Q: Referring to page 40 of Dr. Cannon's direct testimony, please provide the "Canadian Survey of Economic Expectations 2007."

A: The requested document is attached.

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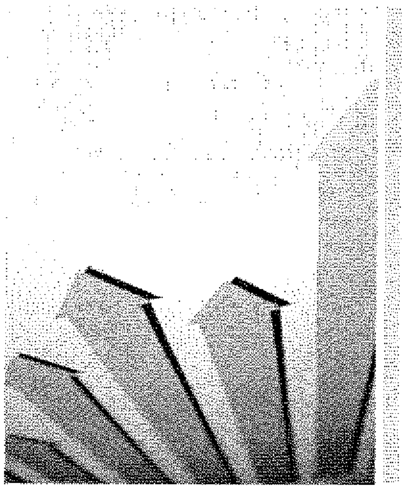

Economic Expectations 2007
26th Annual Canadian Survey

Watson Wyatt
Worldwide

Economic Expectations 2007
26th Annual Canadian Survey

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The 26th Annual Canadian Survey of Economic Expectations provides forecasts for 30 economic and financial indicators as well as views on factors affecting investment returns and pension investment strategies. Leading economists and portfolio managers from 42 organizations, such as chartered banks, investment management firms and other corporations, provided:

- A forecast for the 2007 Canadian Economic Outlook, including predictions on short-, mid- and long-term major economic and financial market indicators
- A forecast of major factors affecting investment returns over the next ten years
- Views on pension investment strategies

Canadian Economic Outlook

2007 Highlights

Moderate growth in 2007, rebounding after 2008

- With the anticipated housing-led economic slowdown in the United States, most survey participants expect the Canadian economy to continue growing in 2007, albeit at a more moderate pace of about 2.5%. Mid- and long-term projections remain optimistic, suggesting that the slowdown is temporary and the Canadian economy will pick up again in 2008.

Strong domestic economy, but weak exports

- The domestic economy will continue to be the main source of economic growth in 2007, owing to robust consumer spending and business investment. In contrast, a slowing U.S. economy and the continued strength of the Canadian dollar are expected to have an adverse impact on Canadian exports, resulting in a significant lag on near-term economic growth.

Continued buoyant labour market

- Substantial employment growth has kept Canada's unemployment rate at a record-low level of less than 6.5% for most of 2006. There is a firm expectation among respondents that the unemployment rate will stay under 6.5% in 2007. Wages are expected to outpace inflation in the near term, indicating real wage gains for Canadian workers. Following the recovery in 2005, labour productivity is expected to continue improving at a median rate of 1.5% in 2007, and 2% over the long term.

More Interest Rate Cuts in the U.S. than Canada

- With the expected slowing of both economies, most respondents predict that the Bank of Canada and the U.S. Federal Reserve will cut their policy rates in 2007. For Canada, the majority of participants anticipate a reduction of 25 to 50 basis points, as opposed to more aggressive rate cuts of 75 basis points or more in the United States.

Low interest rates, healthy gains in equity market

- The low-interest-rate environment will continue in 2007, and there is little sign that the yield curve will steepen in the mid and long term. Following the S&P/TSX Index's surge to record highs in 2006, the risk of a major correction in Canadian equity market appears to be small in 2007. The median expected return is 6.4% for 2007, below the mid- and long-term forecasts of 8%.

About the Study

The results of Watson Wyatt's 26th Annual Canadian Survey of Economic Expectations are based on the projections of the country's leading business economists and portfolio managers in 42 organizations such as chartered banks, investment management firms and other corporations. Participants were asked to provide forecasts in their areas of expertise.

The results have been compiled to give a consensus opinion on Canada's economic prospects over the short (2007), medium (2008-2011) and long terms (2012-2021). The graphs and summary table present all data as actually collected and without corrections for outliers. The collective opinion or central tendency is shown by the median – half of the responses are higher than the median and half are lower. To avoid the potential problem of outliers, the variability in responses is shown as the difference between the 10th and 90th percentiles.

In the bar charts for financial indicators, 25% of all responses are below the third quartile and 25% are above the second quartile. Therefore, half of all responses lie between these two quartiles. The top and bottom of each bar represent the response in the 10th and 90th percentiles.

