Global Export Forecast | **Fall 2007**

CONSUMERS LOSING MOMENTUM

Canada

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Forecast and analysis based on information/data available up to and including October 5, 2007

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EXPORT FORECAST OVERVIEW

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Global Export Forecast – Consumer Losing Momentum

1.0 Executive Summary

When it comes to global slowdowns, events rarely unfold smoothly. In mid-summer, the global economy was still humming along, and it looked like the forecasters were once again underestimating world growth. Central banks around the world were on inflation watch, and it looked a lot like a repeat of the early 1970s – rapid global growth, capacity problems aplenty and inflation. How quickly things changed in August. Almost overnight, subprime became both street language and an adjective for crisis, 2007 style. And in a radical about-face, central banks were pumping liquidity into the system on a daily basis.

A bolt out of the blue?

Headlines around the world created the impression that the August turbulence came from nowhere. But this U.S.-centered event was in the works for some time, and the surprise is that it didn't happen sooner. And it was a well-worn slowdown indicator, the U.S. housing sector, that reacted first. Official interest rate hikes that began in June 2004 ended two years and 425 basis points later, exposing excesses in the U.S. housing market that had been building for five years. The outcome? A recession-style plunge in key U.S. housing indicators that sparked a surge of mortgage defaults. Financial service firms around the globe are already reporting big losses, and the defaults have yet to run their course.

Contagion or containment?

When economic slowdown spills into financial markets, fear of contagion is never far away. For the moment, the recent actions by central banks have quelled those fears. In fact, many market watchers are seeing an end to this turbulent interlude in a matter of weeks. Optimists almost always surface at this point in the economic cycle, with stories of how different things are this time – a soothing message of hope that almost invariably disappoints.

Undoubtedly there have been significant changes to the structure of the global economy since the last big slowdown. Just the same, it is hard to imagine that the current housing slowdown will not spread to the broader economy. With home equity no longer the stash of spare cash it has been for the last five years, U.S. consumers have already reined in spending significantly. Moreover, employment growth has weakened and confidence is waning. Long the engine of the economy, consumers are now a burden – over the coming 12 months, U.S. consumer spending growth is expected to be a drag on the rest of the economy.

Not just a U.S. phenomenon

It is equally hard to believe that a U.S. slowdown will not spread to the rest of the world. At 20% of world GDP, the U.S. economy has been a growth engine for at least the last decade. And consumers are 70% of the U.S. economy, its most important trade link with the rest of the world. At the same time, technology and increased trade have knit global economies together more closely than they have ever been. Like cyclists in a tight race for the finish, the world's economies are crowded together, and when one slows, the whole pack feels the effects.

Initially, the slowdown looked lop-sided, confined to U.S. borders. This prompted talk of a world economy decoupled from the U.S. malaise, able to continue cranking out rapid growth. But weakness has traversed oceans. Markets in Europe are more vulnerable to slowdown than was previously thought. European consumers, shocked by developments in global financial markets in the summer, are now spending at a slower pace. At the same time, Japan's recovery has been short-circuited by consumer retrenchment.

Emerging markets not immune

Emerging markets will also be affected. True, the economic numbers are still looking quite good, but in time the cracks are sure to show. Despite the significant economic deepening that has happened since the last major global slowdown, emerging markets' domestic economic base has not yet matured to the point that it can sustain growth independently. Even the large, fast-growing markets like China and India do not yet have this capacity. Recent studies underline the continued strong linkages between emerging markets and demand from the developed world. But the impact of slower world demand will not be instant. It will likely be 2008 before slowdown shows up in the data, and even then it may be masked by increases in inventory.

Financial market turbulence caused ripples in emerging markets, and as creditors re-evaluated positions, interest rate spreads widened. While the moves in some cases were large, the more dramatic moves were confined to a small group of the riskiest markets. For the most part, rate increases were far more modest than in past episodes. Why? Well, the slowdown is still in its infancy. But more importantly, emerging markets have in general adopted stronger fiscal and monetary policies, and accumulated reserves to increase resilience in periods of downturn. So while current headwinds affect overall growth, emerging markets are expected to fare relatively well during the global economy's soft spot.

Recession? Not likely

Normally, the U.S. housing market slowdown we are seeing would lead to a recession. And in recent weeks, the likelihood of a U.S. recession has risen to about 50:50. At this point, it is difficult to say whether the U.S. will teeter into recession, or narrowly avoid it as in 2001. Much depends on confidence, which is fickle at the best of times, and prone to rapid change. But there are good fundamental reasons to believe that the economy will only slow, and then revive in 2009. The U.S. economy has harnessed the forces of globalization so well that productivity growth has remained unusually strong at a late point in the cycle. That has preserved liquidity, which has kept investment strong, and allowed for non-inflationary wage acceleration as resources grew thinner. And the weaker greenback has been a boon for U.S. exporters. Although job growth has slowed, economic growth suggests that modest employment growth can be sustained during the downturn – no outright decline, as in normal recessions.

At present, the U.S. is the planet's most recession-prone economy. In the absence of a recession in the U.S., it is unlikely that the world economy will experience one. In fact, as growth slows and competition intensifies, the process of globalization is likely to intensify, deepening trade linkages and broadening the reach of global supply chains.

The effect at home

To date, Canadian economic numbers have been surprisingly strong. In contrast to our southern neighbours, our housing market is still on a high and consumers are still happily spending. Even with the strong dollar, exporters have hung in there, managing to eke out small growth even in certain sectors that are more exposed. But in a strange twist, slower global growth will actually bring needed relief to exporters.

Strength in the global economy has ignited demand for oil, base metals and now agricultural products – commodities that Canada specializes in. Prices have skyrocketed, and have taken our dollar with them. And as the dollar has risen, speculators have nudged it higher. At current levels, the loonie is a huge threat to near-term exports. Fortunately, slower world growth is expected to cut demand for commodities. Along with increased supplies, this tempered demand is expected to bring prices back down swiftly, although to higher average levels than in the past. This is expected to lower demand for our currency – we expect to see it below 90¢ U.S. by the end of 2008.

Even so, total exports will just manage to grow in 2008. Key price gains have put exports on track to increase by 3.7% this year, but for 2008 growth will be more than halved to 1.5%. Consumer goods, automotive products and base metals will weigh down overall growth next year, the effect of weaker U.S. and global demand. The forestry sector and service industries will also be weak performers. On the upside, the agri-food, fertilizer and energy industries are all expected to post strong growth in 2008.

Reflecting the outlook, Canadian export diversification is expected to continue in the forecast period. For 2008, exports to the developed world are expected to rise by less than 1%. In contrast, export growth in emerging markets as a whole is projected at 11%.

Is the turbulence over?

The global slowdown is still in its early stages. Weakness is only just spilling into other developed markets, and will take time to infect emerging markets. Judging by past episodes of turmoil, we will likely see more turbulence in the coming months. But all told, we don't expect the extent of turmoil seen in the mid- to late-1990s, or the wild fluctuations seen in certain emerging markets in the 1980s.

The bottom line

Preparing for slowdown is never pleasant. It rarely happens in exactly the same way and for the same time span as in the past. We can take solace that on balance, the world has a more sound structural platform than in the past, and should get through the weak spot without a major pile-up. And sooner than you think, we will all be back to worrying about the tricky side of a rebound: shortages, capacity constraints and looming inflationary pressures.

Peter Hall

Vice-President and Deputy Chief Economist

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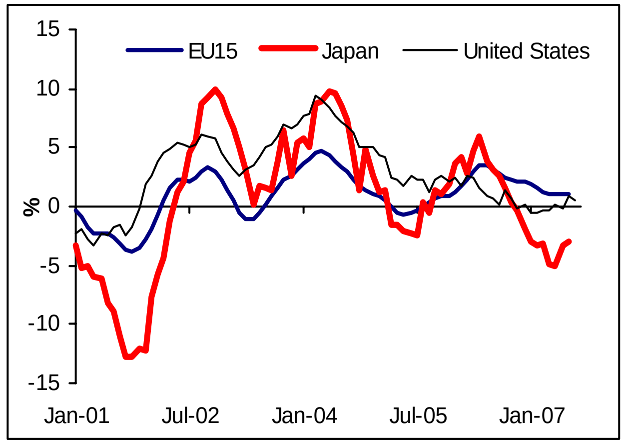
2.0 Forecast Synopsis

Recent economic and financial developments have introduced much uncertainty into the outlook for the world economy over the next 12 to 18 months. Such doubts are having a negative impact on consumer and business confidence in many parts of the world, suggesting corporations and households will become increasingly cautious with respect to their finances and new spending. Growing risk aversion will cause economic growth to lose some traction in 2008, much like a cyclist who has become unsure of the path that lies ahead. Global growth had already been losing momentum since late 2006, and leading economic indicators for the US, UK, Eurozone and Japan are suggesting additional moderation. For 2007, we expect the world economy will expand by 4.9%, down from the 5.4% pace set in 2006. Growth will slow further in 2008, to 4.5%.

Figure 1: OECD Composite Leading Indicators – Slower Growth Ahead (YoY % change)

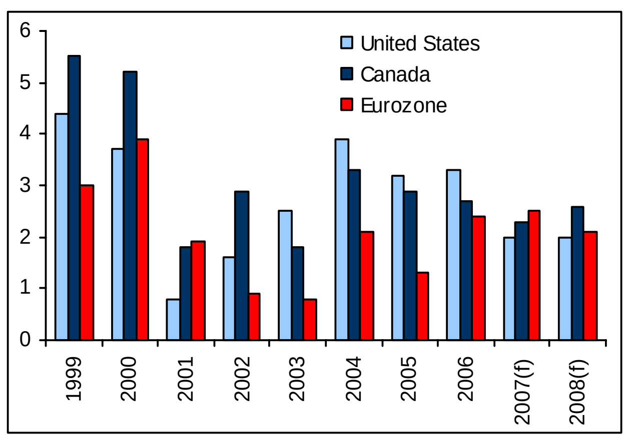


Source: OECD, EDC Economics.

Much of the weakness in our outlook stems from the ongoing downturn in US real estate and related fallout from the sub-prime mortgage meltdown. More important to our forecast is the subsequent negative impact on US consumer confidence and spending, which is proving to be more widespread than first expected.

The softer outlook for consumer spending is not entirely a US story. The same stresses that led to the current situation in the US – namely high levels of personal debt and an unsustainable run-up in home prices and building activity – are appearing in other countries. In particular, household debt loads have reached record high levels in the UK, Australia, Canada, Spain and South Korea. At the same time, recent data show consumer confidence has started to deteriorate in many of these markets – a trend also showing up in Japan and the Eurozone. It is a safe bet that consumers will be more cautious through much of 2008.

Figure 2: Economic Growth Forecasts (annual % growth)



Source: IMF WEO, EDC Economics Forecast.

It is important to remember that we are not forecasting a recession (although the odds of one occurring have increased). What we envision for the next several quarters is a cyclical slowdown centred initially on the US consumer and then spreading to overseas markets. Conditions should begin to improve in the second half of 2008 as the stimulative impact of lower interest rates work their way through the system. Consumers will have also worked off some of their past excesses by late 2008, giving them some breathing room and the confidence to start spending again. For the key US market, we expect employment and income will continue to make modest gains, albeit at a much slower pace than experienced in the past 2 to 3 years.

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Other fundamentals underlying the global economy should remain in decent shape. Corporations will see profits and cashflow grow at a slower pace, but they are still sitting on large reserves of cash. This will help them through the period of slower growth, and more importantly, allow for continued investment in new machinery and equipment. Likewise, emerging markets are better prepared to weather a global economic slowdown. While globalization makes developing countries more exposed to contagion from global trade effects and capital movement, many countries have worked hard to better insulate themselves against financial turbulence. With deeper pockets, and foreign exchange reserves at all-time highs, governments have used the last few years of solid global demand, surging commodity prices and elevated liquidity to lower their external indebtedness, smooth maturity profiles, and improve currency and interest rate dynamics.

Table 1: Global GDP Forecast by Country (Growth)

Top Markets	Share of World Economy (2006)	Global Outlook (growth) 2006	2007(f)	2008(f)
NAFTA	23.2	3.0	2.1	2.1
United States	19.7	2.9	2.0	2.0
Canada	1.7	2.7	2.3	2.6
Mexico	1.8	4.8	2.7	3.1
Western Europe	19.4	2.5	2.5	2.1
United Kingdom	3.2	2.8	2.6	2.0
EMU	14.6	2.4	2.5	2.1
Other Western Europe	1.6	3.4	2.7	2.3
Japan	6.3	2.2	1.9	1.7
Australia & New Zealand	1.2	2.5	2.4	3.0
Asia & Pacific total	30.2	9.0	8.7	8.1
China,P.R.: Mainland	15.1	11.1	11.0	10.0
India	6.3	9.2	8.2	7.9
Asian NIE's	3.4	5.0	4.4	4.1
ASEAN-4	3.5	5.0	5.5	5.5
Other East Asia and Pacific	0.6	7.7	7.0	6.6
Other South Asia	1.3	6.6	6.2	6.0
Eastern Europe & Central Asia	7.0	6.9	6.6	5.6
Russia	2.6	6.7	6.8	5.9
South America	5.2	5.6	5.5	4.6
Argentina	0.9	8.5	7.4	5.1
Brazil	2.6	3.7	4.3	4.1
Central America	0.6	6.8	5.4	4.3
Middle East & North Africa	3.9	5.4	5.5	5.5
Sub-Saharan Africa	2.0	5.2	7.0	6.4
Industrialized Countries	**51.7**	**3.1**	**2.4**	**2.2**
Developing Countries	**48.3**	**7.3**	**7.7**	**7.0**
Total Global Economy	**100.0**	**5.4**	**4.9**	**4.5**

Source: EDC Economics. 2006 is actual data while 2007 and 2008 are forecast. Asian Newly Industrialized Economies (NIEs) are Hong Kong, Singapore, South Korea and Taiwan. ASEAN-4 are Malaysia, Thailand, Indonesia and Philippines.

With economic growth likely to move below potential in the US, and the balance of risks on the downside, we expect the US Federal Reserve will make additional rate cuts in the months ahead. In addition to the 50 basis point cut made on September 18, we anticipate a further reduction of 50 to 75 basis points by the spring of 2008. Softer economic data coming out of the Eurozone suggests the European Central Bank (ECB) will keep interest rates on hold over the near term. Going forward, a weaker global economy and increased uncertainty will put downward pressure on short-term lending rates in most major markets. We believe slower US and global growth will spill over into Canada as well, exposing Canadian markets to these same forces, although a smaller output gap and greater inflationary pressures should lessen the impact.

As energy and other commodity prices pull back through the next 12 to 18 months, the Canadian dollar is expected to depreciate toward 85 cents US by late 2008. We anticipate the US dollar will appreciate modestly against most other currencies in the coming year. To be sure, an upward recalibration of global risk perceptions is currently underway, and this trend should continue through much of 2008. The US dollar typically does better in periods of slower global growth and heightened risk, as investors tend to move more of their capital into the relative safety of the US market during such times. However, the growing popularity and stability of the euro is taking some of this role from the greenback, which may prevent the US dollar from appreciating to the same extent as it did in past episodes of elevated global risk.

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Regional growth prospects

Economic growth in all regions of the world is expected to moderate in 2008. Growth in the US will remain lacklustre at 2%, which is in line with this year's pace. The pace of activity in the Eurozone is forecast to ease back to 2.1%, compared with 2.5% in 2007. We expect the UK to follow a similar path to that of the EU, with growth slowing to 2% next year. Japan's economy is also projected to slow in 2008, advancing by just 1.7%. The Canadian economy is expected to expand by 2.6% in 2008. Although this is up a little from 2007, most of the improvement will not be seen until the second half of the year, which is when we expect the US economy to begin recovering.

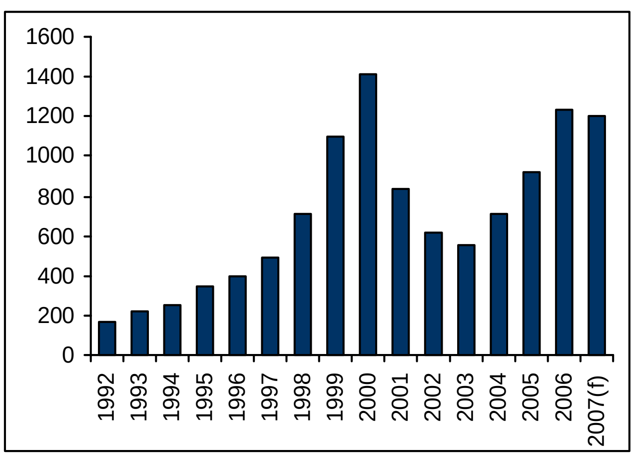
Table 2: Global GDP Forecast by Industry (% Growth)

Main Sectors	% Share of World Economy (2006)	Global Outlook (% growth)		
		2006	2007(f)	2008(f)
Agri-food	5.3	6.0	5.3	4.8
Energy	3.7	2.2	4.0	4.2
Forestry	2.9	3.3	3.5	3.5
Chemicals, Plastics, Fertilizers	2.8	6.4	6.1	5.6
Ores, Metals	3.2	7.4	5.5	5.2
Other Industrial Goods	0.7	6.2	4.7	4.9
Aircraft & Parts	0.3	16.3	8.8	6.0
Motor vehicles & Parts	1.5	6.2	4.2	4.2
Other Ground Transport	0.2	10.6	8.3	6.2
Telecom Equipment	2.5	9.5	8.8	5.3
Computers & Parts	1.4	10.9	9.6	6.0
Other Machinery & Equipment	1.7	8.4	5.8	4.6
Consumer Goods	1.9	3.6	5.1	4.5
Total Goods	**28.0**	**7.9**	**6.2**	**5.3**
Transport Services	3.9	5.0	4.7	4.6
Travel Services	1.4	2.2	3.4	2.8
Financial Services	6.6	6.1	5.2	4.4
Commercial Services	60.2	4.3	4.2	4.0
Total Services	**72.0**	**4.5**	**4.4**	**4.2**
Total Global Economy	**100.0**	**5.4**	**4.9**	**4.5**

Source: EDC Economics, Global Insight. 2006 is actual data while 2007 and 2008 are forecast.

With most of the industrialized world on a weaker growth path, prospects for developing countries have also softened. Average growth in emerging markets is forecast at 7% for 2008, down from an estimated 7.7% in 2007. We are already seeing the impact of weaker US demand on developing economies, as exports for many of these countries have been losing momentum in recent months. In developing Asia, intraregional trade accounts for a significant share of overall trade flows in the region. But most of the region's trade comprises parts and components for incorporation into finished goods that are then shipped outside the region. A recent study by the World Bank shows that once these intermediate components are accounted for, 86% of Asia's exports are ultimately destined for markets elsewhere.[1] Exports to the US represent 29% of this amount, Europe another 25% and Japan about 16% – three key markets likely to post sluggish growth in 2008, and this will filter back into a loss of momentum in the export-oriented East Asian economies.

Figure 3: Global FDI Flows Will Remain at High Levels (World FDI inflows, USD billion)



Source: UNCTAD, EDC Economics.

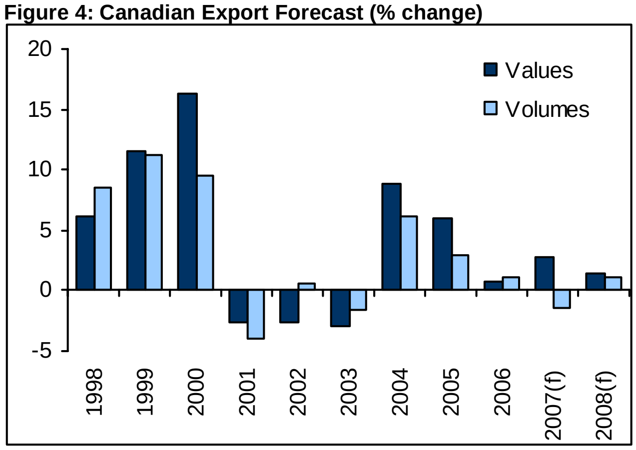
Canadian export and investment prospects

Canadian exports of goods and services are set to rise by 3.7% this year, a marked improvement over the 0.7% increase posted in 2006. Shipments will lose some momentum in 2008, growing by 1.5%. These numbers mask significant stresses in several Canadian export industries. To be sure, the slump in US housing has impacted Canada's lumber and building product exports. Furniture and other household goods

[1] The World Bank. *East Asia Update: Managing Through a Global Downturn*. November 2006.

have also been negatively affected by the drop in US home building. In addition, other elements of Canada's forestry sector face problems. Newsprint companies are having to deal with sluggish foreign demand, excess capacity and rising offshore competition – all while dealing with the strong Canadian dollar. Exports of autos and parts declined further in 2007 amid persistent difficulties in the US vehicle market. Sales of consumer goods will also remain under pressure through the next couple of years.

Figure 4: Canadian Export Forecast (% change)



Source: Statistics Canada, EDC Economics. Volumes refer to price-adjusted exports.

The coming year will see an easing in export growth across most of Canada's major industries. Much of the weakness in our export outlook stems from a receding price environment as oil and commodity prices decline through 2008. Sales of consumer goods and rail equipment are also forecast to decline in 2008. Netting out the impact of price changes shows the physical volume of exports will remain fairly stable in 2007, followed by a 1.3% increase in 2008. The improvement next year can be traced to the auto sector, where a large drop in 2007 volumes is not expected to be repeated in 2008.

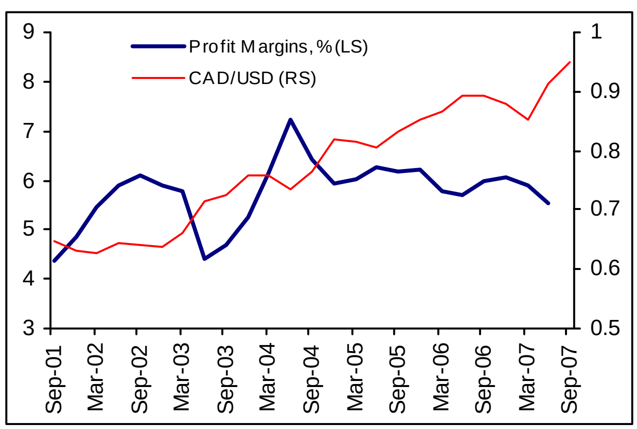
Canadian exporters selling to emerging markets had another banner year in 2007. Exports to the developing world were up by more than 20% in 2007, compared with an average gain of 2.7% for industrialized countries. A sluggish US market accounts for most of this year's weakness in shipments to industrialized countries, as exports to Western Europe advanced quite strongly. The geographic dichotomy will continue in 2008, with sales to the developing world forecast to grow by 11%, compared with less than 1% for developed markets.

Canadian direct investment flows remained at high levels in the first half of 2007. Inflows amounted to $39.2 billion during the January to June period while Canadian direct investment abroad (CDIA) totaled $26.4 billion – in line with the large gains notched up in 2006. High levels of merger and acquisition activity in energy, mining and financial services account for most of the increase in Canadian direct investment flows in the past 2 to 3 years. Recent problems in the financial markets and subsequent difficulties in raising new funds suggest cross-border investment flows will ease through the remainder of 2007 and 2008.

Exporters' response to the higher Canadian dollar

Dealing with the higher dollar has been extremely difficult for many Canadian companies and industries – some sectors of manufacturing, forestry and tourism quickly come to mind. In the case of forestry and tourism, domestic content is quite high, which makes it difficult for producers to take advantage of the stronger dollar through greater use of imported inputs. For these and other export industries, sales have come under pressure and profit margins have taken a hit.

Figure 5: Profit Margins for Canadian Manufacturers Under Pressure from Stronger C$ and Higher Input Costs



Source: Statistics Canada and Bloomberg.

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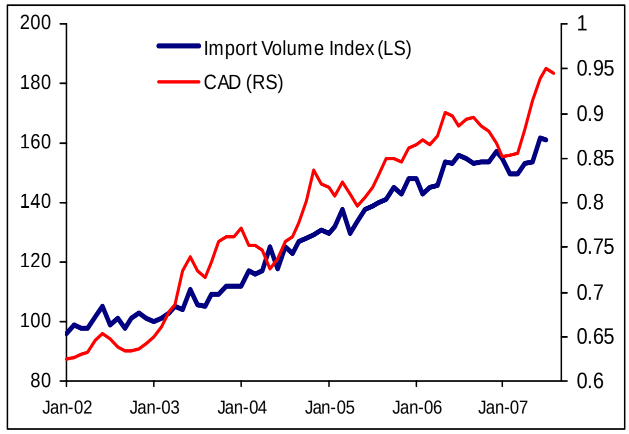
Many exporters will continue to find themselves having to cope with a stronger currency over the next couple of years.

In response, Canadian companies are undertaking a number of strategies to adapt to a stronger currency and increased global competition. These include investment in new capital equipment, increased spending on R&D, investment in their foreign operations, and increased geographic diversification of export sales. We continue to see steady advances on all of these fronts, although investment in machinery and equipment has lost some momentum this year. Following a rise of 7.4% in 2006, real spending on M&E slowed to growth of just 2.2% in the first half of 2007.

Figure 6: Imports of Machinery and Equipment (1997=100) vs. the Canadian Dollar



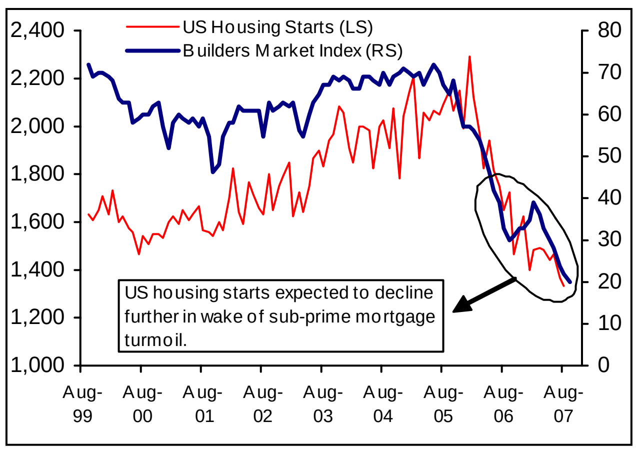
Source: Statistics Canada, Bloomberg.

2.1 Consumer – Epicentre of Weaker Global Growth

The obstacles to continued growth in US consumer spending are stacking up, including the housing slump, record levels of personal debt, higher mortgage payments, and weakening labour markets. The downturn in residential construction and corresponding weakness in home prices has reduced spending on furniture and other household goods. At the same time, the drop in house values has reduced refi activity – an important source of household funds in recent years. High levels of personal debt make it harder to take on new credit, a situation exacerbated by the sub-prime meltdown, which has forced many banks to tighten lending standards across the board.

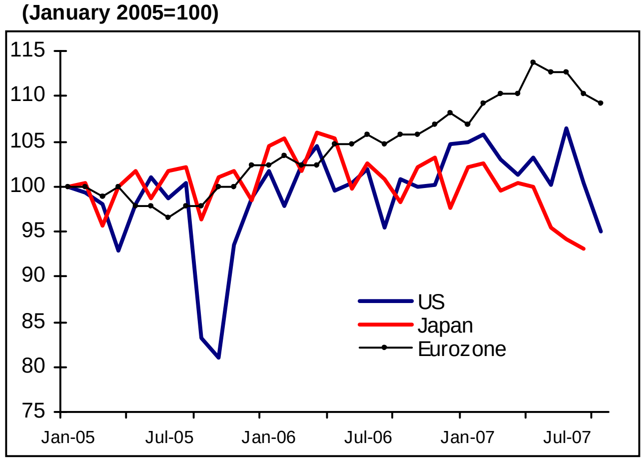
Excesses have accumulated in recent years as lax credit standards allowed a growing number of US households to finance new home purchases on very easy conditions. A growing number of homeowners are unable to meet their monthly payments, resulting in rising foreclosures and more unsold homes on the market – which leads to further weakness in residential construction activity. We expect conditions will get worse as many of the adjustable-rate mortgages signed in the past couple of years will be reset at higher interest rates in the months ahead, placing even

Figure 7: US Housing Starts (mn) and National Association Home Builders' Index



Source: Bloomberg.

Figure 8: Consumer Confidence Weakening in Recent Months (January 2005=100)

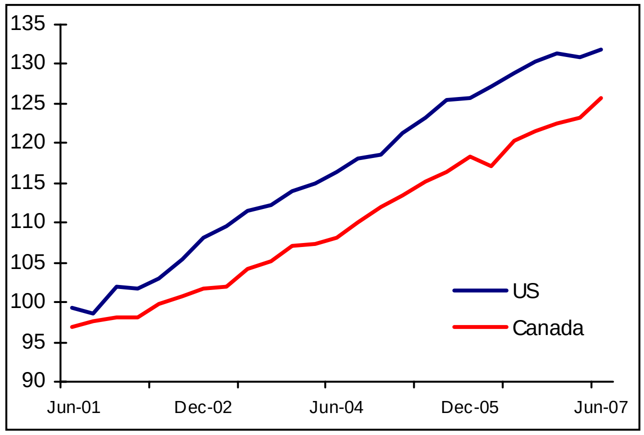


Source: Bloomberg, EDC Economics.

more strain on the ability of households to make their payments.

The US consumer surprised on the upside in 2007Q3, but the quarterly pickup in consumption largely reflects a drop in gasoline prices, which boosted real purchasing power. This is likely to prove temporary since gas prices have stabilized and could potentially move higher through the winter months. More importantly, with the downside risks continuing to accumulate, growth in US consumer spending is likely to slow in the final months of 2007 and through the first half of 2008. To be sure, the Conference Board's September reading on consumer confidence dropped to its lowest level since November 2005.

Figure 9: US and Canadian Household Debt as a Percentage of Disposable Income (%)



Source: Bloomberg, EDC Economics.

The same stresses threatening US consumption are evident in countries around the world. Household debt as a share of disposable income has reached record levels in Canada, the UK, Australia, Spain and South Korea. These markets have also experienced significant run-ups in residential construction activity and home prices, which along with rising credit, have been key drivers of consumer spending. But the uncertain outlook means consumer confidence is now beginning to weaken in many of these same countries, including Japan, the United Kingdom, France, Germany and the Netherlands. In addition, consumer spending is showing signs of cracking. Growth in German retail sales has weakened in recent months (and fell by 2.2% y/y in August) – a somewhat worrisome development given that Germany has been the main driver of overall growth in the Eurozone. On average, we expect the pace of consumer spending to slow throughout most of the industrialized world in 2008.

Similar to industrialized countries, rapid growth in consumer credit is supporting personal consumption throughout much of the developing world. But the expansion in credit is outpacing income growth by a wide margin, which introduces significant downside risk to consumer spending in emerging markets should a deeper and more prolonged global slowdown occur. During 2006, domestic credit in Russia grew by 28%, in Brazil by 22%, while India was up by 20% and Mexico by 15%. In China, average lending to households increased by an estimated 22% in 2006 to reach US$ 11,280 (which is more than double the level of 5 years ago).

Although personal consumption in many developing markets is contributing more to bottom line growth these days, from a global viewpoint it is still not significant enough to compensate for weaker consumption growth in the world's large industrialized markets. Moreover, China's retail sales have been losing momentum in recent months, due in part to rising inflation which has reduced real spending power. High Frequency Economics estimates that price-adjusted retail sales in China slowed to growth of 8.6% y/y in September 2007, down from the 12 to 13% pace recorded early this year.

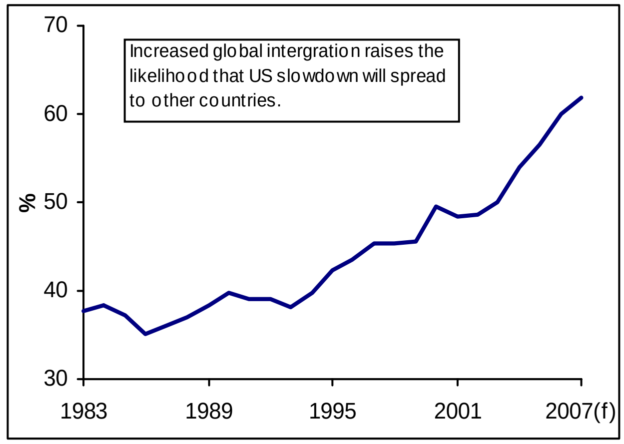
From the US consumer to developing markets

The consumer is the US economy's strongest link to the rest of the world, and as such presents a key risk to global economic performance. US imports of merchandise goods declined at an annual rate of 2.9% during the second quarter of 2007, and we believe this is beginning to materialize in countries that ship a significant portion of their exports to the US. In particular, export growth for Mexico, South America and some East Asian countries has slowed in recent months. Many of Asia's electronics and consumer goods exporters are reporting slower growth in sales to the US market. This includes Singapore, Malaysia, Philippines, South Korea and

Taiwan. Smoothing out the month-to-month volatility in China's trade flows also shows a leveling off in that country's export sales.

We expect US consumer spending will slow in the last quarter of 2007 and through the first half of 2008. In addition, spending in Japan and the EU is forecast to remain tepid through this period. The impact should begin to show up substantively in China and other major exporters of manufactured goods by early 2008. This will translate into slower growth in industrial production, which in turn leads to a softer environment for commodities (and lower prices for things such as metals, chemicals and crude petroleum).

Figure 10: World Trade (Exp + Imp) to World GDP Ratio (%)



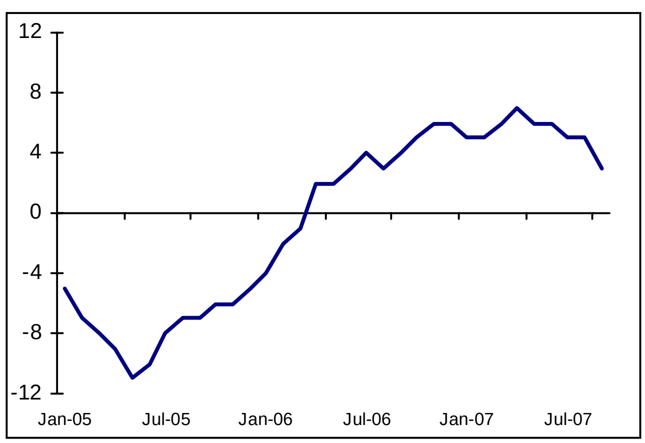
Source: EIU, EDC Economics.

Keeping close watch on China's trade flows will be a key part of this dynamic. As a major supplier of manufactured goods to the world, China imports large amounts of raw materials, parts and intermediate components. As such, some of the first signs of slower growth in the US, EU and Japan should show up in the exports of those countries that ship commodities and semi-finished goods to China.

Businesses will also feel the pinch

Business spending around the world has been growing at a solid pace, but slower economic growth through the next few quarters will persuade many companies to delay some of their investment and spending plans – at least until they see economic activity start to pick up again. The consumer is the ultimate end-user of business goods and services – when the consumer retrenches, corporations do the same, as sales and profits come under pressure. Our forecast assumes business investment in the US and other major markets will grow at a slower pace through the first half of 2008.

Figure 11: Eurozone Industrial Confidence Turning Down



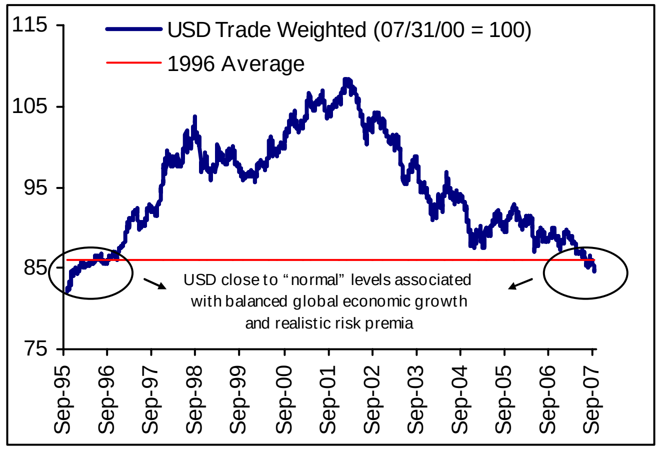
Source: Bloomberg.

Signs of a moderation in business activity have begun to emerge in North America and Western Europe. In the US, the ISM manufacturing and service activity indices have been slipping since the spring, while business sentiment has also come under pressure. In the Eurozone, the September PMI manufacturing index fell to its lowest level in 2 years. The Eurozone's PMI index for services also eased back in September, but still remains at a relatively high level. Business sentiment throughout most of the Eurozone has clearly deteriorated in the past several months. Similar indices for the UK also show a slowing pace of activity in manufacturing. Although easing off in September, growth in the UK service sector is still holding up fairly well. The latest readings for Japanese business confidence (Tankan Survey) show confidence for large companies holding steady, but a decline among small and medium-sized enterprises.

2.2 Outlook for Interest Rates and the Canadian Dollar

Financial market turbulence has rapidly changed interest rate expectations. Before the asset-backed commercial paper debacle hit in mid-August, markets were expecting short-term policy rates in Canada, the Eurozone and the UK to increase. Many investors were also betting the US Fed would keep rates on hold, while others were convinced the Fed would begin raising rates by year end in response to inflationary pressures. What a difference a financial crisis (or fear of one) can make. The US Fed subsequently reduced interest rates by 50 basis points on September 18, and we expect a further 50 to 75 basis point cut by early 2008.

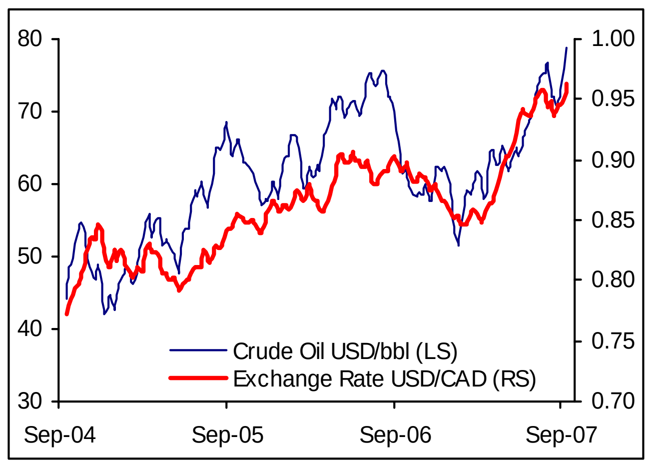
Figure 12: US Dollar – Weakness Is in the Eye of the Beholder



Source: Bloomberg, JP Morgan.

Meanwhile, central banks in Canada, the UK and Eurozone decided not to raise interest rates at their respective September meetings. Just a few weeks before, markets had been expecting with near certainty that all three central banks would raise their key policy rates. With signs of slowing growth becoming more pronounced, the probability of lower rates in most major markets has increased. We believe slower US and global growth will spill over into Canada as well, exposing Canadian markets to these same forces, although a smaller output gap and greater inflationary pressures should lessen the overall impact.

Figure 13: Oil Prices vs. the Canadian Dollar



Source: Bloomberg, EDC Economics.

Although authorities in the UK and Eurozone have suggested monetary policy will return to a tightening stance once the current financial turmoil subsides, we believe the economies of both regions will weaken enough in 2008 to keep both central banks on the sideline (and perhaps even reduce rates). In any case, inflation in most industrialized markets has eased in the past few months, which will give central banks the extra room to keep rates on hold, or reduce them if economic conditions deteriorate.

Outlook for the Canadian dollar

Recent years have seen a strong relationship develop between the Canadian dollar and oil prices. EDC Economics' model of the Canadian dollar shows that oil prices, non-energy commodity prices and the short-term interest rate differential vis-à-vis the United States are the main determinants of movements in the Canada-US exchange rate. Much of the run-up in the Canadian dollar this year to reach parity with its US counterpart can be explained by our model. After dipping below 85 cents US back in January 2007, the loonie increased almost 16 cents by early October. More than half of this increase (9 cents) can be explained by the run-up in the price of crude oil, while another 3 cents is due to the short-term interest rate spread vis-à-vis the

US. This leaves about 4 cents unaccounted for, which can be attributed to speculative activity and momentum in forex markets.

Looking ahead, our forecast calls for a downward easing in oil and commodity prices as global growth moderates – a pattern that will allow the Canadian dollar to ratchet down to around 85 US cents by the end of 2008.

2.3 Risks to the Outlook

There are several risks to our forecast for world growth and Canadian exports. But two stand out in particular: a US recession sparked by a downturn in consumer spending; and a Canadian dollar that remains at parity with the US greenback through 2008.

Risk scenario 1: US recession

EDC Economics has developed an alternative scenario in which the US economy goes into a mild recession in the first half of 2008 (probability of 25%). This scenario assumes a deeper, more prolonged downturn in consumer spending than is currently built into our forecast. Consumer spending is set to contract slightly, resulting in two consecutive quarterly declines in US GDP. On an annual basis, our underlying assumptions result in US GDP growth of 1.1% in 2008 – not as severe as the 2001 recession but deep enough to be felt here in Canada and around the world. We estimate that global growth would pull back to 3.7% in 2008 while the Canadian economy would expand by about 1.5%.

Here in Canada, the impact of a US recession would be felt across the country, with exporters experiencing lower sales. The US recession scenario produces a 2.5% contraction in Canada's 2008 exports relative to 2007, similar to the decline in exports of goods and services recorded during each of the last two US recessions (1991 and 2001). Much of the weakness in Canadian exports would come from lower oil and metal prices, not unlike previous economic downturns. But other industries would feel the impact of weaker growth in US and overseas demand. Exporters of building products, metals, basic materials, capital equipment, autos and consumer goods would all see weaker exports relative to our baseline outlook. In addition, service exports would soften, with tourism and transportation receipts perhaps taking the biggest hit.

Risk scenario 2: Canadian dollar remains at parity with US greenback

A stronger Canadian dollar reduces the value of Canadian exports through two channels (see text box below). Since most of Canada's exports are priced in US dollars, exporters receive fewer Canadian dollars when their sales are converted at the higher exchange rate. The second channel is structural, whereby the higher C$ makes Canadian exporters less competitive in foreign markets, which also reduces export sales.

In this scenario, we also assume oil and commodity prices remain at high levels (which would be required to keep the Canadian dollar on par with the US). This has a positive impact on exports, but not nearly enough to offset the downside of a stronger loonie. In our basecase forecast, we assume the Canadian dollar will average 87 cents US in 2008. Increasing the exchange rate to parity reduces export sales by $15 billion in 2008, which is 2.9% lower than in the basecase.

Mechanical and Dynamic Impacts of the Stronger Canadian Dollar

The appreciation of the Canadian dollar affects Canada's exports in two ways. The first is mechanical. As much as 70% of Canada's exports are priced in US dollars. Canadian companies receiving US dollar revenues for their exports will receive fewer Canadian dollars when converted at a higher exchange rate. So even if there is no change in physical volume shipments, the higher dollar automatically translates into lower export receipts in C$ terms.

The second impact involves a more dynamic process whereby Canada's export sales in physical volume terms are affected by the stronger loonie. For those Canadian exports that are priced in C$, the higher dollar makes these exports more expensive in foreign markets, which puts downward pressure on export sales – customers in foreign countries tend to substitute into less expensive goods and services from third-country competitors. This shows up in the physical volume of Canadian export sales. However, some Canadian companies may choose to charge lower prices to keep their export volumes from falling (i.e. companies may attempt to maintain market share at the expense of lower profit margins).

3.0 Canada's Export Outlook

Canadian exports are on track to rise by 3.7% in 2007, a significant improvement over the small 0.7% advance experienced in 2006. But this year's headline number masks a mixed performance across various industries. Shipments of commodities and resource-based intermediate goods posted substantial gains in 2007 on the back of strong global demand and firmer pricing. Agri-food exports also benefited from higher prices for grains and robust demand conditions. Aerospace, rail equipment, advanced technology and industrial machinery all made solid advances. On the downside, significant declines were experienced in forestry, automotive, telecom equipment and consumer goods. Tourism, business travel, financial services and engineering are also expected to show weak results once the final year-end numbers are tallied up.

Table 3: Canadian Export Forecast by Sector

Main Sectors	CAD bn (2006)	% Share of Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Agri-food	31.9	7.7	4.5	14.5	11.3
Energy	87.2	21.2	-0.5	5.2	5.9
Forestry	39.6	9.6	-8.9	-8.3	3.5
Chemical and Plastics	36.1	8.8	4.3	8.5	-0.6
Fertilizers	4.0	1.0	-9.4	25.9	10.5
Ores and Metals	52.8	12.8	24.1	20.4	-12.0
Other Industrial Products	7.0	1.7	-2.5	-0.9	-0.2
Aircraft and Parts	10.2	2.5	0.3	11.3	5.2
Rail and other Transportation Equip.	2.0	0.5	2.8	4.3	-0.4
Telecom Equipment	7.0	1.7	1.8	-6.2	1.0
Advanced Technology	13.4	3.3	-4.1	3.3	2.2
Industrial machinery and Equipment	26.6	6.5	2.5	3.2	4.4
Motor Vehicles and Parts	75.7	18.4	-6.6	-6.3	1.5
Consumer Goods	9.6	2.3	-6.5	-8.3	-7.0
Special Transactions	8.3	2.0	4.9	-1.6	2.3
Total Goods Sector	**411.3**	**86.0**	**0.7**	**4.1**	**1.5**
Total Service Sector	**67.2**	**14.05**	**0.4**	**1.1**	**1.8**
Total Exports	**478.5**	**100**	**0.7**	**3.7**	**1.5**
Memorandum					
Total Volumes		**100.0**	**1.1**	**-0.2**	**1.3**
Total Goods (excl. Energy)	**324.1**	**67.7**	**1.0**	**3.9**	**0.3**
Total Goods (excl. Autos and Energy)	**248.5**	**51.9**	**3.6**	**7.0**	**-0.1**

Source: EDC Economics. 2006 is actual data while 2007 and 2008 are forecast.

Recent months have seen Canadian exports lose momentum however, as a number of headwinds have come to bear, including a stronger dollar, deteriorating economic conditions south of the border and fallout from the sub-prime mortgage meltdown. As the US and global economies shed growth in the months ahead, Canadian export growth will follow suit. For 2008, we expect Canada's foreign sales will slow to growth of 1.5%, less than half the pace set in 2007.

