According to the Bank of Canada:

- Canadian production slowed more sharply than expected in the second half of 2006. The latest data suggest that real GDP has only gone up by 1.5% in the fourth quarter of 2006 (the previous scenario was for growth of 2.8%), following on an advance of 1.7% in the third quarter.
- In spite of slower growth, the Bank judges the Canadian economy to have been operating at, or just above, its production capacity at the end of 2006.
- The Bank expects real GDP growth to accelerate gradually in 2007 and 2008, to 2.3% and 2.8% on average, respectively.
- There continues to be considerable uncertainty about trend productivity growth. Recent productivity data have been weak, and it is unclear how much of that weakness is due to cyclical factors.
- Core inflation is expected to return to 2% in the first half of 2007 and remain there throughout the projection period.
- The Canada/U.S. exchange rate should fluctuate in the range of 84.5 to 87.5 cents U.S.

Commentary:

As recent comments from Bank of Canada Governor David Dodge intimated, the Monetary Policy Report Update released today includes a major downward revision to the short-term outlook for the Canadian economy’s growth. Note that the monetary authorities’ forecast of 2.8% for real GDP growth in the fourth quarter of 2006 made them among the most optimistic in the country. The Bank’s new scenario is thus for growth of 1.5%, a projection that is identical to ours and much more in line with what the economic indicators have been doing lately.

However, beyond these very-near-term changes, the Bank of Canada’s outlook remains essentially the same for 2007 and 2008. The monetary authorities judge that much of the adjustment in progress in the U.S. real estate market and automotive sector has already taken place and that Canada’s inventory correction is well under way. Real GDP could thus grow on average by 2.5% in the first half of 2007, followed by growth very close to potential in the second half of 2007 and 2008.

This scenario is a little more optimistic than our projections, particularly for the first half of 2007. In fact, we believe that the troubles associated with the U.S. real estate market could once again put the brakes on growth by North America’s economies in the months to come.

In closing, note that the Bank of Canada maintains that the risks to its inflation projection remain balanced, though they have diminished somewhat. In the end, the tone of Canada’s monetary authorities therefore remains fairly positive, and we must conclude that there is no short-term possibility of a potential key interest rate cut. However, if the economy does not grow as much as expected, the stance taken by the Bank of Canada in the April 26 Monetary Policy Report could be slightly softer.

<table>
<thead>
<tr>
<th>Primary forecasts</th>
<th>2006</th>
<th>2007</th>
<th>2nd sem.</th>
<th>2008</th>
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<tbody>
<tr>
<td>Real GDP</td>
<td></td>
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<tr>
<td>BoC</td>
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<td>Desjardins</td>
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<tr>
<td>Core CPI</td>
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<tr>
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<tr>
<td>Desjardins</td>
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<td>1.7%</td>
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</tbody>
</table>

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[...] The Canadian economy is judged to have been operating at, or just above, its production capacity at the end of 2006, following weaker-than-expected growth in the second half of last year. This slowdown stemmed from reduced demand for Canadian exports—related to weakness in the U.S. automotive and housing sectors—and from the need for Canadian businesses to adjust inventories.

Looking ahead, real GDP growth is now expected to average about 2 1/2 per cent in the first half of 2007, rising to about 2 3/4 per cent in the second half of this year. In 2008, growth is projected to remain in line with the growth of potential output (estimated at 2.8 per cent), keeping the economy operating near its capacity throughout the projection period. Expressed on an average annual basis, this profile implies growth of 2.3 per cent in 2007 and 2.8 per cent in 2008.

Total consumer price inflation will continue to be affected by movements in energy prices and, during the first half of 2007, by last year’s reduction in the Goods and Services Tax (GST). Total inflation should average just above 1 per cent in the first half of this year, returning to the 2 per cent target in early 2008. Core inflation should return to 2 per cent in the first half of 2007 and stay there. [...]