All the calculations in projected pension costs are based on the median response. Please note that the median for each survey indicator was calculated independently after the responses from each institution were checked for internal consistency. This means that care should be exercised in interpreting the results. For example, the median real rate of return on equities will not be the difference between the medians of the total return on equities and the CPI. Rather, it is the median of the differences calculated for each respondent on these indicators.

GDP

A housing-led economic slowdown in the United States is expected to have an adverse impact on the Canadian economy, resulting in more moderate growth in 2007. More than 80% of respondents forecast that the growth rate of real Canadian GDP will be in the range of 2% to 3% in 2007, with the median at 2.5% (Figures 1 and 2). This is about 0.5 percentage points lower than last year's survey forecast for 2006. However, most respondents remain optimistic in their mid- and long-term projections, suggesting that the slowdown is temporary and the Canadian economy will rebound after 2008.

Recent data indicates that a correction in the U.S. housing market is underway. This will act as a major constraint on near-term economic growth. Forecasts of real U.S. GDP growth for 2007 are significantly weaker than those for 2006. Most respondents (76%) expect modest growth of 2% to 3% in 2007, while some respondents (18%) predict growth of even less than 2%. Despite this, there is no indication of a U.S. recession. The magnitude of the slowdown depends on the extent to which weakness in the housing sector will broaden to household consumption and business investment. Furthermore, very few survey participants foresee the cooling of the housing market to have a prolonged effect on economic growth. The U.S. economy will begin to rebound in 2008 and fully recover after 2012 (Figures 3 and 4).

Figure 1 | Canada Real GDP Growth – Short Term (%)

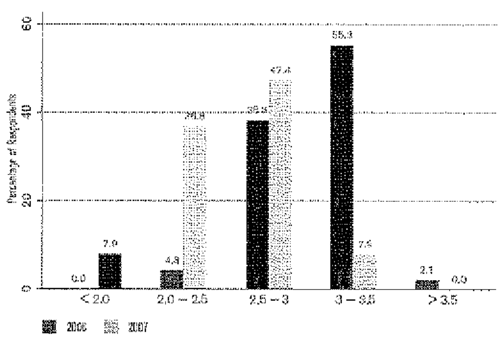


Figure 3 | U.S. Real GDP Growth – Short Term (%)

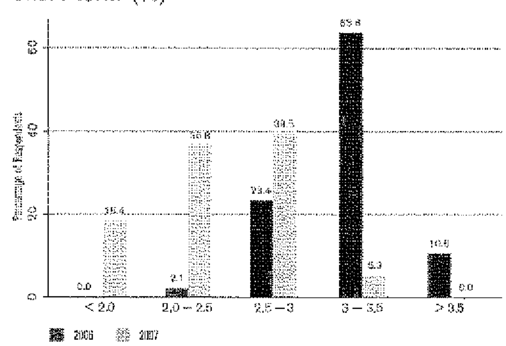


Figure 2 | Canada Real GDP Growth – Mid & Long Term (%)

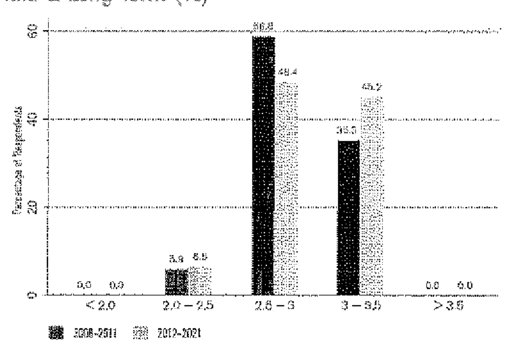
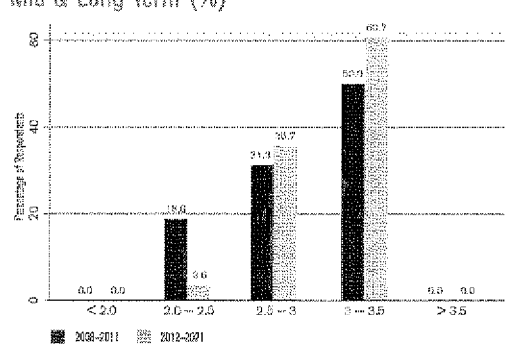


Figure 4 | U.S. Real GDP Growth – Mid & Long Term (%)



Against the backdrop of a slowing U.S. economy and continued strength in the Canadian dollar, real export growth is expected to remain weak in 2007. Real imports are projected to outgrow real exports, implying that net exports will become a significant drag on Canadian economic growth in 2007 (Figure 5).