On a geographic basis, most of the export strength in 2007 was in non-US markets, with developing markets showing the largest percentage gains. Indeed, Canadian merchandise shipments to developing markets were up more than 20% in 2007, continuing the strong gains seen over the past few years. Countries such as Brazil, China, India, Russia and Mexico proved to be very strong markets for Canadian exporters in 2007. Industrialized markets in Western Europe were also bright spots for Canadian companies during the past year, while sales to Japan and the Asian NIEs made more modest gains.

Table 4: Canadian Merchandise Export Forecast by Country

Top Markets	CAD bn (2006)	% Share of Total Exports (2006)	Export Outlook (% growth) 2006	2007(f)	2008(f)
NAFTA					
US	336.7	81.9	-1.9	1.1	0.7
Mexico	4.0	1.0	25.4	17.3	9.9
Western Europe					
UK	9.2	2.2	20.8	28.4	-4.2
Eurozone	15.5	3.8	14.2	9.8	-0.1
Other Western Europe	3.7	0.9	12.4	47.4	-0.2
Cent. & East. Europe	1.8	0.4	21.5	13.7	6.4
Russia	0.8	0.2	54.6	22.2	12.9
Asia & Pacific					
Japan	9.2	2.2	2.8	3.1	1.9
China	7.2	1.7	8.1	32.3	6.0
Asia NIEs	6.4	1.6	12.3	6.8	3.6
ASEAN - 4	2.1	0.5	16.3	19.9	13.4
India	1.5	0.4	48.6	8.4	6.1
Other Asia	1.1	0.3	33.9	8.9	2.0
Oceania	2.1	0.5	10.1	-1.4	4.4
South America (ex. Brazil)	2.2	0.5	13.4	38.4	19.5
Brazil	1.3	0.3	20.2	13.8	9.0
Central America	1.7	0.4	12.3	7.9	8.2
Middle East	2.5	0.6	13.4	34.7	26.6
Africa	2.3	0.5	24.3	30.6	10.4
Total Goods Exports	**411.3**	**100.0**	**0.7**	**4.1**	**1.5**
Total to Developing Markets	**28.5**	**6.9**	**18.4**	**23.9**	**10.9**
Total to Industrialized Countries	**382.8**	**93.1**	**-0.4**	**2.7**	**0.6**

Source: EDC Economics. 2006 is actual data while 2007 and 2008 are forecast. The Asian Newly Industrialized Economies (NIEs) are Hong Kong, Singapore, South Korea and Taiwan. ASEAN-4 are Malaysia, Thailand, Indonesia and Philippines.

Looking ahead to 2008, we expect this geographic dichotomy to continue with Canadian exports to emerging markets rising by an average of 11% compared with an average rise of less than 1% for the industrialized countries. Canadian shipments to the developing world are forecast to reach $50 billion in 2008.

For 2008, we should see an easing in export growth across most of Canada's major industries. Nevertheless, some sectors will fare better than others. Agri-food exports are forecast to rise by 11% in 2008, boosted by strong wheat and grain sales. Fertilizer shipments are expected to increase by 10% next year, following an estimated gain of 25% in 2007. Energy shipments are forecast to rise by 6%, on increases in crude oil, natural gas and coal. After strong gains in 2007, export receipts for ores and metals are projected to decline by 12% in 2008 – the result of a softer price environment. Chemicals and plastics should experience a small decline next year, also the result of weaker prices.

After a dismal 2007, the forestry sector is expected to show modest gains in 2008. Next year's improvement will be mostly the result of small price gains as producers engage in supply management through mill closures and downtime. We do not expect any significant turnaround in demand conditions. The US housing slump is expected to continue through 2008, impacting Canadian producers of lumber and wood products. In addition, newsprint demand is likely to remain weak as US dailies experience falling revenues, while at the same time, rising global capacity will weigh on prices. Pulp exports advanced nicely in 2007, but sales are expected to moderate in 2008, as new global capacity puts downward pressure on prices.

EXPORT FORECAST OVERVIEW

Exports of telecom equipment are forecast to grow a modest 1% in 2008, while shipments of advanced technology are forecast to rise by around 2%. These numbers look rather weak, but when the large price drops are taken into account the performance is not all that bad. Indeed, volume shipments[2] for advanced technology equipment are expected to rise by 6% in 2008. Exports of industrial machinery are forecast to rise 4% in 2008, in line with this year's expected performance. Canadian companies are taking advantage of stronger worldwide investment in machinery and equipment, especially in the agriculture, mining and energy sectors. The main risk for exports of high-tech equipment and industrial machinery comes from slowing economic growth in the US and overseas markets, and the subsequent negative impact on companies' profits and cashflow.

Aerospace exports in 2007 performed much better than we had anticipated earlier in the year. Strong growth in parts, components, business jets and helicopters has been augmented with improving regional jet and turbo-prop orders. Active order books should allow Canadian aircraft and parts manufacturers to make steady gains through 2008, albeit at a slower pace of growth than recorded during the past 12 months.

Consumer goods, furniture and household items have been hit particularly hard by the slump in US housing, and no relief is in sight. About 95% of Canada's furniture exports are destined for the US market. The other major sector showing lower export sales is automotive, where exports are down an estimated 6% in 2007. In addition, Canadian auto parts producers will see export sales crimped by lower North American vehicle production. For 2008, auto exports are projected to stabilize as US vehicle sales level off and the restructuring of the Detroit Three nears completion.

Canadian service receipts are expected to show little growth in 2007 once the final year-end numbers come in. Tourism, business travel, construction and financial services are the main drags on overall export receipts this year. The stronger Canadian dollar and higher gasoline prices certainly discouraged inbound travel from the US in the past couple of years. Lower gas prices and an easing in the Canadian dollar may provide some relief for tourism in 2008, but not enough to fully offset a weaker US economy and new US passport requirements. Service exports are forecast to grow by 1.1% in 2007 and by 1.8% in 2008. The uptick in 2008 comes primarily from our expectations of a rebound in financial services and a small rise in tourism during the latter half of the year.

More detail on Canadian exports by industry and by country/region is provided in Section 7.

3.1 Provincial Export Outlook

The past year witnessed a wide variation in international export growth across the provinces, and the coming year is shaping up for more of the same. During 2007, those provinces with a large share of energy, mining and agri-food in their export mix generally performed above the national average. These include Newfoundland and Labrador, Nova Scotia, Manitoba, Saskatchewan and Alberta. Nearly all provinces reported a significant pullback in forestry

Table 5: Canadian Merchandise Export Forecast by Province

Provinces	CAD bn (2006)	% Share of Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Newfoundland and Labrador*	8.4	2.0	5.9	16.7	5.1
Prince Edward island	0.8	0.2	1.8	4.8	1.9
Nova Scotia	5.0	1.2	-12.0	7.0	2.9
New Brunswick	10.4	2.5	-2.9	5.0	5.7
Quebec	69.1	16.8	3.2	2.7	-1.4
Ontario	177.4	43.1	-1.6	2.4	-0.7
Manitoba	10.9	2.6	12.3	15.1	7.3
Saskatchewan	15.8	3.9	13.4	14.6	11.7
Alberta	78.5	19.1	2.3	6.9	4.3
British Columbia	33.4	8.1	-2.0	-2.4	1.7
Territories	1.6	0.4	-2.9	-1.3	-0.8
Total Goods Exports	**411.3**	**100.0**	**0.7**	**4.1**	**1.5**

Source: EDC Economics. 2006 is actual data while 2007 and 2008 are forecast. NL includes EDC estimate for crude oil exports (*not included in national total from Statistics Canada).

[2] Export volumes refer to physical shipments, which net out the impact of price changes.

exports, the lone exception being Nova Scotia where the re-opening of a paper mill late in 2006 boosted 2007 shipments.

Parts of the country that rely more heavily on manufactured goods (particularly autos, telecom equipment and consumer goods) experienced slower export growth over the past year. The divergence between exports of commodities (energy, fertilizers, grains and industrial metals) and manufactured goods should narrow in 2008 as prices for energy and other resources pull back. However, autos, rail equipment, chemicals, consumer goods and telecom are expected to underperform – a situation that introduces some downside risk for Ontario and Quebec.

International exports for **Newfoundland and Labrador** are expected to rise 17% in 2007. This year's growth has been broad based with energy and mining (iron ore, copper and nickel) leading the way. Transportation equipment, although a small part of the province's export bundle, notched up huge gains in 2007. As in other provinces, Newfoundland's forestry exports were down in the past year. Export growth is forecast to slow to 5% in 2008 as lower prices for crude oil and ores offset increased output. Seafood is also expected to moderate in 2008. **Prince Edward Island's** exports are forecast to finish 2007 with an increase of 5%. The past year saw gains in agri-food, industrial goods, transportation equipment and machinery partially offset by tepid sales of forestry products and consumer goods. Next year should see a moderation in exports for the Island's leading industries, including agri-food, industrial goods and transportation equipment.

Nova Scotia's exports recovered in 2007, rising an estimated 7% – gains in energy, forestry, industrial goods and automotive more than offset weakness in agri-food, machinery and equipment (M&E) and consumer goods. Export growth is forecast to slow to 3% in 2008. Declines in agri-food, industrial goods and consumer goods will be joined by a slower pace of activity in the energy, forestry and auto sectors. Following a decline of 3% in 2006, **New Brunswick's** international export sales are on track to grow by 5% in 2007, largely on strength in energy, mining, metals, fertilizers and chemicals. Shipments are forecast to accelerate a little in 2008, growing by 6%. Next year's increase comes mainly from energy, and to a lesser extent, M&E, as most other sectors post modest declines.

Quebec export growth slowed to an estimated 2.7% this year, due to lower forestry prices and falling sales of automotive products and consumer goods. Bright spots this year include petroleum products, electricity, metals, chemicals and aerospace. The outlook for 2008 will be dogged by a weakening global economic environment, which will cause foreign-bound shipments to pull back by 1.4%. Industrial goods and consumer products will be the main drags on Quebec's export sales, with most other sectors registering modest growth.

Following a year of declining sales, **Ontario's** exporters are on track to make a modest rebound in 2007 despite the continued struggles of the manufacturing sector and, in particular, the automotive sector. Ontario's exports are expected to increase 2.4% in 2007 driven, in large part, by an excellent performance in metals and chemicals. We expect Ontario's exports to decline by almost 1% in 2008 as commodity prices ease amid softer US and global demand conditions. On a more positive note, automotive exports should stabilize in 2008 as US vehicle sales bottom out.

With gains concentrated in primary industries, **Manitoba** ranks among the best export performers across the country this year. Exports are likely to end the year with growth of 15%. Although the outlook going forward is generally positive, waning US consumer demand combined with a stronger Canadian dollar are beginning to take a toll on Manitoba exports. As such, growth is projected to moderate to 7% in 2008. Despite weakness in energy and forestry, **Saskatchewan's** export sector is performing strongly this year. Total exports are expected to rise by 15% in 2007, while non-energy sales should finish the year with growth of nearly 30%. Overall export growth for the province should remain fairly robust through the forecast period as cattle and beef import restrictions to the US are lifted, potash production bounces back, and crop prices remain strong. Export growth is forecast at 12% for 2008, the strongest in the country.

EXPORT FORECAST OVERVIEW

Alberta's exports should grow 7% in 2007 and 4% in 2008. M&E, industrial goods and agri-food all posted solid increases this year. For 2008, gains in energy, forestry and M&E will contribute to the bottom line, albeit at a slower pace. Agri-food will be head and shoulders above all others though, as the stellar export growth experienced in 2007 is expected to continue next year. Industrial goods (metals, chemicals) will lose momentum as prices soften in response to slower growth in foreign demand. **British Columbia's** exports are set to contract by 2.4% in 2007. Declining values of wood products and natural gas exports have been the main source of weakness so far this year, with some softness also witnessed in coal and newsprint. A modest improvement of 1.7% is forecast for BC's international shipments in 2008, although sales of industrial goods will be impacted by lower metal prices.

A comprehensive export outlook by province is provided in Section 8.

4.0 The Bottom Line

The world economy has entered the turbulent period between rapid and more moderate growth, creating much uncertainty around the economic outlook. Also undermining consumer and business confidence is uncertainty over the extent of the US housing downturn and related fallout from the sub-prime mortgage meltdown. We believe these effects will spread to the rest of the world through the final months of 2007 and the first half of 2008. World economic growth will moderate from 5.4% in 2006 to 4.9% in 2007 and 4.5% in 2008.

The consumer is the US economy's strongest link to the rest of the world, and as such presents a key risk to global economic performance. And with the balance of risks on the downside, growth in US consumer spending is expected to weaken through mid-2008. Today's high level of global economic integration means the US slowdown will spread internationally. To be sure, signs of slower growth in many overseas markets have already appeared. We are watching the sequence of the slowdown carefully, and expect that growth will moderate in most markets by early next year.

Slower global growth will put downward pressure on oil and commodity prices. As energy and other commodity prices pull back through the next 12 to 18 months, the Canadian dollar is expected to depreciate towards 85 cents US by late 2008. We anticipate the US dollar will appreciate modestly against most other currencies in the coming year.

Recent months have seen Canadian exports lose momentum, as a number of headwinds have come to bear, including a stronger dollar, deteriorating economic conditions and fallout from the sub-prime mortgage turmoil. As the US and global economies shed growth in the months ahead, Canadian export growth will follow suit. For 2008, we expect Canada's foreign sales will slow to growth of 1.5%, less than half the 3.7% pace set in 2007. On average, Canada's exports to developing countries are growing much more quickly than sales to the industrialized markets, and this should continue over the next couple of years, although here too, the pace will soften a notch.

Near-term risks to the global economy have clearly increased. Investors are becoming more risk averse, which is resulting in an upward re-pricing of risk. Developing market bond spreads and corporate bond yields are likely to rise further through the next several quarters. In this environment, Canadian companies should be prepared for more volatility in foreign exchange and financial markets. Slower economic growth can heighten financial distress among companies, which is something Canadian exporters will have to watch for in their customers through the coming year.

5.0 Developing Markets Overview

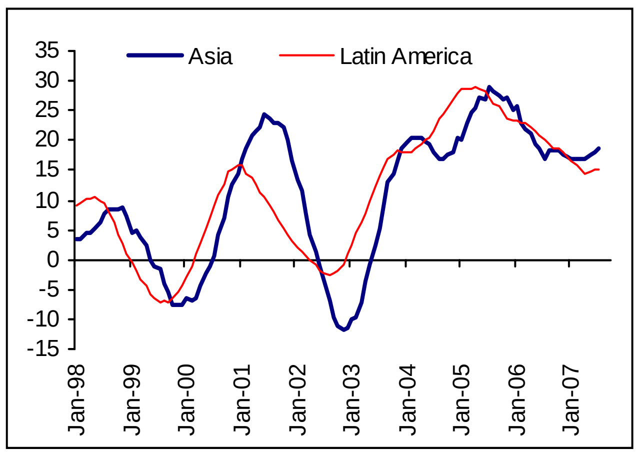
5.1 Developing Markets Summary Outlook – Rising Risk Perceptions

After several years of exceptional economic growth, the outlook for developing markets has been tarnished by slowing growth in the industrialized world. The US and Japanese economies have slowed significantly from last year's pace, and sluggish growth is expected to continue through 2008. In the case of the US, it will likely be 2009 before the economy fully shakes off the effects of the weak housing market and sub-prime mortgage meltdown. The Eurozone economy is also showing signs of slower growth, mainly due to weakness on the consumer front.

Slower growth in the US, Eurozone and Japan will inevitably spill over into the developing world. Indeed, a weaker consumer in these three markets (which constitute more than 40% of world GDP) will crimp export growth for developing countries. For many developing countries, export growth is already losing momentum, particularly for shipments to the US where the consumer slowdown is already in play. For 2007, we expect growth in the developing world will average 7.7%, up from last year's 7.3% pace. Much of the acceleration this year comes from stronger growth in China and India. Developing markets will lose momentum in 2008, with average growth slowing to 7.1% – a respectable pace of growth, but still the slowest since 2003.

EDC Economics is forecasting slower growth across most of the developing world through the remainder of 2007 and 2008. Solid domestic demand will put a floor under growth in many emerging economies, but we believe this will not be enough to offset the loss of momentum in external trade. An expected easing in commodity prices will also act to undermine economic activity. To be sure, weaker growth in exports combined with slower growth in commodities demand will filter through to domestic production.

Figure 14: Emerging Market Exports (6-month MA, y/y%)



Source: Bloomberg, EDC Economics.

As export growth slows, the impact on domestic consumption will be realized through a moderation in employment and wage gains. Moreover, much of the recent upturn in domestic consumption has been financed by households taking on increasing amounts of debt. The liquidity crunch experienced by the global banking system in recent months is likely to reduce the availability of such credit in emerging markets (through tighter lending standards), and further weaken consumption. Many developing economies are also struggling with higher inflation. This has caused authorities in a number of countries to tighten monetary policy, and we expect further action will be forthcoming to keep inflation in check. If the global slowdown fails to slow economic activity by a significant margin, central banks will ensure slower growth through continued tightening of monetary policy. Higher interest rates will affect consumer spending and business investment. India, Turkey, China and parts of Central Europe and Latin America stand out in this regard.

Developing market risk perceptions on the rise

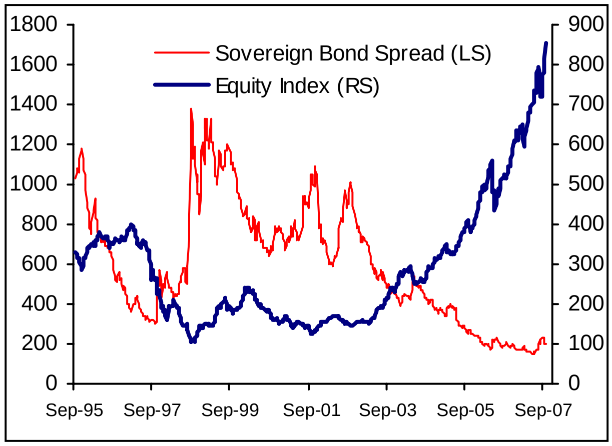
Concerns are growing that emerging markets will be hit hard by the US-led global slowdown. The slowing US and world economies – a situation being exacerbated by the US housing-induced liquidity crunch – is forcing an upward reevaluation of risk perceptions. Yield spreads for emerging market debt have increased in recent months and further widening can be expected as slower growth in the US, EU and Japan produces knock-on effects across the developing world.

DEVELOPING MARKETS OVERVIEW

Yields on sub-investment grade corporate debt have also increased since the summer. Rather than a sharp and painful upward adjustment in risk, we expect a more gradual process that will allow developing economies to manage through the slowdown.

Nevertheless, it is understandable that observers are worrying. Emerging markets are typically hit quite hard during episodes of widespread "flight to quality" such as in 1994 and again in 1997-98. In addition, we believe that the scale of the central bank interventions in Augus and September conveyed a heightened sense of urgency about the possible scope of the sub-prime debacle. Consider that just one week of combined interventions in August eclipsed the size of the entire S&L bailout announced in 1989. Central banks, which characteristically avoid being market-movers, had obviously calculated that any speculation surrounding their actions would be less disruptive than the effects of a potential crisis – leading many to wonder whether the monetary authorities knew something that the market did not.

Figure 15: Rising Equities and Narrowing Bond Spreads Point to Lower Developing Market Risk



Source: Bloomberg.

Nevertheless, we continue to believe that developing markets are better suited than ever before to withstand the current slowdown and re-pricing of risk. While the spectre of globalization makes developing countries even more exposed to contagion from global trade effects and worldwide capital movement, many countries have worked hard to better insulate themselves against financial turbulence. With deeper pockets, and foreign exchange reserves at all-time highs, governments have used the last few years of solid global demand, surging commodity prices and elevated liquidity to lower their external indebtedness, smooth maturity profiles, and improve currency and interest rate dynamics. Notwithstanding a few notable exceptions, policy credibility appears to be entrenched, and general consensus around orthodox market reforms (including the prevalence of free-floating currencies) will likely act as an important shock absorber going forward. Like most governments, the private sector has also experienced an improvement in its balance sheets. In addition, strong global integration, and healthy diversification of both trade partners and products, will further shelter the developing world from external volatility.

Table 6: Canadian Exports to Developing Markets (CAD mn)

	2005	2006	% Change	% of Total to Developing Markets
Central and Eastern Europe	2,033.6	2,640.6	29.8	9.3
Russia	513.0	793.0	54.6	2.8
Middle East	2,246.4	2,547.3	13.4	8.9
Africa	1,819.1	2,261.6	24.3	7.9
Asia	10,294.8	11,902.2	15.6	41.7
China	6,647.2	7,182.8	8.1	25.2
India	1,033.8	1,535.9	48.6	5.4
South America	2,982.1	3,454.0	15.8	12.1
Brazil	1,061.1	1,275.7	20.2	4.5
Argentina	154.6	166.1	7.5	0.6
Central America	1,482.0	1,663.8	12.3	5.8
Mexico	3,215.8	4,031.5	25.4	14.1
Total Goods	**24,108.6**	**28,533.2**	**18.4**	**70.2**
Total Services (est.)	**11,719**	**12,128**	**3.5**	**29.8**
Total Goods and Services	**35,827.6**	**40,661.2**	**13.5**	**100.0**

Source: Statistics Canada, EDC Economics. Data are domestic exports (customs basis).

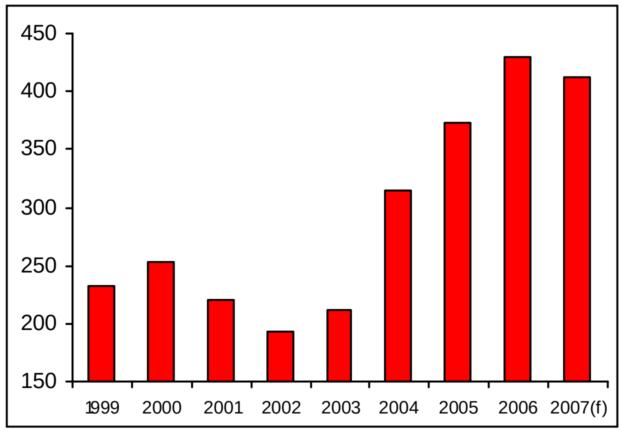
In sum, we do not believe that a broadly based financial meltdown will occur. Keeping our eyes on the big picture, we note that the recent movements of key financial indicators were still relatively small when plotted over the last 5 years.

Of course, a global financial meltdown and accompanying recessions in the world's largest consumer markets would have serious and varying impacts on a country-by-country basis. Should US and EU consumption experience a much deeper downturn (not our basecase scenario), then those economies that have become more reliant on sales to the US would also feel the crunch. This would include Mexico, China, and parts of East Asia and Latin America. Such a higher risk scenario also applies to countries in Eastern Europe (e.g. Russia, Poland, Hungary, Czech Republic and the Baltics) that have become reliant on sales to the EU.

Canadian exports and investment in developing markets

Canadian exports of goods and services to the developing world topped a record $40 billion in 2006, continuing several years of solid growth. This year is bringing more of the same, with Canadian export sales to most emerging markets posting double-digit growth rates so far in 2007. Canadian companies shipped a record $40 billion worth of goods and services to developing markets in 2006, an increase of 13.5% over 2005.

Figure 16: Global FDI Inflows to Developing Markets (US$ bn)



Source: UNCTAD, EDC Economics.

For 2007, EDC Economics expects Canada's exports of goods and services to the developing world will rise a further 20% or more. Commodities and resource-based intermediates are showing the strongest export gains this year, but shipments of high-tech equipment, consumer goods and industrial machinery are also recording solid growth. Exports of energy and mining equipment are doing particularly well, while sales of agricultural machinery are benefiting from rising global crop production. Overall, exports are forecast to grow at a slower pace (8 to 10%) in 2008 as economic activity across developing markets loses some momentum.

Table 7: Stock of Canadian Direct Investment to Developing Markets (CAD mn)

	2005	2006	% Change	% of Total to Developing Markets (2006)
Central and Eastern Europe	8,262	11,205	36	21
Africa	3,560	4,595	29	9
Developing Asia/Middle East	6,006	7,096	18	13
South America	18,833	20,172	7	38
Brazil	6,710	8,244	23	16
Chile	5,369	5,171	-4	10
Argentina	4,172	3,981	-5	8
Central America*	1,978	2,917	47	6
Mexico	3,453	4,369	27	8
Other Developing Markets	1,611	2,219	38	4
Total FDI in Developing Markets	**43,703**	**52,573**	**20**	**100**

Source: Statistics Canada, EDC Economics.
*Excludes Bahamas, Barbados, Bermuda and the Cayman Islands

Investment in developing economies has been strong in recent years as global investors looked to tap into these fast growing markets. Total foreign direct investment (FDI) flows into emerging markets amounted to an estimated US$ 430 billion in 2006. Although we expect some easing in investment flows during the remainder of 2007 and 2008, the annual totals will remain above historical norms. Large amounts of investment in infrastructure, energy, mining and telecom will continue to support Canadian exports of related equipment and services through the next 12 to 18 months, albeit at a slower pace of growth than experienced in the past couple of years.

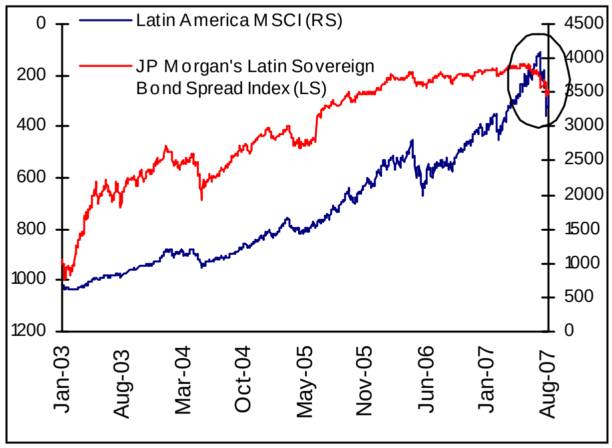
Canadian companies have also boosted their investment in developing countries, with CDIA (Canadian direct investment abroad) flows amounting to an estimated $11 to $12 billion in 2006. Preliminary data for the first half of 2007 show an easing in CDIA to developing markets. At the end of 2006, the stock of Canadian direct investment in the developing world amounted to $52 billion, a 20% increase over the previous year and nearly 2½ times bigger than a decade ago. Slower economic growth and increased risk perceptions suggest Canadian investment in emerging markets will slip back through the next 12 to 18 months. Long-term prospects remain quite favourable however, as strong economic growth and development will provide investment opportunities across the developing world.

5.2 Developing Market Outlook in Detail

5.2.1 Latin America

The US sub-prime fiasco has cast its pall far and wide over emerging markets, converging with several other forces to hasten a global reassessment of risk appetite. Investor concern over the potential effects of a widespread credit crunch on relatively risky Latin American assets surged after the world's leading central banks scrambled to inject critical sums of capital into tightening money markets in August. At the time of writing, JP Morgan's Latin sovereign bond spread index had jumped more than 100 basis points since May – led by Ecuadorian and Venezuelan dollar bonds. In addition, the risk of owning Brazilian debt, the region's most widely held security, had surged (as measured by credit default swaps). Meanwhile, the Latin America MSCI equity index had plunged almost 20% from its July peak, as investors worried that a new global risk aversion would reverse the flow of capital that had been pouring into the region's stock markets. Mexico's Bolsa index was 16% off its highest point of the year.

Figure 17: Latin America – Shaken, but Not Stirred



Source: Bloomberg.

As with the developing world in general, many developing countries in Latin America have taken advantage of the strong global growth and ample liquidity of recent years to improve their financial position. Although the effects of the US-led slowdown will certainly be felt in the region, many countries are now better able to withstand such ill effects. We expect growth in the region will slow in 2008, while recent developments in world financial markets have tilted the balance of risks toward the downside.

Table 8: Canadian Merchandise Exports to Latin America by Country (2005-2006)

Top 5 Markets	2005 (CAD mn)	2006 (CAD mn)	Growth (2006/2005)
Mexico	3,215.8	4,031.5	25.4
Brazil	1,061.1	1,275.7	20.2
Venezuela	512.7	631.2	23.1
Colombia	409.5	452.0	10.4
Chile	379.6	427.7	12.7
All Other	2,098.8	2,327.9	10.9
Total	**7,677.5**	**9,145.8**	**19.1**

Source: Statistics Canada, EDC Economics.

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Mexico

Mexico is highly vulnerable to the US market. Weakness in the US economy has already spilled over into Mexico via stagnating family remittances, slower industrial production and now higher global risk perceptions. These represent the greatest sources of concern for our 2007 and 2008 Mexican GDP outlook. We expect growth of 2.7% and 3.1%, respectively. The government of Mexico is considered investment-grade risk, supported by low external debt ratios, an improved monetary policy, and a fairly stable currency. Despite recent improvements, however, Mexico's commercial operating environment remains challenging, especially with respect to labour market rigidities and contract enforcement. Nevertheless, the country continues to make strides, and the outlook remains positive. Exporting to, and investing in, Mexico present great opportunities for Canadian companies.

Demand for consumer goods will be supported by improved employment, expanding consumer credit and a strong housing market. Manufacturing output should see a modest expansion this year and next, benefiting Canadian exporters of raw materials, intermediate goods and M&E. The manufacturing industry continues to face intensifying competitive pressures from globalization, prompting productivity-enhancing investments. Government spending is also on the rise, particularly in infrastructure. To be sure, overall growth and globalization will stimulate Mexico's demand for transportation equipment and infrastructure investment. But with 35 to 40% of government revenues tied to oil, we caution some downside risk here. Absent any new major investment in oil-production capacity, energy production will probably decline, threatening future economic growth and government spending.

Table 9: Canadian Merchandise Exports to Latin America by Sector (2005-2006)

Top 5 Sectors	2005 (CAD mn)	2006 (CAD mn)	Growth (2006/2005)
Metals	541.9	862.5	59.2
Wheat Farming	665.9	801.9	20.4
Newsprint	641.3	780.5	21.7
Motor Vehicles and Parts	531.1	599.5	12.9
Chemicals	439.4	596.3	35.7
Total	**7,677.5**	**9,145.8**	**19.1**

Source: Statistics Canada, EDC Economics.

Central America and Caribbean

Canadian exports to Central America have seen double-digit growth in each of the past 3 years – with particular strength in petroleum products, building materials, helicopters, pharmaceuticals, food products, and various paper grades. Canadian investment in the region has also surged over that period, capped by a 93% jump in 2006. Going forward, however, Canadian businesses will find a more competitive environment on the isthmus, and will have to be more aggressive to hold onto (if not increase) their market shares. Central America is the only region in Latin America to have both an FTA with the US and stand a good chance of signing one with the EU. Further, after having begun to reduce tariffs unilaterally in the late 1980s, average tariff levels in Central America are today the lowest in all of Latin America.

But the proliferation of new trade and economic cooperation agreements are also expanding the region's potential and improving its investment climate, offering a multitude of new opportunities for Canadian businesses. In addition, large-scale infrastructure projects – including the US$5.2 billion Panama Canal expansion, the multi-billion dollar regional integration scheme known as the Plan Puebla Panamá, and local government infrastructure improvement plans – will offer a host of opportunities for Canadian suppliers and contractors, with overflow into related sectors.

In general, markets in the Caribbean now face elevated risk, not only because of recent global financial strains but also because of high energy costs (despite some offset from the PetroCaribe initiative). **Trinidad and Tobago** is the notable exception, as the country's gas reserves, as well as the government's robust spending plans, mean its appetite for foreign goods and services will stay strong through 2008. The **Dominican Republic** continues to boom, and for Canada the export outlook appears promising, with government spending likely to rise in 2008. Unfortunately, risks will rise too as the country faces elections in May 2008, while there are concerns the IMF program will not be renewed. Growth in Canadian exports to **Cuba** will moderate over the forecast period, but its economy will continue to benefit from high nickel prices and improved access to short-term financing. Meanwhile, exports to **Jamaica** will surge in 2007, but medium-term prospects remain modest, with tourism and resources standing out as potential bright spots.

Overall growth in Central America and the Caribbean is estimated to have slowed to 5.4% in 2007, and a further loss of momentum is expected for 2008 as growth slips to 4.3%. Economic growth averaged 6.8% in 2006, the strongest pace in years.

South America

The South American economy grew 5.6% in 2006 – driven by activity in Argentina and the Andean region. What's more, domestic demand now appears to be picking up at the same time as global trade flows ease and favourable commodity prices trend back toward historical norms. Almost across the board, South American businesses, governments and consumers are playing an increasingly important role in sustaining above-average growth rates. While uncertainty surrounding the US economy could dampen the outlook going forward, we expect average growth over the forecast horizon to fall only slightly. Although the region is better positioned to weather the coming downturn, the consequences of protracted financial market turbulence would differ significantly by country. Like the rest of Latin America, the resource-rich South can be divided into two camps – those that used the commodities boom as a stabilizing force, and those that regressed further into dependency.

The benefits of pragmatic policy orientation and market-based reform underpin macroeconomic stability and structural soundness in Brazil, Colombia, Peru, Chile, and even Uruguay. Solid credit expansion, job creation in the formal sector of the economy, real wage gains, and government transfers have sparked the domestic consumer. Further, comfortable credit and regulatory conditions have facilitated longer planning horizons, leading to improved investment trends and widespread gains in potential growth. Looking ahead, we expect most central bank authorities to remain on alert against inflationary pressure – a result of buoyant domestic demand, and rising food and energy prices. Only Brazil appears to have further scope for monetary relaxation, especially given the sharp appreciation of the *real* and increasing reliance on imports.

The other end of the spectrum is characterized by a general predilection for populist rhetoric, a confrontational approach toward foreign investment, and an often pro-cyclical economic policy bent. In these cases, weak investment, low incentive for diversification and surging government expenditures have fostered increased dependence on commodity prices and rising inflation. The short-sighted policy approach of the Kirchner/Fernandez administration portend another period of economic instability in Argentina, especially in the face of persistent energy shortages. Venezuela remains vulnerable to a sudden and sharp reversal going forward, with oil making up more than half of fiscal revenues and over 90% of the country's export earnings. Ecuador's prospects are also severely constrained by an uncertain investment and macroeconomic backdrop. Like its newly adopted patron, the country's emboldened stabilization fund may allow for some latitude, but on-again off-again musings over a sovereign debt default cloud the outlook for much-needed foreign investment. Weak investment prospects will also undermine Bolivia's economic stability, as will the country's enduring legacy of social and political polarization.

Economic growth in South America is estimated to have averaged 5.5% in 2007, off slightly from last year's 5.6% pace. We expect the pace of economic activity to show a more meaningful slowdown in 2008, as average growth for the region is forecast to pull back to 4.6%. Leading the pack in 2007 is Argentina, Peru, Colombia, Venezuela and Chile with growth in the range of 6 to 8%. The remainder of the region, including Brazil, is on track to post growth in the neighbourhood of 4 to 4.5% in 2007. Growth for all major markets in South America is set to slow in 2008, as commodity prices ease and activity in key export markets loses momentum.

5.2.2 Sub-Saharan Africa

Sub-Saharan Africa has registered 3 years of GDP growth in excess of 5%, and the outlook is promising with GDP growth set to accelerate to 7% in 2007 before easing back to 6.4% in 2008. This performance reflects several years of reforms, strong commodity prices and capital flows from new global investors such as China, India and Russia. Moreover, international commercial lenders have been increasingly involved in large-scale development projects. In addition, the African Development Bank has been able to focus on Africa's large needs for infrastructure and social projects. An increasing share of Sub-Saharan resources can now be channeled to economic growth and development instead of servicing debts.

Table 10: Canadian Merchandise Exports to Sub-Saharan Africa by Country (2005-2006)

Top 5 Markets	2005 (CAD mn)	2006 (CAD mn)	Growth (2006/2005)
South Africa	400.6	575.5	43.6
Nigeria	90.8	212.6	134.2
Ghana	91.4	104.7	14.6
Kenya	37.7	53.2	41.0
Angola	71.4	45.7	-36.0
All Others	322.3	367.1	13.9
Total	**942.8**	**1,313.1**	**39.3**

Source: Statistics Canada, EDC Economics.

The global boom in commodities has certainly made its mark on Sub-Saharan Africa. Many countries have benefited from the run-up in oil and metal prices, including Angola, Madagascar, South Africa, Botswana, Ghana, Mozambique and the Democratic Republic of Congo. Cocoa prices have also been doing much better in 2007, boosting export earnings for Côte D'Ivoire and Ghana. Prospects are equally encouraging for the region's oil producers as crude prices are projected to remain well above their historical averages through the next 2 to 3 years. At the same time, firmer prices for non-energy commodities, donor support and increasingly generous debt relief have lessened the impact of higher oil prices on oil importing African countries.

Table 11: Canadian Merchandise Exports to Sub-Saharan Africa by Sector (2005-2006)

Top 5 Sectors	2005 (CAD mn)	2006 (CAD mn)	Growth (2006/2005)
Aircrafts and Parts	81.6	193.2	136.8
Wheat Farming	126.3	170.2	34.8
Industrial Goods, Other	100.2	130.6	30.4
Agricultural Machinery & Equip.	72.4	92.8	28.2
Other Machinery	43.5	68.6	57.9
Total	**942.8**	**1,313.1**	**39.3**

Source: Statistics Canada, EDC Economics.

Looking ahead, we can expect to see increased activity in the oil and gas sector as companies take advantage of the region's significant energy resources. To be sure, the Gulf of Guinea has emerged as the world's premier deepwater exploration and production basin. Some 55 billion barrels of proven oil reserves were discovered in the past decade and the Gulf of Guinea now accounts for almost 40% of total global deepwater oil production. The Gulf of Guinea is likely to add nearly 3 million barrels per day (b/d) to global oil production by 2012. Although the region presently accounts for less than 5% of proven global oil reserves, more than 20% of global reserves discovered in the past 10 years came from the Gulf of Guinea. Compared to longer established deepwater sites like the Gulf of Mexico, West Africa remains relatively unexplored and exhibits significant potential in oil and natural gas for countries like Nigeria, Angola, Equatorial Guinea, Gabon, Republic of Congo, and Sao Tome and Principe. The impact on investment, balance of payments and GDP growth for these countries will be significant.

Debt Relief Improves the Outlook for Africa

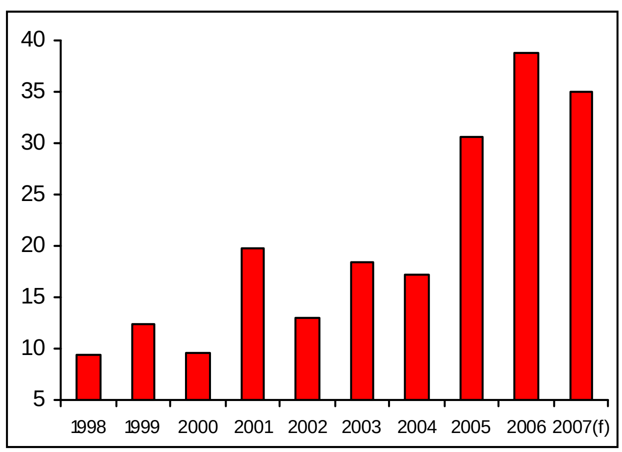
As of August 2007, 23 African countries have implemented macroeconomic policies that can be supported by formal IMF programs. These programs vary across countries, but most have embarked on a Poverty Reduction and Growth Facility (PRGF) program. There are countries, such as Democratic Republic of Congo (DRC), that have been building a track record under a Staff Monitored Program (SMP) to qualify for a formal IMF program. The good news is that these countries are serious about macroeconomic policy, but the bad news is the public sector cannot borrow on commercial terms if these countries want to respect IMF conditionality.

The Heavily Indebted Poor Countries (HIPC) Initiative has identified 40 eligible countries and most of them are in Africa. Among these, 18 Sub-Saharan African countries have reached their “Completion point” so far in 2007. This means that at least 90% of their external stock of debt has been cancelled. In addition, these countries had their debt to International Financial Institutions (IFIs) cancelled in 2006 under the Multilateral Debt Relief Initiative (MDRI). This debt forgiveness has enabled many of the region’s countries to reach balance of payments viability and debt sustainability. Going forward, the focus will be on responsible lending and borrowing, especially in relation to productive investment.

GDP growth in South Africa accelerated to an annual rate of 5% during the past 2 to 3 years, thanks to sound policies, favourable global conditions, and public and private sector spending. Nevertheless, the pace of economic expansion is likely to be sensitive to the higher interest rates required to keep a lid on inflationary pressures, which have been testing the 6% upper limit of the central bank’s target. Conservative policies have reined in the fiscal deficit to manageable levels. Large capital inflows have covered the wider external current account deficit, which have resulted in an accumulation of external foreign reserves equivalent to 6 months of imports cover. South Africa remains an investment grade country. South Africa’s economy is estimated to have grown by 5.4% in 2007, and a similar pace of 5.5% is forecast for 2008.

Despite elections and changes in leadership, **Nigeria’s** economic performance has been improving, and the outlook is encouraging with the new finance minister committed to the reforms introduced by the previous administration. The deputy governor of the central bank has voiced the need for spending discipline, further deregulation and macroeconomic stability. Oil output and earnings have been negatively affected by recurring violence in the Delta region and kidnappings, but the current account remains in surplus. Nigeria has met the performance criteria of the IMF program reviews and made serious progress with its banking sector. An attempt has been made to strengthen the naira (the country’s currency) and check inflation through re-denomination. Credit rating agencies, such as Fitch and S&P, have confirmed their “BB-“rating to Nigeria, a couple notches shy of investment grade. We expect Nigeria’s economy will finish 2007 with growth of 8% before slipping to just below 7% in 2008.

Figure 18: Global FDI Inflows to Africa (USD bn)



2006 is a preliminary estimate.
Source: UNCTAD, EDC Economics.

Angola’s performance has been one of the strongest on the continent, and the outlook is equally promising with double-digit economic growth forecast to continue. GDP is estimated to have grown by 20% in 2007, and we expect an increase of 15% in 2008. The country is benefiting from buoyant oil conditions, diamond mining, agricultural earnings and reconstruction. Admittedly, growth is from a low base. Business conditions are characterized by a feverish macroeconomic climate, double-digit inflation, bottlenecks and shortages, which often result in project cost overruns. Angola is likely to record further large fiscal and external current account surpluses. While reducing external arrears, Angola has been accumulating foreign exchange reserves. The country has been reluctant to follow a multilateral approach to regularize its external debt arrears. However, bilateral oil-backed credit lines have been concluded with countries like China and Brazil.

Table 12: Canadian Foreign Direct Investment (CAD mn)

	2002	2003	2004	2005	2006
Algeria	--	78	--	268	278
Ghana	87	89	284	--	--
Libya	198	--	--	--	--
Mauritius	0	12	12	40	0
Namibia	18	18	19	--	--
South Africa	158	112	129	319	774
Zimbabwe	27	27	27	27	27
Total Africa	**2,804**	**2,218**	**3,277**	**3,560**	**4,595**

Source: Statistics Canada. Data refer to stock of FDI.

Madagascar has been implementing structural reforms for the past 25 years, and has been trying to recover from severe balance of payments and external debt problems since the early 1980s. It remains one of the poorest countries in Sub-Saharan Africa with low savings, poor infrastructure and institutional capacity. Economic growth of around 5% is projected for 2007 and 2008.

Cameroon's GDP growth is improving, but at 4%, it is far too low for an oil-producing country that has benefited from debt cancellation under the Enhanced HIPC initiative and MDRI treatment. Businesses face numerous challenges and foreign investment is held back by poor infrastructure. S&P gives Cameroon a "B-" rating. **Gabon** has benefited from buoyant oil and commodity prices. Far-reaching reforms under IMF guidance and the regularization of domestic and external arrears have boosted investor confidence. Growth appears to have accelerated a little in 2007 with GDP expected to rise by 4.3%. A gain of 4.2% is projected for 2008.

After having implemented back-to-back IMF programs, **Ghana** has experienced solid annual growth of 6% during the past 3 years. For 2007, growth probably accelerated to 6.2%. We expect this pace to continue through 2007. Most of its external official debt has been cancelled. Even though the private sector has to cope with high domestic interest rates and high inflation, private companies have always played a significant role in Ghana. S&P and Fitch have both assigned a B+ rating to Ghana. **Zambia** is emerging from a period of severe macroeconomic problems, which have plagued the country since the beginning of the millennium. The country is recording robust growth while exercising fiscal restraint following the implementation of its PRGF IMF program. Copper output should double by 2009. Zambia has also benefited from the Enhanced HIPC Initiative and MDRI treatment. Economic growth picked up a little in 2007 to an estimated 6.0%, and the momentum is expected to continue with growth forecast at 6.2% for 2008.

The **Democratic Republic of Congo's (DRC)** international financial rescue package is in trouble. The package is conditional on a formal IMF program being put in place. The last Fund program veered off track in 2006, and since then the country has been building a track record. DRC's outlook remains uncertain as the normalization of its financial situation will require additional debt relief under the Enhanced HIPC initiative. Economic growth slowed to 5.1% in 2006, and it looks like the country will not be able to post growth much above this rate through 2007 and 2008.

Kenya's economic growth accelerated to an annual rate of 6% in 2006, and the country is expected to finish 2007 with growth of 6.2% before easing back to 5.8% in 2008. Along with firm prices for tea and coffee, stronger trade flows, tourism and transport activity are adding to the upturn in growth. Kenya's international rescue package, which is back on track, has contributed to a normalization of its financial position while providing a manageable liquidity position. **Sudan**

has recorded high GDP growth and strong export earnings due to oil, but the problems in the Darfur region have made it difficult for the international community to address the country's huge debt arrears.

Canadian exports to Sub-Saharan Africa have been doing very well in 2007. During the first half of the year, exports increased by 45% compared with the same period in 2006. Canadian companies have been shipping more goods to countries such as South Africa (+50% y/y), Nigeria (+56%), Ghana (+42%) and Kenya (+41%). Ongoing investment in mining and energy projects will continue to support Canadian exports of related services and equipment through the next 12 to 18 months.

