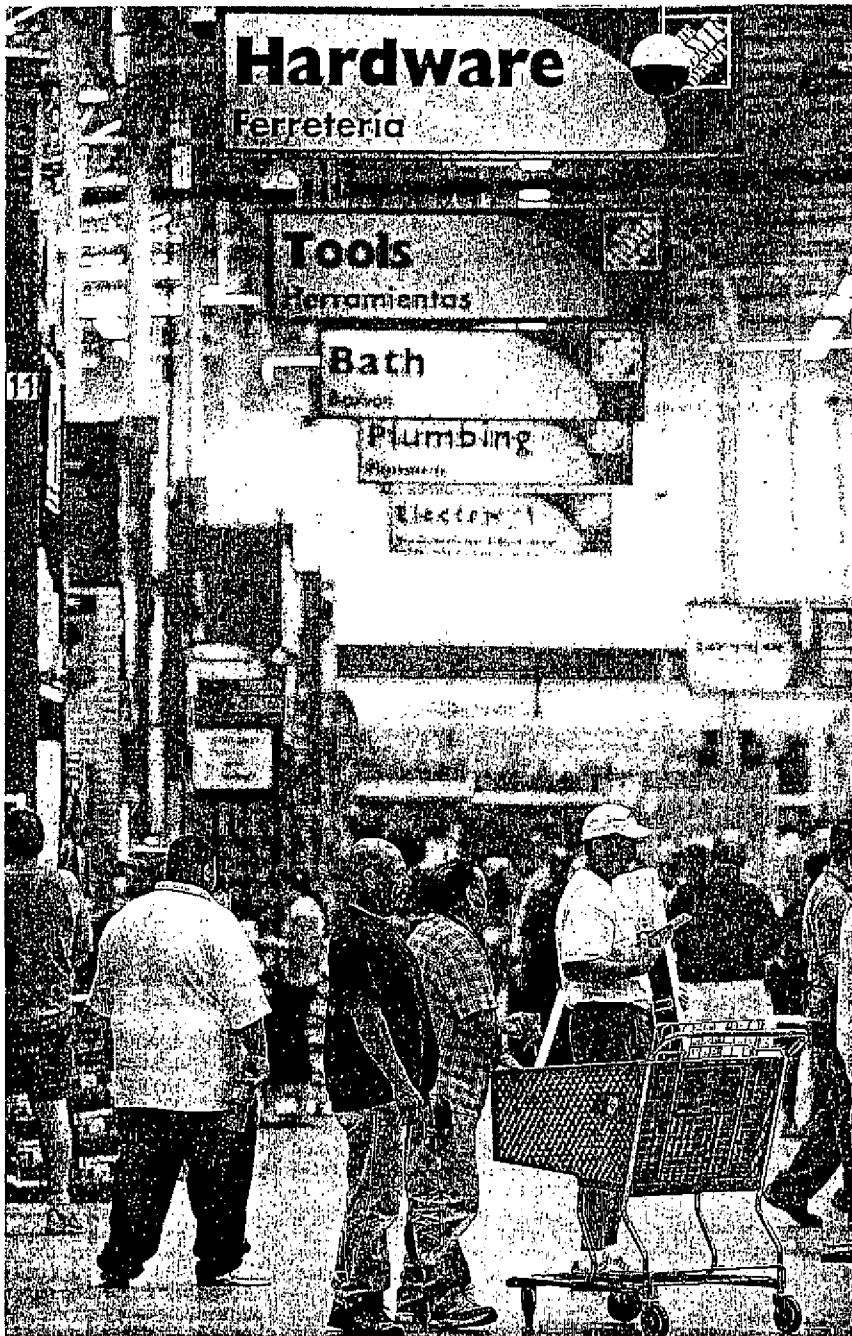
Profit fell 15 per cent to \$1.59-billion or 81 cents a share in the second quarter. Sales dipped 1.8 per cent to \$22.18-billion - the first drop in more than five years.

Canada too is feeling the impact of slowing U.S. consumer demand.

Canadian exports fell for a third straight month in June, according to figures released yesterday by Statistics Canada.

"U.S. housing market woes are spreading to the broader economy, and American consumers - a key engine of world growth in recent years - will feel the greatest effects," according to a report by Export Development Canada.

Economist Clément Gignac



Customers shop at a Home Depot in Chicago this week. The largest U.S. home improvement chain yesterday reported a 15-per-cent drop in second-quarter profit as sales slid. M. SPENCER GREEN/ASSOCIATED PRESS

of National Bank Financial now rates the odds of a U.S. recession next year at 50-50, up from 35 or 40 per cent just a couple of months ago.