In contrast, the domestic economy will continue to be the main source of growth owing to robust consumer spending and business investment. The median response predicts that real consumer expenditure and business investment will increase at a solid pace of 3.2% and 7% respectively in 2007 (Figure 6). Strength in consumer spending is driven by the buoyant labour market with healthy real wage gains. Solid business investment is supported by rising capacity, high energy prices and strong corporate profits (Figure 7).

Figure 5 | Real Export & Import Growth – 2007 (%)

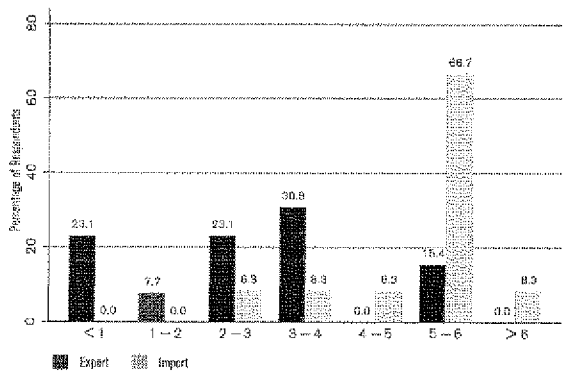


Figure 6 | Real Consumer Expenditure Growth – 2007 (%)

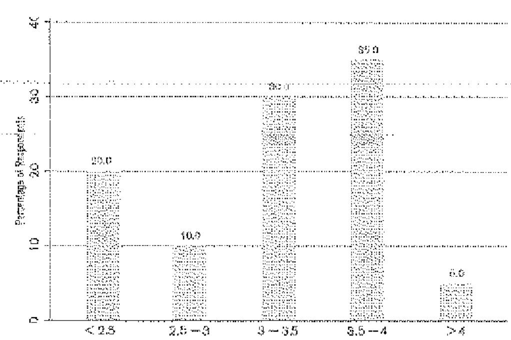
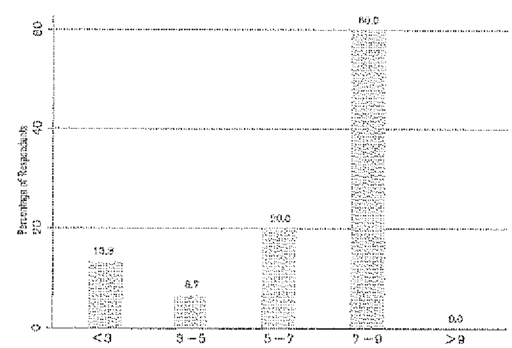


Figure 7 | Real Business Investment Growth – 2007 (%)



Labour Market

Canada's recent labour market conditions have been extremely strong. Substantial employment growth has kept the unemployment rate at a record-low level of less than 6.5% for most of 2006 and there is a firm expectation among the majority of respondents that this buoyant trend will continue in 2007. Less than 3% expect the unemployment rate to rise above 7% in 2007. The mid- and long-term pictures display some divergent opinions. Despite the majority view of 6%-7%, around 14% of participants forecast a further reduction of unemployment rate to below 6% after 2012. Another 14% foresee that an unemployment rate below 7% is unsustainable in the long run (Figures 8 and 9).

Sluggish wage growth has left Canadian workers with zero real wage gains over the past several years. The average hourly wage has been increasing at a rate similar to the CPI over the 2002–2005 period.[1] This trend was reversed in 2006 as the unemployment rate reached a three-decade low, providing signs of labour market tightness. Most participants believe that the average hourly wage will continue to outpace inflation in 2007. Considering that real wages have been rising at an average rate of 1.3% in the first 10 months of 2006,[2] approximately 33% of survey participants predict a further acceleration of growth rate to above 1.5% in 2007. Another 28% expect real wage gains to ease to less than 0.5% (Figure 10).

Recent productivity data has shown some promising signs after stagnant growth in 2003 and 2004. Labour productivity growth in the business sector has rebounded strongly since 2005, averaging more than 2% a year. Virtually all survey participants consider this to be a sustainable pace, with a median growth rate of 1.5% in 2007, and 2% over the long term (Figure 11).