5.2.3 Middle East and North Africa

The Middle East and North Africa (MENA) countries are enjoying a fourth year of buoyant global oil markets. Macroeconomic performance in 2007 is turning out to be stronger than projected at the start of the year, and may be even better than in 2006 despite ongoing pockets of tension. The outlook for 2008 is equally promising given that global demand and pricing for energy will probably remain robust. In addition, countries such as China and India are looking to forge tighter trade alliances in an effort to secure future energy supplies.

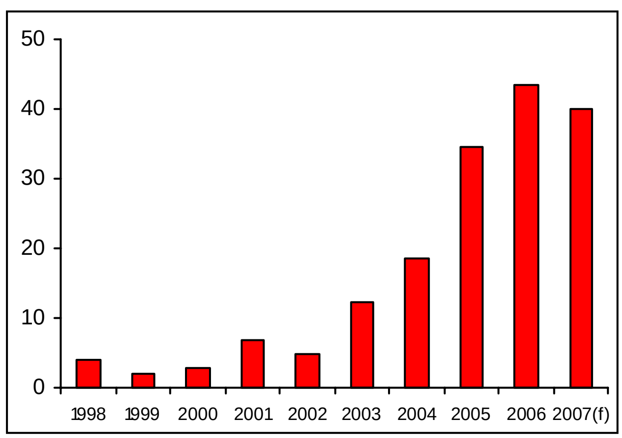
Table 13: Canadian Merchandise Exports to the Middle East and North Africa by Sector (2005-2006)

Top 5 Sectors	2005 (CAD mn)	2006 (CAD mn)	Growth (2006/2005)
Wheat Farming	257.7	674.4	161.7
Other Machinery	423.6	501.7	18.4
Oilseeds and Pulse	191.3	306.2	60.1
Computers and Parts	243.5	242.1	-0.6
Newsprint	248.2	211.2	-14.9
Total	**3118.3**	**3491.4**	**12.0**

Source: Statistics Canada, EDC Economics.

The region has been experiencing an unprecedented macroeconomic boom due to large petrodollar revenues, which have been recycled and re-invested across the region. Over the short term, the Middle East and North Africa is expected to grow faster than the rest of the world, with a GDP growth rate in the area of 5.5% a year during 2007 and 2008, which is respectable given the political difficulties being experienced in the region. The region is characterized by two zones of fast-growing economies – the Gulf Cooperation Council (GCC)[3] countries and the North African countries. The area also embraces a zone of volatility (Iran, Iraq, Syria, PAL and Yemen) where business conditions are challenging. The reconstruction of Iraq and Lebanon has the potential to further boost growth in the region, but violence overshadows prospects in these countries.

Figure 19: Global FDI Inflows to the Middle East (USD bn)



2006 is a preliminary estimate.
Source: UNCTAD, EDC Economics.

The inflow of successive oil windfalls has produced large current account surpluses, which during 2007 are expected to be roughly 10% of GDP for Bahrain and Oman, 20 to 25% of GDP in case of Saudi Arabia and Qatar, and over 30% of GDP in the case of Kuwait. These significant inflows of petrodollars, which coupled with fixed peg currency regimes, have led to a phenomenal accumulation in foreign exchange reserves way beyond simple liquidity needs and exchange rate stability. These earnings, however, have not been reflected in the stock of foreign exchange reserves held by the various central banks of the region. The funds have instead been directed

[3] The GCC includes Saudi Arabia, United Arab Emirates, Kuwait, Oman, Qatar and Bahrain.

into Sovereign Wealth Funds (SWF), which for the region have been estimated at between US$1.5 trillion and US$2.5 trillion. The UAE, for example, has the largest SWF, which is held by the Abu Dhabi Investment Authority, and has been estimated at US$875 billion.

Regional Governments Pursuing Structural Improvements and Economic Diversification

Last July, the largest bank in the region was created with the merging of the Emirates Bank International and National Bank of Dubai (EIB-NBD), with combined assets of US$55 billion. The financial sector has undergone four structural changes over the past few years, which have included: (1) increased lending to the private sector (up by 33% in 2006); (2) a larger role for Islamic banking (growing by 25% a year); (3) modest growth in foreign competition; and (4) reduced public sector involvement, which has been particularly pronounced in Qatar. Despite a relatively large number of banks per capita, particularly in the Gulf countries (e.g. the UAE has 46 banks for a population of 3.2 million), the banking sector remains concentrated with only a few banks holding the majority of lending and deposits. Larger domestic banks are small compared with the large foreign banks looking to participate in the GCC market. Thus, domestic banks have been marginalized in the region's booming project finance and long-term structured financing market. Moreover, domestic banks are heavily exposed to real estate and subsequently vulnerable to price corrections in the regional real estate market, and in particular in the Gulf, following the launching of mega-construction projects.

The pace of economic activity in the region is unprecedented and is due in part to the decision in the MENA countries of investing at home and embarking on economic diversification – especially in the higher value-added end of the hydrocarbon industry such as the petrochemical industry and/or gas production. Unlike the past, petrodollars are remaining in the region, with a greater focus on large-scale mega projects in the Gulf region and in countries with lesser oil resources (e.g. Jordan and Egypt) and in projects in North African countries. Increased spending in infrastructure, construction, real estate, tourism, finance and other non-oil industries (e.g. aluminum smelting) is adding to the area's diversification.

The MENA region has a better business climate than many other emerging countries and the GCC scores high when taking into account institutions, infrastructure and market orientation, according to a study done by Business Monitor International (BMI). The average score for the business environment for the MENA is 52 (over 100) compared with 35 for the rest of Africa. That said, a complex bureaucracy, corruption and skill shortages still undermine the MENA region's business environment.

A planned monetary union among the GCC members by 2010 is questionable after Oman's declaration earlier this year of not being in the position of meeting the criteria, which includes capping budgetary deficits at 3% of GDP, a public sector debt cap at 60% of GDP and an inflation rate cap of 2%. A monetary union has the potential to streamline the GCC's foreign exchange operations, as well as introduce greater monetary and fiscal discipline, which could attract more investment from outside the region.

Issues facing individual MENA countries

Saudi Arabia has announced its largest budget ever for 2007, which could boost expenditures to US$110 billion this year for infrastructure development, capacity building and job creation. Expenditures are aimed at increasing oil capacity to 12.5 million barrels per day (b/d) by 2009 while maintaining 1.5 to 2 million b/d in spare capacity. The Kingdom has been planning a series of mega-projects, such as the US$6.7 billion Knowledge Economic City, the US$8 billion Prince Abdulaziz bin Mosaed Economic City and the US$27 billion King Abdullah City. These special economic zones are expected to focus on tourism, fishing, agriculture, energy and aluminum. Economic growth slipped to 4.6% in 2006, but has since picked up and should average 5% in both 2007 and 2008.

DEVELOPING MARKETS OVERVIEW

The **United Arab Emirates (UAE)**, which are one of the most vibrant economies (7.5 to 8.5% annual GDP growth) among the GCC countries, have embarked on a wave of large-scale investment projects in services, manufacturing and heavier industrial projects that offer a wide range of opportunities for investors. Not only Dubai, but Abu Dhabi has initiated a series of mega-projects. Rating agencies, such as Fitch and S&P, assigned a risk rating of "AA" to Abu Dhabi in July 2007. Economic growth in the UAE is expected to ease back to 8.2% in 2007 and 7.2% in 2008, following a rise of nearly 10% last year.

Kuwait needs major investment to maintain and increase current oil output of 2.5 million b/d. The country intends to build a new oil refinery, perhaps the world largest. Investments in Kuwait's upstream and downstream oil sectors could top US$55 billion by 2020. Kuwait's economy is forecast to grow 7% in 2007 and 6.8% in 2008, up from the 5% pace set in 2006. Last August, Fitch upgraded **Bahrain's** rating to "A". A series of investments to boost oil and non-oil revenues (like low-sulphur diesel and aluminum) is taking place. Bahrain has one of the most liberalized investment codes in the Gulf. Growth in Bahrain's economy has eased from last year's 7.7% to an estimated 6.7% in 2007. A similar pace of 6.6% is forecast for 2008.

Oman, which has aging oil fields, has been pursuing its diversification program through large construction, industrial and tourism projects. Growth is expected to average around 6% in both 2007 and 2008, in line with the past couple of years. **Qatar**, which is at the forefront of the global gas industry, could be the largest LNG producer in the world by the end of 2007 and have the leading role in developing gas-to-liquids (GTL). Qatar has been securing long-term export contracts with the US and countries in Asia and Europe. Developing Qatar's energy sector has involved massive capital spending of about US$40 billion so far, with a further US$10 billion a year required over the next 7 years. These investments will support GDP growth of 7.8% in 2007 and 7.5% in 2008.

Table 14: Canadian Merchandise Exports to the Middle East & North Africa by Country (2005-2006)

Top 5 Markets	2005 (CAD mn)	2006 (CAD mn)	Growth (2006/2005)
United Arab Emirates	511.9	706.4	38.0
Saudi Arabia	395.2	499.0	26.2
Egypt	304.5	405.7	33.2
Israel	396.8	391.7	-1.3
Iran	256.2	287.4	12.2
All Others	1,253.6	1,201.3	-4.2
Total	**3,118.3**	**3,491.4**	**12.0**

Source: Statistics Canada, EDC Economics.

The series of UN and US sanctions, imprudent economic measures and worsening business conditions have taken a toll on **Iran's** economy. Government spending and strong oil prices are boosting growth, for now. But inflation is also a concern. Economic growth is expected to average 4.3% in 2007 before slipping back to 4% in 2008. Investment of US$100 billion is needed to refurbish the oil and gas sector, but investors are nervous. Transferring payments out of the country is increasingly difficult. Tourism and FDI flows to **Lebanon** have fallen dramatically, and disbursements of the US$7.6 billion pledged earlier this year have been difficult due to political impasse and security risk. Economic growth will remain sluggish through the next 18 months.

Algeria's 2007 budget calls for a sharp rise in capital spending under its 2005 to 2009 public investment program. The country has been pre-paying its external debt and has accumulated foreign exchange reserves equivalent to several years of import cover. Algerian economic growth has picked up in 2007 and should average 4.8% for the year. The momentum should continue through 2008 with growth forecast at 5.2%. **Libya's** GDP growth is forecast to accelerate to 8% during 2007 to 2008 (vs. 5.6% in 2006), largely due to strong government spending. Large surpluses have led to foreign exchange reserves equivalent to several years of import cover.

Egypt's economy is benefiting from greater investment inflows, tourism earnings and workers' remittances, due largely to robust economic conditions in the GCC countries. The balance of payments is doing well, but the budgetary deficit and inflation are of concern. Although easing a little, economic growth in Egypt remains solid at an estimated 6.4% in 2007. A similar pace of

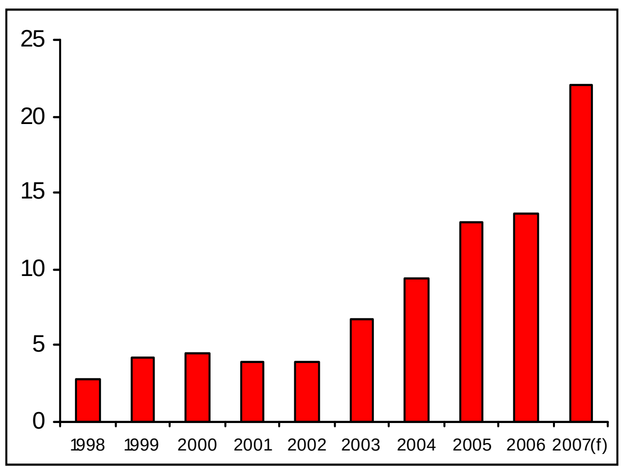
6.3% is projected for 2008. **Tunisia** aims to grow by 6% a year by boosting exports and investment to raise income and reduce unemployment. Tourism receipts, workers' remittances and FDI from the Gulf countries are supporting **Morocco's** economy, although growth has slipped to an estimated 3.5% this year. **Iraq's** reconstruction and oil production continue to be seriously affected by a lack of security. Despite restive neighbours, **Israel's** economy is doing well. Economic growth of around 5% is forecast for 2007 (in line with 2006), but 2008 will see growth slip to 4.5% as the Israeli economy is affected by the slower US and world economies.

5.2.4 Central and Eastern Europe

Central and Eastern Europe (CEE) is continuing its strong growth performance this year, driven by the larger economies of Russia, Turkey, Poland and Ukraine. These countries, with their trade access to developed international markets, have boosted economic activity among the smaller neighbouring countries. Looking forward, the global economic expansion and associated boom in commodity prices now appear to be moderating, led by the housing-related economic slowdown in the United States. The Eurozone, the most important export market for the larger economies in the CEE region, is forecast to grow by 2.4% in 2007 and 2.2% in 2008. This growth profile will frame CEE regional growth of 6.4% in 2007 and 5.4% in 2008.

Risks to the outlook continue to point to the downside. Among developing markets, the CEE region appears somewhat more vulnerable to a more prolonged liquidity crunch, on the basis of their respective weaker macroeconomic fundamentals. In particular, the large current account deficits of Turkey, Hungary and possibly Romania make them vulnerable to any major global financial revolt. Our baseline scenario is that the liquidity squeeze is short in duration, allowing a more gradual re-pricing of risk in developing markets.

Figure 20: Global FDI Inflows to Russia (USD bn)



2006 is a preliminary estimate.
Source: UNCTAD, EDC Economics.

The **Russian** economy continues to expand at a robust pace, driven by strong foreign investment, industrial production and domestic spending. World energy prices are central to the current expansion and improving external balance and will remain pivotal in 2007 and 2008. Even so, growth is forecast to slow somewhat during the remainder of this year and into next. Growth in 2008 is forecast at 5.9% compared with 6.8% in 2007. Demand from EU countries is expected to ease going forward. In addition, real ruble appreciation is expected to dampen export volume growth. Emerging capacity constraints and bottlenecks will impose progressively more binding constraints on real economic activity. And lastly, structural reforms that are either lagging or postponed could prove problematic for growth beyond 2008. But, slower real economic growth will not tarnish Russia's financial health. Although commodity prices are forecast to pull back, prices will remain at levels high enough to continue the feathering of the financial nest egg, helping to ensure strong import volume growth. This will bode well for Canadian exporters, particularly those who specialize in agricultural machinery and energy-related mining equipment. Opportunities also appear to be growing in transportation, electrical, medical and scientific equipment. Canadian companies continue to grow their export sales in Russia, with shipments rising by over 50% to reach $876 million in 2006. Canadian export sales are on track to post strong gains again in 2007, with industrial and mining machinery, aerospace components, automotive and meat products taking the lead.

Turkey's economy accelerated in the early part of this year, thanks primarily to strong exports.

Looking forward, net export volumes, robust capital investment and government spending will continue to generate respectable growth (of just over 5% in both 2007 and 2008). In contrast though, household spending activity will be fairly modest at best due to very high interest rates. Turkey's central bank has kept rates high for quite some time in an effort to bring down inflation, which is currently above inflation target goals. Interest rate relief next year, which is the more likely scenario, will depend upon inflation expectations and the pass-through effects of a weaker lira currency to prices of imported goods. Although Turkey's financial situation is in fairly good shape, with its large current account deficit mitigated by strong FDI and plentiful foreign exchange reserves, certain vulnerabilities are noteworthy. Among the central and eastern developing countries, Turkey's external financing needs are the greatest, which renders itself vulnerable to current turmoil unfolding in international markets. In addition, any potential unwinding of carry trades adds an additional layer of risk to the outlook. So far, global business confidence remains largely intact and the expected re-pricing of risk in financial markets has had little effect on Turkey's external debt. Although subdued household spending will dampen imports, Canadian exports to Turkey will still experience robust growth. Canadian merchandise exports to Turkey increased by 13% in 2006, reaching $540 million. So far this year, the steady upward trend seen in recent years has continued, with exports up around 20% over the first 6 months of the year compared to the last 6 months of last year. Apart from coal exports, the strongest export growth has been in pulp and paper, agricultural products, medical equipment and various machinery and electrical components.

Table 15: Canadian Merchandise Exports to Central and Eastern Europe by Country (2005-2006)

Top 5 Markets	2005 (CAD mn)	2006 (CAD mn)	Growth (2006/2005)
Russia	513.0	793.0	54.6
Turkey	450.2	520.5	15.6
Poland	228.9	261.1	14.1
Romania	149.3	206.9	38.6
Czech Republic	130.7	205.8	57.5
All Others	561.6	653.3	16.3
Total	**2,033.6**	**2,640.6**	**29.8**

Source: Statistics Canada, EDC Economics.

The **Polish** economy broadly speaking is very solid, with its growing trade linkages into developed European markets acting as a real source of strength. Economic growth in the first half of 2007 year has been slightly stronger than last year, running at around 7%. Thanks to foreign direct investment targeted at export-oriented industries, Poland's industrial machine is operating in high gear, with growth up over 13% in the first quarter of this year. While FDI and business spending have added to growth, employment gains and healthy wage and salary growth have boosted household incomes, resulting in stronger consumer spending. Understanding that the real economy is firing on all cylinders, it is fairly remarkable that inflation remains low, clocking in at around 2%. Although there has been some upward momentum recently, inflation is unlikely to pose problems for monetary authorities, which will enable central officials to keep rates fairly accommodative at around 5%. On the financial side, Poland's situation is relatively good. Foreign exchange reserves are rising and FDI flows mostly cover the current account deficit (which is in the range of 2 to 3% of GDP). In addition, the dominance of foreign-owned banking institutions helps limit the financial stress risks to the real economy. Looking forward, the country's growth looks set to continue on the strength of trade linkages and strong domestic activity. But the pace of growth is forecast to slow to 4.4% in 2008 versus this year's expansion of 6.4%. Canadian exports to Poland in 2006 were $310 million, up 16% from $267 million in the previous year. Apart from base metals, export growth has been strong for pharmaceutical and medicine,

Table 16: Canadian Merchandise Exports to Central and Eastern Europe by Sector (2005-2006)

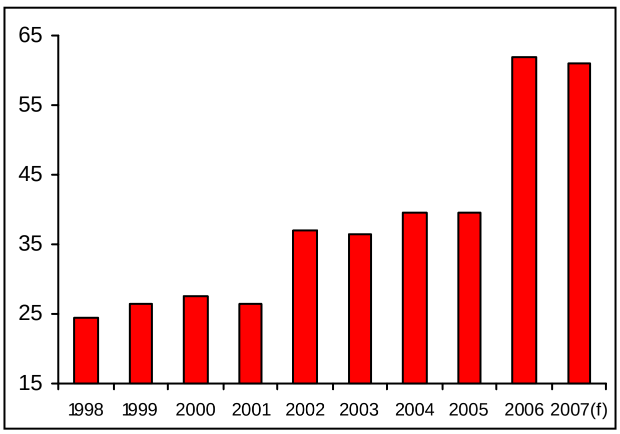
Top 5 Sectors	2005 (CAD mn)	2006 (CAD mn)	Growth (2006/2005)
Other Machinery	246.1	300.9	22.3
Meat Products	165.3	275.1	66.4
Agricultural Machinery and Equipment	131.9	220.1	66.8
Computers and Parts	153.4	187.9	22.5
Chemicals	107.8	177.1	64.3
Total	**2,033.6**	**2,640.6**	**29.8**

Source: Statistics Canada, EDC Economics.

aerospace parts, power transmission equipment, rubbers and plastics, and various industrial and electrical machinery and equipment.

Ukraine's economy is on track to expand briskly this year and next, thanks largely to strong capital investment and household spending. Net exports continue to act as a drag on overall growth though, with the bulk of export shipments (steel and agri-food products) destined for Russia, Turkey and Italy. Looking ahead, Ukraine's trade deficit is expected to rise later this year and into next, due to declines in their terms of trade (natural gas prices up, steel prices down). Strong domestic spending will drive import volume growth, which will also contribute to the trade deficit. Consequently, Ukraine's current account deficit is expected to widen further in 2007 and 2008. Canadian exports to Ukraine in 2006 were $106 million, up 30% from $82 million in the previous year. Growing export opportunities are in pharmaceutical and medicine, seafood products, agricultural machinery and other industrial equipment.

Figure 21: FDI Inflows to Central & Eastern Europe (USD bn)



2006 is a preliminary estimate.
Source: UNCTAD, EDC Economics.

The **Czech Republic** economy is growing at a strong pace, around 6% so far this year. Thanks to solid household spending, domestic demand has been the engine of growth. Looking forward, this is expected to continue, although to a somewhat lesser extent due to government tax reform and reductions in welfare entitlement benefits. We expect economic growth will ease to 4.3% in 2008. Underlying inflationary pressures will remain largely contained this year and next, owing to structural economic changes that are producing productivity improvements. A stable currency together with stronger trade integration with developed European economies will continue to support exports. A strong domestic economy will also ensure robust import demand, which will continue to present export opportunities for suppliers of pharmaceutical and medicine products, refined metals and alloys, aerospace parts, telecommunications equipment and other general industrial machinery and equipment. Canadian exports to the Czech Republic were $217 million in 2006, up 54% from $141 million in the previous year.

The **Romanian** economy is expanding briskly, but concern that the economy is over-heating is evident. Domestic demand growth is hot, driven by employment gains and rapid credit demand growth, compounded further by pro-cyclical fiscal policies with strong public sector wage growth. Domestic spending is now clearly in the driver's seat, as strong import growth pushes the current account deficit higher (over 10% of GDP and rising). Around one third of the deficit is covered by FDI at present, much lower compared to almost full cover in 2002. These developments increase the risk of a loss of financial market confidence, resulting in sudden capital outflows and greater volatility and depreciation of the local currency (the leu). Growth in Romania's economy is forecast to slow to 5.1% in 2008 (down from an estimated 6.3% in 2007) as EU demand softens, and tighter monetary policy dampens domestic consumption. Canadian exports to Romania in 2006 were $214 million, up 34% from $159 million in the previous year. Apart from base metals, Canada's export prospects remain positive for meat products, computer equipment, heat and boiler equipment, wire and wireless telecommunication equipment and industrial and electrical-type equipment.

The **Hungarian** economy is slowing this year, restrained by much weaker household and government expenditure. Consequently, the main growth support this year and into 2008 will come from net exports. Thus far, past appreciation of the local currency (the forint) has not had any substantial effect on exports, thanks to fairly strong foreign demand, particularly from

Germany. Looking forward, export growth is expected to remain relatively solid while weaker domestic spending softens import volumes. Consequently, the current account deficit is not expected to decline further, remaining within 4% to 5% of GDP. Risks to the outlook are noteworthy though. Recent financial market turbulence had a substantial negative impact on the forint, an indication of Hungary's potential vulnerability to further disturbances in financial markets. High external debt and dependence on foreign investors to finance its deficits leaves it vulnerable to a shift in investor confidence. Overall growth in Hungary weakened to an estimated 3.0% in 2007 and a further softening to 2.8% is projected for 2008.

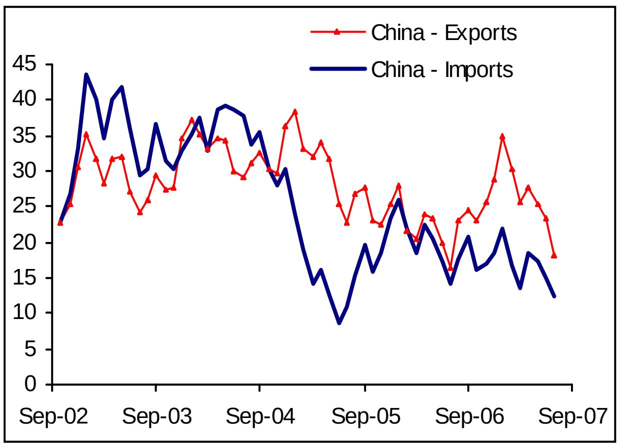
The Baltic economies – **Estonia, Latvia and Lithuania** – are expanding at a fast pace, maybe too fast. Inflation has begun to accelerate, particularly in Latvia and Estonia. These developments alone threaten to delay Eurozone admission, which would be a negative development for these countries given their large current account deficits (15% to 25% of GDP), rising private sector debt, and in some cases low external liquidity and high short-term debt (Latvia). Among the Baltic countries, Lithuania appears to be in a somewhat stronger economic and financial position.

5.2.5 Asia

China

China's economy continued its rapid expansion through the first half of 2007, with growth in the first half of the year averaging 11.5% y/y, above the 10.7% growth achieved in 2006. But the groundwork for an easing in economic growth has been laid – namely a weaker US consumer and ongoing tightening of monetary policy by the Chinese authorities. A strong external sector in recent years has increased the importance of exports to China's economy. Domestic demand remains an important source of growth, but its weighting in the economy has slipped in the past few years. In 2005, household consumption made up 38% of China's GDP, down from 46.4% in 2000. With a weaker US consumer in the outlook, China's growth is expected to lose some steam over the next 12 to 18 months. As a result, growth is forecast at 11.0% in 2007 and 10.0% in 2008.

Figure 22: China Exports and Imports Losing Some Momentum (6-month moving average – y/y % change)



Source: Bloomberg, EDC Economics.

External reserves passed the quasi-mythical level of $1 trillion early this year, and have since continued growing, thus strengthening the country's external position. Export growth in the first 7 months of 2007 increased still further, to 30% y/y versus last year's average growth of 26% during the same period. Import growth has remained relatively stable at around 20%. This has created a burgeoning trade surplus, adding fuel to the potential war of words between the US and Europe over the value of China's currency, the yuan. The top destinations for Chinese exports are the US, EU and Japan. As these economies slow,

Table 17: Canadian Merchandise Exports to Developing Asia* by Sector (2005-2006)

Top 5 Sectors	2005 (CAD mn)	2006 (CAD mn)	Growth (2006/2005)
Metals	1,043.9	1,654.5	58.5
Chemicals	1,474.4	1,524.9	3.4
Pulp	1,160.7	1,497.5	29.0
Wheat Farming	682.7	975.9	42.9
Oilseeds and Pulse	625.7	886.7	41.7
Total	**10,297.2**	**11,905.2**	**15.6**

Source: Statistics Canada, EDC Economics.
*Developing Asia refers to all Asian countries except Japan, Hong Kong, Singapore, South Korea and Taiwan.

China will inevitably lose momentum as well – an outcome that will have a negative spillover effect on countries that ship a significant portion of their exports to China. Much of East Asia and commodity exporters in Latin America and Africa will feel these knock-on effects.

An important corollary of rapid economic growth is inflation. After having been contained from March 2005 to December 2006, inflation has increased this year, reaching a 10-year high of 5.6% in July (above the Central Bank's 3% target). Chinese authorities have attempted to rein in economic growth by tightening bank reserve requirements and raising interest rates, along with other administrative actions. It remains to be seen how much effective tightening the authorities can carry out given that China's financial markets remain relatively shallow. Slower US growth will certainly have a more pronounced effect on China's exports, which has been the country's economic engine.

Table 18: Canadian Merchandise Exports to Developing Asia* by Country (2005-2006)

Top 5 Markets	2005 (CAD mn)	2006 (CAD mn)	Growth (2006/2005)
China	6,647.2	7,182.8	8.1
India	1,033.8	1,535.9	48.6
Indonesia	682.7	779.5	14.2
Thailand	428.3	491.1	14.6
Malaysia	346.5	461.9	33.3
All Other	1,158.5	1,453.9	25.5
Total	**10,297.2**	**11,905.2**	**15.6**

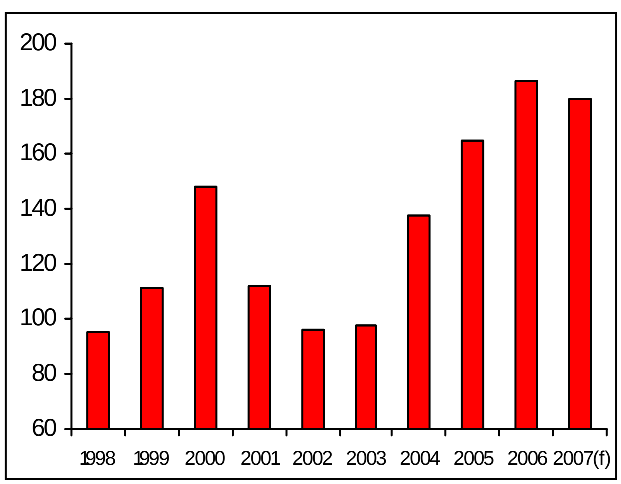
Source: Statistics Canada, EDC Economics.
*Developing Asia refers to all Asian countries except Japan, Hong Kong, Singapore, South Korea and Taiwan.

South Asia

India's economy is continuing its rapid expansion with GDP growth of 9.2% in 2006, ahead of the 8.5% pace set in 2005. But surging economic growth coupled with supply-side constraints, rapid credit growth and a rising current account deficit have raised fears of overheating, prompting a reaction by the Central Bank to cool the economy through successive interest rate hikes and higher bank reserve requirements. Despite these measures, the Indian Central Bank (RBI) is still clearly worried about the growing threat of inflation. The latest data (June 2007) show inflation running between 5.7% and 7.8% in three of the four principal consumer indexes. While this is down from the average of nearly 8% recorded in April-May 2007, it remains higher than the RBI target of 5.0 to 5.5%. Tighter monetary policy could be the reason why industrial production is losing some momentum. Export growth, while still strong, has also been generally weaker in 2007. With the world economy slowing through the next 12 to 18 months, India's economy is also expected to slow. Domestic demand is expected to continue its solid performance, although more restrictive monetary policy will dampen some of the growth in consumption and investment. As a result, Indian GDP growth is forecast to slow to 8.2% in 2007 and 7.9% in 2008.

The political situation in **Pakistan**, **Sri Lanka** and **Bangladesh** will overshadow the solid growth forecast for these countries in 2007 and 2008. Slower growth in the main export destinations of the region, especially the US and Europe, will dampen prospects for the important textile and garment industry of those countries. Nonetheless, we expect the current account balances to improve going forward, based on a smaller oil import bill and rising remittances from abroad, which will remain an important source of foreign exchange. Strong global prices for agricultural commodities including wheat and rice will support farmers' income, but at the same time maintain inflation at elevated levels. As such, monetary policy

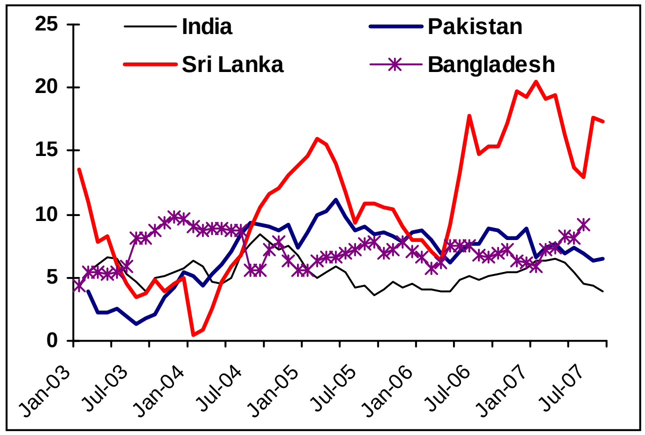
Figure 23: Global FDI Inflows to Asia (US$ bn)



2007 is a preliminary estimate.
Source: UNCTAD, EDC Economics.

easing is unlikely in the near future. At the same time, risk perceptions for the region remain high and capital flight is a possibility. Political instability, governments' fiscal situation and macroeconomic instability are the main downside risks in the region, which could result in capital flight, a more rapid depreciation in local currencies against the US dollar and much weaker growth. Overall, we expect economic growth in Pakistan to remain just above 6% in 2007 and 2008, in line with 2006. In Sri Lanka, economic growth will slow to a still respectable 6.0% in 2007 and 2008 after expanding 7.4% in 2006, as tighter monetary and fiscal policies take their toll. Growth in Bangladesh will slow to 6.3% in 2007 and 6.2% in 2008, as weaker export demand for textiles and garments, and more moderate growth in the agriculture sector take hold.

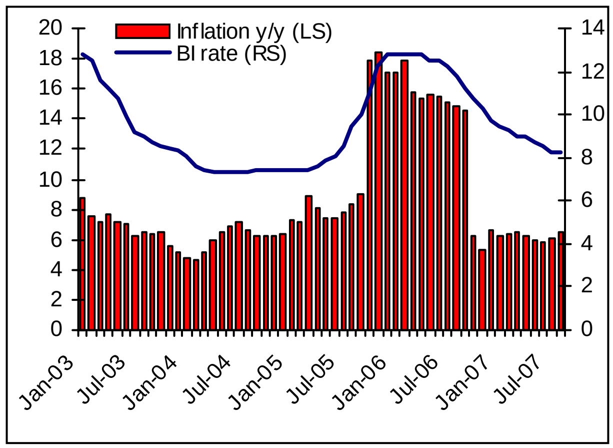
Figure 24: Inflation Pressures Remain in South Asia (y/y % change in consumer price indices)



Source: Bloomberg, IMF, Bangladesh Bank.

Southeast Asia

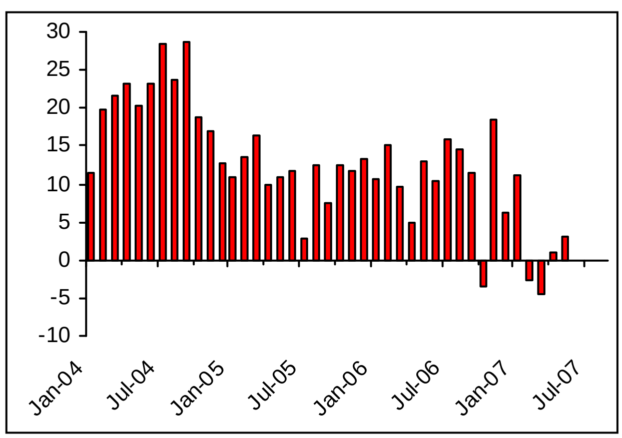
Figure 25: Monetary Policy Easing Continues in Indonesia



Source: Bloomberg. Note: Before July 2005, the reference rate for Indonesia was the SBI 1-month auction yield.

Indonesia's growth will hold steady through 2007 and 2008, driven by government spending, and greater investment and household consumption generated by aggressive interest rate cuts. With inflation sitting comfortably within the target range of 5 to 7%, rate cuts will be sparser from now on. A new investment law passed in March will also encourage FDI inflows, and provide further support to growth. Real GDP growth will reach 6.1% in 2007 and 6.0% in 2008, up from 5.5% in 2006. The proposed 2007-08 budget includes substantially higher government spending in transportation safety, education and infrastructure, three major roadblocks to improving the country's growth potential. Other reforms in mining, labour, customs and taxation are underway, which could support stronger growth in 2008 and beyond.

Figure 26: Malaysian Exports Faltering (y/y % growth)

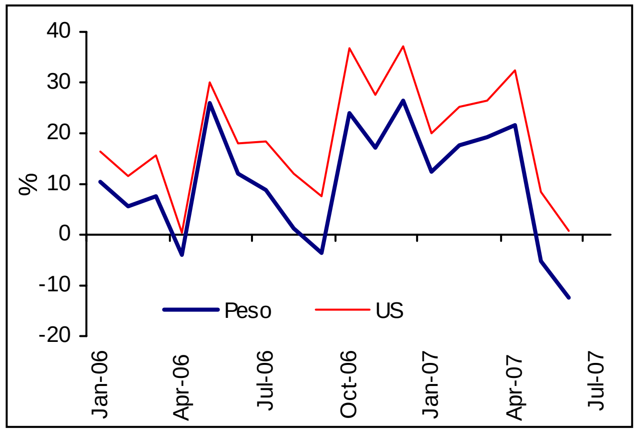


Source: Bloomberg.

Malaysia's real GDP growth will soften to 5.5% in 2007 (after showing a strong 5.9% increase in 2006), as electronics exports (49% of total) weaken with the US and global tech slowdown. The ringgit's recent depreciation will benefit exporters, but will not be sufficient to offset weakening demand from key markets. Higher public investment from the Ninth Malaysia Plan will put a floor under economic growth in 2007 and 2008, along with the expansion of the palm oil sector for the biofuel industry and the manufacturing sector. Government spending pressure will also come from generous public service wage increases announced in May, the construction of a US$7 billion oil pipeline bypassing the Malacca Strait, and the Northern Economic Corridor Region development program. Nonetheless, the government's deficit-to-GDP ratio will continue to improve and remain manageable. With inflation under control, the Central Bank will maintain its neutral stance regarding monetary policy. In 2008, growth is expected to stabilize at 5.5%, as greater government spending offsets weaker external trade.

Philippines' real GDP growth hit a 17-year high in the first half of 2007, reaching 7.2%, on the strength of greater household consumption and election-related spending from the government. While government spending will ease in the remainder of 2007, record levels of remittances, which rose 18% y/y in the first half of 2007, will continue to support household spending. Electronics exports, which represent over half of total exports, have been weakening in recent months as global demand for electronic goods slows, and are expected to weaken further going forward. Exporters will also be affected by the strong peso, which had increased 13% y/y against the US dollar at the end of August. Excess liquidity, related to record levels of remittances and portfolio investment inflows, will prevent the Central Bank from easing monetary policy in the short term despite low inflation. GDP growth should accelerate to 6.4% in 2007 before slowing to less than 6.0% in 2008.

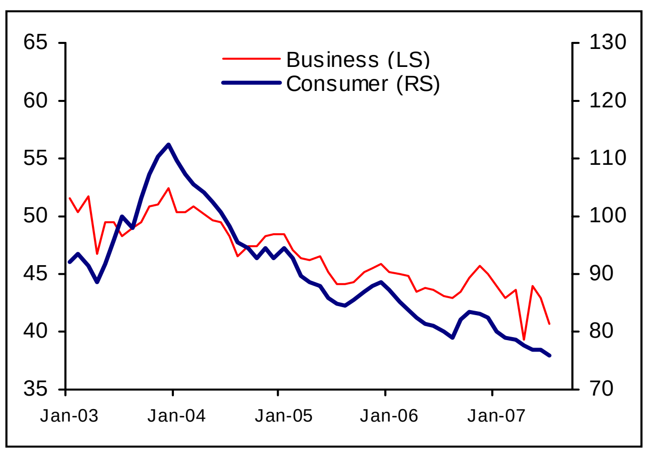
Figure 27: Philippines' Remittances (y/y % change)



Source: Bloomberg.

Thailand's real GDP growth will slow markedly to 4.0% in 2007, as a series of controversial decisions by the military government has sapped business and consumer confidence, leading to sharp declines in household consumption and investment. At the same time, the rapid appreciation of the baht and weaker growth in the US and Japan are putting more and more pressure on exporters, the last remaining engine of growth in Thailand. The baht's appreciation and the retreat of private demand have created a low inflationary environment, which allowed the Central Bank to repeatedly cut interest rates in a bid to stimulate growth. Growth in 2008 will be a little stronger at 4.3%, as we anticipate pent-up personal consumption will be released following the return of a democratically elected government and supported by the interest rate cuts in 2007.

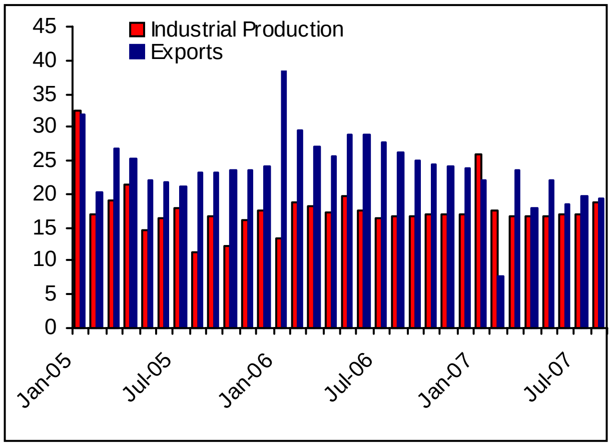
Figure 28: Thailand's Business and Consumer Confidence Continue to Deteriorate



Source: Bloomberg.

Vietnam export growth will remain strong over the next 2 years as large inflows of FDI build up export capacity. Oil exports will soften with reduced production at existing fields and lower prices, but will be compensated by high agricultural prices and increased textile exports. FDI inflows have boosted inflationary pressures, leading the government to take a series of measures to rein it in. Letting the *dong* appreciate was not one of them, as the government wants to support its exporters. Imports will also expand rapidly, because of greater consumer demand and investment. With greater investment and the related construction boom, real GDP growth will remain high in 2007 and 2008 at 8.0%. The government's fiscal balance will come under pressure with weaker oil production and prices, reduced tariffs (WTO obligations), higher public sector wages and greater investment in infrastructure.

Figure 29: Vietnam Exports and Industrial Production Still Strong (y/y % change)



Source: Bloomberg.

Canadian exports to developing Asia continued to increase rapidly in the first half of the year, gaining 18.4% y/y. Rising exports to China (+41%) and India (+52%) represent almost two thirds of the increase. China is now the main export destination of Canadian goods in emerging Asia, and is closing in on Japan as the number one market for Canada in the region. Canada's exports to other countries have also increased substantially, including Indonesia (+16%), Thailand (+34%), Pakistan (+41%), Philippines (+47%), Malaysia (+12%), Bangladesh (+47%) and Vietnam (+30%). Surging economic growth and industrialization have increased the demand for Canadian industrial goods, energy, and machinery and equipment. Exports of agricultural commodities have also increased rapidly so far this year, thanks to higher prices for some of Canada's major crops, especially wheat, canola and barley.

Table 19: Quarterly GDP Growth in Select Asian Countries (y/y % change)

	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q2 2007
China	10.4	11.5	10.6	10.4	11.1	11.9
Indonesia	5.0	5.0	5.9	6.1	6.0	6.3
India	10	9.6	10.2	8.7	9.1	9.3
Malaysia	6.0	6.1	6,0	5.7	5.5	5.7
Philippines	5.7	5.5	5.1	5.5	7.1	7.5
Thailand	6.1	5	4.7	4.3	4.2	4.4
Hong Kong	8.1	5.6	6.8	7.3	5.7	6.9
South Korea	6.3	5.1	4.8	4.0	4.0	4.9
Taiwan	5.0	4.7	5.1	4.0	4.2	5.1

Source: Bloomberg

Central Asia

Strong global demand for oil, gas and metals will sustain high growth rates in much of Central Asia in 2007 and 2008, but at a generally softer pace than in 2006. The rapid industrialization of China, India and Russia will only partly offset softening demand from the US, Europe and Japan, weakening overall export demand for metals and petroleum. As in recent years, the continued development of mining and hydrocarbon projects will again be supported by greater public spending and infrastructure investment. The high level of investment capital flowing into the region has in most cases driven up inflation, which

Table 20: Stock of Canadian FDI in Major Asian Markets (CAD mn)

	2002	2003	2004	2005	2006
Hong Kong	2,642	3,037	3,062	3,361	3,801
Singapore	4,228	3,703	3,577	3,532	4,007
Indonesia	4,193	3,436	3,248	2,639	3,127
China	721	838	1,034	1,344	1,563
Korea, South	749	698	1,362	356	431
Malaysia	718	435	564	494	568
Thailand	923	534	610	802	972
India	222	204	214	314	327
Taiwan	66	72	69	98	103
Philippines	153	117	119	114	141

Source: Statistics Canada.

monetary authorities have had little, if any, success in keeping under control. Outside the mining and energy sectors, FDI in the region will be limited, as political instability and a generally difficult operational environment continues to drive away many potential investors.

In Kazakhstan, oil output will increase only slightly in 2007, so economic growth will mostly come from the construction industry and the rapidly expanding services sector, particularly financial, banking, telecommunications and transportation. The development of oilfields will continue to generate high FDI inflows in the future, despite the ongoing problems at the Kashagan oilfield. High inflation and credit growth are potential sources of macroeconomic instability, especially considering the rapid increase of external borrowing to finance domestic credit demand.

Canadian exports to Central Asia and Caucasus have increased significantly over the past few years, but declined 8% y/y in the first half of 2007 to $106 million. Almost 70% of the total so far in 2007 was destined for Kazakhstan. High prices for metals and oil and gas will sustain mining projects and the demand for mining and construction machinery and equipment. At the same time, the push to develop commercial wheat farming in Kazakhstan and its high price will continue to sustain demand for Canadian agricultural machinery.

6.0 Political Risk Overview – In the neighbourhood: A regional look at politics and investment

We have observed that companies' discussion and framing of international political developments have tended to take place on two levels: global and national. Large-scale, multi-continental situations such as the Cold War, the debt and financial crises of the 1980s and 1990s and, more recently, the so-called Global War on Terror play a major role in shaping investors' risk appetites and judgments about which markets make good investment destinations and which do not. At the same time, many companies also pay close attention to political trends, regulatory environments and government attitudes toward business within individual countries. This national-level focus is understandable as it is local laws, regulations, institutions and personalities that effectively enable the establishment and continued operation of foreign-invested enterprises and with which oversees managers have the most contact. This two-level focus has been the general rule for at least a decade and a half.

However, in the past year or so many of our clients have raised concerns that imply another level of analysis: regional. We are being asked questions such as:

- Could terror attacks in one Middle-eastern country significantly destabilize the whole region?
- Can we expect contract renegotiations in Venezuela to be repeated in other Latin American markets? and
- Why are we losing out to Kremlin-connected Russian companies in Central Asia? With increasing frequency.

In addition, concepts such as correlation risk and policy contagion are entering the underwriting calculus of the political risk insurance industry.

The questions above imply a central premise: political developments in one county can affect the investment environments of neighbouring nations. In the emerging markets, the dynamics of intra-regional influence are often based upon circumstances particular to the region at hand and vary greatly in terms of their sustainability.

Political risk assessment at EDC has always had a heavy regional component and has led to the development of a solid understanding of the investment implications of regional power dynamics. In the following pages, we present our observations and conclusions on a number of regional situations about which Canadian investors have expressed concern.

Latin America

Much of the political discourse on Latin America revolves around the United States' *de facto* leadership position in regional affairs and its bilateral relationships with individual countries. Indeed, Washington's close involvement, combined with Latin American leaders' inability or unwillingness to exert influence beyond their borders, has been a hallmark of the region's history. However, in today's Latin America at least two countries – Venezuela and Brazil – are having a marked influence on investment and business conditions in other countries in the region.