"The bursting of a housing

or capital market bubble is likely to bring on hard times," Mr. Gignac predicted.

The silver lining for Canada is that healthy public finances, strong exports of natural re-

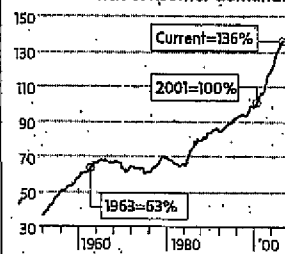
sources and more conservative mortgage lending practices make a recession there less likely.

Mr. Gignac puts the odds of a Canadian downturn in 2008

Signposts

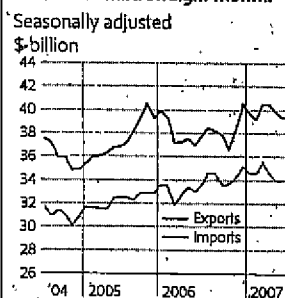
U.S. HOUSEHOLD DEBT SOARS

In the United States, the ratio of household debt to disposable income has skyrocketed, which could stanch consumer demand.



CANADIAN EXPORTS FALL

Canada is feeling the impact of slowing U.S. demand as exports fell for the third straight month.



MAGGIE WONG/THE GLOBE AND MAIL
SOURCE: FEDERAL RESERVE BOARD,
MERRILL LYNCH, STATISTICS CANADA

The future is very likely in the hands of the consumer on Main Street, USA, and the latest signposts are not encouraging.

David Rosenberg,
Merrill Lynch economist

Signs of consumer-led recession

retailers missing sales and profit targets has analysts ringing alarm bells

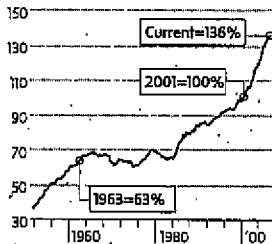


Home Depot in Chicago this week. The largest U.S. home improvement chain reported a 30-per-cent drop in second-quarter profit as sales slid. M. SPENCER GREEN/ASSOCIATED PRESS

Signposts

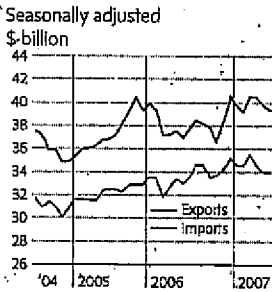
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Seasonally adjusted
\$-billion
SOURCE: FEDERAL RESERVE BOARD, MERRILL LYNCH, STATISTICS CANADA

The future is very likely in the hands of the consumer on Main Street, USA, and the latest signposts are not encouraging.

David Rosenberg, Merrill Lynch economist

at 30 per cent.

Investors shouldn't count on the prospect of a sharp interest rate cut by the U.S. Federal Reserve Board to stave off recession, Mr. Gignac warned. Interest rate relief will take anywhere from six to 18 months to take effect.

U.S. consumers are tapped out after leveraging the rising value of their homes during the long housing boom, Merrill Lynch's Mr. Rosenberg said. Real estate gains were responsible for roughly 40 per cent of consumer spending while the economy expanded, and now "the wealth effect is heading into reverse," he explained.

Christian Weller, a senior fellow at the Center for American Progress, said it's now apparent that the unwinding of the housing boom has "spilled into the wider economy."

He pointed out that wage growth has been meagre, job growth has stalled, family debt is near record highs and mortgage foreclosures are rising.

Banks are also making it tougher for homeowners to borrow. The Fed's July survey of loan officers showed that banks have made it harder to get almost any type of mortgage.

And what's happening in the United States may spill over to much of the rest of the world.

Global economic and trade expansion could slump in 2008 because of the credit crunch sparked by the collapse of the U.S. subprime mortgage market, according to a report by the World Trade Organization.

Global goods trade growth for 2007 will slow to about 6 per cent from 8 per cent last year, the WTO said in a 119-page report.

"If the problems in the subprime market continue or are aggravated, we're looking perhaps at a bigger impact on economic growth and trade growth next year," Robert Teh, acting director of the body's economics division, told the Associated Press.

He insisted it was too early to forecast a global economic slowdown.

WAL-MART STORES INC.
Close: \$43.82 (U.S.), down \$2.35
HOME DEPOT INC.
Close: \$33.52, down \$1.72

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or capital market bubble is likely to bring on hard times," Mr. Gignac predicted. The silver lining for Canada is that healthy public finances, strong exports of natural resources and more conservative mortgage lending practices make a recession there less likely. Mr. Gignac puts the odds of a Canadian downturn in 2008

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