Figure 8 | Unemployment Rate – Short Term (%)

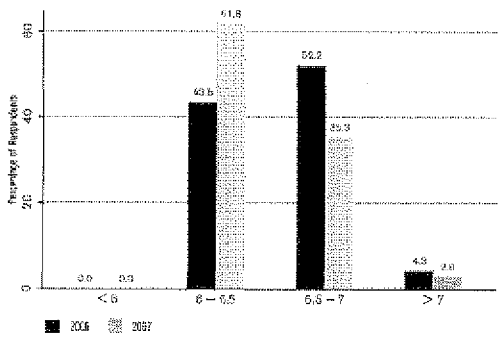


Figure 9 | Unemployment Rate – Mid & Long Term (%)

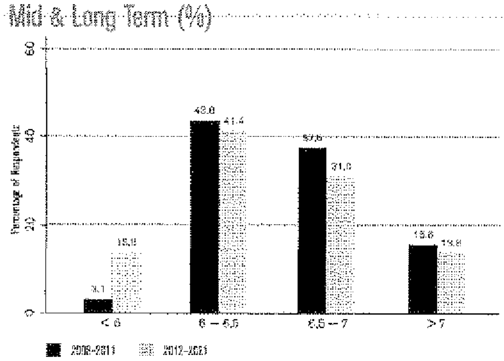


Figure 10 | Real Wage Growth (%)

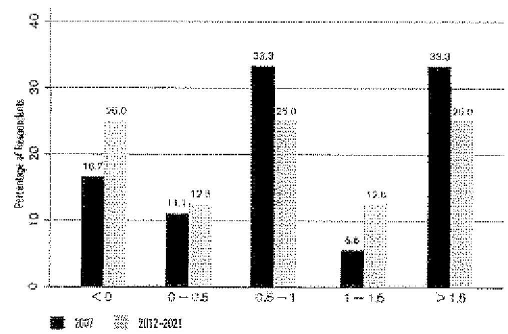
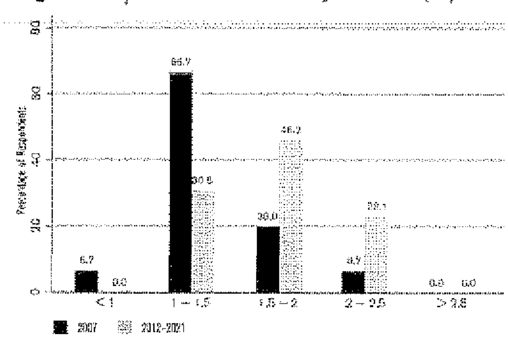


Figure 11 | Labour Productivity Growth (%)



[1] Statistics Canada Labour Force Survey, January 2002 to December 2005.
[2] Statistics Canada Labour Force Survey, January 2006 to October 2006.

Exchange Rates, Inflation and Monetary Policy

The total CPI inflation forecasts for 2007 are somewhat lower than those in the 2006 survey, reflecting the decline in energy prices in recent months. Furthermore, the 2007 forecasts are virtually identical to the mid- and long-term projections, which imply that inflation expectations are well anchored in the range of 1.5% to 2.5%, with the median right at the Bank of Canada's target of 2% (Figures 12 and 13).

With the Canadian dollar trading at a relatively stable range of 85 cents to 90 cents U.S. in 2006, more than 70% of respondents expect this steady pattern to continue in 2007 (Figure 14). Increasing concerns over the massive U.S. trade and current account deficits may lead to a more bullish view on the future movement of the Canadian dollar over the mid and long term (Figure 15). More than 20% of participants expect it to appreciate to more than 95 cents U.S. after 2012.