Venezuela's leader, Hugo Chávez, is spearheading what he calls the "Bolivarian socialist revolution," combining old fashioned charismatic populism with an empowerment of Venezuela's poor and increased regional integration through financial or "in-kind" assistance. Domestically, the revolution is predicated upon channeling economic wealth into massive government spending and social programmes for the benefit of the poor. In Venezuela, a country that is highly dependent upon oil exports, social spending of this magnitude requires that the state get its hands on much of the money generated by the petroleum sector. One of the ways that Chávez has done this is by renegotiating contracts between the state and foreign investors to increase the state's ownership stake and degree of control over the sector. Firms that have not agreed to the state's new terms have been forced to leave the country.

POLITICAL RISK OVERVIEW

Venezuela's Bolivarian project has been enabled, to a great extent, by the tremendous increase in energy prices following Chávez' rise to power in 1998. Oil revenue windfalls have financed government spending, and the combination of high prices and Venezuela's plentiful reserves have kept foreign companies engaged in the market even as the government imposes less than favourable conditions upon them. So long as oil prices remain high, there will be enough money to keep many investors interested even as the government targets an ever larger share of the petroleum pie.

Proponents of the Bolivarian Revolution hold that the revolution's principles are applicable to other countries with characteristics similar to pre-Chávez Venezuela (i.e. wealth and power concentrated in the hands of a small elite alongside vast numbers of virtually disenfranchised poor). As such, there is a sense that the Bolivarian socialist ideology can and should be exported. The Chávez regime has approached these ideological exports in two ways. Firstly, the oil revenue bonanza has enabled Venezuela to attempt to buy political and ideological influence in Latin America and the Caribbean through financial grants or "in-kind" assistance such as discounted oil. Secondly, and more important to the issue of foreign investment, is that Chávez has produced a demonstration effect. His success in altering the business/operating/investment environment with respect to foreign investors has shown other leaders that it is possible to gain the upper hand and is directly or indirectly encouraging them to try to do the same.

For example, the governments of Bolivia and Ecuador have attempted to follow in Chávez' footsteps by pushing for greater state participation in their countries' respective energy sectors. However, their success to date has been limited. Bolivia had to temper its demands for gas price renegotiations with Brazil while Ecuador has found it difficult to attract foreign investors under its more stringent regulations. Since these countries lack Venezuela's enormous oil reserves and much of the capital and technology needed to extract what they do possess, Bolivia and Ecuador are simply not able to generate enough money and bargaining power to jump on the Bolivarian Revolution bandwagon. Furthermore, other populist leaders who might have been tempted to follow the Chávez example, Nestor Kirchner of Argentina comes to mind, have also realized that they simply don't have the level of natural resources required.

Brazil's impact on the rest of Latin America is deep, long term and structural. The country's vast natural resources, well-established manufacturing base particularly for automobiles, aerospace and capital equipment, and huge labour pool make it an attractive investment destination and trading partner. Covering approximately 50% of the continent, Brazil shares common borders with all but two other South American countries, and as such, has been pushed to develop tight networks of diplomatic and political relationships with a broad range of partners.

In addition, Brazil's leadership position in Latin America has been greatly enhanced by its relatively recent transition from an inward-looking military-ruled state to a democratically governed, emerging power. Abandoning the free spending habits of previous governments as well as the failed import substitution model prevalent in the 1980s in favour of fiscally responsible, investor friendly policies and regulations laid the groundwork for Brazil's emergence and established the governance and investment standards for other nations in Latin America, and in South America in particular. Furthermore, Brazil's policy shift does not appear to be transitory. Four consecutive administrations of differing political persuasions have endorsed and maintained the new course.

Brazil now actively exerts its influence through formal channels as evidenced through leadership of Mercosur, its role as regional leader in World Trade Organization (WTO) and G20 talks, or as a counterweight to the US in Free Trade Area of the Americas (FTAA) negotiations. Regional neighbours/partners that have not integrated with the Brazilian model have seen their investment flows or economic output suffer. One such example was the rapid and unceremonious diversion, earlier this decade, of auto-industry investment from Argentina to Brazil in the face of the Argentine peso crisis and worsening investment conditions there.

Many major, multinational investors have chosen to use a hub and spoke model for South America given Brazil's stability, policy evolution and geographic stature.

A confrontation between the Brazilian and Venezuelan propositions is currently playing out in Central America and the Caribbean on the subject of energy. Following the Brazil-US agreement on ethanol production and relying upon its technological lead in sugarcane-based ethanol, Brazil is proposing assistance to Central American and Caribbean countries to develop their own ethanol industry. Through PetroCaribe, Venezuela is providing cheap oil to 13 Caribbean countries in addition to making small investments in a number of the country's energy sectors. Chávez has also made numerous promises (pipelines, refineries, etc.) to Central American countries while providing them with cheap oil and electrical generators. In general, we expect to see many Central American and Caribbean countries align themselves with Venezuela to adopt more state-centred investment models in the short term.

In the longer term, Brazil's size and its more varied economy will enable it to have a more lasting influence in the hemisphere. The workability of the Bolivarian project appears to be dependent upon circumstances unique to Venezuela at this particular point in time. Therefore, despite Venezuela's stated aspirations toward regional leadership, its overall influence on the Latin American investment environment will be limited. In fact, a precipitous fall in oil prices would raise doubts about the sustainability of Chávez's agenda in Venezuela itself. Meanwhile, Brazil will be able to exert continuing regional influence through outward investment, technical cooperation with Latin American governments and provision of a market for neighbouring countries.

Middle East

Over the centuries, the Middle East has been a key playground of the world's great powers. Empires have overrun and been pushed off Middle Eastern soil for more than two millennia, and the current US troop presence in Iraq is proof that superpower interest in the region has not abated. Fluid intra-regional power dynamics have also been a key component of Middle Eastern history. In recent years, numerous states, including Iran, Iraq, Saudi Arabia, Egypt, Syria and Israel have, at various times and in various capacities, assumed the mantle of regional leadership and influence.

The US-led invasion of Iraq in 2003 triggered a dramatic shift in the balance of power in the Middle East, the effects of which grow stronger with time. Firstly, the removal of Saddam Hussein and the chaos that followed nullified the influence of one of the region's erstwhile key powers. Post-Saddam Iraq cannot govern itself nor secure its people, let alone exercise coherent influence over its neighbours. Secondly, Washington's difficulties in Iraq have taxed the US to the point where it is clear that it no longer has the capability or credibility to impose its will on the region.

Chaos in Iraq and the US quagmire have opened space for Iran. Iran has always been a major player in the region, but its position has been greatly enhanced since 2003. The country's nuclear programme has dominated world headlines, but more tangible and immediate evidence of its rising regional stock can be found in the new-found dominance of Shia groups in Iraq and the emboldened positions and recent military successes of Hizbollah in Lebanon and Hamas in the Palestinian Territories.

The Sunni Arab regimes of the Persian Gulf region (Saudi Arabia, Kuwait, Qatar, Bahrain, the United Arab Emirates (UAE) and Oman) are increasingly preoccupied by the ascendancy of Iran and deeply concerned that instability and militancy in the region will foster sectarian tensions and increased terrorism throughout the Gulf region. In particular, Sunni states with significant Shia populations, such as Saudi Arabia and Bahrain, are wary of the potential for Iran to stir up discontent among their own Shia minorities. The Arab Gulf states are also cognizant that any instability in the Gulf risks dampening investor enthusiasm with respect to a myriad of expanding economic and investment opportunities. These include a real estate boom, numerous industrial mega-projects and the proliferation of schemes aimed at transforming the smaller states into financial, commercial and tourism hubs.

Saudi Arabia's concern over regional developments has prompted it to undertake an increasingly proactive domestic security and foreign policy stance – a major shift away from its traditional role as a behind-the-scenes player under the US umbrella. The Saudi transition is correlated with the decline in US policy credibility in the Middle East but is principally motivated by its recognition that growing regional strife and the militancy it spawns pose direct threats to the Saudi regime's stability and the Royal Family's financial interests. In addition to greatly enhancing its domestic counter-terrorism capabilities, Riyadh is also actively involved in finding a resolution to the worsening Lebanese political crisis, brokered the now defunct Hamas-Fatah National Unity Government and has made efforts to dampen regional sectarian tensions. This is evidenced by Riyadh's hosting of a meeting of Iraqi clerics in late 2006 calling for an end to sectarian strife in Iraq.

Interestingly, although the Saudis perceive Iran as an enabler or provocateur of the very kind of instability they fear so greatly, Riyadh, unlike the United States, is not trying to isolate Tehran. Instead, it is pursuing a delicate balancing act, which includes the possibility of trade negotiations and joint dialogue on a number of political matters with regional implications. Neither side appears to be seeking any form of direct confrontation.

The smaller Arab Gulf states, which lack the political and economic clout of Saudi Arabia, have largely stayed on the sidelines of regional crises. However, they remain keen to retain the regional status quo and appear to be largely onside with Saudi efforts to check Iran on the one hand and engage with it on the other.

From the point of view of investors from most Western countries, Iran is currently off limits for all intents and purposes owing to sanctions and other restrictions related to its nuclear program and alleged sponsorship of terrorism. The investment climates of Saudi Arabia and the smaller Gulf states are highly dependent upon domestic and regional security considerations. Accordingly, the success or failure of Riyadh's current efforts to de-escalate regional tensions and control home-grown terrorism will have direct and far-reaching effects on economic developments on the Arabian Peninsula. At this stage, the situation is largely under control, but a sustained increase in regional instability could well bring the now robust Persian Gulf investment boom to a screeching halt.

Eastern Europe and Central Asia

In Eastern Europe and Central Asia, Russia remains the dominant regional power. One of the main factors behind this position is President Putin's efforts to reassert the Russian state, both in diplomacy and global business. This administrative strength was not always the case. Just a few short years ago, the Russian business model was one of young business tycoons functioning outside the governmental and political realm. In reality, they dabbled in both if needed, but there was no purposeful coordination between the state and business. In fact, they were often at odds. Much of this division stemmed from the speed and totality of the privatizations of the 1990s. State officials often suggested that the young tycoons had run away with what had been public assets and made their profits in a manner at odds with state aims. This, of course, took place in the context of a post-crisis environment in which state capacity had been constrained by economic events and lingering remnants of the post-Soviet bureaucratic culture. The new business people were capitalizing on a hamstrung state and worked at the pace of international business while the bureaucrats were left reeling from the fall of the Soviet Union.

This continued until the state takeover of Yukos, then Russia's largest oil company, in 2004. With this move the state returned to dominance in the strategically important energy sector. At the time, many Russia analysts felt the Yukos takeover and other state interventions into the private sector realm were discrete actions to fix specific problems left over from the chaos of the 1990s. However, the two and a half years since that event have shown that Yukos was only the beginning. There appears to be an even newer business model emerging; one premised upon a highly coordinated approach to business and the economy and in which the Kremlin's intentions and reach into the private sector extend beyond a few repairs. The line between business and state has blurred and as such, commercial and political aims have become inextricably intertwined.

Companies and governments operating in the paradigm of mostly separate state and commercial realms are at a disadvantage when doing business, at home or abroad, with entities from today's Russia Inc. In the most negative of scenarios, non-Russian companies are neither able to compete nor hold good negotiating positions unless they are able to convince their governments to lend the same kind of direct and substantive support.

While this new business model has implications for anyone wanting to do business with Russian counterparts, it poses particular challenges for the governments of the countries on Russia's borders. This is particularly true if they are also courting investment from or political alignment with the West. Copying the Russian business model leads to Western accusations of corruption and state capture, purposely keeping a strong division between state and business, and puts one's own companies at a disadvantage vis-à-vis Russia The cases of the Central Asian countries and Ukraine are illustrative.

Throughout Central Asia this new business model has been tested, likely due to the nature of many foreign investments in the region: with oil, gas or mineral wealth, investment projects tend toward natural resource projects. The large Russian players in the oil, gas and mining sectors (e.g. Gazprom, Rosneft, Rusal, Norilsk Nickel) are globally competitive and proximate. Given that natural resource projects tend to be complicated and implicate many arms of government regardless of the business model being followed, the new Russian model is particularly apt for these projects as it allows government-to-government influencing.

With only five million people and an abundance of hydrocarbon resources, Turkmenistan is an investment destination of interest to many players. All foreign investors wanting to enter into Turkmenistan must be comfortable with working with the government since independent sources believe that the government accounts for three quarters of all economic activity. The government selectively chooses its investment partners in what is a poor investment climate suffering from a lack of established rule of law and arbitrary decision changes.

Uzbekistan has the largest population in Central Asia and significant mineral and gas resources. Granting incentives on a case-by-case basis, foreign investors need a strong negotiating position against the government, especially given the capricious regulatory environment. State-owned or government-affiliated businesses often receive unfairly advantageous treatment from the judiciary in business disputes. This lack of predictability can be a major impediment to foreign investors not wanting to dedicate time and resources to government relations activities.

On the other hand, investors have not been deterred from entering Kazakhstan, investing more than US$30 billion since independence, primarily in the huge oil and gas sector. The government is very involved in foreign investment oversight, including an early screening of investments, sometimes by very high-level officials. Major projects go through the president's office.

In these three countries as well as Tajikistan and Kyrgyzstan, the ability for the Russian state to influence the government is critical. In some cases, Russian firms are displacing Western companies, but for the most part, the Russian state influence is felt on a project-by-project basis. It is difficult to tell whether these countries adopted this model of business after seeing the Russian state's own success with it, or whether it is just that this model particularly fits with the style of doing business (interpersonal relations, tendency toward adversarial negotiations) of the CIS.

In Ukraine, which through its two major parties was struggling to decide between alignment with Russia or alignment with the European Union, the situation is more complex. The eastern part of the country, with its energy-intensive heavy industries, has traditionally been more pro-Russian than Kyiv. During the period after the Orange Revolution, when Kyiv was abuzz with pro-West Kyiv-based politicos energized by the defeat of presidential candidate Viktor Yanukovych and his backer, former president Leonid Kuchma, Eastern business people must have felt under pressure both from the new government and from Russian competitors. The ability to pair with their government officials was limited, right at the time when Gazprom-Ukraine negotiations over gas supply.

At present, investors' interest in Ukraine appears to be on hold. The ever-changing political dynamic in the country has left foreign investors unable to comfortably predict policy direction. Russian firms are still interested, and the Russian state has a strong interest in the outcome of the current political wrangling. Should the political instability continue, government-to-government negotiations on behalf of investment projects are likely to continue.

Asia

Asia is unique among the world's developing regions in having two countries with legitimate aspirations as global powers. Both India and the People's Republic of China (PRC) have populations in excess of one billion and are home to extremely fast-growing economies. By 2050 the two countries are expected to account for more than of 30% of global GDP (up from about 8% in 2006). Furthermore, India and China possess considerable military strength and are in the process of modernizing their capacities – particularly their navies – to further extend their reach. Both countries are becoming intent on carving out diplomatic influence and representation in international institutions commensurate with their demographic, economic and military power.

That the presence of two dynamic giants in their midst affects their smaller neighbours is obvious. Their sheer size alone is enough to create a powerful gravitational pull. However, despite the fact that they are often mentioned in the same breath when global developments are discussed they do not carry the same weight in a global or regional context.

Following centuries of focusing inward, China began to open its economy to international trade and investment in the early 1980s. The rapid economic growth and connections to the global economy that ensued meant that the PRC once again had vital interests beyond its borders and, as importantly, the means to pursue them. Through a combination of economic incentive, deft diplomatic maneuvering and implicit military threat, China has been largely successful in shaping the continent in a way broadly aligned with its interests.

Examples of Chinese success are many. The PRC has effectively isolated Taiwan – an island that the PRC perceives to be a breakaway province but whose government was recognized by many countries as the legitimate authority over all of China until well into the 1970s. Now, Taiwan has few diplomatic allies, and it is fair to say that no one anywhere in the world makes policy or commercial decisions about Taiwan without first taking stock of the PRC's likely reaction.

On its western flank, where the PRC's interests are shaped by its desire for domestic stability, territorial integrity and energy security, the PRC has taken a proactive stance in its relations with the Central Asian states. The security focus of the Shanghai Cooperation Organization (SCO) and substantial Chinese investment in Central Asian energy projects are evidence of this. Furthermore, the PRC combined its interest in being a global actor and its influence vis-à-vis long-time ally North Korea, to play an integral role in facilitating the 2007 agreement on the dismantling of Pyongyang's nuclear program.

The source of Chinese regional power, however, is the degree to which the economies of most East Asian countries are now linked with that of the PRC. As has often been noted, the PRC has become a crucial hub for the global supply chains of most multinational enterprises (MNEs). "Made in China" labels – indicating that products have undergone final assembly in the PRC – have become ubiquitous. However, many of the components used in Chinese-assembled products are made elsewhere – particularly in developing East Asia. MNEs invest in intermediate facilities there for the express purpose of feeding into their Chinese assembly operations. As such, much of the region's trade takes the form of exports to China, and much of its inward investment is predicated upon complementary investment in China. Therefore, East Asian governments have found themselves in a position in which their vital interests depend upon the continued success of Chinese businesses and, by implication, on the political stability in the PRC.

In comparison, India has experienced difficulty in taking its position among the global powerhouses and has struggled to match China's reach. Its diplomatic purview has been largely confined to South Asia, it has consistently underperformed as an investment destination and it has not succeeded in creating the kind of economic linkages that would give other governments a direct stake in the country's stability or prosperity.

There are several hypotheses as to why this is the case. Firstly, India has very few neighbors (four) compared to China which borders 14 states. As such, China is required to engage with almost four times the number of countries on matters of territorial integrity and domestic stability. It is possible that the PRC's need to deal with such a broad range of next-door neighbours has pressured the country into developing more nuanced and multi-faceted diplomatic capabilities.

A second key consideration is the Indo-Pakistani relationship. Ongoing tensions and the potential for open conflict between the two counties tie down attention, resources and political capital that India could otherwise use to project its influence throughout Asia and beyond. China does not face any threats of similar magnitude. Interestingly, the PRC, through its long-term support of Islamabad, has contributed to India's hamstrung position.

A third factor that could help to explain China's current regional standing relative to India is the differing nature of internal politics within the two countries. The PRC is a one-party state in which the government/party is directly involved in the majority of political, economic and social matters and in which decision making is ostensibly centralized in Beijing. Conversely, the Indian model is one of a multi-party democratic federal state characterized by political and economic decentralization and numerous ideologies. Whereas, in general, the Chinese Communist Party (CCP) leadership can decide upon a course of action and follow through with it, India's government often finds itself with limited options and difficult implementation processes owing to internal wranglings or resistance from opposition political groups and other levels of government. In addition to these structural constraints, a host of domestic security issues including militants in the northeastern and central states and sectarian tensions throughout the nation require New Delhi to focus its attention inwardly rather than on building the country's regional and global standing.

While China's position in the region is now paramount, it may not always remain so. Recent reform in India has opened the country's economy to a greater degree than ever before and, for the first time since independence in 1947, there appears to be workable agreement in society as to the best way forward. At the same time, the Chinese development model is pushing against some limitations. While centralized, directive government may work well in conjunction with low-level manufacturing activities, it is a hindrance to the higher-value elements of the value chain that China must master if its economy is to continue to grow fast enough to meet the expectations of the population. Similarly, the broad, nebulous scope of global diplomacy requires much more agility than relatively well-defined 'neighborhood' issues. Micromanagement is anathema to complex economic and political activity; yet micromanagement has, to now, been the hallmark of the PRC government. Adjustment may well prove difficult for government and populace alike.

Paradoxically, India's historical problems may well turn out to be its greatest assets. Indian officials have spent decades, if not centuries, navigating myriad complexities and uncertainties without recourse to a consistent central authority. It is quite possible that the skills developed in that regard will help enable Indian business and government to excel at high-value, complex activities more readily than their Chinese rivals.

For investors, the Asia story illustrates the need for long-term thinking and a balanced approach. The immediate competitiveness gains that can be generated by assembling product in China are clear. This will continue to be true for the foreseeable future. At the same time, India is already becoming a global hub for services and advanced technologies and socio-political conditions suggest that this will continue. Furthermore, if, as is entirely possible, India gains momentum on China in the Asian power game some of the current China-East Asia alignment would likely shift toward India. A prudent regional strategy would therefore include due consideration of Asian giants and creation of East Asian assets that can contribute to either India or China-focused supply chains.

Sub-Saharan Africa

Regional influence can emanate from many sources. Often, we look toward geographic or demographic influence, military might or economic prowess to analyze the reasons behind regional power dynamics, but ideas and the ability to adopt different policies can be equally influential. Countries, by devising novel approaches to their own situations can act as examples to neighbours facing similar issues. Such "demonstration effects" are currently having a significant impact on the investment environment in Sub-Saharan Africa.

Across the region it is apparent that many governments no longer buy in to the liberal economic doctrine that dominated the 1990s and early 2000s. Indeed, the belief that the sole path to economic development was through foreign private investment – largely from Western sources – is fast becoming a thing of the past. Today, African governments are looking for alternative economic policy and investment strategies to grow their economies and capitalize on resource wealth, though virtually all still recognize the importance of, and continue to seek access to, foreign capital. This gradual change in outlook is being fueled by a few coinciding factors: the continued high levels of poverty and underdevelopment throughout Africa despite increased liberalization, the current boom in commodity prices, and the increased attention the continent has received from "non-traditional" investors, most significantly from China.

It is in this particular context that the very different experiences of two important countries, Angola and South Africa, are acting as examples that other African countries are increasingly looking to as models for how to advance their own economies. Angola has become the most notable example of the "alternative investor" strategy through its partnership with China, an approach that has seen Angola benefit from billions of dollars of Chinese financing and investment. On the other hand, South Africa has become the example of the "local empowerment" strategy through the advancement of its black economic empowerment (BEE) strategy. Through BEE, the South African government aims to redress historic economic inequities within the country and ensure long-term sustainable economic growth through the equal integration of the black population into the domestic business environment. For a variety of economic, political, and even geographic factors, several African countries are following in the footsteps of Angola or South Africa, though these two strategies should not be viewed as mutually exclusive.

Sudan, Zimbabwe, Guinea, Chad, Nigeria, Equatorial Guinea, and most recently the Democratic Republic of Congo, appear to be taking a page out of Angola's book. Each of these countries' engagement with non-Western investors is on the rise and each is increasingly looking to countries such as China, and to a lesser extent India, Russia, and various Latin American and Middle Eastern countries to invest in natural resource and infrastructure projects and to also provide critical financial assistance. The key advantage for these African countries is that partnering with China (or others) gives them economic and political leverage over and the opportunity to bypass private investors and the multilateral financial institutions. Financial support from these alternative sources does not come with the high price tag of economic and political reform that the IMF and World Bank would impose as conditions for financial assistance.

Falling into the South Africa "empowerment" camp are several other Southern African countries that are considering their own versions of affirmative action policies to try to increase the local economic benefit from investment in their countries. Zambia passed its Citizens' Economic Empowerment (CEE) Act in September 2006 and Namibia is anticipated to have its own BEE legislative framework in place by the spring of 2008. Botswana has had empowerment legislation designed to boost local entrepreneurs in place since 2001, and there is currently active debate in policy circles about whether the country should adopt broader citizen empowerment laws. The major challenge for governments pursuing empowerment strategies is to find ways to implement legislation that generally imposes a range of local employment, ownership, training and management requirements on companies without deterring investment. If the implementation is not well managed, empowerment policies can result in a more cumbersome investment environment as companies encounter additional bureaucratic and regulatory requirements.

Both the “alternative investor” and “local empowerment” strategies result in a stronger role for the government vis-à-vis business – albeit in different ways. Countries such as South Africa and Namibia are using legal and regulatory mechanisms to bring about economic redistribution and transformation – an approach that is likely to eventually result in greater transparency and clarity, though investors will continue to face short to medium-term uncertainties regarding exactly how these policies will be implemented. Conversely, the approach being taken by Angola, Sudan, Chad and Guinea produces a more politicized business environment where investment patterns are largely determined by high-level political interests and personal connections. As is the case already in Angola, the adoption of this alternative investor strategy has a significant impact on the environment for Western investors.

Engagement with China has had a clear effect on the way in which the Angolan government now prefers to do business. As such, companies face an environment where there is weak and/or unclear separation between the state and business, poor transparency, and arbitrary and inconsistent regulation. Investors bidding on government tenders often have to include possible financing arrangements in order for their proposals to be considered, and for large projects the Angolan government prefers bids to come with some form of political support from the investor’s home country government.

In summary, the expanded number of foreign investors and public financiers throughout Africa, and the disillusionment with foreign direct investment as a catalyst of economic development are influencing policy dynamics in many African countries. The more politicized nature of the alternative investor approach produces an investment environment that is more arbitrary and less transparent for investors, while the empowerment approach presents risks related to government expectations about local participation in foreign-owned projects and companies. Essentially, what these developments point to is the ever-growing importance of companies assessing and understanding the local context of their investment destinations and adapting their market choices and business strategies accordingly.

Conclusion

As has been illustrated above, one country’s ability to influence the investment environment of others can emanate from several sources – some structural and long term, others more circumstantial and transitory in nature. What’s more, evolving power dynamics within regions mean that some of the key dilemmas facing investors today are likely to be less important in the coming years.

- In Latin America, we believe that the reach and depth of Venezuela’s regional influence is limited as its Bolivarian Revolution is enabled by circumstances unique to the country and, in the case of high oil prices, of potentially limited duration. Brazil’s lead as an increasingly outward-looking, market-based regional powerhouse is much more likely to carry the day. As such, overall investment conditions for Western firms in Latin America should improve in the coming years.
- In the Middle East, the chaos of Iraq is giving rise to a pronounced rivalry between Saudi Arabia and Iran. From foreign investors’ point of view, Iran is a destabilizing force in the region while Saudi Arabia, despite having its own problems with Islamic extremism and a somewhat ambivalent attitude toward foreign investment, has emerged as a *de facto* guarantor of the investment boom that is currently transforming the smaller Persian Gulf states. Investors’ fortunes will rise or fall based on Riyadh’s success or failure in preserving regional stability.
- Russia has adopted a new business model characterized by the intertwining of state and commercial interests and, as the dominant power in Eastern Europe and Central Asia, is exporting the model to its neighbours. The neighbours have bought in to varying degrees.

Western investors interested in these neighbouring countries need to realize what they are up against and prepare appropriately.

- In the current environment, China is clearly Asia's dominant player. The country's economic boom and subsequent assertion of political and diplomatic power has impacted the whole continent, and the structure of the East Asian economy has been profoundly changed by China's rise. India, also a rapidly growing giant, has yet to attain China's regional and global reach, but this balance could change as both countries strive to attain places at the high end of the value chain. Investors need to be aware of this dynamic and plan their pan-Asian strategies accordingly.
- In Sub-Saharan Africa, new ideologies are emerging as governments, frustrated by the unmet expectations of liberal economic policies, develop new approaches toward foreign investment. Some are courting non-Western investors and making concurrent political deals with the firms' home governments. Others are working to codify the participation of nationals and the host-country benefits. The latter group of countries, led by South Africa, should eventually produce more amenable environments for Western investors – even though the process of creating "empowerment" rules is likely to be fraught with hiccups.

"Know thy markets" remains political risk assessment mantra. Adding a regional layer to the well-established global and national layers can help international investors make their market knowledge more complete and improve the prospects of a healthy return.

SECTOR OUTLOOK

7.0 Sector Export Outlook

Export Growth: Volumes and Prices

When forecasting the value of Canadian exports, two components have to be considered: volume and price. Volumes refer to the actual physical quantity of the goods being shipped while price is the dollar amount paid for those goods. The dollar value of the export is thus simply the volume multiplied by the price. For example, if volume growth is forecast at 5% while prices are projected to rise by 7%, the overall increase in value is 12%. Given the large relative changes in prices and volumes often seen for some goods, it is important to break down the contribution of each component to the overall growth in export value. This differentiation becomes particularly useful in the case of commodities and computer equipment, where prices can be particularly volatile.

7.1 Energy Sector

EDC Economics expects Canadian energy exports to record volume-induced increases of 5% in 2007 and 6% in 2008, but there remains upside price risk to this outlook. In particular, geopolitical risks could escalate or unplanned production declines occur, which along with generally tight demand and supply conditions, could boost the price of crude oil above our 2008 forecast level. Commodity price volatilty remains elevated, particularly in the near term.

Table 21: Energy Export Outlook by Sector

Top Markets	CAD bn 2006	% Share of Energy Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Petroleum*	53.3	61.2	18.3	7.1	5.0
Natural Gas	27.8	31.9	-22.6	2.0	5.7
Coal	3.5	4.0	1.7	-6.9	22.0
Electricity	2.5	2.9	-21.2	16.6	7.1
Total Energy	**87.2**	**100.0**	**-0.5**	**5.2**	**5.9**

Source: Statistics Canada, EDC Economics. 2006 actual, 2007 and 2008 are forecast.
*Includes crude petroleum and refined products.

For 2007, we expect the WTI price of **crude** to average US$66/barrel before it falls to US$64/barrel in 2008. This year has been a wild ride for crude with prices dropping to US$50/barrel near the start of the year only to rise later to a record of more than US$80/barrel in September. Indeed, this year there are solid fundamentals supporting high oil prices. OPEC spare capacity remains low at under 3 million barrels per day while the organization's production cutbacks since last fall have left its mark on the market. Although OPEC announced this fall an increase in production of 500,000 barrels per day, this will not show up in the market in the very near term. While we have not backed away from our story that high oil prices stimulate investment, new supply is taking longer and costing more, while at the same time, production by some existing suppliers (e.g. Mexico) is falling faster than was previously expected.

Table 22: Price Forecast for Oil and Natural Gas

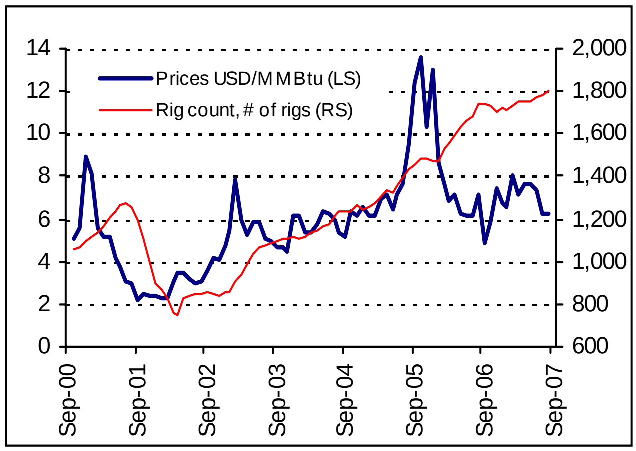
	Long-term Average*	2005	2006	2007(f)	2008(f)
Petroleum, WTI - USD/bbl	26.4	56.57	66.09	66.00	64.00
Natural gas(HH) - USD/mmbtu	3.57	8.89	6.72	7.00	7.50

Source: Bloomberg, EDC Economics. 2005 and 2006 actual, 2007 and 2008 are forecast.
*Long-term averages cover 1983 to 2006 for oil and 1991 to 2006 for natural gas.

At US$64/barrel for 2008, EDC Economics' outlook remains below that of many other forecasters. Here there are several things to consider. First, we suspect there remains a great deal of speculation tied up in crude markets given that its fundamentals look better than most industrial metals. Moreover, the recent liquidity crunch, if it continues to broaden, will show up in lower commodity prices across the board. Second, our global GDP outlook calls for a stronger growth deceleration than most forecasters, which results in a larger scaling back of our oil demand projections. Already in September the IEA cut its fourth quarter demand outlook by 250,000 barrels/day and suggested that more downside demand moves were probable. Third, OECD inventories are near the upper end of the 5-year average range, which introduces greater potential for downside price movements. Conversely, US crude inventories have been coming down, which has been supporting prices. But weaker economic growth, and the resulting slowdown in energy demand, will allow US oil supplies to build up again.

The Canadian supply story is almost exclusively good. There were signficant increases in non-conventional crude production in 2007 and potentially stronger growth in 2008. Much of this expansion will come from Alberta, but other big producing provinces such as Saskatchewan and Newfoundland and Labrador also saw increases. There is a caveat however. Export growth could be hampered by pipeline capacity contraints, a concern recently pointed out by the National Energy Board.

Figure 30: US Natural Gas Price and US Gas Rig Count



Source: Bloomberg.

The price for Henry Hub **natural gas** is forecast to average US$7.0/Mmbtu in 2007 before increasing to US$7.5/Mmbtu in 2008. Natural gas prices have been extremely volatile over the past 2 years with prices ranging from over $15 to a low of $3 to $4. Through the next 12 to 18 months, US natural gas demand should grow at levels only slightly below trend despite the expected slowdown in that economy. Industrial demand, which accounts for 33% of total US consumption, should hold up reasonably well as the manufacturing sector gets support from steady export sales. With the rise in the price of crude, and recent fall in gas prices, a large wedge has opened up in the price of crude and gas when the two are measured in terms of energy content. This should help lift gas prices over the forecast period.

Contrary to our earlier expectations, and despite a considerable drop in 2007 drilling activity, Canadian export volumes of natural gas are up through the first half of this year. EDC Economics expects lower drilling activity, already high US inventories and increased gas consumption in Canada will result in declining export volumes through the forecast horizon. Although we are calling for gas prices to rise in 2008, US underground storage at the time of writing was near the upper bound of normal inventory levels recorded over the past 5 years. We expect exports of natural gas to rise 2% in 2007, before higher prices lift export receipts by 6% in 2008.

Exports of **electricity** are up a robust 25% in the first half of 2007, driven by unusually high shipments in February and April. Price and volume gains will be solid this year with sizable increases recorded in both Quebec and British Columbia. For the year as a whole, electricity exports are on track to rise by an average 17%. Looking ahead, we expect export growth to soften as the US economy moderates. A modest increase in the price of electricity, along with slight growth in volumes and a weaker Canadian dollar, should boost electricity exports by 7% in 2008.

EDC projects a 7% drop in **coal** exports in 2007 before rising 22% in 2008. Canada's coal exports are almost exclusively metallurgical and therefore tied closely to the world's steel market. Although global steel production is moderating, and should continue to do so with our slowing GDP outlook, supply constraints in Australia are making the market for metallurgical coal very tight. Canadian volume shipments are up handily, and we expect this trend to continue through the forecast horizon. After falling in the early goings of 2007, we expect prices to rebound somewhat in 2008.

7.2 Metals Ores and Industrial Metals

Strong global demand with rapid growth in developing economies, particularly China, led to a sharp upswing in demand for most industrial metals in the past several years. Significant under-investment during the 1980s and 1990s has added pressure on prices, with producers simply unable to keep pace with surging demand. Against this bullish backdrop, strong buying opportunities arose for many investors, which were bolstered by loose credit conditions and low risk aversion. In fact, investment demand has become an increasingly powerful force in metal market developments, a force largely viewed as permanent (sustainable) by market participants.

Table 23: Canadian Metal Ores and Industrial Metal Export Outlook

Top Markets	CAD bn 2006	% Share of Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
US	35.4	67.1	19.2	10.2	-14.6
United Kingdom	4.7	8.9	52.2	37.0	-10.1
Eurozone	2.6	4.8	15.5	58.3	-3.9
Other Western Europe	2.1	3.9	17.0	78.0	-2.2
Japan	2.2	4.1	30.0	7.9	-15.6
China	1.9	3.6	61.1	62.7	-7.3
Asian NIEs	1.6	3.0	50.4	25.8	-8.8
Total Developing Markets	**4.1**	**7.8**	**45.5**	**41.8**	**-8.0**
Total Metals	**52.8**	**100.0**	**24.1**	**20.4**	**-12.0**

Source: EDC Economics. 2006 is actual, 2007 and 2008 are forecast. Asian NIEs are Hong Kong, Singapore, South Korea and Taiwan.

Looking forward, Canadian businesses can expect metal prices to remain at fairly high levels, well above recent historical averages – however, expect further volatility across the base metals complex. Although fundamentals remain robust for metals, demand and supply are forecast to ease in 2008 and 2009. Global economic demand is forecast to moderate, led by the cyclical slowdown in the United States. Weaker US demand will spread to the developing economies, erasing as much as 1% growth from bottom line GDP. On the supply side, the lagged investment response will begin to kick in, adding further upward pressure to metal stockpiles – already we have seen some LME inventories begin to trend up. EDC Economics is forecasting metal prices to decline somewhat toward the end of 2007 before pulling back in 2008 and more substantially in 2009. Our export forecast for metals and ores calls for growth of 20% in 2007 (vs. 13.4% in the Summer Outlook). Lower metal prices should induce a fall in export earnings of 15% in 2008 (to a still respectable estimated $55 billion in export receipts).

Table 24: Industrial Metal Price Forecast

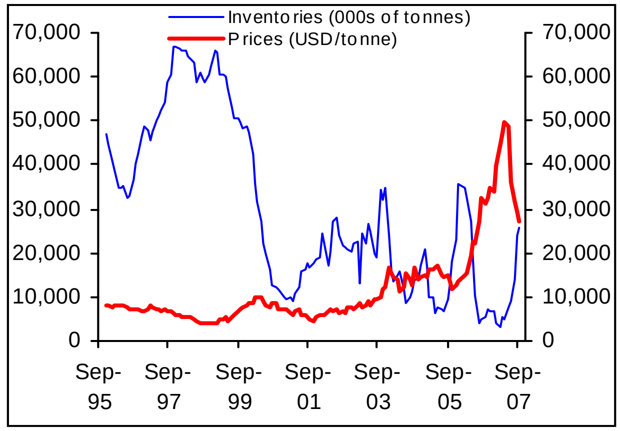
	10-Year Average	2005	2006	2007(f)	2008(f)
Aluminum (USD/tonne)	1,630	1,902	2,573	2,570	2,240
Copper (USD/tonne)	2,552	3,682	6,731	7,075	5,560
Nickel (USD/tonne)	10,138	14,782	24,126	40,050	30,260
Steel (hot-rolled, USD/ton)	355	596	504	532	517
Zinc (USD/tonne)	1,274	1,382	3,266	3,425	2,650

Source: EDC Economics, Bloomberg. 2005 and 2006 actual, 2007 and 2008 are forecast.

Downside risks to the metals outlook are evident. Although not our baseline scenario, any substantial decline in Chinese industrial production (in response to the US economic slowdown) would weaken global demand growth and most likely hurt investor confidence. The other downside risk is the possibility (although small) of a more prolonged and deeper liquidity crunch. Given the recent liquidity concerns experienced by investment funds in financial markets, metal prices are to some extent vulnerable to an outflow of investment fund capital. If there is flight to quality, a precipitous drop in prices could occur, albeit to levels still above historic norms.

While underlying stainless steel demand remains fairly solid, price-related substitution has clearly had an influence on **nickel** prices recently. From its historical high of US$54,200 per tonne in May 2007, LME nickel was trading in the range of US$26,000 to US$30,000 per tonne by mid-September. The recent correction in LME nickel was initially triggered by a change in trading regulations on the LME, intervention taken against suspected hedge fund collusion. Looking forward, we expect supply and demand in the nickel market to roughly balance out through the remainder of 2007. In 2008, a supply surplus will gradually emerge, becoming more pronounced in 2009.

Figure 31: LME Nickel Prices and Inventories

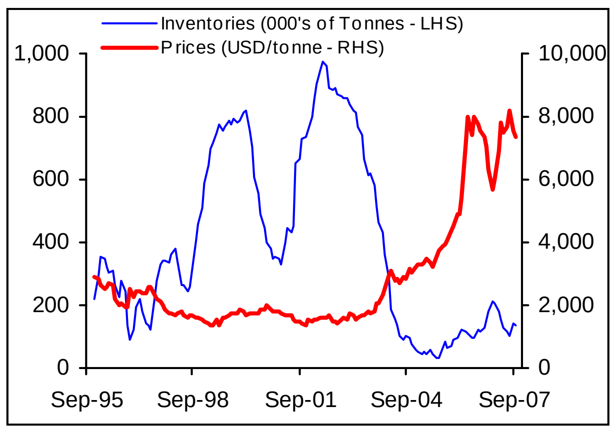


Source: Bloomberg.

Market fundamentals remain fairly strong for **copper**. China and other fast-growing developing countries have ensured strong demand growth. Supply limitations among major copper producers have also supported copper prices, with supply disruptions causing several months of volatile trading on the LME. New refined copper supply on the market is expected going forward, but the timing is less clear. Even so, LME copper trading around US$7,300 per tonne (mid-September) appears out of line with fundamentals, and we forecast the price of copper will pull back in 2008 and 2009.

The underlying economic conditions for **zinc** appear less supportive than a year ago. Higher Chinese exports coupled with less optimism among investment funds should result in substantial price declines through the next 18 to 24 months. Supply of refined zinc is expected to gradually catch up to demand during the remainder of this year and overtake demand next year, with a healthy surplus developing. As such, LME zinc is forecast to average around US$2,600 m/t in 2008, compared to its recent high of just over US$4600 m/t late last year.

Figure 32: LME Copper Prices and Inventories



Source: Bloomberg.

The environment for **aluminum** remains fairly strong, thanks mainly to rapid growth in Chinese demand. Despite slowing economic activity in the United States, Japan and Europe, LME aluminum prices are forecast to remain relatively high during the remainder of this year and next (average just over US$2,200 per tonne in 2008, which is still off the past couple of years). However, inventories have been steadily increasing and troubles in the US economy and the associated squeeze in liquidity conditions have resulted in some investment selling activity. Together, these forces have put and are likely to place further downward pressure on prices over the very near term.

Iron ore producers have been unable to keep pace with global demand, resulting in rising ore prices. Asian **steel** demand and production are expected to remain fairly strong through the next 12 to 18 months, a major factor supporting the outlook for iron ore. Global steel consumption is expected to moderate somewhat going forward, but the market will remain in a reasonably tight supply-demand balance. High energy and metallic input costs will also act to support steel prices around current levels. Overall, steel prices are expected to average higher this year and next compared to levels recorded in 2006.

7.3 Forestry Products

Prospects for the forestry sector are bearish for the remainder of 2007 and 2008 – weakness in the US housing market is expected to continue until the second half of next year, while the contraction of newsprint consumption in the US is not likely to improve anytime soon. The industry will continue to be pressed by the higher Canadian dollar, increased energy costs, greater international competition, lumber export barriers to the US, a weaker US consumer, and wood chip availability. While we maintain our 2007 export forecast of an 8% decline in forestry exports, we have raised slightly our export outlook for 2008. We now expect forestry exports to grow 3.5% next year, based largely on better than previously anticipated prices in the pulp and paper sector.

The main driver of **wood product** demand, US housing starts, continues to weaken as the sub-prime market collapse persists. Housing market woes will continue through much of 2008. Rising foreclosures will add to the supply of houses for sale, while tighter underwriting standards, higher mortgage rates and falling prices will dampen demand. We expect US housing starts to fall to 1.40 million units in 2007, a 22% decline from last year. Starts are forecast to bottom out in 2008Q2 and average 1.32 million units in 2008, down another 5%. As a result, lumber and oriented strand board (OSB) prices will remain weak until early 2008, falling by 12% and 22% respectively in 2007, the third year of double-digit decline in both cases. Demand will remain soft next year, but we expect curtailments and mill closures to limit further price declines. We expect lumber prices to gain 2% in 2008, while OSB prices will fall another 2%. With current market conditions, a number of OSB projects are being delayed or reconsidered, or may be shelved altogether. Less than one year since coming into effect, the Softwood Lumber Agreement is going to the international tribunal to settle differing interpretations of the calculation of export quotas, surge mechanisms and provincial programs. Overall, we expect wood product exports to decline 18% in 2007. A partial recovery is anticipated for 2008 with exports rising 7%.

Table 25: Lumber and Wood Products Export Outlook by Region

Top Markets	CAD bn 2006	% Share of Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
US	14.8	85.2	-16.4	-23.3	4.8
Japan	1.4	7.8	-2.5	-9.7	14.5
Eurozone	0.4	2.4	20.1	11.2	18.7
Asian NIEs	0.2	1.0	16.6	32.8	15.5
United Kingdom	0.1	0.7	2.0	63.3	18.7
Total World	**17.4**	**100.0**	**-14.0**	**-18.0**	**6.7**

Source: EDC Economics. 2006 actual, 2007and 2008 are forecast.
The Asian Newly Industrialized Economies (NIE's) are Hong Kong, Singapore, South Korea and Taiwan.

Table 26: Lumber and OSB Price Outlook

	Long-term Average*	2005	2006	2007(f)	2008(f)
Lumber, spf, 2x4 (USD/mbf)	306.2	353.1	296.5	260	266
OSB, 7/16" (USD/000 ft.)	232.7	318.2	211.1	165	162

Source: Bloomberg, EDC Economics. 2005 and 2006 actual, 2007and 2008 are forecast.
*Long-term average figures are for 1997 to 2006.

The fundamentals are also bearish in **paper** markets, with the decline of newsprint consumption in North America, particularly by US dailies, a weaker pricing environment, increased competition from overseas, and higher costs for energy and pulp. Canadian producers have also had to deal with the higher dollar – a direct hit on their bottom line. As readers and advertisers turn to the Internet and other media, newsprint consumption in North America has declined 11% y/y,[4] while newspaper advertising spending has

Table 27: Market Pulp Export Outlook by Region

Top Markets	CAD bn 2006	% Share of Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
US	2.7	42.1	-3.3	21.4	1.4
China	1.1	16.5	28.6	23.3	13.9
Eurozone	0.8	11.8	-24.6	-3.8	-3.7
Asian NIEs	0.6	9.1	18.6	19.1	6.6
Japan	0.5	7.8	13.9	5.3	0.4
Total World	**6.5**	**100.0**	**2.8**	**13.9**	**4.1**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.
The Asian Newly Industrialized Economies (NIEs) are Hong Kong, Singapore, South Korea and Taiwan.

[4] Source: Pulp and Paper Council of Canada.

fallen by 8%[5] so far this year. Despite capacity shutdowns and mill conversions, the newsprint market remains oversupplied, as lower prices can attest. We also expect a further deterioration of fundamentals during the forecast period, driven by the weakening US economy and consumer demand, resulting in a further 4% price decline in 2008. The collapse of the sub-prime housing market in the US will also affect the demand for newspaper advertising space, as 10% of US newspaper revenue comes from real estate classifieds. On the supply side, the Abitibi-Consolidated Bowater merger, once completed, should result in capacity reduction, partly offsetting shrinking demand and bringing some balance back into the market. So far this year, other paper and paperboard products have fared better, with less pronounced downward price pressures as markets are generally more balanced, thanks to continued curtailment, conversion, and capacity closure taken by producers. Despite some recent price increases for supercalendered, lightweight coated and coated paper grades, the latter largely related to the imposition of US countervailing and anti-dumping duties on imports from China, South Korea and Indonesia, few grades will see gains in 2007 and 2008. Overall, Canadian paper exports will decline 7% in 2007 and remain flat in 2008.

Table 28: Pulp and Paper Price Outlook

	Long-term average*	2005	2006	2007(f)	2008(f)
Market Pulp (USD/tonne)	571.5	611.0	674.6	768	765
Newsprint (USD/tonne)	560.4	581.0	634.1	561	540

Source: Bloomberg, EDC Economics. 2005 and 2006 actual, 2007 and 2008 are forecast.
*Long-term average figures are for 1997 to 2005.

Table 29: Newsprint and Other Paper Export Outlook by Region

Top Markets	CAD bn 2006	% Share of Exports (2006)	Export Outlook (% growth) 2006	2007(f)	2008(f)
US	13.4	85.1	-7.3	-9.9	-1.5
Eurozone	0.4	2.3	-24.3	23.2	-5.0
South America	0.3	1.7	14.0	11.3	12.3
United Kingdom	0.2	1.3	-28.8	48.7	-10.1
Asian NIEs	0.2	1.1	-7.7	-24.6	-4.0
Total World	**15.7**	**100.0**	**-7.1**	**-6.9**	**0.0**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.
The Asian Newly Industrialized Economies (NIEs) are Hong Kong, Singapore, South Korea and Taiwan.

Meanwhile, Canadian **pulp** producers have faced a protracted bullish pricing environment, despite the introduction of large amounts of pulp capacity in Latin America and the reduction of paper capacity in North America and Europe. The global demand for pulp has been largely sustained by paper and paperboard capacity expansion in Asia, which is largely based on recycled fibre. However, new fibre is usually added to improve the overall paper quality. We expect new Latin America capacity to drive down the price of hardwood kraft pulp in the final months of 2007, creating a gap with softwood pulp prices and eventually driving those down as well. However, global pulp shipments have remained strong and inventories tight, for both hardwood and softwood kraft pulp (especially the latter).

Table 30: Forestry Exports Outlook by Sub-Sector

Top Sectors	CAD bn 2006	% Share of Exports (2006)	Export Outlook (% growth) 2006	2007(f)	2008(f)
Lumber and wood products	17.4	43.9	-14.0	-18.0	6.7
Pulp	6.5	16.4	2.8	13.9	4.1
Newsprint and other paper products	15.7	39.7	-7.1	-6.9	0.0
Total Forestry	**39.6**	**100.0**	**-8.9**	**-8.3**	**3.5**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

The recent tightness in softwood pulp was also affected by the forest worker strike in BC, which has constrained wood chip availability, forcing local pulp producers to curtail production. This has delayed the expected cycle peak in pulp prices, which we now anticipate will occur in the first quarter of 2008 for both hardwood and softwood grades. While further paper capacity expansion will come on line in Asia during 2008, the new demand will be largely overshadowed by the

[5] Source: Newspaper Association of America.

massive amount of new pulp capacity being introduced to global markets next year. As a result, prices are forecast to decline by 1% and 5% in 2008 for softwood and hardwood pulp respectively. Following the 14% increase estimated for 2007, Canadian pulp exports are expected to make more modest gains in 2008, increasing by 4%.

7.4 Advanced Technology

Canadian exports of high-tech goods are on track to rise by 3 to 3.5% in 2007. Although the industry has been successful in lowering costs, thanks to a myriad of factors including outsourcing more production overseas, the global economic slowdown will impose a drag on Canada's technology exports, which are forecast to advance a modest 2% in 2008. These numbers may look weak on the surface, but when isolating the significant price declines currently experienced in the high-tech sector, we find solid growth in export volumes (9% in 2007 and 6% in 2008) – a notable accomplishment for Canadian tech companies given the run-up in the loonie and intense global competition in this sector.

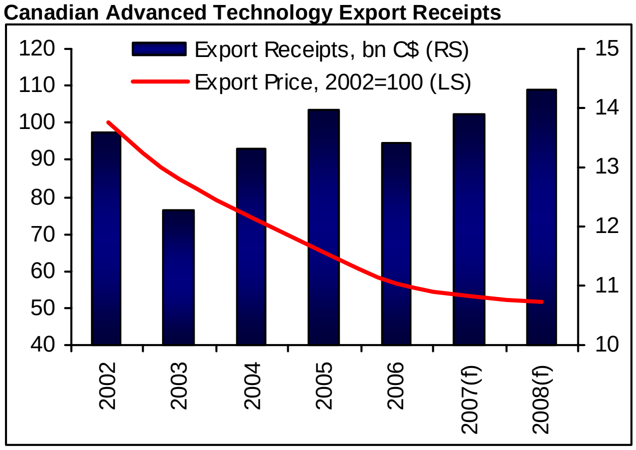
Table 31: Advanced Technology Export Outlook by Region

Top Markets	CAD bn 2006	% Share of Exports (2006)	Export Outlook (% growth) 2006	2007(f)	2008(f)
US	9.4	67.5	-9.4	4.4	2.0
United Kingdom	0.5	3.4	-6.3	-11.9	-6.2
Eurozone	1.0	7.5	23.3	8.0	7.3
Asian NIEs	0.5	3.6	-5.8	-11.0	-4.3
China	0.3	2.3	18.0	11.7	9.3
Japan	0.3	1.8	10.8	-1.5	-0.4
Middle East	0.2	1.5	3.7	-0.6	0.6
Mexico	0.2	1.2	51.9	-10.0	-1.4
Oceania	0.1	1.0	-6.5	-2.0	0.6
Central/Eastern Europe	0.1	1.0	9.4	0.4	1.5
Total Developing Markets	**1.5**	**10.6**	**15.7**	**4.9**	**4.9**
Total World	**13.4**	**100.0**	**-4.1**	**3.3**	**2.2**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.
The Asian Newly Industrialized Economies (NIEs) are Hong Kong, Singapore, South Korea and Taiwan.

Robust profit gains and buoyant cash flows have served to encourage US business expenditure on high-tech equipment during the first 6 months of this year, unlike the lacklustre performance witnessed in the second half of 2006. To be sure, Canadian exports of advanced technology equipment to the US (70% of the total export market) performed rather well in 2007, rising an estimated 4.4% and representing a noticeable improvement over the export contraction observed in 2006. However, the ailing US housing market, a nervous US consumer and slower profit growth will have a negative impact on export growth in 2008. With tightening lending standards, consumer and business sentiment is expected to continue deteriorating, followed by slower growth in expenditure on high-tech products. Considering that a large portion of our advanced technology exports has been driven by the US market, waning confidence will serve as a bane for outbound shipments – the ramifications of which will become apparent in 2008 when growth in US-bound exports is expected to slow to 2%.

Figure 33: Falling Export Prices Are Capping Growth in Canadian Advanced Technology Export Receipts



Source: Statistics Canada, EDC Economics.

Exports of Canadian high-tech goods to non-US markets put in a mixed performance during 2007, and 2008 will bring more of the same. Shipments to Africa, Brazil, China, the Eurozone, India, Russia and South America grew strongly in 2007, and we expect exports to these markets will post decent growth again in 2008 (albeit at a slower pace). Salient growth from emerging markets such as Latin America and Asia; the recovery in Europe; and oil windfalls in the Middle

East are bolstering global tech sales. Likewise, the swift expansion of information technology (IT) industries and broadband in India and China is motivating purchases of computer hardware and equipment in these markets. On the negative side of the ledger, exports to Japan, East Asia (ex-China) and Mexico were down in 2007, and little recovery is projected for 2008.

7.5 Communications Equipment

Canadian manufacturers of communications equipment are having a challenging 2007, with export sales estimated to be down by 6% on the year. Next year should see exports stabilize, with modest growth of 1%. Shipments to most major markets are down in 2007, including the US, West Europe, Mexico, China and Japan. We expect to see some modest gains for these markets in 2008. On a more positive note, exports to Eastern Europe hit a record high in 2007, and further gains can be expected for the coming year. Shipments to Brazil and much of Africa also posted strong growth in 2007, a pattern forecast to continue through 2008, albeit at a more subdued pace.

Table 32: Communications Equipment Export Outlook

Top Markets	CAD bn 2006	% Share of Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
US	4.5	63.9	-5.2	-6.0	1.0
Eurozone	0.7	9.7	39.6	-17.8	-4.0
United Kingdom	0.4	5.9	-15.0	-9.9	1.0
Asian NIEs	0.2	3.0	10.2	-6.9	-2.0
Oceania	0.2	2.9	77.3	-3.0	2.0
China	0.1	2.1	16.1	-8.9	3.0
Japan	0.1	1.6	-12.0	-5.0	-2.0
Mexico	0.1	1.9	54.5	-11.9	-2.5
Total Developing Markets	**0.8**	**12.0**	**19.4**	**3.5**	**5.1**
Total World	**7.0**	**100.0**	**1.8**	**-6.2**	**1.0**

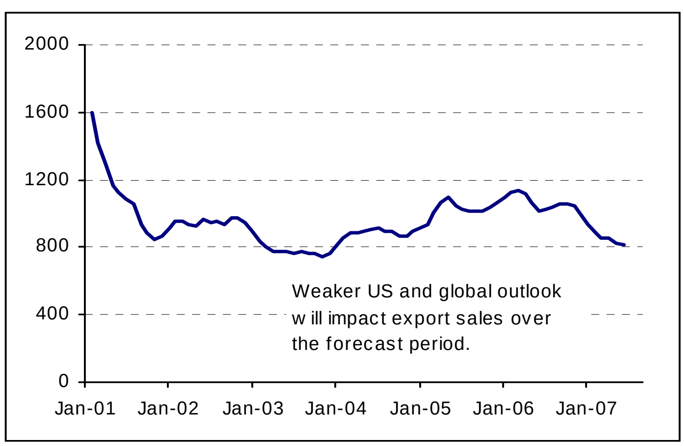
Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.
The Asian Newly Industrialized Economies (NIEs) are Hong Kong, Singapore, South Korea and Taiwan.

The tepid outlook for telecom equipment is in contrast to the past 3 years, when exports posted solid gains. A strong Canadian dollar, increasing competition, downward price pressures, some rigidity in regulatory frameworks (especially in Europe and Japan) and a weaker US economy are driving the more subdued forecast. As industrialized markets account for about 80% of the Canadian export market for telecom equipment, the softer performance in these countries will have a dampening impact on overall exports for the sector.

Canadian telecom exports to industrial countries are expected to finish off 2007 with a decline of 7.5%, before stabilizing in 2008. In contrast, shipments to the developing world are on track to rise by 3 to 4% in 2007 followed by a further rise of 5% in 2008. Over the longer term, we expect that better growth opportunities will be in developing markets due to their higher rates of economic growth and the corresponding need for communications infrastructure.

There are several reasons why emerging markets have such strong potential. First, corporations in these countries will continue updating their networks in search of further improvements in efficiency and productivity. This is true for companies in Eastern Europe, Russia, Latin America and increasingly among SMEs in Asia. Second, governments plan to continue investing in telecom infrastructure as part of their fiscal programs, especially in Latin America, Eastern Europe and Africa. Third, many emerging markets have already, or will soon be, launching 3G services and granting the

Figure 34: Canadian Telecom Equipment Exports (Monthly, millions CAD, 3 months MA)



Source: Statistics Canada, EDC Economics.

corresponding licenses. Taking those factors into account, good prospects exist for Canadian exports of telecom equipment to Eastern Europe, South America (especially Brazil), developing Asia and India.

Given the gradual convergence of the telecom and IT sectors around the world and the sustained growth in the mobile and broadband subscriber base, non-traditional exports of equipment such as mobile TVs, 3G mobile phones and related devices for internet telephony (VoIP) generally offer the better growth prospects for the next few years. On the other hand, manufacturers of traditional fixed-line phones and less modern mobile equipment will be hard pressed to grow their export sales. Successful exporters will be those able to reduce costs and innovate to face growing competition.

7.6 Industrial Machinery and Equipment

Canadian exports of machinery and equipment (M&E) are set to rise by 3% in 2007, followed by a projected gain of 4% in 2008. This year's performance is impressive given the run-up in the Canadian dollar, increased global competition and downward pressure on selling prices. Needless to say, profit margins for exporters have come under serious pressure. But it is also competition and a lack of industry pricing power which are boosting export sales for some M&E producers. Although economic growth is slowing, companies all over the world will continue to invest in new capital equipment to reduce costs and remain competitive.

Table33: Machinery and Equipment Export Outlook by Region

Top Markets	CAD bn 2006	% Share of Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
US	20.2	75.8	-0.9	2.6	2.4
Eurozone	1.6	5.8	14.0	-3.9	5.5
Middle East	0.6	2.2	18.2	1.8	8.4
China	0.4	1.7	12.5	25.2	6.1
United Kingdom	0.4	1.6	10.1	-3.1	14.2
South America	0.4	1.4	-1.7	9.0	15.1
Oceania	0.4	1.4	13.9	-14.1	12.4
Asian NIEs	0.3	1.1	-10.4	6.0	9.0
Total Developing Markets	**3.3**	**12.5**	**17.9**	**15.4**	**11.6**
Total World	**26.6**	**100.0**	**2.5**	**3.2**	**4.4**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.
The Asian Newly Industrialized Economies (NIEs) are Hong Kong, Singapore, South Korea and Taiwan.

Looking ahead through the next 12 to 18 months, the strongest growth for Canadian M&E exporters will be for equipment used in the energy and mining sector, followed by agriculture and construction machinery. On a geographic basis, growth in exports to the developing world will continue to outpace sales to industrialized markets by a wide margin.

Exports of **mining and oil and gas M&E** are on pace to grow by 30 to 40% this year. A boom is underway in mining investment as prices of metals remain high. Energy prices also remain elevated, though there was some softening in natural gas at the time of writing. Although we expect a drop in commodity prices through 2008, prices will remain well above historical norms, supporting the economic viability of the majority of upstream mining/energy projects. Nearly one third of this year's export growth came from the large US market, but considerable strength was also seen in Russia, Central America, Eastern Europe, Brazil and Africa. We anticipate ongoing strength from these emerging markets in 2008. Overall, we expect exports to rise 34% in 2007, before slowing to growth of 12% in 2008.

Exports of **chemical and plastics M&E** should hit a new record in 2007, as exports to most major markets posted gains. Exports to the US (60% of the total) will experience only modest growth in 2008 despite a high capacity utilization rate for plastics manufacturing in that country. Chemicals and plastics manufacturing is a cyclical industry, and it is highly exposed to some key areas of anticipated weakness in the US economy in 2008, namely autos, consumer goods and housing. Markets like South America, and China in particular, will offer some reprieve but not enough to stop a deceleration in exports as growth moves from 12% in 2007 to only 1.6% in 2008.

Metal and woodworking machinery experienced a 2% drop in exports during 2006. The lion's share of receipts in this category come from metal working equipment, which normally sees 80% of exports head to the US. Looking forward, weaker activity in the US economy means this sub-sector is expected to record a decline in exports in 2007. Further modest declines are forecast for 2008.

Canadian exports of **agriculture and construction machinery** showed limited growth in 2007, as demand for construction machinery in the US declined in line with the housing sector. At the same time, weaker farm income south of the border has limited agriculture machinery demand despite higher crop prices. However, stronger demand for both agriculture and construction machinery in emerging markets offset declining US demand in 2007, allowing exports to increase an estimated 3%. In 2008, a bottoming of the US housing sector, improved farm income, rising demand from emerging markets, and the weaker Canadian dollar should support a 12 to 15% increase in Canadian exports of agriculture and construction machinery.

7.7 Automotive Products

Canadian exporters of motor vehicles and parts saw their woes continue in 2007 with a decline of 5.6% YTD (January-July) in foreign shipments. While passenger vehicles (-6%) and medium/heavy-duty trucks (-28%) saw their exports fall, exports of automotive parts remained flat. Looking ahead, we see a continuation of this trend through the remainder of 2007, as auto sales in the US are expected to decline further and the Detroit Three continue to lose market share. Although Canadian automotive exports are projected to fall 6.3% this year, exports will begin to stabilize in 2008 with a modest 1.5% gain as the US auto market is expected to recover modestly at the end of 2008 and the restructuring of the Detroit Three nears completion. Risks to the export sector include renewed strength of the Canadian dollar, a marked slowdown in the US economy and production disruptions arising from current contract negotiations between the UAW and the Detroit Three. At the time of writing, EDC Economics' baseline forecast assumed there would be no significant production disruptions arising from labour disputes.

Table 34: Automotive Exports by Product

Market Segments	CAD bn 2006	% Share of Total Exports (2006)	Export Outlook (% growth) 2006	2007(f)	2008(f)
Passenger Vehicles	50.0	66.0	-7.5	-6.2	0.8
Automotive Parts	20.1	26.6	-8.4	-1.4	1.9
Medium/Heavy Duty Trucks	5.6	7.4	11.9	-25.7	8.2
Total Automotive	**75.7**	**100.0**	**-6.6**	**-6.3**	**1.5**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

In the largest auto market of the world and Canada's main export destination, US passenger car and light truck sales have fallen 2.8% YTD (January-August) and are expected to descend to a 9-year low of 16.1 million units in 2007, down from 16.5 million units in 2006. The downturn in the US housing sector has directly affected sales of light trucks. This is reflected by the recent announcement of GM to cut output to two shifts from three at the Oshawa plant, which makes the Chevrolet Silverado and GMC Sierra pick-up trucks. In addition, the correction in the US housing market will indirectly affect sales of passenger cars and light trucks through the wealth effect. Finally, consumer indebtedness triggered by rising adjustable rate mortgages (ARMs) and incentive-based forward buying in recent years will also impact sales in 2007 and 2008. Although late 2007 should signal

Table 35: Automotive Export Outlook by Region

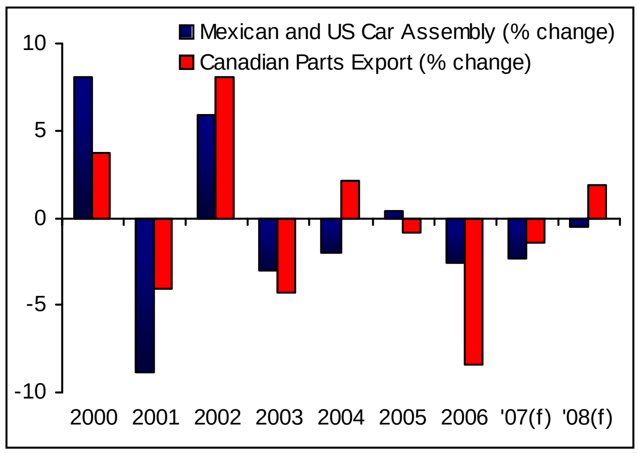
Top Markets	CAD bn 2006	% Share of Total Exports (2006)	Export Outlook (% growth) 2006	2007(f)	2008(f)
US	73.7	97.4	-6.7	-6.8	1.5
Eurozone	0.4	0.5	13.1	12.0	-19.5
UK	0.1	0.1	-9.1	7.8	-9.3
Oceania	0.1	0.1	-67.5	12.2	-6.9
Japan	0.0	0.1	-47.7	25.1	-10.7
Total Developing Markets	**1.4**	**1.9**	**9.5**	**11.2**	**9.5**
Total World	**75.7**	**100.0**	**-6.6**	**-6.3**	**1.5**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

the bottom of the current cycle, passenger and light truck sales are forecast to show only a modest increase in 2008 at 16.2 million units. Given this backdrop, Canadian **passenger vehicle** exports are forecast to decline 6.2% in 2007 and increase by 0.8% in 2008.

Persistently high gasoline prices are also changing the mix of vehicles sold in the US market, with sales of light trucks declining sharply in recent months. The Detroit Three are modifying their ways in the face of demand for fuel-efficient vehicles and pressure by governments (the US Senate recently approved an energy package that would require higher fuel efficiency standards by 2020). GM announced that hybrid technology will be introduced in its Chevrolet Silverado and GMC Sierra pick-up trucks to be built in Oshawa and made available in 2008. Ford will assemble hybrid versions of the new Edge and Lincoln MKX vehicles by 2010 in its Oakville assembly plant. These announcements are critical for Canadian auto exports, as the market for hybrid vehicles is expected to increase significantly in the long term. A further boost to the longer term outlook for Canadian auto exports is the significant investment announcements made by all the OEMs in Canada, including GM, Ford, Chrysler, Toyota and Honda.

Figure 35: Canadian Auto Parts Exports



Source: Statistics Canada, EDC Economics, CSM Automotive.

Canada's **automotive parts** sector faces no less of a challenging outlook than the passenger vehicle sector. EDC expects auto parts exports to fall a further 1.4% in 2007 before increasing modestly by 1.9% in 2008. The forecast is based on two factors. First, the market share of the Detroit Three will continue to shrink over the forecast period and, hence, further erode the demand for Canadian auto parts. Second, North American automotive assembly companies will increasingly make use of non-traditional auto parts suppliers such as China and India. The major reason why Canadian exports of auto parts are expected to do somewhat better than passenger cars is due to the fact that Canadian auto parts exporters have, to some extent, been able to diversify into Chinese, Indian and European vehicle production. Areas where we see the strongest growth are in the higher valued-added and technologically advanced components, which are less vulnerable to competition than more commoditized parts.

As expected, Canadian exports of **heavy-duty trucks** were hit hard in 2007 by the significant pre-buying in the United States the year prior. The pre-buying was brought about by new US emission standards. The outlook is not as grim as pent-up demand for heavy trucks will outweigh the dampening effect of a slowing US economy. On balance, EDC expects to see Canadian exports rebound in 2008 with a growth rate of 8.2%, although this still leaves the value of export sales well below the levels recorded in 2005 and 2006. Most of the risk for truck exports is on the downside as the outlook for the US economy calls for slowing growth through the next 3 to 4 quarters. Persistently high gasoline prices are another important issue that the trucking industry must contend with. It drives the demand for fuel-efficient vehicles both in terms of aero-dynamics and efficiency of engines. New hydraulic hybrid drive systems are targeted at medium and heavy-duty trucks, such as public buses and waste trucks, allowing for more fuel-efficient stop-and-go driving. Dual-mode, diesel-electric hybrid engines are being developed for long-haul, heavy-duty trucks. The trend toward more fuel-efficient technology will continue into the near future based on demand and government regulation.

7.8 Aerospace

Following a year of no growth, Canadian exporters of aerospace products had a much better year in 2007, with export sales rising an estimated 11 to 12%. This bullishness will persist into 2008, when exports are projected to grow a further 5%. In the past few years, the Canadian aerospace industry moved along two tracks – while the regional jet (RJ) industry experienced waning demand, the rest of the sector saw robust conditions. The situation is now starting to look up for the former, however.

Table 36: Aerospace Export Outlook by Region

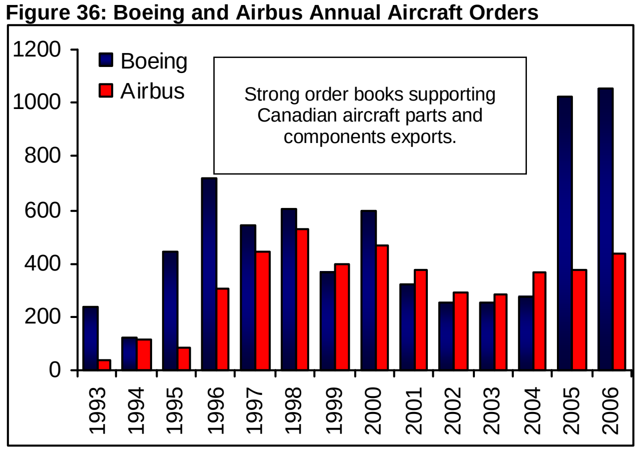
Top Markets	CAD bn 2006	% Share of Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
US	6.2	60.3	-20.7	23.2	6.1
Eurozone	1.9	18.3	82.5	4.0	3.0
UK	0.6	5.5	80.1	6.1	4.5
Oceania	0.3	2.8	367.6	-36.4	5.0
Japan	0.3	2.5	15.0	-27.3	2.0
Total Developing Markets	**0.7**	**7.0**	**2.5**	**0.9**	**5.7**
Total World	**10.2**	**100.0**	**0.3**	**11.3**	**5.2**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

Indeed, the shift in interest to higher seating capacity RJs has spurred the creation of new models that are now fueling demand. The 100-seat CRJ 1000, for instance, garnered 38 orders so far this year, bringing the total new orders for RJs in the first half of 2007 to 131, up from 78 in all of 2006. Furthermore, the resurrection of talks about the 110 to 130 seat C-series family reflects increasing interest in higher capacity RJs and is a very positive development for the longer term outlook (first deliveries are expected around 2013). Although these aircraft will be partly assembled in China in partnership with AVIC I, this new family will bolster Bombardier's backlog, with notable spillover effects on the broader Canadian aerospace industry.

While demand for RJs is firming up, the other segments of the industry will continue to perform solidly. High fuel prices will pressure cost-conscious airlines to look toward new turboprops to replace aging aircraft or small RJs on short-medium routes. At the same time, 5 years of strong corporate profits and the increasing hassle factor at commercial airports will again buttress demand for business jets through 2008. However, the slowing US and global economy will dampen the pace of growth in the business jet market through the next 12 to 18 months.

Figure 36: Boeing and Airbus Annual Aircraft Orders



Source: Bloomberg.

Prospects for parts suppliers remain bright, bolstered by a cyclical upturn in the commercial segment as well as defence-related spending. Boeing and Airbus continue to register record levels of new orders for their new generation models, as airlines are seeking to replace aging fleets with more fuel-efficient aircraft. Also, the expansion of hub networks and rising traffic in emerging markets are adding to growth in demand. On the defence side, security and counter-terrorist efforts, as well as rising geopolitical uncertainties, will continue to spur military spending.

Meanwhile, strong product investment by some of Canada's leading names will also boost exports. To cite but a few, Pratt & Whitney Canada is seeing increased demand for its new super light engine, while Bell Textron Helicopter's sizable order backlog of its new MAPL chopper will keep it operating at full capacity over the next decade. The success of the helicopter maker will have significant ripple down effects for the whole Canadian aerospace industry, benefiting Pratt &

Whitney Canada and Mecaer among others, which will be producing their engines and landing gear.

On a geographic basis, exports to the US should continue to fare well through 2008, thanks to sustained demand for business jets and important military contracts with some key Canadian aerospace players. In Europe, rising traffic and improving airline profitability should support Canadian exports to the region. Asian demand will remain very healthy, with China and India displaying strong growth thanks to expanding traffic and a mushrooming of new hubs; however, Japanese and Australian demand will soften.

There is some upside risk to our aerospace outlook for 2008 as Canadian companies continue to win new contracts, particularly in Asia and Europe. New product development also has the potential to further boost next year's export sales.

7.9 Rail and Other Transportation Equipment

Table 37: Rail and Other Transportation Equipment Export Outlook

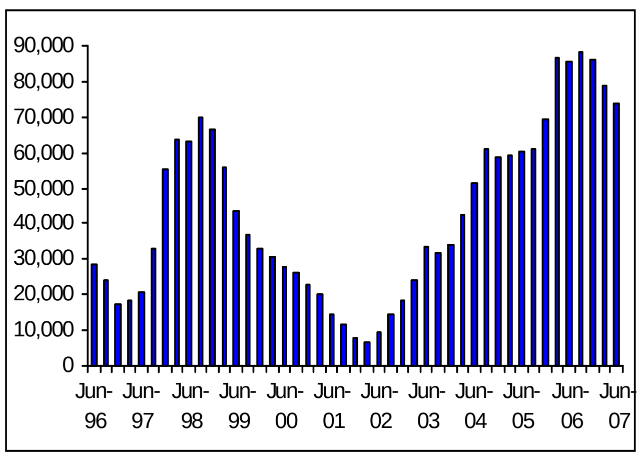
Top Sectors	CAD bn 2006	% Share of Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Rail and Transport Equipment	0.7	34.1	4.0	-7.8	5.4
Other Transportation Equipment	1.3	65.9	2.1	10.5	-2.9
Total Rail and Other Trans.	**2.0**	**100.0**	**2.8**	**4.3**	**-0.4**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

In 2006, rail and other transportation equipment exports climbed 2.8%, led by sales of railroad rolling stock. Growth continued at a moderate pace this year, but is expected to pull back in 2008. While the sector's exports are forecast to grow by 4% in 2007, it is the "other transportation equipment" segment that will account for all of the gains. Heading into 2008, sputtering global growth and slowing international trade will negatively impact worldwide transportation networks, leading to a slight contraction in exports.

The **railcars and related rail equipment** segment is notoriously volatile, tracking the impulses of global shipping activity and fleet lifecycles. In 2006, Canadian exporters benefited from solid global economic growth, record commodity prices, and increased spending on transportation infrastructure. This year, however, exports of rail transport equipment are posting losses. Still-buoyant commodity prices are encouraging new investments in emerging giants like Brazil and China, while transportation companies in the UK and the Netherlands are working to upgrade their networks. But Canadian suppliers cannot elude ever-weakening US sales – a trend we expect to persist through the forecast horizon.

Figure 37: Backlog Orders for US Freight Cars Have Levelled Off, Suggesting Lower Exports of Canadian Rail Equipment



Source: Railway Supply Institute.

Current rail traffic volumes reflect a global economy in retreat. After a record-setting 2006, total volume on US railroads was down 2.3% y/y in the first 8 months of 2007. US freight railcar deliveries continue to slide from their 2006Q2 peak; down 17.1% y/y in 2007Q2, versus growth of 8.7% a year earlier. Looking ahead, US freight car orders are down 58.0% y/y so far this year, with the backlog for US railcar orders down 11.4% in the same period. The trend has already begun hitting Canadian suppliers, portending an 8% decline in exports this year, before rebounding 5% in 2008.

Export receipts earned from **ship/boat building and repair** are showing signs of strength this year, as the Baltic Dry Index continues to reach new heights. While we expect the Index to pull back going forward, it should remain at historically elevated levels through 2008. Further, ongoing offshore oil and gas exploration in the Barents Sea has helped power sales to Russia and Norway. The coming into force of new Sulphur Emission Control Areas (SECA) in the Baltic Sea, the North Sea and Channel Islands is also supporting new contracts for Canadian companies in some non-traditional markets. But heading into 2008, the global slowdown should ease many of the capacity shortages that bolstered the industry over the past few years.

Exports of all **other transportation equipment** took off in the years following the September 11th attacks, but have since begun to cool. While armoured vehicle sales to major markets like the US and Saudi Arabia were up in 2006, they paled in comparison to their 2004 peaks. However, this year's troop surge in Iraq and ongoing efforts in Afghanistan are causing both traditional and non-traditional buyers to ramp up purchases, a trend likely to continue through the 2008 US presidential elections. Slowing consumer demand south of the border, however, will likely reduce recreational vehicle exports going forward.

7.10 Consumer Goods

Canadian exports of consumer goods are expected to continue the trend of falling foreign shipments. After 4 years of consecutive declines, consumer exports are forecast to fall further – by 8.3% in 2007 and 7.0% in 2008. Although the Canadian dollar is expected to depreciate modestly versus the currencies of most of its major trading partners during 2008, increased foreign competition, particularly from Asia, and a slowing US economy will lower export volumes and more than off-set any gains from a lower exchange rate.

Since 88% of Canadian consumer goods exports are destined for the United States, the spending behaviour of the US consumer takes on critical importance. The fall-out of the US housing downturn will have a direct impact on the consumption of durable goods, especially of furniture, household fixtures and appliances. However, the weakness in consumer goods exports to the US will not be limited to this segment. The wealth effect resulting from falling real estate prices will reverberate to spending that is not necessarily tied to housing markets. Reduced household wealth will have an impact on borrowing, in particular, home-equity refinancing, which has been an important source of funds (and spending) for US households in recent years. A tight labour market remains the primary support to wage growth and, thus, consumer spending. However, as the US economy slows, so will wage and employment growth.

Table 38: Consumer Goods Export Outlook by Region

Top Markets	CAD bn 2006	% Share of Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
US	8.5	88.5	-7.4	-10.1	-8.1
Eurozone	0.4	3.8	-0.1	1.0	-4.1
United Kingdom	0.2	1.6	-17.0	11.1	-9.1
Japan	0.1	0.6	-16.8	-9.1	11.1
Oceania	0.0	0.4	2.9	1.0	1.0
Total Developing Markets	**0.3**	**3.3**	**9.8**	**16.6**	**8.7**
Total World	**9.6**	**100.0**	**-6.5**	**-8.3**	**-7.0**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

Despite an expected depreciation of the Canadian dollar vis-à-vis the US dollar, exports to the US market are forecast to further decline by 8% in 2008, continuing the 10% drop estimated for 2007. Canada's three largest export sub-sectors of consumer goods – furniture, wood kitchen cabinets and major appliances – have already experienced persistent declines in US sales, and the downturn in US housing will only add to their woes. We believe the US housing market has yet to reach bottom, and it will probably be late 2008 or early 2009 before a meaningful recovery sets in. As a consequence, these sub-sectors will be challenged to find new foreign markets to compensate for export losses to the United States. Canadian exports of consumer goods have not performed much better in other major foreign markets. However, there are some highlights including significant increases in exports of major appliances to Mexico and of jewellery to the UK, Belgium, Germany and Chile.

Most sub-sectors of Canada's consumer goods industry have experienced declining exports during the past 5 years, some even at an accelerating rate. The only exceptions have been the export of jewellery and medical equipment. While jewellery exports have been able to sustain the momentum of 2006 into the first half of 2007, growth in medical equipment exports is slowing from a strong 5-year average. Nevertheless, we expect these two sub-sectors to continue to outperform the other larger sub-sectors. Exporters of clothing and apparel, in particular, experienced a contraction in exports this year, and this trend is likely to continue. To succeed, Canadian exporters of consumer goods need to produce merchandise that will distinguish themselves from the competition through either superior quality and/or a distinctive Canadian label.

7.11 Agri-Food

Canadian farmers are having a good year, as prices for many agri-food products made staggering gains in 2007. Fueled by the expansion of biofuels, adverse weather conditions and strong demand from emerging markets, grains, oilseeds, and specialty crops have displayed year-over-year price accelerations above 20% while live animal via rising feed costs have witnessed price gains greater than 10%. In sum, these factors boosted Canadian agri-food exports by an estimated 15% in 2007. Many of the favourable factors that supported export growth in 2007 should remain in place, lifting exports by a further 11% in 2008.

Table 39: Agri-food Export Outlook by Product

Top Sector	CAD bn 2006	% Share of Total Agri-food Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Food and Beverage Manufacturing	8.6	27.0	1.0	4.8	8.5
Meat Products	4.8	15.2	-15.2	5.2	6.8
Fish Products	4.1	12.9	-5.2	-0.7	-2.7
Oilseeds and Pulse	5.0	15.7	15.8	23.1	9.5
Wheat Farming	4.1	12.9	30.8	55.5	31.4
Other Crop Farming	2.1	6.6	6.1	9.8	6.3
Live Animals	2.4	7.4	33.0	10.7	12.0
Coarse Grains	0.8	2.4	3.7	13.1	10.7
Total Agri-Food	**31.9**	**100.0**	**4.5**	**14.5**	**11.3**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

Much of this year's growth in Canada's agri-food exports has been to the developing world, with exports expected to finish 2007 with a gain of 41%. A further increase of 26% is projected for developing markets in 2008. Export sales to industrialized markets are also up in 2007, but at a more subdued pace of around 7%. A similar gain of 6% is forecast for 2008.

Although export growth opportunities are to be found in many developing markets, Sub-Saharan Africa, Brazil and Egypt warrant attention as destinations for wheat, while for coarse grains the markets to follow are China, Mexico, the Middle East and Southeast Asia. The strength in exports, though, should be interpreted with caution as the advance has generally been driven by the upward trend in global crop and grain prices. This becomes more evident in the slower pace of export growth we expect for 2008, when agricultural commodity prices are forecast to

Table 40: Agri-Food Export Outlook by Region

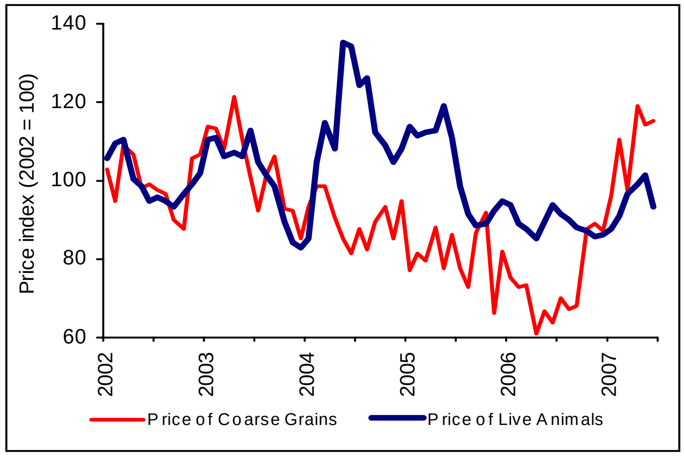
Top Markets	CAD bn 2006	% Share of Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
US	18.6	58.3	1.0	9.2	7.1
Japan	2.7	8.5	7.5	7.4	-0.1
Eurozone	1.7	5.4	20.0	-22.6	-9.4
Asian NIEs	1.1	3.6	-6.2	8.5	11.2
China	0.9	3.0	-22.0	27.0	22.4
Total Developing Markets	**6.8**	**21.3**	**23.4**	**41.0**	**25.8**
Total World	**31.9**	**100.0**	**4.5**	**14.5**	**11.3**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

moderate. A moderation in US and global economic growth will also dampen agricultural export growth in 2008.

Wheat and coarse grain prices should continue to make impressive gains for the remainder of 2007, thereafter moderating in 2008. World demand for grain has been quite high while supply has been curtailed due to erratic weather patterns that have left major exporters with significant crop damage, resulting in the lowest level of global stocks since the early 1970s. At the same time, strong economic growth in emerging markets will keep demand for agricultural commodities high. In addition, population growth and greater urbanization is motivating diet diversification, which is in turn stimulating demand for meat products and, by default, feed grains. Overall, exports of major **grains** are expected to average 37% growth in 2007. The pace will moderate in 2008 with exports forecast to rise by 20%.

Figure 38: Grain Prices and Feed Costs Boosted by Global Shortages, Increased Consumption and Rising Biofuel Demand



Source: Statistics Canada, EDC Economics.

Canadian exports of **processed food and beverage** products are on track to rise by 5% in 2007. The coming year should see exports grow by 8%, largely the result of stronger prices. It is thought that food prices will remain high as larger amounts of cereals and crops are allocated to the production of biofuels. In terms of factors affecting export volumes, we should mention the increasing tendency to consume fresh and locally produced food, fruits and vegetables in Europe and the US. Many countries are promoting the consumption of local products in their domestic markets. If we take into account that about 84% of Canadian food exports go to the US, UK and the Eurozone, this has the potential to impact the bottom line of Canadian exporters. However, it serves as an opportunity for exports of organic and functional foods, given the increasing tendency of consumers to buy goods that support a healthier lifestyle. Finally, a weaker US consumer will spend less on processed foods and beverages, particularly luxury foods, making the environment even more challenging.

Live animal exports have grown by 14% from January to June this year in comparison with the same period of 2006. **Cattle** exports to the US have been particularly strong, growing by 18.3% during the same period. We expect that exports of live animals will finish 2007 with growth of 11%, before rising by 12% in 2008. Several factors affect our forecast through the next 12 to 18 months. These include China's ban on pork and poultry imports from the US, which has increased supplies of these products in the US market, and led to the knock-on effect of reducing US import demand. In addition, the spread of the avian flu into relatively important export destinations (Europe) may encourage stringent export restrictions limiting market penetration for new products. Increasing costs in livestock and meat production will result in lower slaughter weights for cattle and pork, introducing further upward pressures on already high prices. On the upside, the US government's recent announcement allowing imports of older Canadian cattle and beef products could provide an additional boost to Canadian exports.

Seafood and Fishing

Challenges facing Canadian seafood companies include the strong dollar, high energy costs and in some cases labour shortages – all of which are squeezing industry margins. In 2008, we expect the Canadian dollar to depreciate against the USD and Japanese yen, and energy prices to moderate, offering some reprieve. However, sluggish US and Japanese consumer spending will crimp Canadian seafood exports. A bright spot for the industry is crab, whose exports have been boosted by solid price gains (up 20 to 30% in the first half of 2007). Lobster exports should drop slightly in 2007 on slightly lower catches, but we expect early weakness in Nova Scotia to dissipate through the rest of 2007. PEI exports will fall as catches returned to normal this year following a very successful 2006 – landings in that year were the highest in over a decade.

For 2008, we anticipate slightly lower prices for crab, lobster and salmon but shrimp should remain steady. With respect to the latter, exports to Europe should prove strong as the autonomous tariff rate quota for that market was increased from 10,000 tons to 20,000 tons in July 2007. For salmon, 2008 is expected to see a slight increase in export volume, but shipments to the US market will face pressure from increased capacity in Chile. Overall, EDC Economics estimates that exports of seafood will end 2007 with a 1% drop. Modest price declines are expected to result in a 3% drop during 2008.

7.12 Fertilizers

Canadian fertilizer producers are going through a period of strong expansion, as surging prices and demand for agricultural crops continue to feed the demand for fertilizers. This expansion has largely been linked to the rapid development of the biofuel industry and greater purchasing power from consumers in emerging economies. Since the current capacity build-up of the biofuel industry is largely based on some of the most fertilizer-intensive crops (sugarcane in Brazil, corn in the US and palm oil in Southeast Asia), we expect the global demand for fertilizer to maintain a high pace of growth while energy prices remain at elevated levels. Although the high global price for wheat, which is currently more than double last year's level, is not related to the biofuel expansion but to droughts and weather-related events in key producing regions, it will nonetheless contribute to greater fertilizer demand next year, as farmers rebuild depleted grain inventories. As a result, farmers are increasing their fertilizer use in search of higher crop yield to maximize their profits.

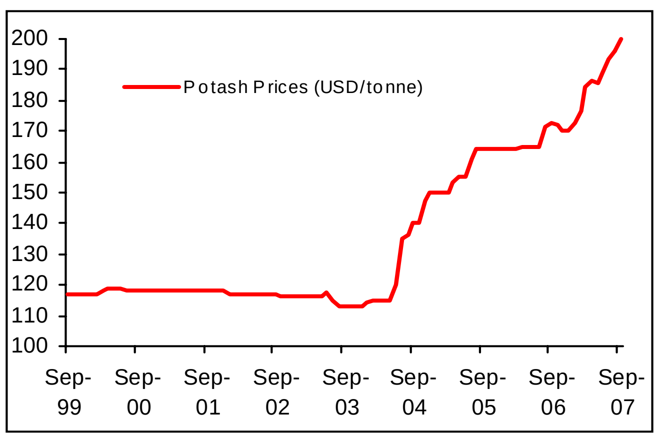
Table 41: Fertilizers Export Outlook by Region

Top Markets	CAD mn 2006	% Share of Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
US	2,915.5	73.5	-7.5	16.6	9.6
China	244.6	6.2	-44.0	90.7	18.6
ASEAN-4	233.5	5.9	6.0	26.4	14.4
Brazil	216.3	5.5	1.4	58.0	3.9
India	118.6	3.0	-14.7	90.7	13.3
Total World	**3,966.1**	**100.0**	**-9.4**	**25.9**	**10.5**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

Fertilizer prices have also increased rapidly, with potash prices up 18% since January, while granular urea prices rose to a high of US$364/tonne in April, greatly improving the bottom line of major Canadian fertilizer producers. In their latest quarter, both Alberta-based Agrium and Saskatchewan's PotashCorp announced record earnings. The outlook for fertilizer demand is promising, although short-term supply will remain constrained as a number of major urea capacity expansion projects across the globe have hit cost overruns, while the opening of new potash mines can take up to several years. With such strong fundamentals

Figure 39: Potash Prices



Source: Bloomberg.

in the outlook, Agrium has announced the construction of a US$1.2 billion urea production facility in Egypt, due to be completed in 2010, while PotashCorp has announced the opening of a new potash mine in Sussex, New Brunswick, a $1.6 billion project due to be completed in 2011.

Over the next 2 years, the demand for Canadian fertilizers will continue to be driven by key events in the agricultural markets and the development of the biofuel industry. Demand is expected to be strong in North America, China, Brazil and India, but also in other emerging Asian nations such as Malaysia, Indonesia, Vietnam and Pakistan. As a result of greater demand and prices, Canadian fertilizer exports are on track to increase 26% in 2007 and by another 11% in 2008. One downside risk to this outlook would be the collapse of energy prices, which would quickly shelve biofuel expansion plans and reduce the profitability of existing ones.

7.13 Chemicals and Plastics

Exports of chemicals and plastics are expected to rise 9% this year before dropping 1% in 2008. The big mover in 2007 was chemicals, which are expected to grow 13% this year before falling 1.4% in 2008. This year, a rise in prices will completely offset a large reduction in export volumes. The price gain is due mostly to a significant rise in prices of inorganic chemicals.

Table 42: Chemicals and Plastics Outlook by Sector and Region

Top Sectors	CAD bn (2006)	% Share of Exports (2006)	Export Outlook		
			2006	2007(f)	2008(f)
Chemicals	26.0	72.2	7.7	13.2	-1.4
Rubber and Plastics	10.0	27.8	-3.5	-3.9	1.9
Total Chemicals and Plastics	**36.1**	**100.0**	**4.3**	**8.5**	**-0.6**
Total Chemicals, Rubber and Plastics by Market					
US	29.7	82.3	3.5	4.9	-1.2
Eurozone	14.8	41.2	5.1	35.4	1.0
China	1.4	3.9	5.4	9.6	3.1
Asian NIEs	0.5	1.3	-8.3	3.2	2.2
Total Developing Markets	**2.8**	**7.9**	**12.8**	**9.8**	**3.0**
Total World	**36.1**	**100.0**	**4.3**	**8.5**	**-0.6**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.
The Asian Newly Industrialized Economies (NIEs) are Hong Kong, Singapore, South Korea and Taiwan.