Figure 12 | Total CPI Inflation — Short Term (%)

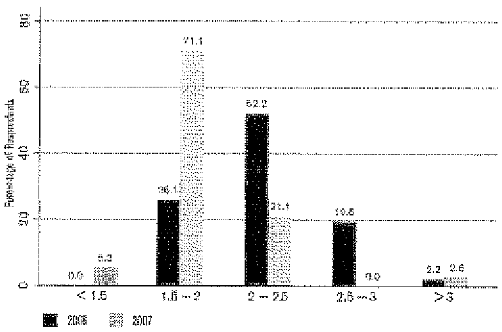


Figure 14 | Canada-U.S. Exchange Rate — Short Term (%)

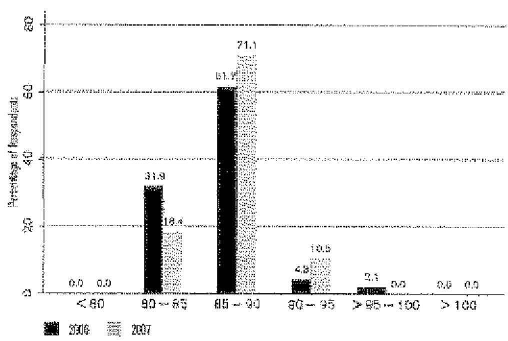


Figure 13 | Total CPI Inflation — Mid & Long Term (%)

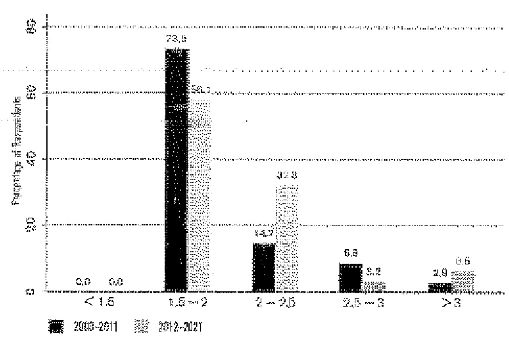
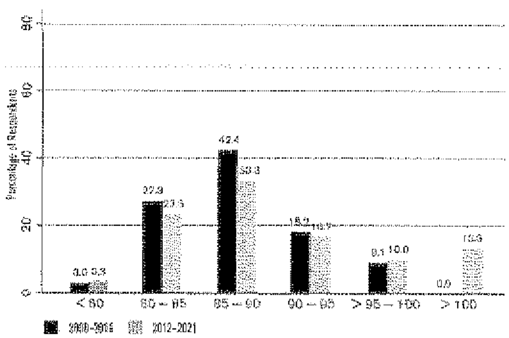


Figure 15 | Canada-U.S. Exchange Rate — Mid & Long Term (%)



Over the past several months, the Bank of Canada and Federal Reserve have left their policy rates unchanged at 4.25% and 5.25% respectively. With the expected slowing in both economies, most respondents predict that the central banks will cut rates in 2007, although the magnitude of monetary easing is likely to be smaller in Canada than in the United States. For Canada, 47% of participants anticipate a reduction of 25 to 50 basis points by the end of 2007, whereas 52% predict more aggressive rate cuts of 75 basis points or more in the U.S. Federal Funds rate. Most respondents project the long-term policy rate, sometimes referred to as the neutral interest rate, to be at least 4% for both countries (Figures 16 and 17).

Figure 16 | Canada Overnight Target Rate (%)

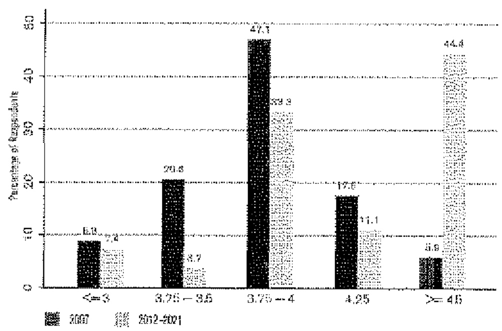
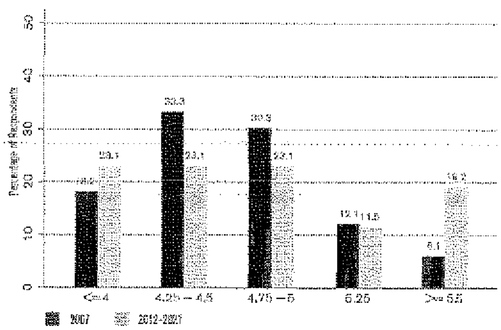


Figure 17 | U.S. Federal Funds Rate (%)



Financial Markets

The perception of a low interest rate environment remains unchanged between the 2006 and 2007 forecasts. The median respondent forecasts that the yield on three-month T-bills and 10-year Canada bonds will be 3.9% and 4.1% respectively in 2007, as compared to 3.8% and 4.3% predicted a year ago for 2006 (Figures 18 and 19). As a result, the yield curve (defined as the difference in the yield between three-month T-Bills and 10-Year Canada bonds) remains flat from a historical perspective, and even flatter than last year's prediction. Moreover, there is little sign of substantial steepening in the mid and long term (Figures 20 and 21). More than 70% of participants expect that the differential between short and long rates will remain below 1% after 2012.