The increase in chemical exports during 2007 is coming from the catch all category "**other inorganic chemicals"** and **pharmaceuticals**, whose exports are up 120% and nearly 140% respectively through the first half of 2007.[6] Pharmaceuticals have been an export growth machine for Canada since the early 1990's. Exports rose nearly 30% in 2006 and have advanced 20% annually in the last 10 years. In contrast, **organic chemical** exports are expected to be down this year on some plant closures, but with no large-scale plant closures/expansions planned for 2008, we anticipate little change in export volumes next year. Organic chemical producers will find their margins squeezed through the forecast horizon as feedstock costs remain high, prompting some price increases in 2008. Canadian capacity utilization in chemicals is currently running at high rates (hitting a 3-year high in 2007Q1). As such, there is little upside for increased volume exports in 2008, not only for inorganics but also for chemicals as a whole.

On the **plastics and rubber** front we expect exports to fall 4% in 2007, and then rise a modest 2% in 2008. Sector exports fell 4% last year and have not grown by more than 3% in over 4 years. Moreover, capacity utilization rates here in Canada are low at just over 70%, down from recent highs of 84%. Looking to the US, which accounts for fully 93% of total Canadian exports for the sector, demand conditions are not great. First, the US housing market is in a free fall, and new home starts on the order of 1.3 million units or lower are expected for 2008. Second, US auto production and purchases will slow. Third, although US consumption will grow in 2008, it will decelerate considerably from its trend of the past several years. In this environment, it will be difficult for Canadian plastics and rubber manufacturers to pass along higher prices should strong

[6] Definition of Other Inorganic Chemicals – A broad range of chemicals derived from mineral inputs (metals, sulfur, silica etc.) rather than carbon based inputs (crude, coal, natural gas or related products).

feedstock prices lift the costs of resins. Canada's mostly small and medium-sized plastics and rubber manufacturers will therefore face an uphill battle. If there is any good news for this sector it is that US capacity utilization remains quite high at 85.4%. This, along with Canada's low current capacity utilization rate, will allow for a very modest increase in plastics and rubber exports in 2008. As with any sector so exposed to the US, there is room for sizable downside risk given the uncertain outlook for US economic growth.

7.14 Canada's Services Export Sector

Canadian service exports came under pressure in 2006 as a strong dollar impacted travel and tourism. And 2007 brought more of the same, with service exports expected to rise by just 1.1% on the year. All three major sectors – commercial services, transportation and travel – are expected to improve modestly upon their 2006 performance. Areas of weakness in 2007 were concentrated in business travel, insurance, engineering, communication and engineering services. In contrast, transportation, financial services, management and R&D services are performing fairly well.

Looking forward, 2008 should see service exports increase by 1.8% as the Canadian dollar depreciates vis-à-vis the US dollar. Much of the modest upturn forecast for 2008 comes from tourism, transportation, finance, insurance, R&D and audio-visual services. Given the tepid outlook for the US consumer, we do not expect to see tourism improve until later in 2008. Engineering, construction and business travel are likely to remain weak through 2008. Downside risks include a US recession and continued strength in the Canadian dollar.

Table 43: Canadian Services Export Outlook

	2002	2003	2004	2005	2006	2007(f)	2008(f)
Total Service Exports (C$ mn)	**63,482**	**61,781**	**64,690**	**66,980**	**67,229**	**67,995**	**69,217**
-- annual % change	**5.69**	**-2.68**	**4.71**	**3.54**	**0.37**	**1.1**	**1.8**
Commercial Services (C$ mn)	34,246	35,512	35,319	36,888	36,708	36,654	37,002
-- annual % change	8.56	3.70	-0.54	4.44	-0.49	-0.1	0.9
Transport Services (C$ mn)	11,061	9,942	11,039	11,750	12,130	12,952	13,497
-- annual % change	4.10	-10.12	11.03	6.44	3.23	6.8	4.2
Travel Services (C$ mn)	16,741	14,776	16,746	16,674	16,598	16,541	16,815
-- annual % change	1.86	-11.74	13.33	-0.43	-0.46	-0.3	1.7
Government Services (C$ mn)	1,436	1,550	1,588	1,666	1,794	1,848	1,903
-- annual % change	-1.44	7.94	2.45	4.91	7.68	3.0	3.0

Source: Statistics Canada, EDC Economics. 2002 to 2006 are actual, 2007 and 2008 are forecast.

Travel Services

The US Western Hemisphere Travel Initiative (WHTI) was introduced January 23, 2007. The WHTI essentially requires citizens of the Americas – including US citizens – to carry a passport prior to entering or re-entering the United States. Before the introduction of the WHTI, 29% of US citizens who traveled to Canada by air or sea did not have a US passport. As a consequence, the WHTI has had a negative impact on Canada's travel industry. Business travel service exports were down 2.5% YTD (January-July), while personal travel services exports exhibited a modest increase of 0.5% YTD – mainly due to a rise in non-US travelers.

Table 44: Canadian Travel Services – Export Outlook

	2005	2006	2007(f)	2008(f)
Total Receipts (C$ mn)	**16,674**	**16,598**	**16,541**	**16,815**
% change	**3.54**	**0.37**	**1.1**	**1.8**
Business Travel (C$ mn)	2,789	2,890	2,832	2,832
% change	4.89	3.62	-2.0	0.0
Personal Travel (C$ mn)	13,886	13,709	13,709	13,983
% change	-1.42	-1.27	0.0	2.0

Source: Statistics Canada, EDC Economics. 2006 actual, 2007 and 2008 are forecast.

Given that the US Department of State had difficulties keeping up with the demand for US passports, it announced on June 8, 2007 that US citizens traveling to Canada who have applied for, but not yet received passports, could re-enter the United States by air without a passport. This passport holiday, however, expired at the end of September 2007.

Business travel has been more negatively affected by the WHTI than personal travel, as business exhibits a higher proportion of air travel. Given that there are no passport requirements to enter the United States by land until 2008, the WHTI has affected personal travel less. As such, EDC Economics expects business travel to fall by 2% in 2007 and personal travel (i.e. tourism) to remain stable. Looking ahead, business travel receipts are expected to remain flat in 2008 given the slowing US economy, while personal travel receipts are expected to increase by 2%. The latter will benefit from a depreciating Canadian dollar – making Canada a more attractive US tourist destination. However, we expect it will be the latter half of 2008 before any improvement in tourism is seen.

Transportation Services

Export receipts for transportation services will continue to see positive growth during the forecast period. Exports are expected to increase by 6.8% in 2007 before moderating to growth of 4.2% in 2008. Water transport will continue to be the main contributor to transportation services growth. The strong growth in water transport reflects the demand for transportation related to Canada's booming resource sector. Looking further ahead, growth in water transport exports is expected to moderate in 2008 (but remain at healthy levels), in line with slower growth in world trade and economic output.

Table 45: Canadian Transportation Services – Export Outlook

	2005	2006	2007(f)	2008(f)
Total Receipts	**11,750**	**12,130**	**12,952**	**13,497**
% change	**6.44**	**3.23**	**6.8**	**4.2**
Water Transport	3,350	3,812	4,613	5,074
% change	15.28	13.79	21.0	10.0
Air Transport	4,888	4,834	4,786	4,834
% change	4.67	-1.10	-1.0	1.0
Land and Other Transport	3,513	3,484	3,554	3,589
% change	1.41	-0.83	2.0	1.0

Source: Statistics Canada, EDC Economics. 2006 actual, 2007 and 2008 are forecast.

Passengers traveling by air account for 60% of total air transport exports. As such, air transport receipts are heavily affected by passenger travel. Given the significant impact of the US WHTI (see travel services), EDC Economics expects air transport exports to fall by 1% in 2007 and to increase by just 1% in 2008.

Over 50% of Canadian merchandise exports to the US are transported by road, while another 20% are transported by rail. The major products shipped by road from Canada to the US include autos, transport equipment, M&E, plastic and chemical products, and base metals. Together, these products account for almost 80% of exports by road. Given the slowdown forecast for the US economy through the next 12 months, export receipts earned by road and rail carriers are set to lose momentum as well. EDC Economics expects land transport exports to rise by 1% in 2008, down from this year's estimated increase of 2%.

Commercial Services

Commercial services account for over 50% of total Canadian service exports. Hence, the performance of this sub-sector has a significant impact on total service receipts. Commercial service exports are not expected to make a turnaround over the forecast period, with little to no growth expected in 2007, followed by a modest 0.9% increase in 2008. Although the US dollar is expected to appreciate against the Canadian dollar, this positive effect will be offset by the slowing US economy.

SECTOR OUTLOOK

Construction service exports declined significantly in the first half of 2007. Given the continued weakness in the US housing sector, we expect construction, engineering and architectural service exports to continue to underperform in the remainder of 2007 and 2008. The only commercial services sub-sector that is on pace with its 5-year annual average growth is research and development. Canada's export performance of commercial services remains subdued compared to global commercial service exports, which have grown at an average annual rate of 15% through the past 5 years, compared with an average of 3% for Canada.

Table 46: Commercial Service Export Outlook by Sub-Sector

Commercial Service Exports	CAD bn 2006	% Share of Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Communication Services	2,611	7.1	-0.7	-2.0	1.0
Insurance	3,920	10.7	0.8	-2.0	2.0
Other Financial Services	2,149	5.9	11.8	1.0	5.0
Computer and Information Services	4,575	12.5	-3.8	0.0	2.0
Royalties and License Fees	3,679	10.0	6.8	0.0	1.0
Management Services	4,978	13.6	-2.9	0.0	-2.0
Research and Development	3,185	8.7	13.4	5.0	3.0
Architectural, Engineering, and Other Technical	4,609	12.6	-1.6	-3.0	-3.0
Miscellaneous Services to Business	4,186	11.4	-14.3	3.0	3.0
Audio-Visual Services	2,590	7.1	2.7	0.0	1.0
Construction Services	225	0.6	1.4	-40.0	-10.0
Total Commercial Services	**36,708**	**100.0**	**-0.5**	**-0.1**	**0.9**

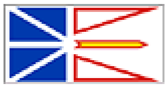
Source: Statistics Canada, EDC Economics. 2006 actual, 2007 and 2008 are forecast.

8.0 Provincial Export Outlook

Interprovincial Versus International Exports

It is important to point out that our export outlook is for international exports only. Interprovincial exports can make up a significant share of a province's shipments but are not included in international exports data from EDC or Statistics Canada. Shipments of raw materials or goods to other provinces for additional value-added processing are recorded as an international export from the province where the final good is eventually shipped. The distinction is significant as interprovincial exports do create jobs and gross domestic product in the province of origin. Perhaps the best example where this discrepancy has the most impact is in Newfoundland and Labrador where roughly 50% of offshore crude and all of Voisey's Bay nickel are shipped interprovincially and therefore do not show up as international exports.

PROVINCIAL OUTLOOK



8.1 Newfoundland and Labrador

International exports from Newfoundland and Labrador will surge 17% this year and a further 5% in 2008. This year is being led by higher energy and ore shipments, and to a much smaller degree, transportation equipment. Next year, a weaker Canadian dollar will help give exports a kick. Seafood will moderate slightly but energy, forestry and industrial goods should rise. Note that our forecast covers international exports only. As such, most Voisey's Bay and some other mining activity does not show up in our data.

Table 47: Newfoundland and Labrador Merchandise Export Outlook

Top Sectors	CAD mn 2006	% Share of Province's Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Energy*	5,941	70.5	8.9	16.4	7.1
Industrial Goods	1,063	12.6	13.6	40.2	1.8
Agri-Food	803	9.5	-10.8	3.2	-2.5
Forestry	475	5.6	-11.8	-12.8	5.3
All Others	145	1.7	17.4	-1.0	0.4
Total	**8,427**	**100.0**	**5.9**	**16.7**	**5.1**
Total excl. energy	**2,486**	**29.5**	**-0.5**	**17.5**	**0.5**

Source: Statistics Canada; EDC Economics.
* NOTE – Energy exports history and forecast estimated by EDC Economics.

EDC is forecasting a 16% increase in energy exports this year and another 7% increase in 2008. We forecast total production of 130 million barrels of crude this year with about half destined for international markets. Next year, production is expected to rise to nearly 150 million barrels on higher output from White Rose and Hibernia. With no planned production increases slated for the Come-by-Chance refinery, we expect export receipts to move in line with refined petroleum product prices. EDC Economics is forecasting WTI crude to average US$64/barrel in 2008, down slightly from 2007. The longer term outlook for energy is positive, with possible consideration being given to construction of a second refinery and the go-ahead given for Hebron.

Seafood exports rebounded slightly in 2007, but are expected to drop modestly in 2008. Higher prices for crab are the principal driver this year and could surprise on the upside. Shrimp exports to Europe should improve as the autonomous tariff rate quota for that market was increased from 10,000 tons to 20,000 tons in July 2007. While there are no major quota reductions expected for next year, consumers in the US, Japan and Europe appear fatigued, leading to lower seafood prices and a 2.5% drop in agri-food exports in 2008.

Competition from overseas, a strong dollar and high energy costs are hitting the bottom lines of paper manufacturers. Demand is also suffering as North American newspapers get 10% of their revenues from real estate classifieds. Newfoundland paper often goes to European markets, so exports could fare better for the province than was previously expected. While lumber prices are expected to increase slightly in 2008, this comes after significant price declines in each of the previous 3 years. Regardless, lumber will have little impact on the forestry sector as it accounts for only 6% of the sector's exports. In sum, forestry exports are expected to rise 5% in 2008 after dropping 13% in 2007.

Exports of industrial goods posted a massive increase this year, as summer shipments of nickel and copper totalled $400 million. This ore is normally processed within Canada but was instead sent to customers in Europe, so while the impact on international exports will be large there will be no extra kick to the province's real GDP. With respect to iron ore, even with global economic activity slowing, Asian steel demand should remain fairly high, supporting iron ore prices. This, along with a lower C$ and higher production levels, are expected to boost exports of iron ore by 14% in 2008, after a healthy increase in 2007.

Transportation equipment surged in 2007. Increases came from shipbuilding activities and aerospace parts manufacturing, which could hit $60 million this year versus $15 million in 2006. Next year is difficult to gauge, with growth coming from only a few companies and information scarce. Either way, the gain is impressive and bodes well for future exports of higher value-added manufactured goods.

8.2 Prince Edward Island

The value of international exports from Prince Edward Island is expected to rebound by 5% in 2007 before moderating to growth of 2% in 2008. Two thirds of the Island's exports come from the agri-food sector which, in turn, is dominated by potato and lobster exports. The softer outlook in 2008 is mainly due to weaker lobster and frozen potato exports, partially offset by continued strength in aerospace and pharmaceutical exports.

Table 48: PEI Merchandise Export Outlook

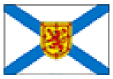
Top Sectors	CAD mn 2006	% Share of Province's Total Exports (2006)	Export Outlook (% growth) 2006	2007(f)	2008(f)
Agri-Food	522.1	66.4	5.0	2.6	1.3
Industrial Goods	46.9	6.0	-13.2	10.1	-1.7
Transportation	41.3	5.2	0.3	37.4	9.2
M&E	27.1	3.4	-5.9	56.8	3.4
Forestry	12.0	1.5	-45.7	-30.0	6.1
All Others	137.2	17.4	5.6	-5.9	1.9
Total	**786.5**	**100.0**	**1.8**	**4.8**	**1.9**
Total excl. energy	**786.4**	**100.0**	**1.8**	**4.8**	**1.9**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

Frozen potato products (french fries) account for 70% of the value of the Island's potato exports, or 25% of the province's total exports. Frozen potato exports are expected to increase 20% in 2007, benefiting from a poor 2006 potato crop in Europe and from solid US demand. The number of fast food outlets in the United States is still growing, and this is expected to continue. Irrespective of a slowdown in the US economy, exports of frozen fries to the US are expected to remain on an upward trend. On the other hand, this year's potato crop in Europe has been good despite some minor losses resulting from flooding in the UK. This will produce some downward price pressures in non-US markets. In total, frozen potato exports are expected to increase by a more modest 5% in 2008. Nevertheless, PEI exporters are continuing to make inroads into emerging markets such as Saudi Arabia, China and the United Arab Emirates.

The Island's lobster fishery accounts for over 60% of total fishing exports. Lobster exports are set to decline in 2007 based on two factors. First, lobster landings were abnormally high in 2006. Secondly, cold waters this spring reduced early lobster landings by 10%. But east coast lobster landings in the US were also down this year, leading to a tight supply-demand balance. While PEI's fresh lobster shipments should hold fairly steady, frozen lobster will see lower export levels this year as European countries, with the exception of France and Norway, have significantly reduced their purchases. Nevertheless, fishing exports are expected to rise a modest 2.8% in 2007, as significant increases in exports of mussels and frozen crab more than offset the decline in lobster shipments. EDC Economics expects fishing exports to fall by 4.0% in 2008 based on a less favourable pricing environment and sluggish US consumer spending.

Prince Edward Island has become the first province in Canada to export wind power to the United States. On May 7, 2007, wind-generated electricity was exported to the New England Power Pool via the international interconnection node located at Keswick, New Brunswick. The majority of the province's wind-generated electricity is ear-marked for export. The aerospace sector continues to grow in importance. Exports of turbo propellers and parts of turbo jets recorded strong growth in 2007. EDC expects healthy growth in 2008, as manufacturers of aerospace parts continue to see busy order books. Pharmaceutical exports have grown consistently over the past 5 years, and this trend is expected to continue in 2008, in particular exports of vaccines for veterinary medicine. Shipbuilding is also doing quite well, as global seaborne transportation, expanding port facilities and offshore oil exploration drive an active order book for tug boats until the end of 2008. Exports of rail equipment, on the other hand, will continue to see significant declining numbers in 2007 before leveling off in 2008.



8.3 Nova Scotia

Top Sectors	CAD mn 2006	% Share of Province's Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Energy	1,008	20.2	-29.9	14.9	10.9
Agri-Food	1,244	25.0	-5.2	-2.2	-0.4
Forestry	713	14.3	-31.6	27.6	2.3
Motor Vehicle	848	17.0	1.5	7.3	1.8
Industrial Goods	562	11.3	3.1	5.0	-2.8
All Others	609	12.2	23.9	-9.9	2.1
Total	**4,985**	**100.0**	**-12.0**	**7.0**	**2.9**
Total excl. energy	**3,976**	**79.8**	**-6.0**	**5.0**	**0.7**

Table 49: Nova Scotia Merchandise Export Outlook

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

Nova Scotia's exporters experienced a tough year in 2006. While the stronger Canadian dollar continued to hurt competitiveness, lower natural gas production, newsprint shutdowns and weaker seafood landings and prices dampened the value of exports. Looking forward, international exports recovered somewhat this year, and should post a further modest gain in 2008. The Sable offshore compression deck platform has enabled natural gas production to increase, which will boost export growth significantly in 2007 and 2008. Stora Enso's resumed paper mill operations have been a major boost to export growth. Michelin's tire plant operations have also supported exports and are expected to contribute further in 2008. Exports will also be supported by growth in food and beverage, pulp processing, rubber and plastics and some machinery equipment manufacturing. However, the province's large seafood industry is not expected to show any export gains through the coming year. Overall, the value of exports is forecast to grow by 7% in 2007 and by a modest 3% in 2008.

Natural gas production at the Sable offshore energy facility is expected to ramp up in the second half of this year – production was restrained earlier in 2007 due to commissioning delays following the installation of the compression deck platform. The ramp-up will result in export growth of 17% in 2007 and 12% in 2008. While stronger gas shipments contributed to export growth this year, rising natural gas prices and a weaker Canadian dollar will boost export earnings next year. The price for Henry Hub natural gas is forecast to average US$7.0/mmbtu in 2007 before increasing to US$7.5/mmbtu in 2008.

The housing bust south of the border has been deeper than previously thought and is expected to inflict a prolonged period of weakness in US housing construction. The glut of new homes on the market will take some time to work through – a process that will be hampered by more restrictive bank lending standards. As a result, Nova Scotia's shipments of lumber and wood products are forecast to weaken this year and well into next year.

Refurbished newsprint operations in Port Hawkesbury have injected a new lease of life into the province's paper mill industry. After shutting down newsprint operations for almost one year, operations resumed late last year and have boosted export growth in 2007. The production of high quality newsprint and supercalendered paper lines is expected to contribute positively to export growth in 2008.

North American motor vehicle sales and production are expected to deteriorate heading into next year. However, the impact of this slowdown on auto parts suppliers will be limited thanks to Michelin's development of its fuel and energy-efficient X-One generation of heavy truck tires in Waterville. The Michelin X-One replaces a truck's traditional dual tires with a single wide tire, creating fuel and energy savings.

Higher seafood prices this year have helped buffer the effects of lower landings. Higher crab prices have been the highlight, up 20 to 30% in the first half of 2007. Lobster exports should drop slightly this year on slightly lower catches, but we expect earlier weakness in the year to dissipate through the final months of 2007. In 2008, slightly lower prices for crab, lobster and salmon (shrimp prices should remain steady) and lower overall landings will result in lower seafood earnings.

8.4 New Brunswick

Top Sectors	CAD mn 2006	% Share of Province's Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Energy	5,995	57.8	-5.8	5.5	12.2
Forestry	2,007	19.4	4.5	-2.2	-7.1
Agri-Food	1,146	11.1	-5.5	-2.3	-1.0
Industrial Goods	811	7.8	6.7	32.0	-0.4
M&E	190	1.8	-12.2	-4.7	3.8
All Others	216	2.1	8.6	2.6	0.1
Total	**10,366**	**100.0**	**-2.9**	**5.0**	**5.7**
Total excl. energy	**4,371**	**42.2**	**1.4**	**4.2**	**-3.2**

Table 50: New Brunswick Merchandise Export Outlook

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

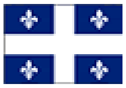
After declining 3% last year, New Brunswick's exports are geared toward growth in 2007, with greater energy, pulp, paper and fertilizer exports offsetting the collapse of lumber shipments. Overall, New Brunswick's international exports are expected to grow 5% in 2007 and accelerate modestly to 6% in 2008.

Saint John is positioning itself to become an energy hub in the Maritimes. While crude prices have increased rapidly since January, gasoline prices have been much weaker. Export sales have also been tempered by the rise in the Canadian dollar. Nonetheless, we expect energy exports to expand 5.5% in 2007 with greater volume from the Irving Oil refinery. Additionally, the province started shipping natural gas this year, with Corridor Resources connecting the McCully natural gas field to the Maritimes & Northeast pipeline. With the Irving Canaport LNG terminal expected to start operating late next year, natural gas exports will surge, boosting growth in total energy exports to 12% in 2008, despite softer US demand for refined petroleum products. Electricity exports however, will contract in 2007 and again in 2008, due to shutdowns at the Point Lepreau nuclear power plant, largely related to its refitting, which is due to be completed late in 2009.

Wood product exports have taken a beating this year, declining faster than in most other provinces. The collapse of the US housing market has resulted in a sharp contraction in lumber demand, causing a number of shutdowns and curtailments in the province. As a consequence, wood product exports will fall 35% in 2007, but rise by 7% next year as better prices will be supported by supply management and a softer Canadian dollar. Driven by strong market fundamentals, higher prices, and capacity expansion in Edmundston and Nackawic, pulp exports will expand 26% this year and another 7% next year. The increase in paper exports so far this year however, is mostly related to the 3-month closure of the Miramichi mill early in 2006. This increase will unwind through the remainder of this year and into 2008, as the company recently began a 9-month shutdown due to weak market conditions. We expect the mill to remain closed for much of next year, resulting in paper exports contracting 23% in 2008 after expanding 12% this year.

Agri-food exports will decline slightly in 2007, as better potato prices and higher processed food exports are offset by weaker seafood shipments. Softer lobster landings and prices, a reduced crab quota and a reduction in farmed salmon production will offset a rise in processed food exports. A disappointing potato harvest will be partly offset by higher prices. A further 1% contraction in agri-food exports is expected in 2008, as US demand for prepared food products wanes, while global seafood prices remain generally depressed.

Stronger fundamentals for metals and fertilizers have propelled exports of industrial goods up by an estimated 32% in 2007. Metal mining exports will be supported by the reopening of the Cariboo and Restigouche mines this year, which will help offset the zinc price correction expected next year. Potash prices and provincial exports are also up significantly with the expansion of ethanol capacity in the US and Brazil, and record high wheat prices. Potash exports should post further increases in 2008. Despite increased mining output and continued growth in fertilizer shipments, a pullback in metal prices is expected to see exports of industrial goods stabilize in 2008.



8.5 Quebec

Quebec export growth slowed to an estimated 2.7% this year, due to lower forestry prices and falling sales of motor vehicle products and consumer goods. The outlook for 2008 will be dogged by a weakening global economic environment, which will cause foreign-bound shipments to pull back by 1.4%. Industrial goods and consumer products will be the main drags on overall provincial export sales, with most other sectors registering modest growth.

Table 51: Quebec Merchandise Export Outlook

Top Sectors	CAD mn 2006	% Share of Province's Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Industrial Goods	25,016	36.2	20.3	8.9	-9.5
Forestry	11,383	16.5	-5.2	-9.4	3.5
M&E	9,523	13.8	-6.2	-0.3	3.3
Transportation	8,524	12.3	-8.4	8.0	4.8
Consumer Goods	3,775	5.5	-9.7	-11.1	-7.0
Agri-Food	3,815	5.5	-0.1	9.4	7.6
All Others	7,047	10.2	5.9	1.8	5.6
Total	**69,083**	**100.0**	**3.2**	**2.7**	**-1.4**
Total excl. energy	**66,870**	**96.8**	**3.4**	**2.2**	**-1.8**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

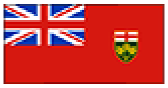
On the heels of a 20.3% surge in 2006, exports of industrial goods will rise by only 9% this year, completely on the back of robust gains in metal and chemical prices – shipped volumes will actually contract. Looking forward to 2008, slower global industrial production will weaken the pricing environment considerably, causing the value of exports to fall by almost 10%.

Prospects are hardly better for the forestry industry, where depressed lumber and newsprint prices will accentuate already falling sales of these commodities. The decline in US residential construction and a government-mandated 20% reduction in allowable cuts (Bill 71) will dampen exports of Quebec timber. Furthermore, global oversupply and weak demand from US dailies and advertisers will drag down provincial newsprint sales. Looking to 2008, conditions will improve somewhat, but mostly because current plant closures will rebalance supply conditions and thereby buttress prices. Also, a weaker Canadian dollar will provide some relief to forestry exporters, which should see shipments rise by a modest 3.5%.

Meanwhile, a healthy aerospace sector will propel provincial exports of transportation equipment ahead by 8% this year. A revival in prospects for Bombardier's regional jets, as well as continued strong demand for corporate airplanes, helicopters, engines, aircraft parts and avionic products will offset declines in the railway equipment segment. Next year, the same trend is likely to be repeated, with the aerospace-side of the business driving overall transportation exports up by a further 5%. Recent contract wins by Quebec companies introduce some upside risk to the 2008 outlook for aerospace.

Despite low interest rates and high corporate profits setting the stage for capital investment, exports of Quebec machinery and equipment (M&E) will drop another 0.3% this year, below the national average of nearly 2% growth. A price-induced decline in exports of telecommunications and advanced technology will be the main drag on provincial M&E exports, offsetting modest gains in overall industrial machinery sales. Looking forward to 2008, the M&E sector should see a 3% rebound that would put the province at par with the rest of the country. However, the pick-up in exports will be principally due to a lower base in 2007 instead of a real turnaround in demand conditions.

Increasing competition from low-wage countries and a strong Canadian dollar will be the main factors dragging down Quebec's apparel and furniture industry, two major sub-sectors of the provincial consumer goods industry. At the same time, slowing economic activity and high energy costs will concur to cap household consumer spending growth, reducing demand for consumer goods south of the border. In Europe and in the UK, where local currencies are expected to hold their ground vis-à-vis the Canadian dollar, we see some upward potential for the industry as a whole. In aggregate, however, EDC Economics forecasts that exports of consumer goods will decline over the next 2 years.



8.6 Ontario

Following a year of declining sales, Ontario's exporters are on track to make a modest rebound in 2007 despite the continued struggles of the manufacturing sector and, in particular, the automotive sector. Ontario's exports are expected to increase 2.4% in 2007 which is driven, in large part, by an excellent performance in the metals and chemicals sectors. The metal sector is riding a wave of strong global demand, and benefiting from the associated high commodity prices. Looking forward, we expect Ontario's exports to decline by almost 1% in 2008 as commodity prices ease amid softer US and global demand conditions.

Table 52: Ontario Merchandise Export Outlook

Top Sectors	CAD mn 2006	% Share of Province's Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Motor Vehicle	70,442.9	39.7	-7.3	-6.7	1.3
Industrial Goods	47,784.2	26.9	8.4	18.3	-7.2
M&E	28,916.1	16.3	0.0	0.3	2.6
Forestry	7,595.9	4.3	-16.5	-16.5	3.6
Agri-Food	8,519.3	4.8	0.1	5.7	9.2
Consumer Goods	4,165.9	2.3	-3.3	-6.6	-6.8
All Others	9,940.9	5.6	7.1	12.3	4.1
Total	**177,365.3**	**100.0**	**-1.6**	**2.4**	**-0.7**
Total excl. energy	**174,344.5**	**98.3**	**-1.5**	**2.0**	**-0.8**

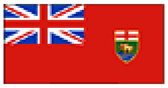
Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

Auto exports, including passenger cars, auto parts and trucks, represent Ontario's largest tradable goods sector, accounting for close to 40% of total exports. Passenger cars alone account for over 25% of the province's export sales. As the Detroit Three continue to lose market share and US auto sales drop to a 9-year low in 2007, passenger vehicle exports are forecast to decline 6.2% in 2007 before leveling off in 2008. The start-up of a new Toyota plant in 2008 will provide a welcome boost to auto exports. But the continuing loss of market share of the Detroit Three will hurt exports of auto parts. Combined with continued intense foreign competition, exports of auto parts are expected to fall by 1.4% in 2007 before increasing modestly by 1.9% in 2008. Finally, exports of heavy-duty trucks were hit hard in 2007 by the significant pre-buying that occurred in 2006. New US emission standards caused the pre-buying. Although heavy truck exports are expected to drop by 33% in 2007, the corresponding pent-up demand will see shipments partially recover in 2008 with growth of 8.2%.

The industrial goods sector is expected to more than offset weakness in the automotive sector. With foreign shipments on track to grow 18% in 2007, the industrial sector will be the largest contributor to the province's export growth this year. In particular, export receipts for metals and metals manufacturing are expected to expand 24% in 2007, with most of the growth coming from the mining sector. Mining is benefiting from strong global demand and high commodity prices. However, EDC Economics expects commodity prices to moderate next year. As such, industrial goods are set to make a negative contribution in 2008. In contrast, pharmaceuticals have been a stellar performer over the past 5 years, and this trend is expected to continue through 2008 with particularly strong growth to European markets.

Another bright spot is the transportation sector, which is made up of aircraft and parts, and railroad equipment. Transportation exports are expected to grow by 15% in 2007, driven by rising shipments of aircraft and parts, and solid gains in railroad equipment. Both sectors are expected to come off exceptional growth rates but to remain in positive territory in 2008. As such, the transportation sector is expected to see more subdued growth of 3 to 4% in 2008.

Ontario's forestry exports are down an estimated 17% in 2007. Sales should start to improve a little in 2008, with growth forecast at 3.6%. But most of the risk is still on the downside. The newsprint sector will experience another challenging year in 2008 as intense foreign competition, especially from China, has a negative impact on market share and prices. In addition, lumber exports will continue to be impacted by the fallout in the US housing market, which is likely to extend into 2008.



8.7 Manitoba

With gains chiefly concentrated in primary industries, Manitoba ranks among the best export performers across the country this year. Although the export outlook going forward is generally positive, waning US consumer demand combined with a strengthening of the Canadian dollar are beginning to take a toll on exports. Given that these variables are expected to intensify over the remainder of the year, export growth is envisaged to moderate, ending the year at a still-impressive 15%. This moderation will permeate into 2008, with growth slowing to 7%. Exports to non-US destinations continue to be strong, led by shipments of metals, with major increases in sales to Japan, Taiwan and Hong Kong.

Table 53: Manitoba Merchandise Export Outlook

Top Sectors	CAD mn 2006	% Share of Province's Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Industrial Goods	3,208	29.5	62.1	31.6	6.2
Agri-Food	2,661	24.5	-5.2	20.0	13.1
Energy	1,504	13.8	22.0	-2.6	-1.4
M&E	1,027	9.4	-3.2	11.5	11.5
Forestry	742	6.8	-13.3	-9.6	6.8
Motor Vehicle	690	6.4	1.7	2.3	7.0
All Others	1,038	9.5	-2.3	7.0	2.3
Total	**10,870**	**100.0**	**12.3**	**15.1**	**7.3**
Total excl. energy	**9,367**	**86.2**	**10.9**	**17.9**	**8.5**

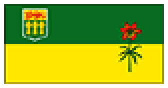
Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

Meanwhile, there are some concerns over the strength of the hog and cattle industry. While robust crop prices drove a 23.2% advance in farm cash receipts during the first half of 2007, higher feed costs have cut heavily into the pockets of livestock producers. Relatively weak prices for hogs and pork products during the first few months of this year partially explain the fragile export growth in the hog industry. There appears to be an excess supply of hogs within the North American market in general, and many farmers have been hoping for Chinese sales to come through. But the recent rejection of pork shipments from Canada and the US portend continued softness in the market through the coming months. With hopes for a pick-up in export volumes to China dashed, pork tonnage is anticipated to overrun demand and in turn depress prices. On the domestic front, the Manitoba government has currently put a freeze on the building of new barns, making it difficult for hog producers to combat rising input costs with volume gains.

Although the US border has been reopened to Canadian cattle shipments, restrictions remain. For instance, only boxed beef and cattle under 30 months of age are allowed entry whereas older cattle and breeding stock remain banned. This does not bode well for Manitoba's cattle producers who send much of their stocks south for processing. However, the recent announcement by US authorities to remove these restrictions late in 2007 will serve as a boon for cattle farmers. According to the *Winnipeg Free Press*, as a result of these trade constraints the industry loses about $1.25 million per day, even after receiving a certification from the World Health Organization that the BSE (mad cow disease) risk in Canada is under control.

Biofuel demand has bolstered the price of the province's leading crops. Thus far, export earnings of coarse grains, wheat and oilseed have been impressive, posting year-to-date gains of 41%, 45% and 59% respectively. The continued expansion of US ethanol capacity will apply upward pressure on coarse grain prices and volumes through the end of 2007. Likewise, wheat prices are likely to remain relatively high but are likely to soften in 2008, eroding export earnings. Overall, major grain prices are poised to remain strong and Manitoba exporters stand to gain from tight global supplies and firm demand. Agri-food exports are set to rise 20% in 2007 and by 13% in 2008.

Notwithstanding the current challenges in the hog and cattle sectors, Manitoba's export prospects look optimistic. With a nickel mine coming online in 2008; the expected start-up of production by Boeing Winnipeg for parts associated with Boeing's Dreamliner 787, which has already attracted record orders; a diverse export base; and a softer C$ in 2008, exports are well placed to weather the US and global economic slowdown.



8.8 Saskatchewan

Saskatchewan's economy is booming and the export sector is no exception. Total exports increased by 11.5% y/y during the first 7 months of this year, while non-energy sales have grown by more than 30%. Overall export growth for the province should remain fairly robust through the forecast period as cattle and beef import restrictions to the US are lifted, potash production bounces back, and crop prices remain strong. EDC Economics forecasts that total exports for Saskatchewan will finish 2007 with annual growth of 15%. Export growth will moderate in 2008, to a still respectable 12%.

Table 54: Saskatchewan Merchandise Export Outlook

Top Sectors	CAD mn 2006	% Share of Province's Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Energy	6,078	38.4	22.6	-9.1	5.4
Agri-Food	4,939	31.2	32.1	38.2	21.3
Industrial Goods	3,574	22.6	-1.8	27.9	6.5
Forestry	511	3.2	-43.5	-3.7	5.3
M&E	517	3.3	-0.1	1.8	9.2
All Others	220	1.4	2.8	-4.1	1.7
Total	**15,839**	**100.0**	**13.4**	**14.6**	**11.7**
Total excl. energy	**9,761**	**61.6**	**8.3**	**29.4**	**14.5**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

The agri-food sector shows great export potential for the next couple of years as demand for crops used in ethanol production remains strong and cattle markets re-open. The province continues to expand its seeded acreage, while projects such as Great West Beef and Bison Inc. will expand export capabilities. EDC Economics expects exports of agri-food products will grow by 38% in 2007 and by a further 21% in 2008.

Saskatchewan's exports of agricultural machinery are also benefiting from the strong global demand for crops and the ensuing run-up in prices. Farmers around the world are increasing their acreage, which requires investing in new equipment – and high crop prices give them the cashflow to finance these purchases. The province's shipments of agricultural equipment are on track to rise by 8 to 10% in 2007. A more modest, but still solid gain of around 5% can be expected for 2008.

Fertilizer exporters will continue benefiting from the biofuel boom as farmers around the world increase the use of fertilizers in related crop production (corn is the largest end-user of potash and other fertilizers). Moreover, the provincial government is expected to invest around $80 million in expanding biofuel production facilities through the SaskBIO Program. Potash exports in particular, have been very strong so far this year, and even though growth is expected to slow in the second half as the pricing dispute between PotashCrop, China and India has now been resolved, the overall results are very promising. It is expected that global demand for potash, especially from China, will continue growing at a rapid pace. Overall, fertilizer exports are expected to rise by 33% in 2007 and by an additional 11% next year.

On the downside, even though prospects for uranium are very positive, there are some concerns regarding production capacities in the province as the Cigar Lake mine will probably not be operative until 2011.

Crude petroleum exports have been weak so far in 2007, decreasing by some 25% y/y during the first 7 months of the year. For the next few months, drilling activity will be sluggish at the national level and will likely remain flat in Saskatchewan, according to predictions from the Petroleum Association of Canada. For that reason, exports for the energy sector are expected to decline by 9% in 2007 before rebounding by 5% in 2008.

Finally, exports of lumber and wood manufacturing products are down significantly this year as a result of the housing crisis across the border and the high Canadian dollar that has hurt producers in the sector. The weakness in wood exports will continue through much of 2008, although some improvement should be seen by the second half as the US construction sector slowly recovers. Exports of lumber and wood manufacturing products are down an estimated 16% in 2007, but a partial rebound is expected in 2008 with growth of 7%.

8.9 Alberta

International merchandise exports should grow 7% in 2007 and 4% in 2008. M&E, industrial goods and agri-food all posted solid gains this year. For next year, EDC Economics expects respectable gains for energy, forestry and M&E to contribute to the bottom line. Agri-food will be head and shoulders above all others though, as the stellar export growth experienced in 2007 is expected to continue next year.

Table 55: Alberta Merchandise Export Outlook

Top Sectors	CAD mn 2006	% Share of Province's Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Energy	54,997	70.0	0.0	4.9	4.4
Industrial Goods	9,766	12.4	11.3	9.1	-2.7
Agri-Food	5,756	7.3	9.1	22.6	15.1
M&E	3,850	4.9	18.4	16.1	4.6
Forestry	2,675	3.4	-12.8	-3.5	5.4
All Others	1,470	1.9	4.2	0.7	0.8
Total	**78,513**	**100.0**	**2.3**	**6.9**	**4.3**
Total excl. energy	**23,516**	**30.0**	**8.0**	**11.6**	**4.3**

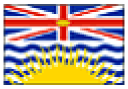
Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

With a WTI crude oil price forecast of US$66/barrel and US$64/barrel in 2007 and 2008 respectively, crude and related exports will have solid price support through the forecast period. The price of crude set several new records in September, and there is sizable upside risk to our price forecast. With some oil sands investments nearing completion, and more in development, non-conventional crude production is on a steady rising path. Additional strength will come from increased refinery output, but gains here will be modest. While we are forecasting a 5% increase in crude and related product exports in 2008, pipeline capacity constraints may limit volume gains. Natural gas exports are expected to fall in 2007 and 2008 on lower production, greater diversion toward domestic consumption and high exploration and development costs. Moreover, if prices don't recover from recent lows (August-September), our outlook for drilling activity could prove over-optimistic, resulting in lower export volumes. Our current forecast for Henry Hub gas calls for prices to average US$7.5/mmbtu in 2008. The outlook for coal exports is solid, with higher prices in 2008 supported by robust emerging market steel production, as well as supply constraints that are limiting Australia's coal export potential.

Oilseeds, pulse and wheat exports jumped significantly in 2007, and we expect the latter to see another large price-induced increase in 2008. Demand for biofuels, poor weather conditions and strong developing market demand will be the key drivers. World demand for grain has been high, while supply is being curtailed by weather-related crop damage that has trimmed global stocks to lows not seen since the early 1970s. This will work its way downstream into higher feed prices where 10% increases have already been seen, boosting costs for Alberta's $2.5 billion live animal and meat processing export industries. Alberta's fertilizer, chemicals and plastics exports will turn in mixed performances in 2008. Fertilizers should continue to show strength as high grain prices lift global planting intentions. Chemicals and plastics, however, will face headwinds from slowing US housing and consumer demand along with a more generalized softening of the global economy. Emerging market growth is expected to limit downside risks.

Machinery and equipment exports are expected to grow 5% in 2008 after an estimated gain of 16% in 2007. Exports of mining and oil and gas equipment should prove solid through 2008 while high crop prices lift sales of agricultural equipment. However, the outlook for telecommunications and other electronic equipment calls for moderating growth with investment intentions in the US and other key markets expected to soften through the first half of 2008.

Export earnings are heavily dependent on energy as it represents 70% of the province's total merchandise exports. While 90% of Alberta's shipments go to the US, excluding energy shows some geographic diversification is evident, with 64% of non-energy sales going to non-US markets in 2006.



8.10 British Columbia

Table 56: British Columbia Merchandise Export Outlook

Top Sectors	CAD mn 2006	% Share of Province's Total Exports (2006)	Export Outlook (% growth)		
			2006	2007(f)	2008(f)
Forestry	13,461	40.3	-3.7	-6.5	4.4
Energy	6,410	19.2	-17.5	-4.2	12.4
Industrial Goods	6,368	19.1	17.0	3.2	-14.1
M&E	2,664	8.0	8.3	2.9	4.3
Agri-Food	2,461	7.4	1.8	3.5	3.6
All Others	2,057	6.2	1.2	-0.9	-1.9
Total	**33,421**	**100.0**	**-2.0**	**-2.4**	**1.7**
Total excl. energy	**27,011**	**80.8**	**2.6**	**-1.9**	**-0.8**

Source: EDC Economics. 2006 actual, 2007 and 2008 are forecast.

British Columbia's exports declined 2% in 2006, following impressive growth of 10% in the previous 2 years. So far this year, exports have fallen further, down 3.6% y/y during the first 7 months. Declining values of wood products and natural gas exports have been the main sources of weakness so far this year, with some softness also witnessed in coal and newsprint. Helping to mitigate this weakness has been exports of food and beverages, pulp, manufactured metal products and computer equipment.

The housing-led economic slowdown in the US is a major challenge facing forestry and wood product manufacturers. The province's forestry sector, which accounts for half of Canada's entire forestry industry, will continue to suffer from the US housing recession this year and next. On a more positive note, demand from emerging markets will limit the downside. In particular, exports to China (BC's third largest export market) should remain robust, particularly exports of pulp, metal ores and machinery and electrical equipment. Total exports are forecast to decline 2.4% in 2007. In 2008, the value of exports will rebound partially (up 1.7%), thanks to higher export prices and steady export shipments.

The housing bust south of the border has been deeper than previously thought and is expected to inflict a prolonged period of weakness in US housing construction. The glut of new homes on the market will take some time to work through – a process that will be hampered by more restrictive bank lending standards. As a result, shipments of lumber and wood products are forecast to decline by around 15% in 2007. A partial recovery of 6% is projected for 2008 (concentrated in the second half). Firmer prices next year will help offset the effects of lower volume shipments. But even with next year's expected improvement, annual export earnings for lumber and wood products would still be more than $2 billion below their 2004 level.

With natural gas supply and demand conditions fairy tight and crude oil prices higher, natural gas prices are expected to average higher through the remainder of 2007 and rise further in 2008. These stronger fundamentals will help support the value of gas exports, with dollar depreciation adding to export earnings in 2008. The value of coal exports also suffered this year due to weaker prices and shipments. Higher export prices combined with stronger shipments are forecast to boost coal exports by almost 22% in 2008.

The contrast in export performance between pulp and paper export growth is due primarily to the emergence of China, which is offsetting weaker pulp demand elsewhere (US). China's demand for raw materials (pulp included) is expected to remain fairly robust in 2008, supporting BC's exports of pulp products. In contrast, paper exports (destined almost entirely to the US) continue to exhibit softness, largely in response to the rapid growth of Chinese paper production and global paper capacity.

Strong global demand for industrial metals, led by China, will ensure healthy activity in metal mining and industrial metal exports. However, easing base metal prices will prevent positive export growth in 2008. Even so, the dollar value of export earnings is expected to remain above historical levels.

The economic slowdown unfolding in the US will act to moderate exports of agri-food (including seafood) and machinery and equipment in 2007 and 2008. In addition, exporters of consumer goods, broadly speaking, can expect weaker levels of orders over the next 12 to 18 months.

9.0 Annexes

9.1 EDC Experience and Attitude

9.2 Short-, Medium- and Long-Term Payment Risk Maps

To receive free economic and political research covering over 200 markets worldwide, please visit our website at www.edc.ca and register under EXPORT Market Insight.

Just one of the excellent services provided by EDC Economics. If you have any questions, or require additional information regarding the **Global Export Forecast**, please call us at our toll-free number 866-574-0452 or e-mail us at EDCEconomics@edc.ca

ALGERIA

Collection Experience

- Usual Trading Terms: ILC is the norm. Some Europeans use open account.
- Overall Experience: Good with LCs; delays could be due to buyer and administration difficulties, not to lack of foreign exchange. Bank delays average 3-4 months.
- Credit/Financial Issues: Key steps made in financial sector toward liberalization, but Banque Nationale d'Algerie or Banque Exterieure d'Algerie and Banque de l 'Agriculture et du développement rural are still owned by public sector. Bureaucratic red tape, corruption and high taxes affect business climate.

EDC Experience and Attitude

- Short Term: Open on a full range of payment terms.
- Claims Experience: Claim paid in 2006, but not in the first half of 2007.
- Medium/Long Term: Open under total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Open.

ANGOLA

Collection Experience

- Usual Trading Terms: Very secured terms: CIA and confirmed ILC.
- Overall Experience: Has been reducing its old stock of arrears mainly with ECA creditors on MT/LT business.
- Credit/Financial Issues: High inflation and commercial risk. Corruption is rampant. Caution with banking sector. Payment process is still slow.

EDC Experience and Attitude

- Short Term: Case-by-case; while ILC preferred, other terms considered.
- Claims Experience: Little experience due to lack of business.
- Medium/Long Term: High country risk; consult with head office.
- Political Risk Insurance: Case-by-case.
- Wrongful Calling of Bonds Insurance: High country risk.

ARGENTINA

Collection Experience

- Usual Trading Terms: LC recommended.
- Overall Experience: Fair. In the short term there are no concerns over access to FX. A number of more serious concerns exist for the longer term, and caution is advised.
- Credit/Financial Issues: The private market has little capacity, and many public insurers have restrictions. Some will consider structured financing arrangements that offer assurance of FX access.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: No recent claims paid.
- Medium/Long Term: Case-by-case, with preference for FX-generating business. Caution for energy-dependent business.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

ARMENIA

Collection Experience

- Usual Trading Terms: Secured terms. ILC is the norm.
- Overall Experience: Very limited experience, but poor.
- Credit/Financial Issues: Caution advised due to lack of information. Weak banking sector.

EDC Experience and Attitude

- Short Term: Case-by-case; while ILC preferred, other terms considered.
- Claims Experience: EDC has not paid any recent claims.
- Medium/Long Term: Highly selective. Public sector cannot borrow on commercial terms.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

AUSTRALIA

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Good.
- Credit/Financial Issues: Stable business environment.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Decline in value of claims paid in 2007.
- Medium/Long Term: Low risk.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Very low country risk.

AZERBAIJAN

Collection Experience

- Usual Trading Terms: Secured terms. ILC is the norm.
- Overall Experience: Very limited experience.
- Credit/Financial Issues: Weak banking sector undergoing reforms. Strong liquidity position.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: No claims experience in this market in view of limited business.
- Medium/Long Term: Highly selective. Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

BAHAMAS

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Good.
- Credit/Financial Issues: Fairly stable business environment.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Favourable.
- Medium/Long Term: Low risk. Open under total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low risk.

BAHRAIN

Collection Experience

- Usual Trading Terms: Full range of terms. Terms rarely exceed 60 days.
- Overall Experience: Good.
- Credit/Financial Issues: Strong financial sector; one of the most advanced in Middle East regulatory regimes. Basically no FDI barriers.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: EDC has not paid any recent claims.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

BANGLADESH

Collection Experience

- Usual Trading Terms: Secured terms – CLC constitutes minimum and recommended terms, but LCs remain acceptable for repeat business or with large importers. Some open account transactions reported, though they remain the exception.
- Overall Experience: Little experience due to lack of business.
- Credit/Financial Issues: Most ECAs and the private market are very restrictive in this market due to the nation's recurring international liquidity problems.

EDC Experience and Attitude

- Short Term: Case-by-case; while ILC preferred, other terms considered.
- Claims Experience: Claims paid in 2005 and in 2006.
- Medium/Long Term: Highly selective. Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: High country risk.

BARBADOS

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Good.
- Credit/Financial Issues: Fairly stable business environment.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Decent claims experience.
- Medium/Long Term: Low risk. Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low risk.

BOLIVIA

Collection Experience

- Usual Trading Terms: CLC recommended.
- Overall Experience: Fair to poor. Payments performance is improving in 2007, but Bolivia's policy environment should be monitored.
- Credit/Financial Issues: Caution advised with respect to banking sector.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: One claim in 2007H1.
- Medium/Long Term: High risk. Case-by-case in public and private sectors, public subject to HIPC guidelines.
- Political Risk Insurance: Case-by-case.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

BOTSWANA

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Good.
- Credit/Financial Issues: Business conditions are benefiting from lower inflation (7.8%), but domestic interest rate (16%) reflects tightening monetary policy. Sound liquidity position.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: There have been no claims recently.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low country risk.

BRAZIL

Collection Experience
- Usual Trading Terms: Full range of terms, with LC recommended.
- Overall Experience: Good. The high cost of local credit can lead to payment delays, but mostly for smaller companies.
- Credit/Financial Issues: Improved external position has eased short-term credit concerns, but the effects of the global credit crunch on Brazil should be monitored.

EDC Experience and Attitude
- Short Term: Open without restrictions.
- Claims Experience: No claims in 2007H1.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

BULGARIA

Collection Experience
- Usual Trading Terms: LC is recommended, open account increasingly common.
- Overall Experience: Fair, some minor delays.
- Credit/Financial Issues: Current account deficit is a concern, but other aspects of the economy are comforting. Business environment continues to improve. The effects of global credit squeeze should be monitored.

EDC Experience and Attitude
- Short Term: Open without restrictions.
- Claims Experience: No recent experience.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

CAMEROON

Collection Experience
- Usual Trading Terms: Confirmed and unconfirmed ILCs are the norm and predominantly with public sector.
- Overall Experience: It should improve. Arrears (domestic and external) are gradually dealt with oil windfalls and debt cancellation with Paris Club creditors and IFIs.
- Credit/Financial Issues: Cumbersome administration; needs to develop “the culture of paying its debts”; Fitch & S&P upgraded risk rating. Private and public sectors have access to the CFA franc zone for transfer.

EDC Experience and Attitude
- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: EDC paid a claim in the first half of 2007.
- Medium/Long Term: Public sector cannot borrow on commercial terms. Private sector with appropriate financial structure.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

CHILE

Collection Experience
- Usual Trading Terms: Full range of terms, with open account predominant.
- Overall Experience: Good. Some payment delays are reported, more often at the state or state-linked level than in the private sector.
- Credit/Financial Issues: The effects of the current global credit crunch should be monitored.

EDC Experience and Attitude
- Short Term: Open without restrictions.
- Claims Experience: Decline in claims so far this year.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low country risk.

China

Collection Experience

- Usual Trading Terms: Much business continues to be done on LC and quite a bit on the basis of drafts, although open terms are becoming more common.
- Overall Experience: Good.
- Credit/Financial Issues: Difficulty obtaining credit and financial information. China is still a relations rather than a law-based system, where it is imperative to know the customer well and where legal recourse is still difficult if things go wrong.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Some claims paid every year since 2004.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

Colombia

Collection Experience

- Usual Trading Terms: LC recommended.
- Overall Experience: Good. Occasional payment delays still occur and economy remains vulnerable to security situation.
- Credit/Financial Issues: Prospects for an eventual US FTA remain uncertain.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: No claims in 2007H1.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

Costa Rica

Collection Experience

- Usual Trading Terms: Full range of terms, with open account the most common.
- Overall Experience: Good to fair.
- Credit/Financial Issues: Despite the dependence of external accounts on a single company, the country is not threatened by near-term liquidity issues. Most of the longer delays are customer related.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Two claims made in 2007H1.
- Medium/Long Term: Open subject to the availability of acceptable financial information.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

Cote D'Ivoire

Collection Experience

- Usual Trading Terms: Very secured terms (cash in advance).
- Overall Experience: Very poor. Accumulating domestic and external arrears. Trying to pay arrears to IFIs to unlock the international rescue package.
- Credit/Financial Issues: Extreme caution warranted. Business conditions are extremely difficult. Private and public sectors have access to the CFA franc zone for transfer. Liquidity is very tight.

EDC Experience and Attitude

- Short Term: Case-by-case with a strong preference for ILC terms, but other terms may be considered subject to strong risk mitigants.
- Claims Experience: Very limited experience due to difficult situation.
- Medium/Long Term: Highly selective. Accumulating arrears since 2002.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: High country risk.

CROATIA

Collection Experience

- Usual Trading Terms: Mainly LC; but open account increasingly common.
- Overall Experience: Fair.
- Credit/Financial Issues: Banking system largely foreign owned, which is good for business.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: EDC paid claims in 2006, but no claims so far this year.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

CUBA

Collection Experience

- Usual Trading Terms: Very secure terms. ILC required.
- Overall Experience: Poor.
- Credit/Financial Issues: Caution advised.

EDC Experience and Attitude

- Short Term: Case-by-case on ILC terms with selected banks.
- Claims Experience: Long-standing and accumulating arrears on medium- and long-term exposures; there have been improvements on the short term.
- Medium/Long Term: Highly selective.
- Political Risk Insurance: Case-by-case.
- Wrongful Calling of Bonds Insurance: Medium-high risk.

CZECH REPUBLIC

Collection Experience

- Usual Trading Terms: Full range of terms; open account predominant.
- Overall Experience: Generally good.
- Credit/Financial Issues: None.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: EDC paid claims in 2006, similar amount expected in 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low country risk.

DOMINICAN REPUBLIC

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Fair.
- Credit/Financial Issues: Conditions continue to improve but risks remain. Currency stable and inflation holding in single-digit territory, resulting in a stable business environment. Risks could rise in 2008 with presidential elections slated for May. Potential that the government will not renew its IMF program in 2008 is also a concern. Textiles industry is under severe strain.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Recent experience is good. Payment delays are a relatively normal occurrence. Delays in payment from the government are also a risk.
- Medium/Long Term: Medium risk in the short term. Higher risk in long term as concerns relating to government debt, global economic conditions and the troubled power sector present challenges.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

Ecuador

Collection Experience

- Usual Trading Terms: CLC recommended.
- Overall Experience: Poor to fair. Country's international liquidity position could become strained; caution is advised especially with longer term commitments.
- Credit/Financial Issues: Caution advised with banking sector.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: No claims in 2007H1.
- Medium/Long Term: High risk. Open on a restricted case-by-case basis for the public sector. Open on a case-by-case basis for private, non-bank risk.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

Egypt

Collection Experience

- Usual Trading Terms: ILC and DOP/SD.
- Overall Experience: There has been a clear improvement since 2004.
- Credit/Financial Issues: Concerns over periodic dollar shortages have dissipated. Liquidity is better. Caution advised for state banks and enterprises. Inflation is a concern. World Bank is supporting banking sector reform.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: There has been an improvement with no claim paid in the first half of 2007, but EDC had to pay claims in 2006; frequent extensions or payment demands on contract bonds remain an issue.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

El Salvador

Collection Experience

- Usual Trading Terms: Full range of terms, with LC recommended.
- Overall Experience: Fair.
- Credit/Financial Issues: No reason for concern over the country's external accounts, especially given CAFTA-DR.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Very limited experience.
- Medium/Long Term: Open for the public sector. Open on a case-by-case basis for private, non-bank risk.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

Equatorial Guinea

Collection Experience

- Usual Trading Terms: Very secured terms.
- Overall Experience: Fair.
- Credit/Financial Issues: Banking sector needs reform. Serious governance and transparency issues. Private and public sectors have access to the CFA franc zone for transfer.

EDC Experience and Attitude

- Short Term: Case-by-case; while ILC preferred, other terms considered.
- Claims Experience: No recent experience.
- Medium/Long Term: Highly selective on a case-by-case basis.
- Political Risk Insurance: Case-by-case.
- Wrongful Calling of Bonds Insurance: High country risk.

ESTONIA

Collection Experience

- Usual Trading Terms: Generally open account.
- Overall Experience: Very limited experience; some payment delays reported.
- Credit/Financial Issues: Exchange rate is fixed. No exchange controls.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Small claims this year.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low country risk.

ETHIOPIA

Collection Experience

- Usual Trading Terms: Very secured terms; usually confirmed ILC.
- Overall Experience: Needs new track record after recent stock of debt treatment.
- Credit/Financial Issues: Caution is required with banking sector and state enterprises. Liquidity has been tightening, below manageable level.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: Very limited experience; very difficult to recover if payment difficulties occur.
- Medium/Long Term: Public sector is quite vulnerable; private sector on case-by-case basis.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

FRANCE

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Payments performance (30 days or more) is favourable and remains better than the EU average; however, the share of prompt payments deteriorated further, from 32.8% in Q1 to 31.4% in Q2.
- Credit/Financial Issues: The number of business insolvencies for 2007 is expected to remain at 2006 levels (i.e. around 47,000 cases).

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Claims paid in first 6 months suggest an amelioration in 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Very low country risk.

GABON

Collection Experience

- Usual Trading Terms: Secured terms. Confirmed and unconfirmed ILCs.
- Overall Experience: Has decidedly improved.
- Credit/Financial Issues: Liquidity has eased due to debt relief in the first half of 2000s and then to stronger oil prices. Transparency and falling oil reserves remain issues. Private businesses are often linked to public sector. Private and public sectors have access to the CFA franc zone for transfer.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: No recent claim experience due to restrictive cover policy.
- Medium/Long Term: Prepare to consider business under a total commitment limit; case-by-case.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

GEORGIA

Collection Experience

- Usual Trading Terms: Secured terms. ILC and CILC.
- Overall Experience: Poor.
- Credit/Financial Issues: Weak banking sector. Local and FX/bank delays remain extensive.

EDC Experience and Attitude

- Short Term: Case-by-case; while ILC preferred, other terms considered.
- Claims Experience: No claims experience in recent years.
- Medium/Long Term: Highly selective. Public sector cannot borrow on commercial terms.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: High country risk.

GERMANY

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Payments performance (30 days or more) has improved notably in Q2 and remains notably better than the EU average; however, the number of payments arriving over 120 days late (1.8%) is above the regional average.
- Credit/Financial Issues: The number of business insolvencies for 2007 is expected to remain at 2006 levels (i.e. around 32,000 cases).

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Although the number of claims paid has not increased, the value of claims paid is larger in first 6 months of 2007 compared with the same period in 2006.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Very low country risk.

GHANA

Collection Experience

- Usual Trading Terms: LCs the norm.
- Overall Experience: Satisfactory.
- Credit/Financial Issues: High domestic interest rates to deal with high inflation affecting business conditions. Government heavily involved in private sector. In November 2006, introduced the Kimberly Certification to deal with illegal diamond exports. Bank of Ghana redenominated the “cedi” in July 2007 (the rate to be GHC 10,000 to one new Ghana cedi). Difficult for small business to access credit.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: EDC paid no claims in 2006 and first half of 2007.
- Medium/Long Term: Open under a total commitment limit; case-by-case.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

GUATEMALA

Collection Experience

- Usual Trading Terms: Full range of terms, with open account the norm.
- Overall Experience: Good to fair.
- Credit/Financial Issues: Banking sector has recovered, but a check of local banks used is essential.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: No claims in 2007H1.
- Medium/Long Term: Open with the private sector and on a case-by-case basis with the public sector, preferably when there are other financial institutions involved in the financing.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

GUINEA

Collection Experience

- Usual Trading Terms: Very secured terms.
- Overall Experience: Very poor.
- Credit/Financial Issues: Poor business conditions. Domestic and external arrears are accumulating.

EDC Experience and Attitude

- Short Term: Case-by-case with a strong preference for ILC terms, but other terms may be considered subject to strong risk mitigants.
- Claims Experience: No recent experience due to little business.
- Medium/Long Term: Highly selective due to accumulating arrears.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: High country risk.

HAITI

Collection Experience

- Usual Trading Terms: Very secured terms.
- Overall Experience: Very limited experience.
- Credit/Financial Issues: Business conditions are very difficult.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: Limited experience.
- Medium/Long Term: Extremely selective, third-party offshore guarantees encouraged.
- Political Risk Insurance: Case-by-case.
- Wrongful Calling of Bonds Insurance: High country risk.

HONG KONG

Collection Experience

- Usual Trading Terms: Open account predominant.
- Overall Experience: Most transactions continue to be settled promptly. The local bankruptcy rate has been going down, a trend that is expected to persist for the foreseeable future.
- Credit/Financial Issues: It is important to know your buyer's business as there is often an end buyer in China involved, which should be considered when assessing the credit risk.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: A few small claims in 2004, 2005, 2006 and 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low country risk.

HUNGARY

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Experience ranges from excellent to poor, but generally good.
- Credit/Financial Issues: Economy and banking sector fair, effects of global credit crunch should be monitored.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Paid claims in 2006, similar claims so far in 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low country risk.

INDIA

Collection Experience

- Usual Trading Terms Full range of terms; LC becoming less prevalent as open account is becoming more common; but LC still recommended for first-time customers.
- Overall Experience: Payment performance is improving but expect delays on most transactions.
- Credit/Financial Issues: Focus on customer risk rather than country risk; caution in dealing with regional and local governments since some are in financial straits.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Small claims paid in 2005 and in 2006; none so far in 2007.
- Medium/Long Term: Medium risk.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

INDONESIA

Collection Experience

- Usual Trading Terms: Secured terms – LC is the minimum but CLC is recommended; new business with private sector is approved on a case-by-case basis; MoF guarantee required for most long-term public sector transactions. Some open account reported with good, established customers.
- Overall Experience: Payment delays are reported.
- Credit/Financial Issues: Concern about weakness in banking system and slow improvements. Continue to exercise caution in assessing customer and bank risk.

EDC Experience and Attitude

- Short Term: Open on a case-by-case basis.
- Claims Experience: Claims paid in 2005 and 2006; none so far in 2007.
- Medium/Long Term: Medium risk. Open to public and private sectors under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

IRAQ

Collection Experience

- Usual Trading Terms: Third-party financing structure and risks stop at the border.
- Overall Experience: Very limited experience due to political conditions. Moratorium on external debt.
- Credit/Financial Issues: Local and banks delays can take 4 to 5 months due to ongoing violence. Legislation to resolve the distribution of oil revenues is close to completion, but its draft may be strongly challenged. Security (kidnapping) is a serious concern. The three foreign banks – HSBC, National Bank of Kuwait and the Standard Chartered Bank – have been awarded licenses to set up operations, but are concerned by security.

EDC Experience and Attitude

- Short Term: Case-by-case with strong risk mitigants – third-party financing structure/offshore payment.
- Claims Experience: No recent experience.
- Medium/Long Term: Third-party financing structure and risks stop at the border.
- Political Risk Insurance: Case-by-case.
- Wrongful Calling of Bonds Insurance: High country risk.

ISRAEL

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Good.
- Credit/Financial Issues: Credit/Financial Issues: Strong business activities and comfortable foreign exchange reserves.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: EDC received no claims in the first half of 2007.
- Medium/Long Term: Open under total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

ITALY

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Payments performance (30 days or more) continues to be weaker than EU average.
- Credit/Financial Issues: Outdated bankruptcy legislation leads to costs and delays. The number of business insolvencies for 2007 is expected to remain at 2006 levels (i.e. around 12,000 cases).

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Claims paid in the first 6 months of 2007 equivalent to claims paid for all of 2006.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Very low country risk.

JAMAICA

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Fair but delays are relatively common.
- Credit/Financial Issues: Economy is on a modest upswing led by tourism and some mining. Although stable environment at present, caution remains a persistent recommendation as currency volatility and government liquidity crunches could re-emerge.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Two claims submitted in 2006, none so far in 2007. No claims in 2005 and only one in 2004.
- Medium/Long Term: Sovereign has large debt overhang. Little fiscal room available in the event of an internal or external economic shock.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium risk.

JAPAN

Collection Experience

- Usual Trading Terms: Full range of terms, with lenient terms predominating.
- Overall Experience: Good.
- Collection costs: Very expensive.
- Credit/Financial Issues: Bank lending has been slowing down since the beginning of the year. July had the slowest rate of domestic credit growth since March 2006. Corporate Bankruptcies were up 32.4% y/y in June and have increased consistently over the past 9 months. Small and medium firms in the construction and retail industries have seen the greatest deterioration. These firms are mostly domestic market oriented and are suffering under a weak consumer.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: One claim in 2005 and two in 2006. No claims since then.
- Medium/Long Term: Open without restrictions
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Very low country risk.

JORDAN

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Good.
- Credit/Financial Issues: Local and bank delays are reasonable. Foreign exchange reserves are at comfortable levels.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: EDC recovered in 2007 claims paid in 2006.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

KAZAKHSTAN

Collection Experience

- Usual Trading Terms: Mostly secured terms, but some open account, generally with oil companies or affiliates, or agents of well-established companies.
- Overall Experience: Continued improvement in promptness of payments.
- Credit/Financial Issues: Strong banking sector; challenging (but improving) business environment. Liquidity is substantial because of oil and gas revenues.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: No recent claims experience.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

KENYA

Collection Experience

- Usual Trading Terms: Confirmed and unconfirmed ILCs the norm.
- Overall Experience: Satisfactory.
- Credit/Financial Issues: Financial statements need to be scrutinized. Banking sector needs to be watched. Corruption is a real issue. Inflation is close to double-digit rate of increase.

EDC Experience and Attitude

- Short Term: Open on a case-by-case basis. Preference for ILCs.
- Claims Experience: No recent claims experience.
- Medium/Long Term: Highly selective; private sector on case-by-case.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

KUWAIT

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Good.
- Credit/Financial Issues: Large foreign exchange assets. Sound banking sector. Dinar has been pegged to a basket of currencies, which resulted in revaluation in July 2007.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Claims paid in 2004, 2005, 2006 and 2007 due to default and call on bond.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

KYRGYZSTAN

Collection Experience

- Usual Trading Terms: Secured terms; ILC the norm.
- Overall Experience: Very limited experience.
- Credit/Financial Issues: Weak banking sector, slow progress in reforms.

EDC Experience and Attitude

- Short Term: Case-by-case; while ILC preferred, other terms considered.
- Claims Experience: No claims experience due to very limited business.
- Medium/Long Term: Highly selective. Public sector cannot borrow on commercial terms.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

LEBANON

Collection Experience

- Usual Trading Terms: mainly ILCs.
- Overall Experience: No sign of deterioration.
- Credit/Financial Issues: Received pledges from Paris III donor conference in January 2007 and the Gulf countries, but disbursements are difficult due to security. The Gulf countries have been supporting Lebanese banks. Business conditions remain very difficult.

EDC Experience and Attitude

- Short Term: Case-by-case; ILC preferred.
- Claims Experience: EDC paid one claim in the first half of 2007.
- Medium/Long Term: Highly selective; concerned by the level of indebtedness of the public sector.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

LIBYA

Collection Experience

- Usual Trading Terms: Confirmed and unconfirmed ILCs.
- Overall Experience: Payment experience reasonably good on secure terms. Payment process is slow despite abundance of foreign exchange reserves. Irregularities are common.
- Credit/Financial Issues: Business done mainly through the Libyan Arab Foreign Bank or Central Bank.

EDC Experience and Attitude

- Short Term: Open on a case-by-case basis. Preference for L/Cs.
- Claims Experience: One claim paid in 2006, but none in the first half of 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

LITHUANIA

Collection Experience

- Usual Trading Terms: Generally open account, although North American exporters tend to be more restrictive.
- Overall Experience: Limited, but good.
- Credit/Financial Issues: More recently economy has shown signs of over-heating. Very large external deficits. Effects of global credit crunch should be monitored.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: One claim in 2006, no claims so far in 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low country risk.

MALAYSIA

Collection Experience

- Usual Trading Terms: Full range of terms, although open account is predominant.
- Overall Experience: Payment experience with Malaysian importers remains good but still need to carefully assess customer risk.
- Credit/Financial Issues: Strong local banking system; easing of capital and FX restrictions.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Small claim paid in 2005, none since.
- Medium/Long Term: Low risk. Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

MALI

Collection Experience

- Usual Trading Terms: Mainly ILC.
- Overall Experience: Expected to improve.
- Credit/Financial Issues: Caution is needed with state enterprises; belongs to the CFA franc zone.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: EDC has not paid claims in recent years.
- Medium/Long Term: Public sector cannot borrow at this juncture; private sector with appropriate financial structure.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

MAURITANIA

Collection Experience

- Usual Trading Terms: Mainly ILCs.
- Overall Experience: Satisfactory.
- Credit/Financial Issues: Corruption and bureaucracy are issues in business activities. Legal system cumbersome. Oil revenues coming on stream. Introducing foreign exchange regulations and banking sector changes.

EDC Experience and Attitude

- Short Term: Case-by-case; while ILC preferred, other terms considered.
- Claims Experience: EDC did not pay any claims in recent years due to limited business.
- Medium/Long Term: High-risk market; considering well-secured transactions.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

MAURITIUS

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Good.
- Credit/Financial Issues: Business Facilitation Act implemented in 2006 to attract FDI.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: EDC did not pay any claims in recent years.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

MEXICO

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Short-term products face somewhat challenging environment as recoveries hampered by poor enforcement of creditor rights. After improved claims experience in 2006 on strong economic growth, 2007 has seen some deterioration as US economic slowdown has moved south. In our US downside scenario, further weakening of credit conditions in Mexico could occur. Medium to long-term good experience.
- Credit/Financial Issues: Difficult to obtain financial information. Commercial morality can be problematic.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Challenging. Slow and cumbersome court system makes recoveries challenging.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium risk.

Moldova

Collection Experience

- Usual Trading Terms: Secured terms, usually L/Cs.
- Overall Experience: Limited, as business is mainly done with a few trading partners.
- Credit/Financial Issues: Limited information; very difficult business conditions.

EDC Experience and Attitude

- Short Term: Case-by-case; while ILC preferred, other terms considered.
- Claims Experience: No recent claims experience.
- Medium/Long Term: Highly selective.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

Mongolia

Collection Experience

- Usual Trading Terms: Secured terms. ILC is the norm.
- Overall Experience: Very limited experience.
- Credit/Financial Issues: Banking system is strengthening, but vulnerabilities remain. Non-performing loans in banking sector still high despite substantial improvements.

EDC Experience and Attitude

- Short Term: Case-by-case; while ILC preferred, other terms considered.
- Claims Experience: No recent claims experience due to very limited business.
- Medium/Long Term: Highly selective. Subject to availability of financial information. Sovereign is negotiating IMF program and may come under borrowing restriction.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

Morocco

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Good.
- Credit/Financial Issues: New banking law with more powers for the Central Bank. Successful in attracting FDI, mainly in tourism.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: EDC paid several claims in the first half of 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

Mozambique

Collection Experience

- Usual Trading Terms: Secured terms, mainly ILC.
- Overall Experience: Satisfactory.
- Credit/Financial Issues: Banking sector would be weak without Portuguese support; the choice of domestic bank is important.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: Very little experience with the market.
- Medium/Long Term: Open under a total commitment limit. Public sector cannot borrow on commercial terms.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

NAMIBIA

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Good.
- Credit/Financial Issues: Business conditions are good by African standards. Foreign exchange reserves have increased.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: No claims experience, but very little business.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

NETHERLANDS

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Payment experience (30 days or more) remains stable and better than EU average.
- Credit/Financial Issues: The number of business insolvencies for 2007 is expected to remain at 2006 levels (i.e. around 6,000 cases).

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Claims paid (dollar value) in the first 6 months of 2007 increased significantly compared to 2006 based on one large claim.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Very low country risk.

NIGERIA

Collection Experience

- Usual Trading Terms: Confirmed ILC is the norm.
- Overall Experience: It has improved with ECAs; still large domestic arrears to be dealt with.
- Credit/Financial Issues: Domestic interest rates are high (14%); major banking reform underway. Widespread campaign against corruption, but it is still an issue; cumbersome administration due to three levels of management. Large foreign exchange reserves. Currency changes frozen in August 2007.

EDC Experience and Attitude

- Short Term: Case-by-case with preference for ILC terms, but other payment terms considered.
- Claims Experience: No recent experience.
- Medium/Long Term: Lines of credit signed to support private sector business. Public sector cannot borrow.
- Political Risk Insurance: Case-by-case.
- Wrongful Calling of Bonds Insurance: High country risk.

OMAN

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Good.
- Credit/Financial Issues: Experienced cyclone damages of US$2.6 billion. Rial is pegged to the US dollar. Inflation is a concern. Buoyant business conditions. Banking sector praised by some rating agencies.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: No recent experience.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

PAKISTAN

Collection Experience

- Usual Trading Terms: Full range of terms. Secure terms still preferred but growing reliance on open account.
- Overall Experience: Fair but improving.
- Credit/Financial Issues: More liberal terms for established customers but private sector transactions typically limited to those with a commercial bank as obligor or guarantor; preference for MoF guarantee for public sector transaction.

EDC Experience and Attitude

- Short Term: Open for a full range of payment terms.
- Claims Experience: No claims paid recently.
- Medium/Long Term: Highly selective. Open to public and private sector under total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: High country risk.

PANAMA

Collection Experience

- Usual Trading Terms: Full range of terms, with open account the norm.
- Overall Experience: Fair to good.
- Credit/Financial Issues: Fairly stable business environment, but careful credit checks recommended for unknown customers..

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: No claims in 2007H1.
- Medium/Long Term: Open for the public sector, while on a case-by-case basis for private risk.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

PERU

Collection Experience

- Usual Trading Terms: Full range of terms, with open account the norm.
- Overall Experience: Fair. Secure terms are recommended for less well-known private sector customers. Note: Local laws give creditors only 7 days to protest a draft.
- Credit/Financial Issues: Banking system improving, but caution still advised.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: No claims in 2007H1.
- Medium/Long Term: Open for public sector with a preference for sovereign guarantee. Private sector on a case-by-case basis subject to the availability of acceptable financial information.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

PHILIPPINES

Collection Experience

- Usual Trading Terms: Full range of terms but LC is recommended based on customer rather than country risk.
- Overall Experience: No claims paid recently.
- Credit/Financial Issues: Country risk has been declining and is not a grave concern over the near term; customer risk needs to be assessed thoroughly.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: No claims paid in 2005. Two claims paid in 2006.
- Medium/Long Term: Medium risk. Fiscal situation improving but remains fragile. Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

POLAND

Collection Experience

- Usual Trading Terms: Open account has become predominant.
- Overall Experience: Satisfactory.
- Credit/Financial Issues: Stable banking sector, economy robust. Red tape is an issue. Polish law caps past-due interest on receivables.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: One claim paid in 2006, two claims paid so far in 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low country risk.

PORTUGAL

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Payment experience has been poor in comparison to other EU countries.
- Credit/Financial Issues: Business bankruptcies have been rising in 2006 due to persistently weak economic conditions.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: No claims paid in first 6 months of 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Very low country risk.

QATAR

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Good.
- Credit/Financial Issues: Buoyant business conditions. Trying to attract foreign investment. Fixed exchange rate to the US dollar.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: No claim paid in 2006.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

ROMANIA

Collection Experience

- Usual Trading Terms: Open account is becoming more prevalent.
- Overall Experience: Generally satisfactory, but caution advised with state enterprises.
- Credit/Financial Issues: Reforms continue (joined EU in 2007), corruption still a concern.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: EDC paid one claim in 2006, no claims so far in 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

Russia

Collection Experience

- Usual Trading Terms: No longer difficult to get an ILC by a Russia bank; usage of open account terms has increased considerably.
- Overall Experience: Fair and improving, with the bulk of payments made within 60 days.
- Credit/Financial Issues: Bank restructuring moving slowly in Russia. Appreciation of the ruble.

EDC Experience and Attitude

- Short Term: Open without restriction.
- Claims Experience: No claims experience since 2002, but collection work is difficult if needed.
- Medium/Long Term: Open under a total commitment limit, but selective (for leading corporations and banks).
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

Saudi Arabia

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Showing distinct improvement, especially government bodies, since tenders are now covered by budget allocations.
- Credit/Financial Issues: Problems occur more often with government agencies than with private sector buyers. Local practice forces foreign suppliers to government entities or royal family to sell to intermediaries. Recourse and interest on late payments are very difficult.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: EDC paid claims in 2005, 2006 and in the first half of 2007. Recovery of claims in this market is very difficult due to high cost of legal action and a lack of collection agencies.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

Senegal

Collection Experience

- Usual Trading Terms: Secured terms, particularly for the public sector.
- Overall Experience: It has been improving.
- Credit/Financial Issues: Private and public sectors benefit from membership in the CFA franc zone. Regulations on starting business, dealing with licenses; employing workers and registering property have been eased.

EDC Experience and Attitude

- Short Term: Open on full range of payment terms.
- Claims Experience: EDC paid claims in 2006; some recoveries took place in the first half of 2007.
- Medium/Long Term: Public sector could not borrow on commercial terms in 2006 due to IMF program; IMF program expired, but donors insist on a new program to maintain gains achieved so far. The timing of the new program is unknown at this juncture; private sector under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

Singapore

Collection Experience

- Usual Trading Terms: Full range of terms, though open account predominant. Initial credit checks on new customers are recommended.
- Overall Experience: Excellent.
- Credit/Financial Issues: Due to payment experience and virtually no claims paid, private market premiums remain attractive.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Small claims paid in 2005 and 2006.
- Medium/Long Term: Lowest to slight risk.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Very low country risk.

SLOVAKIA

Collection Experience

- Usual Trading Terms: Open account terms are predominant, but assess non-established customers.
- Overall Experience: Fair to good, bulk of payments within 60 days.
- Credit/Financial Issues: None.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: No recent claims paid.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low country risk.

SLOVENIA

Collection Experience

- Usual Trading Terms: Open account terms are predominant.
- Overall Experience: Good.
- Credit/Financial Issues: Bank sector has improved. Joined Eurozone in 2007. Economy solid.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: No recent experience.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low country risk.

SOUTH AFRICA

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Satisfactory, depending on buyers.
- Credit/Financial Issues: Good year ahead; domestic interest rates are high (10.5%); caution with private buyers.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: EDC paid claims due to defaulting buyers in the first half of 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

SOUTH KOREA

Collection Experience

- Usual Trading Terms: Full range of terms, and SD is in common use.
- Overall Experience: Good.
- Credit/Financial Issues: Banking system remains strong. Customer risks should still be assessed with care. Bankruptcies and delinquency rates on loans have improved since 2006.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Claims declined during the first half of 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

SPAIN

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Payment experience (30 days or more) improved moderately in Q2 but remains much weaker than the EU average.
- Credit/Financial Issues: The number of business insolvencies for 2007 is expected to remain at 2006 levels (i.e. around 900 cases). Businesses continue to prefer either to arrive at amicable settlements or to cease trading to avoid the legal expenses involved in court proceedings.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: First 6 months of 2007 suggest a significant improvement in claims paid.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Very low country risk.

SRI LANKA

Collection Experience

- Usual Trading Terms: Use of LC declining with increase in more liberal terms. Caution is still recommended.
- Overall Experience: Fair, but recent deterioration; limited experience.
- Credit/Financial Issues: Inexperience with the market or customer requires caution to be exercised; received its first sovereign rating by Fitch and S&P in December 2005. Banking sector and supervision have strengthened; NPL remain high despite marked improvements.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: No claim paid in recent years.
- Medium/Long Term: High risk. Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

SYRIA

Collection Experience

- Usual Trading Terms: Secured terms, mainly ILC.
- Overall Experience: Satisfactory if properly secured.
- Credit/Financial Issues: Cumbersome administration; Commercial Bank of Syria is under US sanctions, no US bank, broker-dealer or mutual fund can open an account with this Syrian bank.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: No claim paid in 2006 or in the first half of 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

TAJIKISTAN

Collection Experience

- Usual Trading Terms: Secured terms. ILC is the norm.
- Overall Experience: Generally poor; limited to key trading partners. EDC has no experience in Tajikistan.
- Credit/Financial Issues: Weak banks; monetary policy instruments insufficient; transparency and accounting practices poor. A possible new IMF facility could put restrictions on sovereign borrowing.

EDC Experience and Attitude

- Short Term: Case-by-case; while ILC preferred, other terms considered.
- Claims Experience: No recent claims experience due to very limited business.
- Medium/Long Term: Highly selective. Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: High country risk.

TAIWAN

Collection Experience

- Usual Trading Terms: LC predominates since local firms are often requested to request these terms. Open account is reasonably widespread, with minimal collection delays.
- Overall Experience: Excellent.
- Credit/Financial Issues: Despite slowing GDP growth, exports have remained strong. The world's third-largest forex reserves would dampen the impact of a sharp downturn.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Claims paid in 2005 and 2006.
- Medium/Long Term: Selectively open subject to total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low country risk.

TANZANIA

Collection Experience

- Usual Trading Terms: Mainly L/Cs.
- Overall Experience: Has been improving, but preference for L/Cs.
- Credit/Financial Issues: Business conditions are better, except for power shortages; corruption and high oil prices remain an issue. Higher inflation. Banking reform resulted in privatization of a few banks. High energy costs for private sector. Tanzania is a favoured country for investment.

EDC Experience and Attitude

- Short Term: Open on full range of payment terms.
- Claims Experience: EDC has not paid any claims recently.
- Medium/Long Term Public sector could not borrow on commercial terms due to IMF restrictions; private sector: case-by-case.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

THAILAND

Collection Experience

- Usual Trading Terms: LC are common, but open account is the preference.
- Overall Experience: Fair to good.
- Credit/Financial Issues: Lenient terms acceptable with established customers – subject to financial disclosure. Payment delays are improving.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Small claim paid in 2005, none in 2006, and none so far in 2007.
- Medium/Long Term: Medium risk. Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

TRINIDAD & TOBAGO

Collection Experience

- Usual Trading Terms: Full range.
- Overall Experience: Fair to poor.
- Credit/Financial Issues: Economy booming with no concerns regarding currency stability. There have been reports in the past of delays in accessing foreign exchange despite the significant level of hard currency reserves at the Central Bank. Caution advised when limited buyer information available.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Five claims in 2006, and 2007 looks to be on pace for the same outcome. Experience is limited.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium risk.

TUNISIA

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Good.
- Credit/Financial Issues: Caution with banking sector. Good business conditions. Stronger investor protection among Maghreb countries.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: EDC paid claims in the first half of 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

TURKEY

Collection Experience

- Usual Trading Terms: Full range of terms. LC recommended.
- Overall Experience: Broadly positive with most exporters continuing to report satisfactory collection experience. Payment usually within 60 days.
- Credit/Financial Issues: Banking industry has strengthened. Use of currency hedging by importers is not widespread. Effects of global credit squeeze should be monitored.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Small claims paid from 2004 through 2006.
- Medium/Long Term: Selectively open subject to total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

TURKMENISTAN

Collection Experience

- Usual Trading Terms: Very secured terms. This includes payment in advance.
- Overall Experience: Poor; limited to key trading partners.
- Credit/Financial Issues: Lack of transparency, weak corporate governance and foreign exchange rationing compound an already difficult business environment.

EDC Experience and Attitude

- Short Term: Case-by-case with a strong preference for ILC terms, but other terms may be considered subject to strong risk mitigants.
- Claims Experience: No claims experience due to very limited business.
- Medium/Long Term: Highly selective.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

UGANDA

Collection Experience

- Usual Trading Terms: Secured terms; L/Cs and confirmed ILC.
- Overall Experience: Satisfactory if well packaged.
- Credit/Financial Issues: Coffee exporter affected by higher oil prices. Political stability results in higher FDI flows. Affected by energy crisis and power shortages.

EDC Experience and Attitude

- Short Term: Open on a case-by-case basis.
- Claims Experience: No recent experience.
- Medium/Long Term: Public sector cannot borrow on commercial terms due to IMF program restrictions; private sector on case-by-case.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

UKRAINE

Collection Experience

- Usual Trading Terms: CLC recommended. Transactions are often cash in advance.
- Overall Experience: Poor to fair. Payment can take up to 90 days.
- Credit/Financial Issues: Creditworthiness of customers remains difficult to assess. Banking sector is in questionable health. Lack of transparency.

EDC Experience and Attitude

- Short Term: Open on a case-by-case basis.
- Claims Experience: Several claims in 2006, value of claims lower in 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

UNITED ARAB EMIRATES

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Distinction should be made between Dubai and Abu Dhabi and the other five emirates. Payments default is an issue despite huge assets.
- Credit/Financial Issues: Dirham is pegged to the US dollar. Despite large foreign reserves, buyer default is an issue. Inflation and shortages are resulting in project cost overruns.

EDC Experience and Attitude

- Short Term: Open without restrictions
- Claims Experience: EDC paid claims in 2004, 2005, 2006 and in the first half of 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Low country risk.

UNITED KINGDOM

Collection Experience

- Usual Trading Terms: Full range of terms; most sales on open account.
- Overall Experience: Payment experience (30 days or more) has deteriorated in Q2 and, as a consequence, is now weaker than the EU average.
- Credit/Financial Issues: Business insolvencies are expected to increase by 3% in 2007 (i.e. around 26,400 cases), which would represent a new 10-year high.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Claims paid have improved significantly in the first 6 months of 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Very low country risk.

UNITED STATES

Collection Experience

- Usual Trading Terms: Full range of terms.
- Overall Experience: Auto-related companies, air transport and housing-related industries (including mortgage companies in particular) facing challenges.
- Credit/Financial Issues: US housing market under severe strain with knock-on affects to related financial entities. Commercial lending rates have been rising since mid-May on reappraisal of risk perceptions, again motivated by housing market woes. Consumer is getting pinched and this is likely to impact consumer goods sectors including autos. EDC Economics' downside scenario includes a US recession with potentially significant further increases in corporate lending rates (even as Fed funds rate stays fixed or moves down slightly). US companies geared toward export markets are likely to fair much better as demand for their wares is boosted by the lower US dollar.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: Upturn in claims paid in 2006 has continued into 2007 and is likely to persist over the coming 6 to 12 months.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Very low country risk.

URUGUAY

Collection Experience

- Usual Trading Terms: LC recommended.
- Overall Experience: Fair. A healthier financial system and increased liquidity should help improve conditions, but credit exposure to Uruguay should be monitored.
- Credit/Financial Issues: Business and banking conditions are improving.

EDC Experience and Attitude

- Short Term: Open on a full range of payment terms.
- Claims Experience: Generally satisfactory.
- Medium/Long Term: Open on a case-by-case basis subject to the availability of acceptable financial information.
- Political Risk Insurance: Open on a selective basis for FX-generating transactions.
- Wrongful Calling of Bonds Insurance: Low-medium country risk.

UZBEKISTAN

Collection Experience

- Usual Trading Terms: Very secured terms. ILC is the norm. Payment in advance and payments from sources of FX outside the country are often stated as conditions.
- Overall Experience: Poor; limited to a few trading partners.
- Credit/Financial Issues: Lack of transparency, weak corporate governance and foreign exchange rationing compound an already difficult business environment.

EDC Experience and Attitude

- Short Term: Case-by-case; while ILC preferred, other terms considered.
- Claims Experience: No recent claims experience.
- Medium/Long Term: Highly selective.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

VENEZUELA

Collection Experience

- Usual Trading Terms: CLC recommended.
- Overall Experience: Experience varies depending on buyer. FX controls require authorization from CADIVI, a process subject to politics and corruption. Government interference is common.
- Credit/Financial Issues: Caution advised. Full disclosure of financial information is often difficult to obtain. Close monitoring of buyers and their relation to the government is recommended. Possible devaluation of the Bolivar should be monitored.

EDC Experience and Attitude

- Short Term: Case-by-case on a full range of payment terms.
- Claims Experience: No claims in 2007H1.
- Medium/Long Term: New MLT transactions are considered on a selective case-by-case basis – with preference for sovereign, FX-generating entities.
- Political Risk Insurance: Case-by-case.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

VIETNAM

Collection Experience

- Usual Trading Terms: Secured terms – mainly LC (not always confirmed). Some open account reported, many with good experience.
- Overall Experience: Fair but limited experience.
- Credit/Financial Issues: Capacity in private sector is tight and restricted, particularly for private sector deals; public sector deals require full faith and credit of the government; banking system weak.

EDC Experience and Attitude

- Short Term: Open without restrictions.
- Claims Experience: One small claim paid in 2005, none paid since.
- Medium/Long Term: Medium risk but limited experience. Some restrictions on government borrowing.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium country risk.

YEMEN

Collection Experience

- Usual Trading Terms: ILC terms the norm.
- Overall Experience: Satisfactory.
- Credit/Financial Issues: Slow administration, weak banking sector and unpredictable business environment.

EDC Experience and Attitude

- Short Term: Case-by-case; while ILC preferred, other terms considered.
- Claims Experience: EDC did not pay any claims in 2006 or in first half of 2007.
- Medium/Long Term: Open under a total commitment limit.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

ZAMBIA

Collection Experience

- Usual Trading Terms: Secured terms – confirmed and unconfirmed ILCs.
- Overall Experience: Satisfactory, but payments have to be secured.
- Credit/Financial Issues: Slow administration, weak banking sector. Liquidity improved after generous debt relief. Business conditions are challenged by high interest rates of 18%.

EDC Experience and Attitude

- Short Term: Case-by-case on full range of payment terms.
- Claims Experience: EDC did not pay any claims in 2005, and none since.
- Medium/Long Term: Public sector cannot borrow on commercial terms; private sector case-by-case.
- Political Risk Insurance: Open.
- Wrongful Calling of Bonds Insurance: Medium-high country risk.