After the S&P/TSX Composite Index surged to a record high toward the end of 2006, the risk of a major correction in Canadian equity market appears to be small in 2007. Only 3% of participants anticipate no further gains in the near term. The median expected return is 6.4% for 2007, below the mid- and long-term forecasts of 8%. The distribution for long-term projections is considerably narrower, with 96% of respondents expecting the average long-term return to be in the range of 5% to 10%. Almost identical forecast patterns are observed in the U.S. equity markets (Figures 22 and 23).

Figure 18 | Canada 3-Month T-Bill Yield (%)

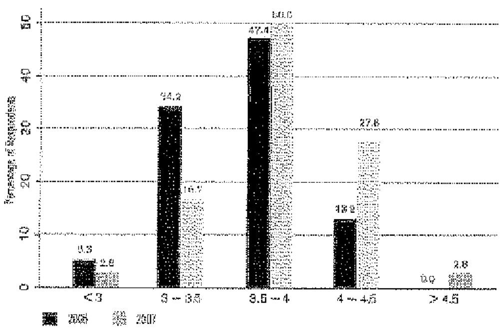


Figure 19 | 10-Year Canada Bond Yield (%)

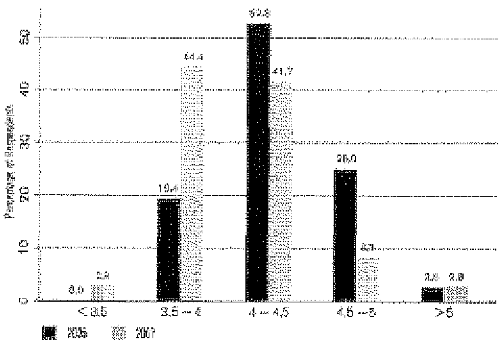


Figure 20 | Yield Curve – Short Term (%)

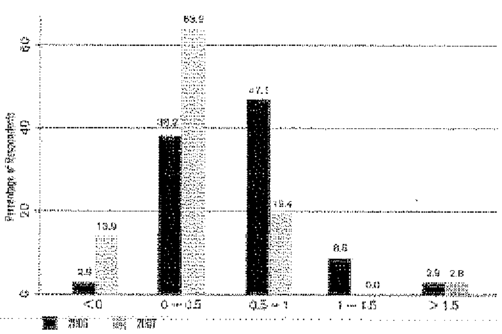


Figure 21 | Yield Curve – Mid & Long Term (%)

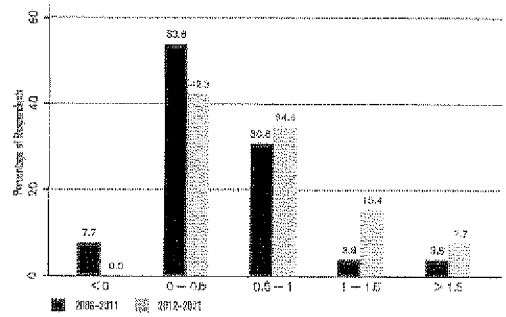


Figure 22 | S&P/TSX Return (%)

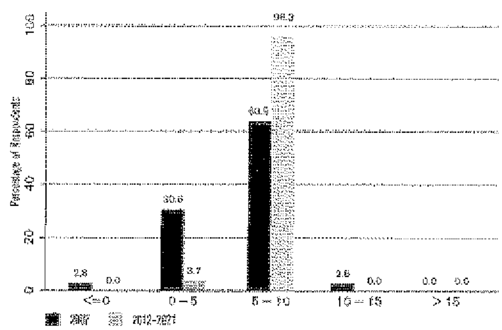
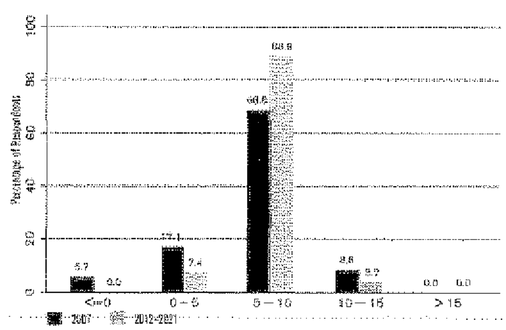