ZIMBABWE

Collection Experience

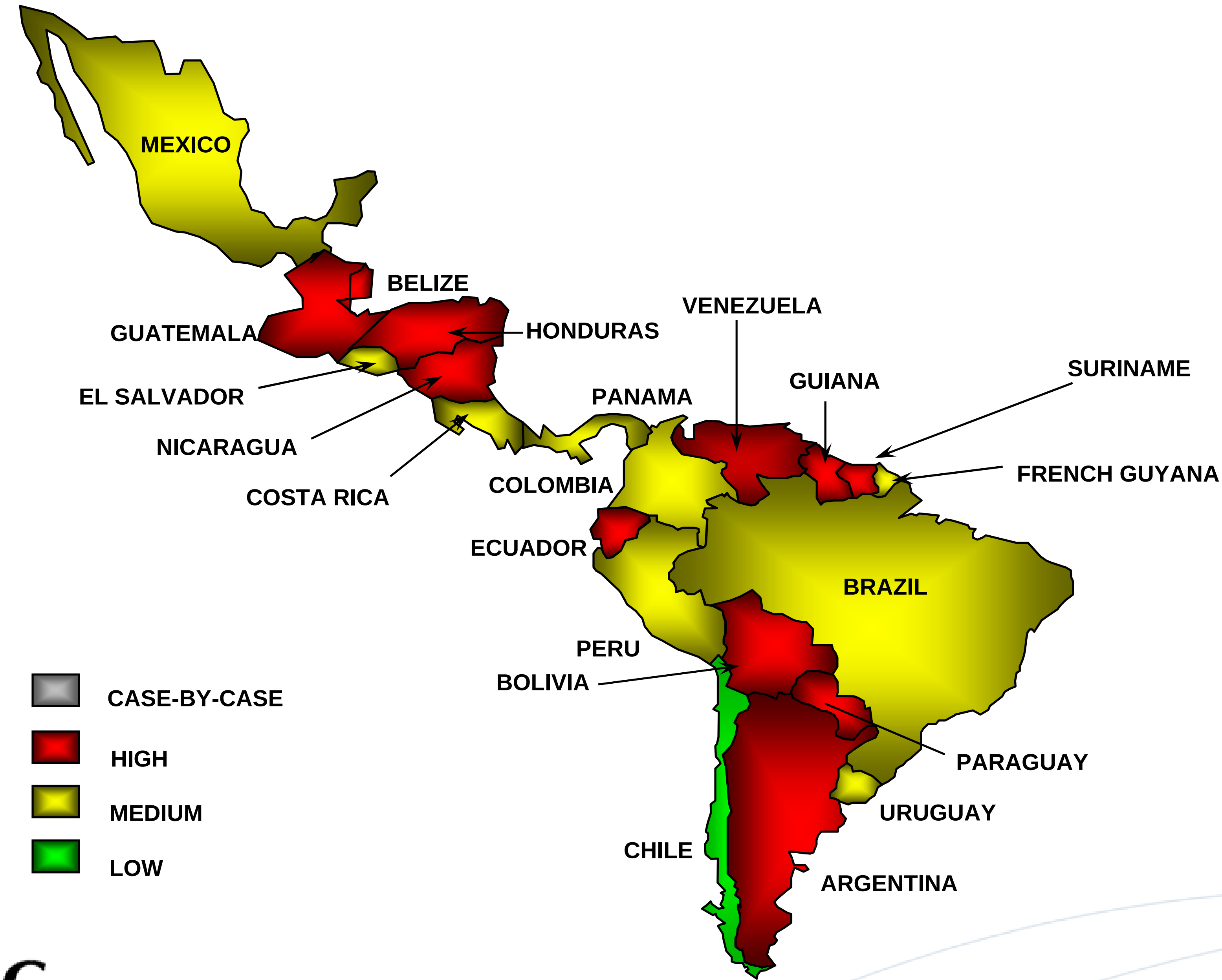
- Usual Trading Terms: If trade is to be done, recommend only most secured terms (off-shore ILC).
- Overall Experience: Very difficult, characterized by domestic and external arrears to all type of creditors.
- Credit/Financial Issues: Extreme caution. Very difficult business conditions. Acute liquidity crisis.

EDC Experience and Attitude

- Short Term: Off cover.
- Claims Experience: No recent experience.
- Medium/Long Term: Off cover.
- Political Risk Insurance: Off cover.
- Wrongful Calling of Bonds Insurance: Off cover.

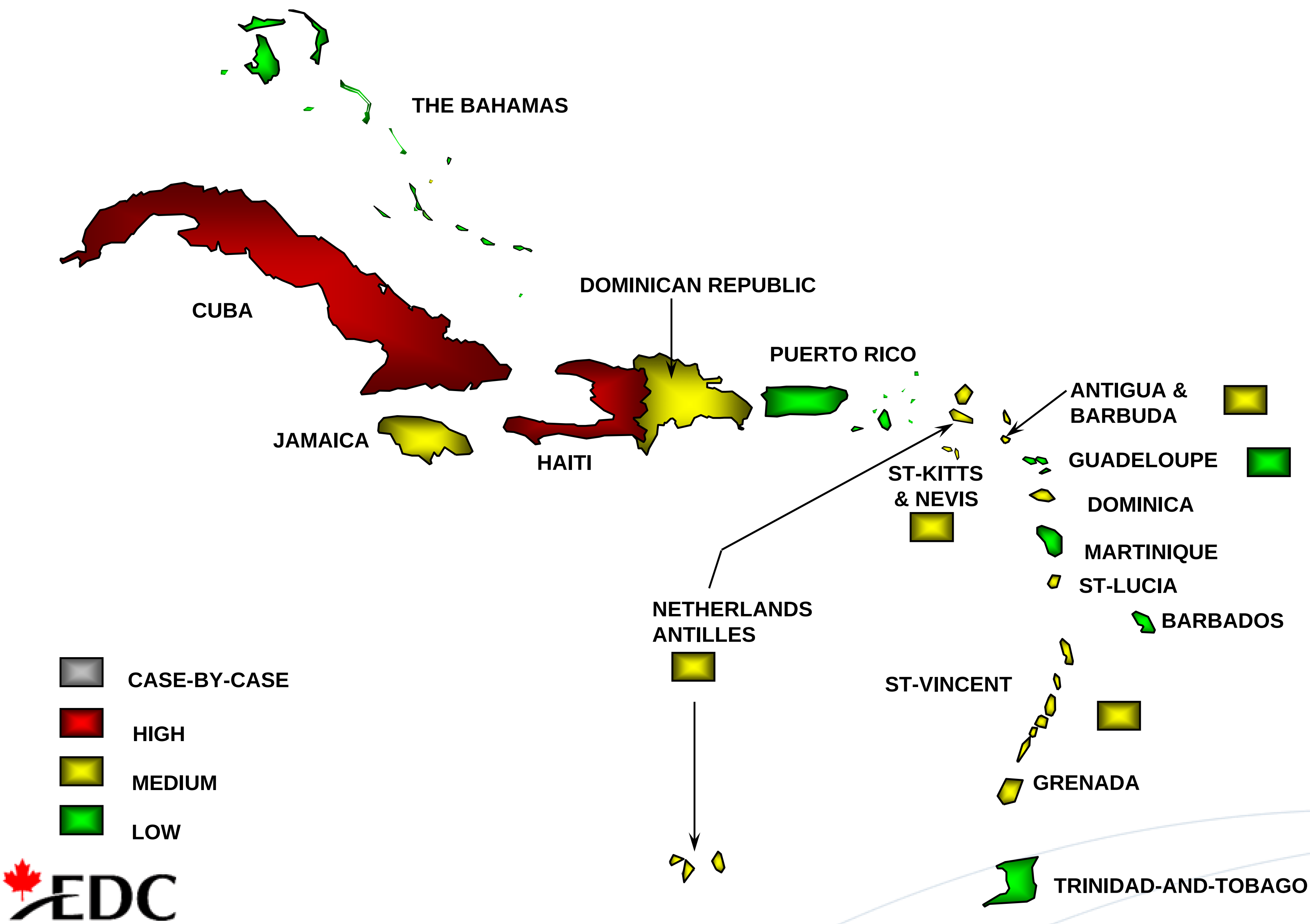
Latin America

Short-term payment risks



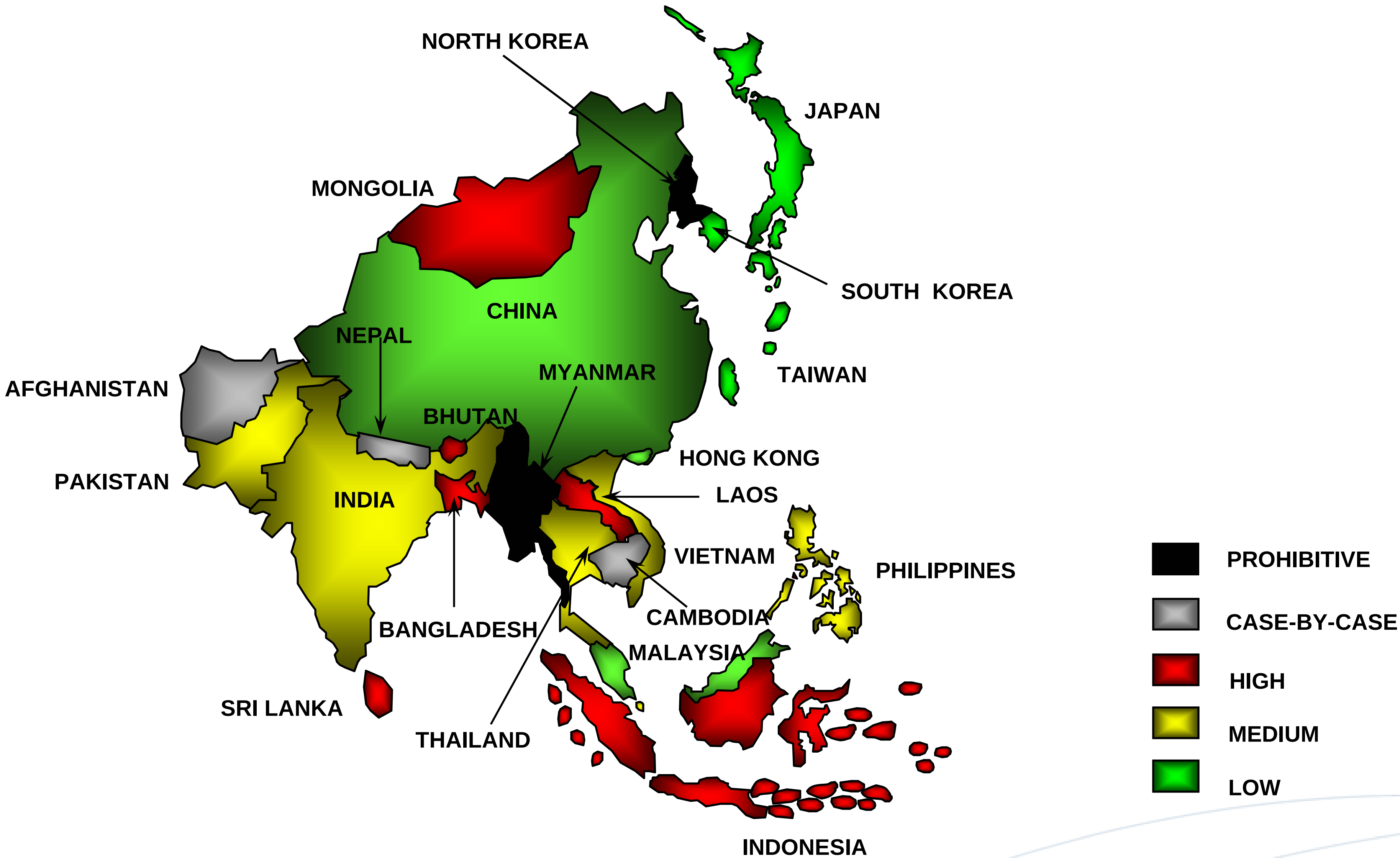
Caribbean

Short-term payment risks



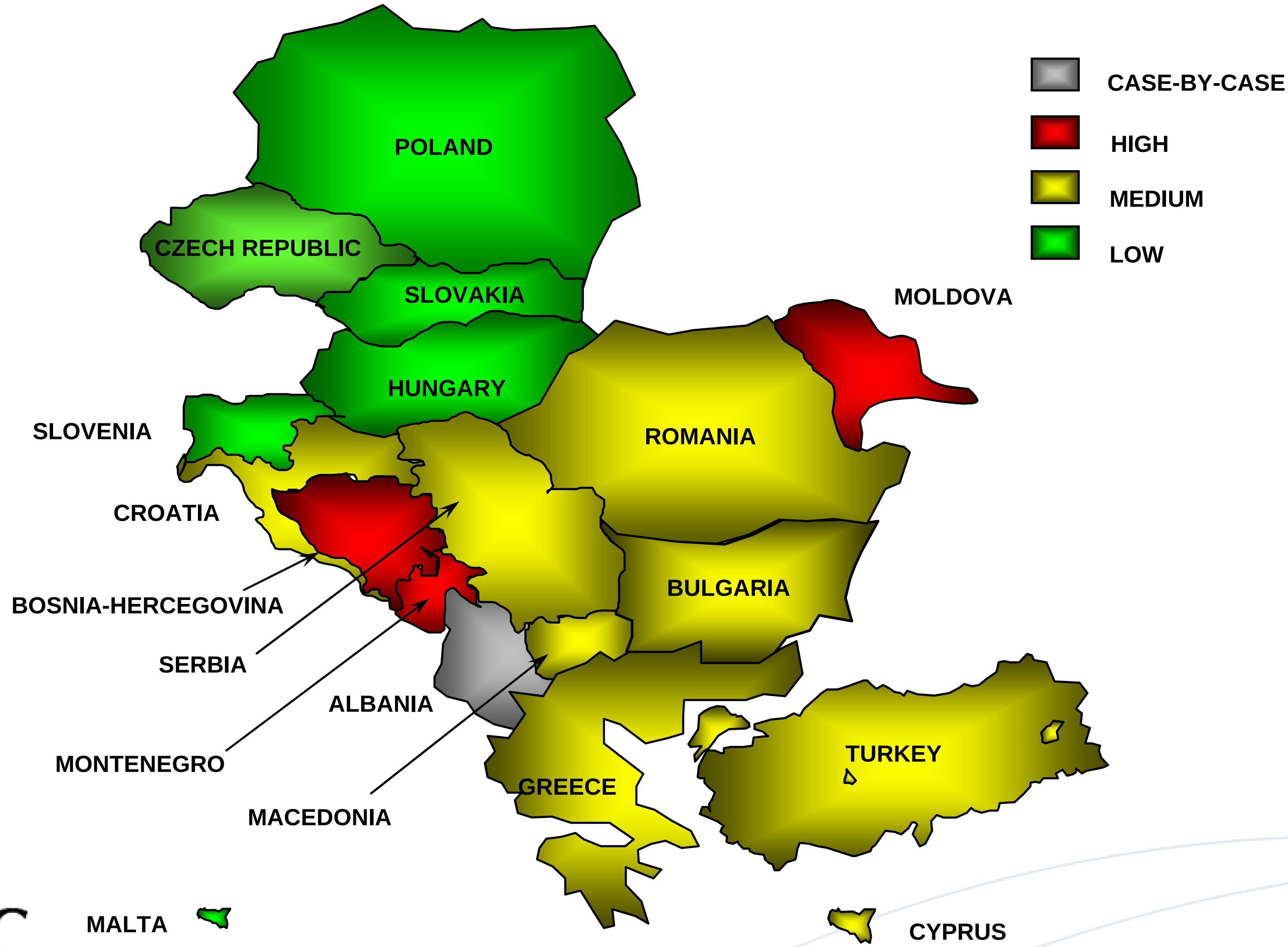
Asia / Pacific

Short-term payment risks



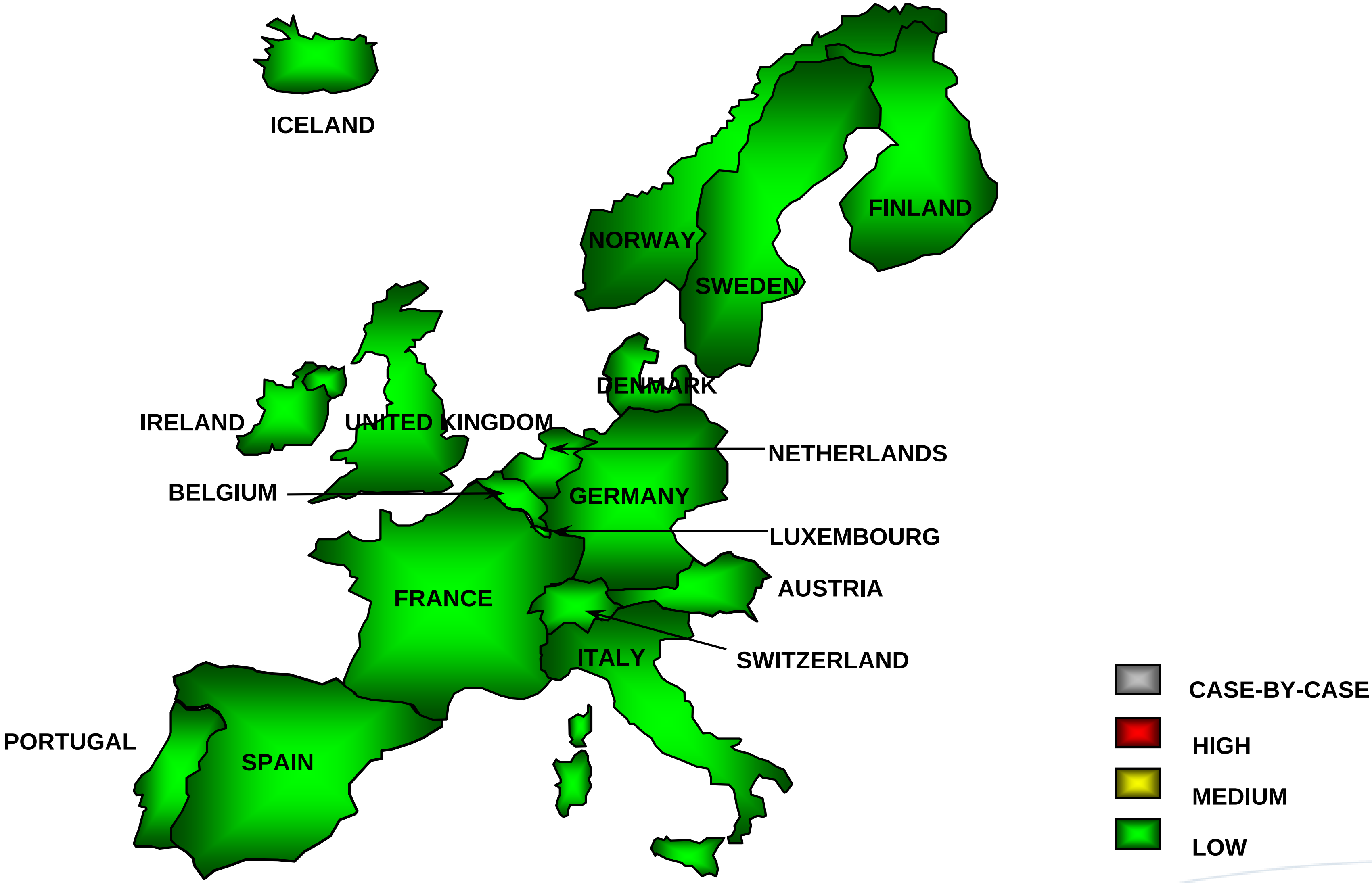
Central Europe

Short-term payment risks



Western Europe

Short-term payment risks



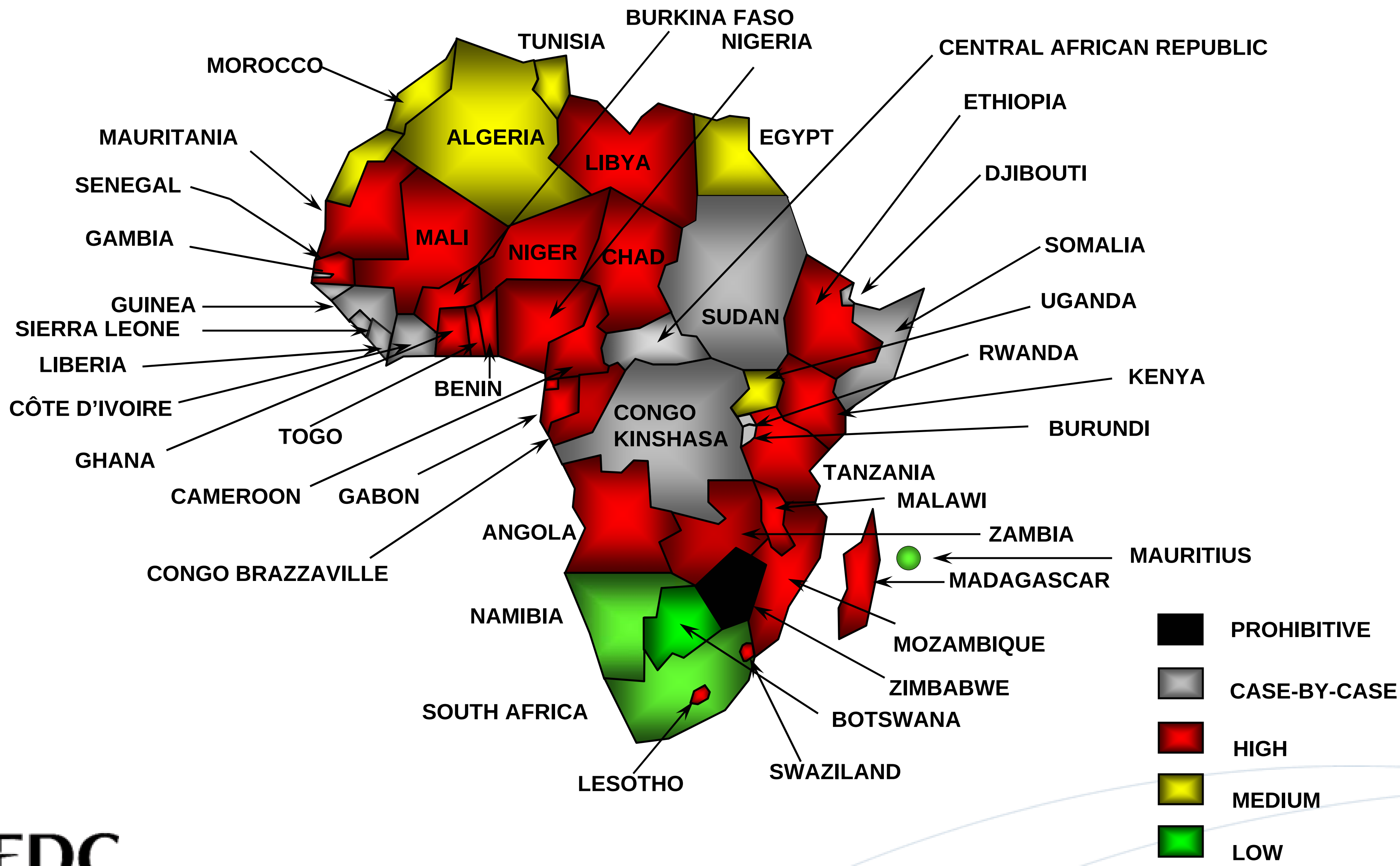
Former Soviet Union

Short-term payment risks

EDC

Africa

Short-term payment risks



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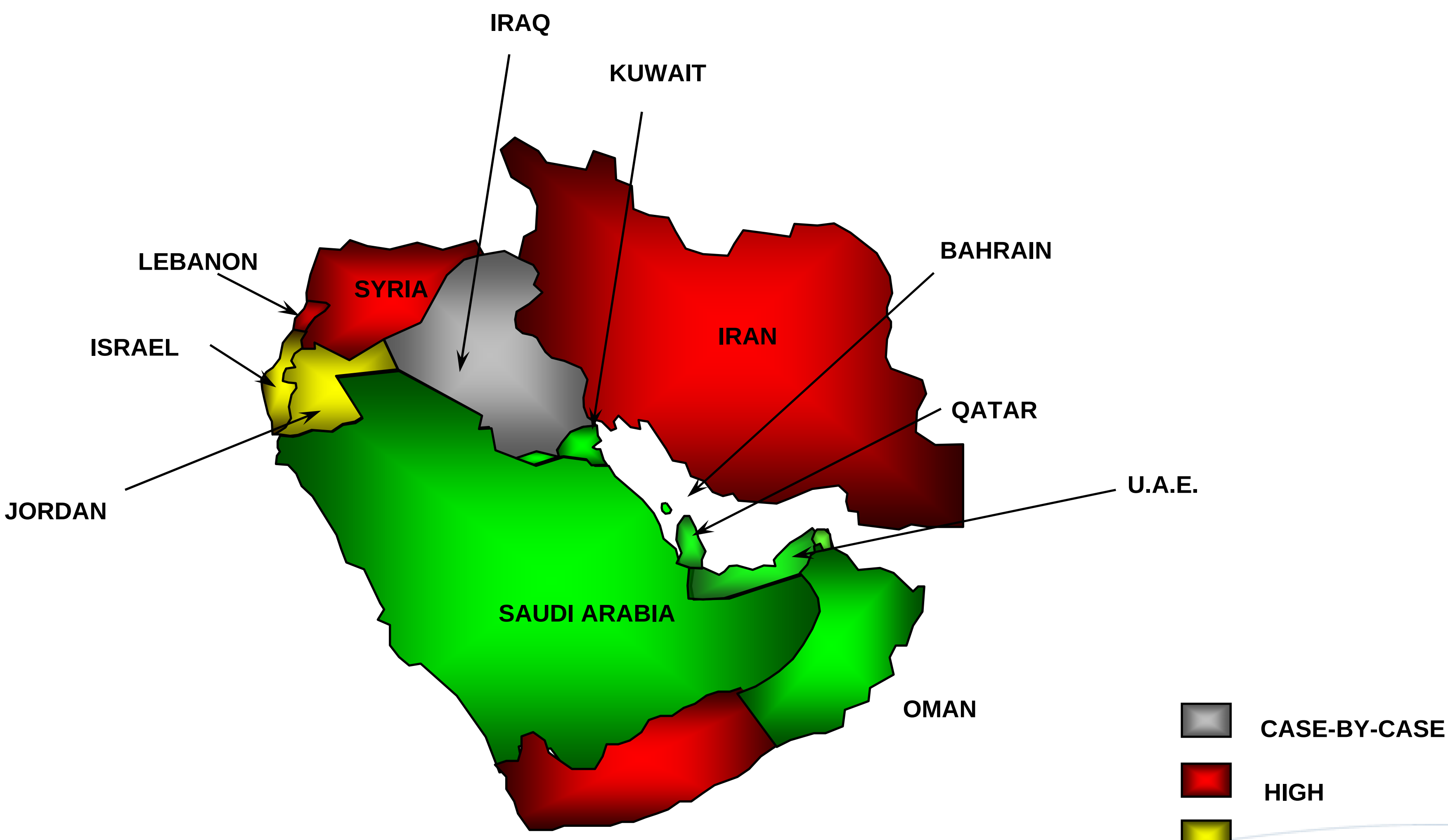
Middle East

Short-term payment risks



EDC

Short-term payment risk maps

This assessment is valid at date of issue but always subject to review.

Please contact the EDC Economics Division for current position.

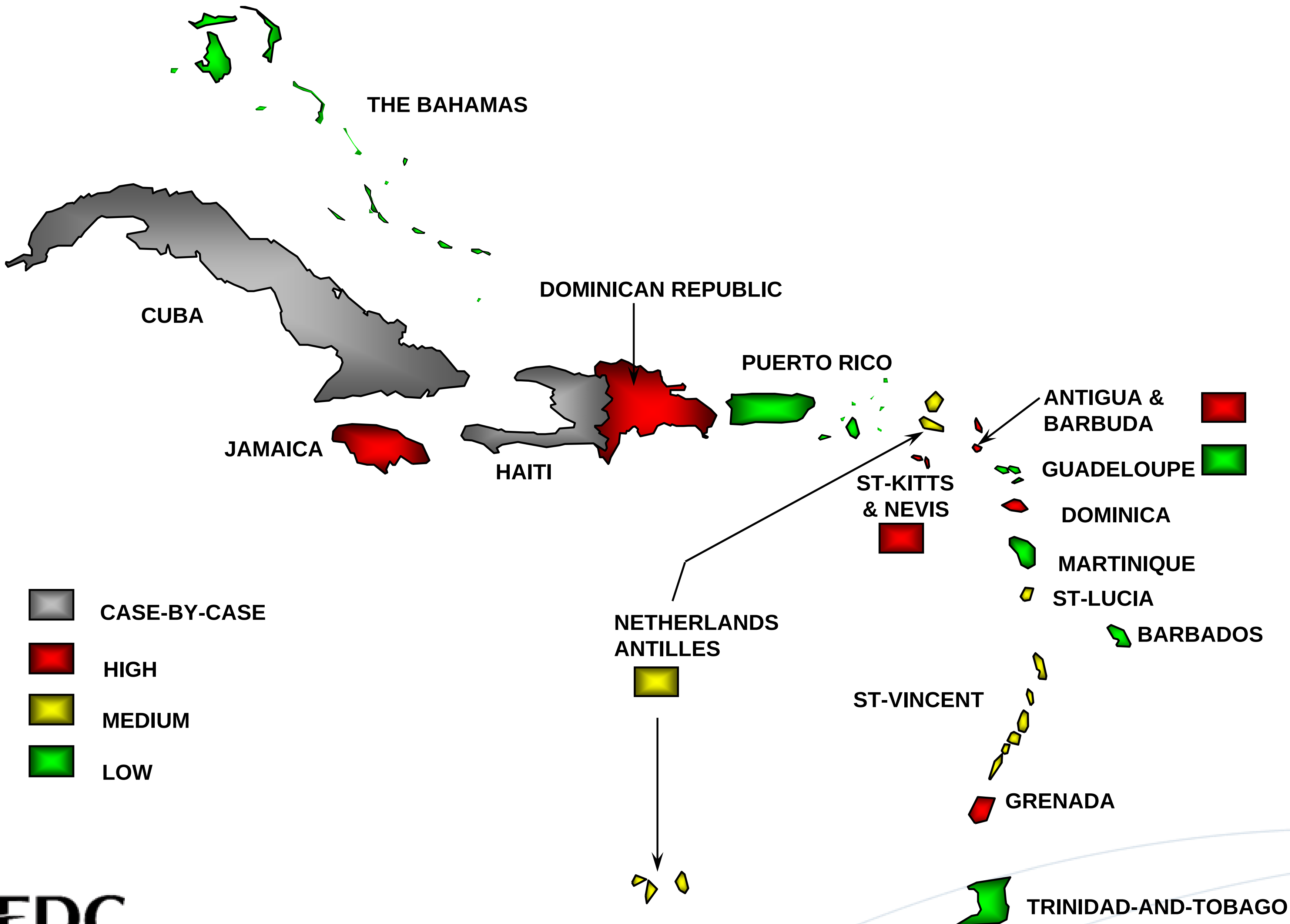
Please visit our website at www.edc.ca/economics

Latin America

Medium & long-term payment risks

Caribbean

Medium & long-term payment risks



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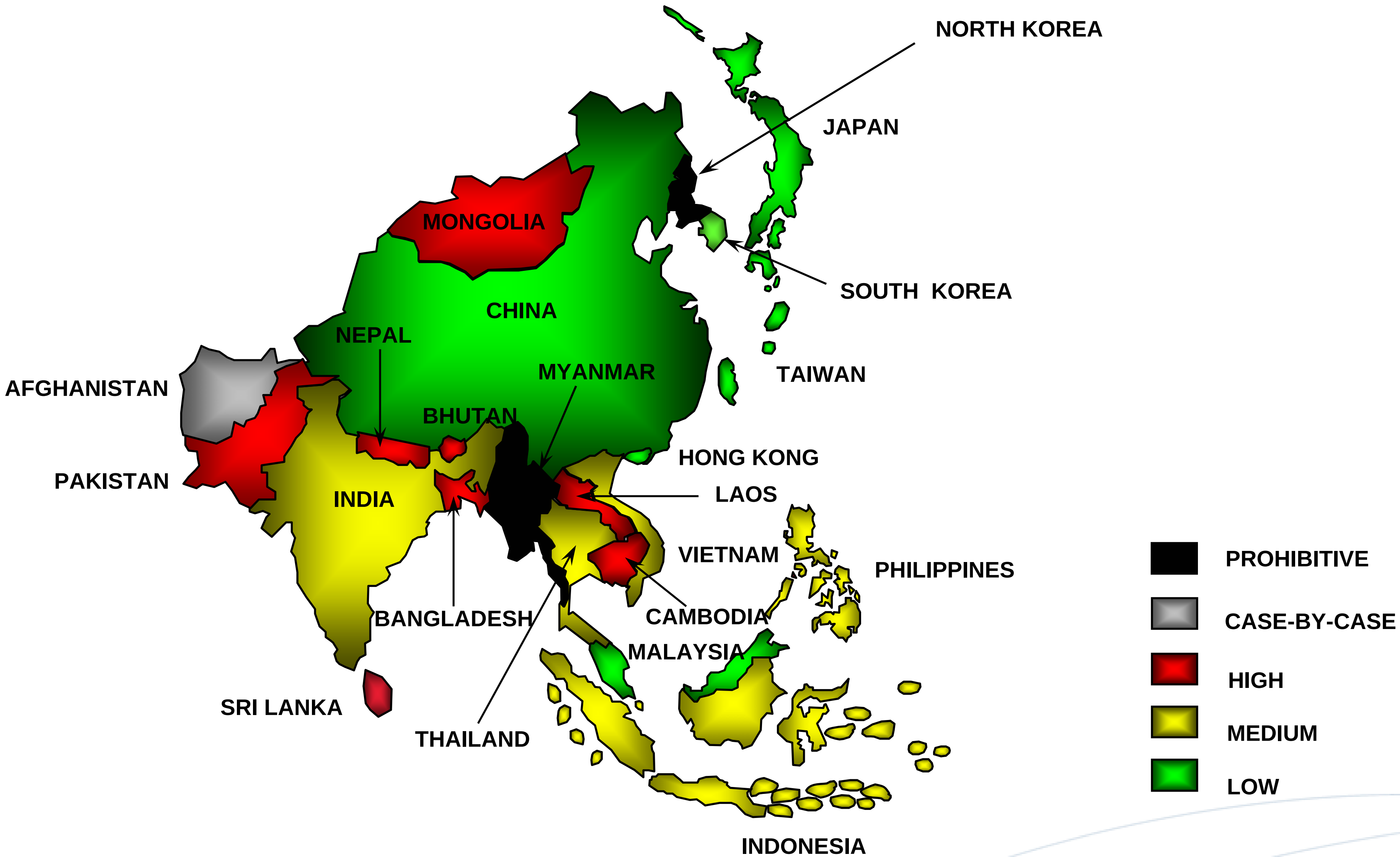
Asia / Pacific

Medium & long-term payment risks



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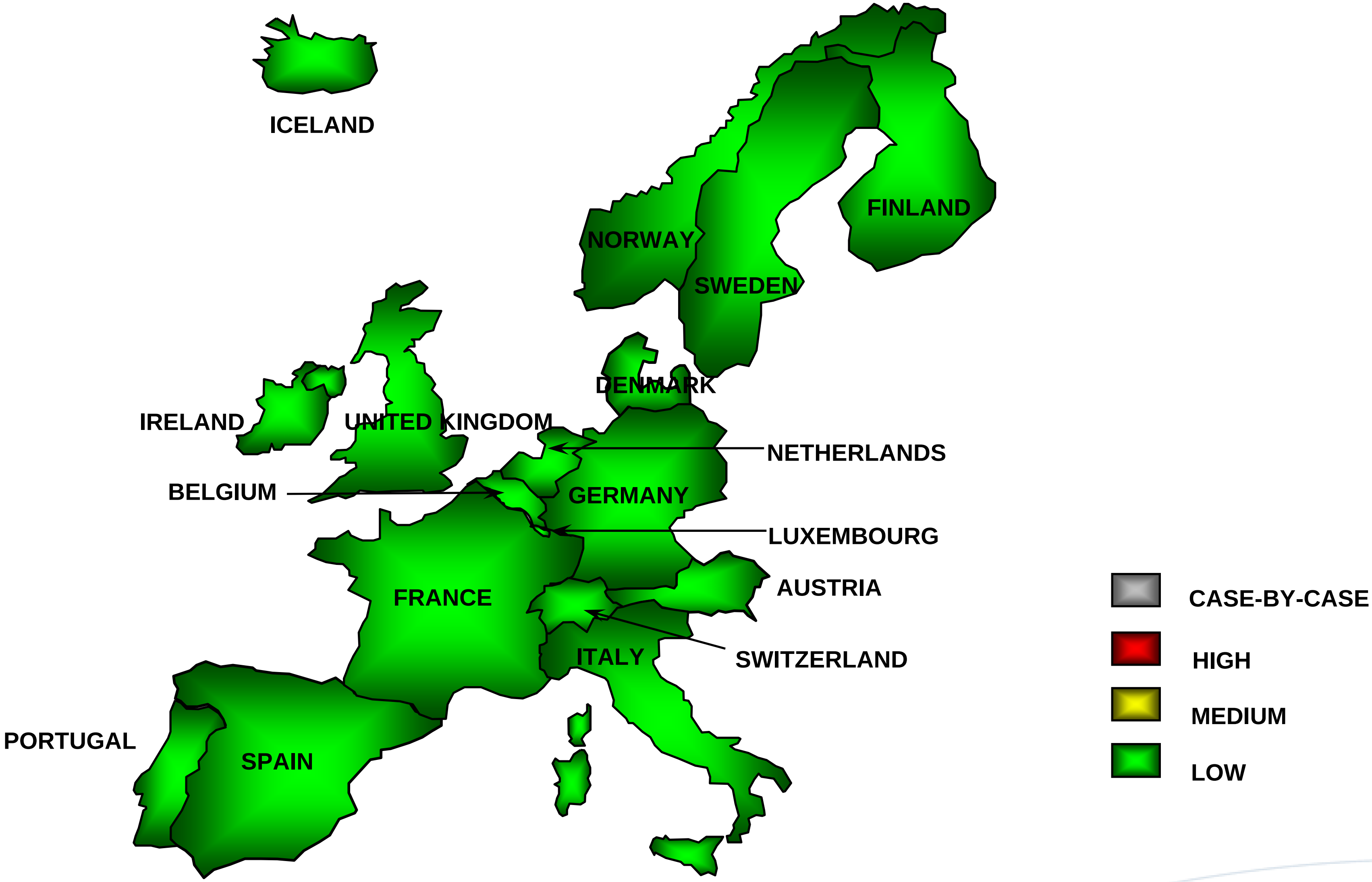
Central Europe

Medium & long-term payment risks

EDC

Western Europe

Medium & long-term payment risks



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Former Soviet Union

Medium & long-term payment risks

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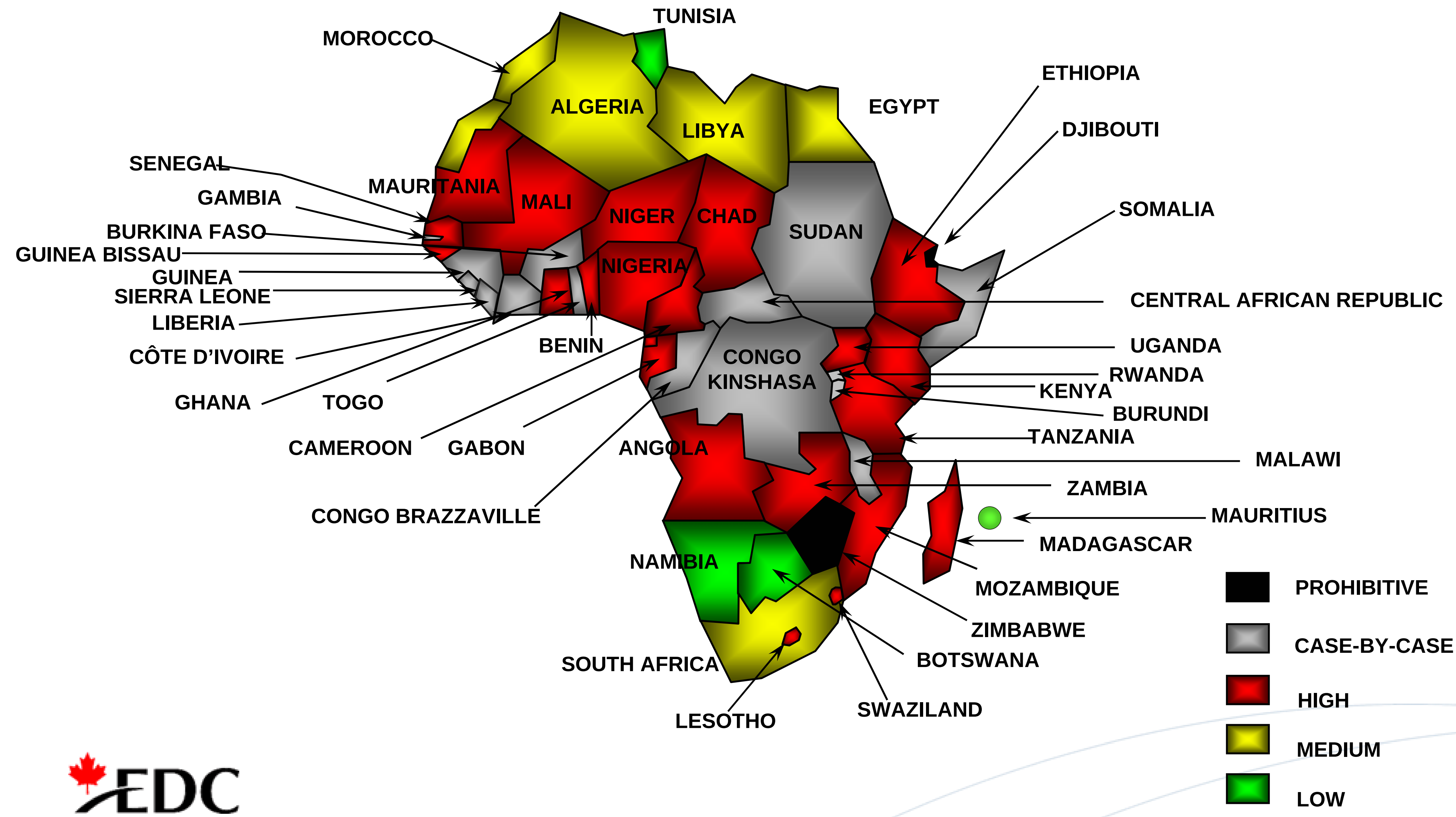
Africa

Medium & long-term payment risks



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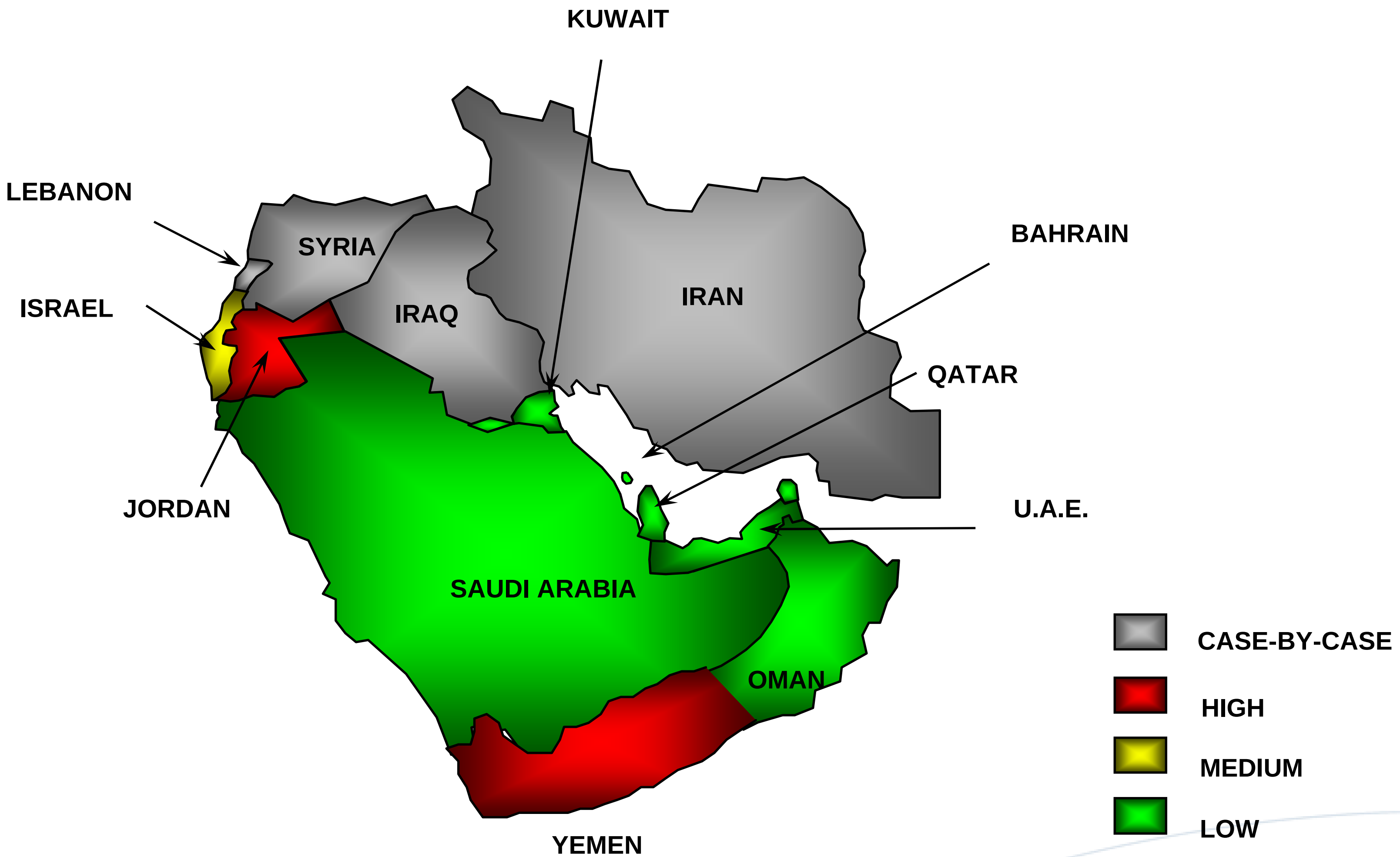
Middle East

Medium & long-term payment risks



Medium & long-term payment risk maps

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Please contact the EDC Economics Division for current position.

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