Figure 23 | S&P 500 Return (%)



Pension Costs

The long-term gross return on a pension fund invested 60% in equities (including foreign) and 40% in bonds is projected to be 6.8% (nominal) or 4.7% (real). While slightly higher than last year's prediction, it is virtually identical to the prediction from two years ago, leading to the conclusion that survey participants' predictions for long-term gross returns on typical pension funds have been stable over the last two years.

Looking at the predicted gross returns for the short term, the pension fund referenced above is predicted to earn 6.0% (nominal) in 2007, following an actual gross 2006 return that will likely be in the 12% to 15% range. Combining this with the participants' prediction of slightly higher yields-to-maturity on long Canada bonds as compared to current levels, and taking into account the significant employer contributions made to defined benefit plans during 2006, we are already seeing an improvement in funded ratios.

The discount rate used in determining these particular pension liabilities is based on long-bond yields, which impacts solvency valuations (and potentially contributions) and financial statement items. Some modest relief might be in sight in the longer term, as 30-year Canada bond yields-to-maturity are projected to rise to 4.8% over the 2008–2011 period and 5.1% from 2012.

Pension Investment Strategies

In recent years, several investment themes have been prominent: soaring energy prices; waxing and waning geopolitical worries; the influence of demographics; the emergence of China and India (henceforth termed "Chindia"); and a revival of investors' sentiment toward equities. We asked survey participants which of these factors were likely to continue to influence stock markets in the coming years.

Responses for many of these themes elicited no clear tendencies. However, two items did reveal a tilt of opinion among respondents. The rapid growth and burgeoning importance of Chindia in the global economy has been evident for a number of years. As shown in Figure 24, rated on a scale of 1 (very negative) to 7 (very positive), a majority of our survey respondents expect that this influence will be a positive factor for stock markets going forward. In contrast, respondents generally took a slightly dimmer view of the potential impact of sentiment (Figure 25). This may reflect a view that investors had become a little too bullish about stocks during the strong rally at the time the survey was conducted.

Definitely Contemplating DC

Investors' and pension plan sponsors' attitudes toward risk have changed substantially over the past decade. Given this backdrop, and with the growing importance of defined contribution (DC) pension plans, our survey asked whether respondents' firms are developing new products or options for these plans. A plurality said that they have done so already, with another solid block indicating that their firms might add new product offerings in this area.

More tellingly, the range of new options being considered was quite broad (Figure 26). Many of these new offerings were extensions to the options for investing in equities and bonds. However, the response also suggests a move toward providing new options for DC plan participants, including alternative asset classes, absolute return products and asset allocation products other than traditional balanced funds.

Figure 24 | Impact of Chindia

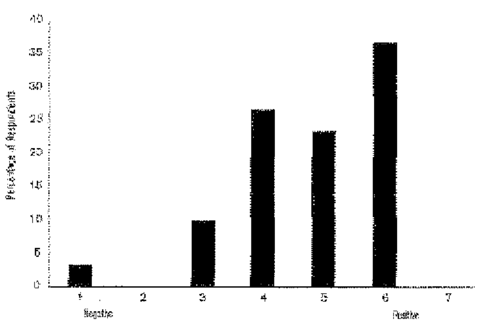


Figure 26 | New Products Being Developed/Considered for DC Market

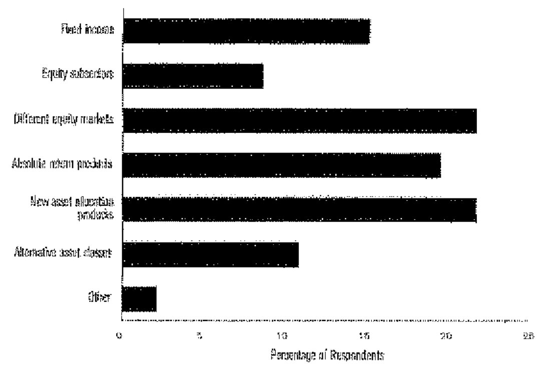


Figure 25 | Impact of Sentiment