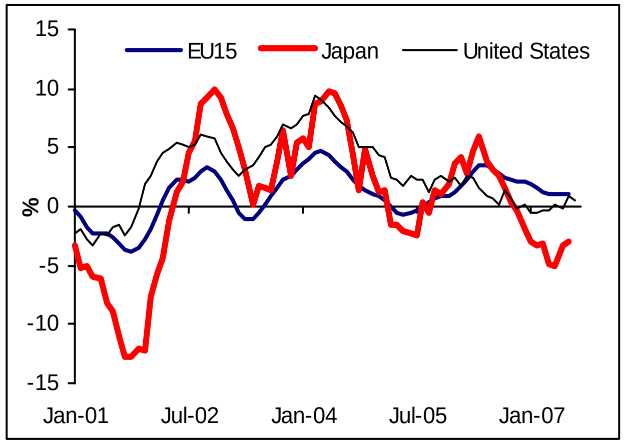
EXPORT FORECAST OVERVIEW

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)

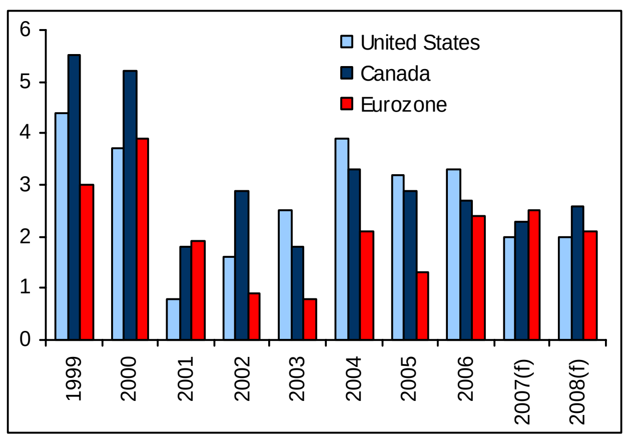


Source: OECD, EDC Economics.

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.

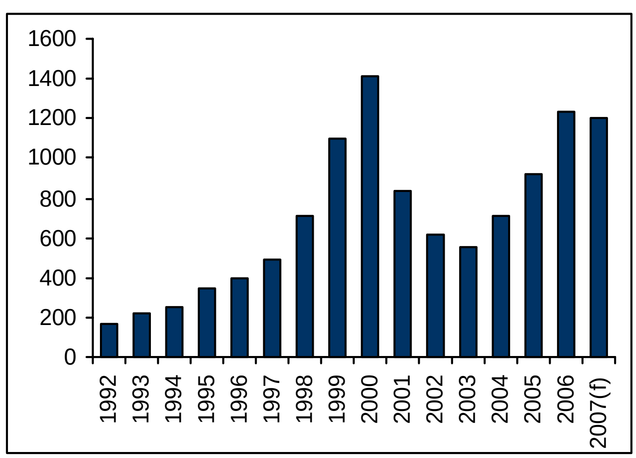
Table 2: Global GDP Forecast by Industry (% Growth)

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.

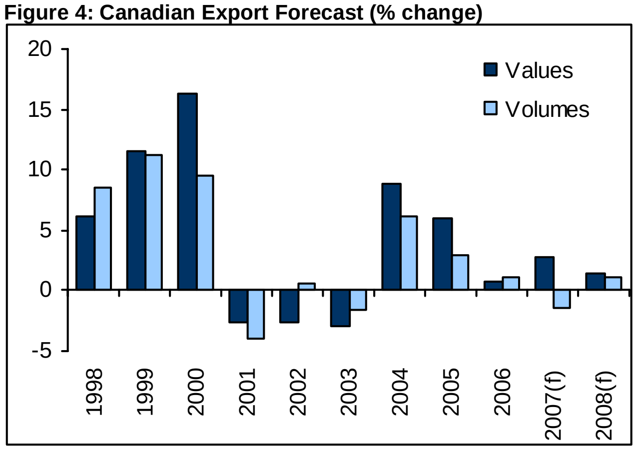
Canadian export and investment prospects

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.

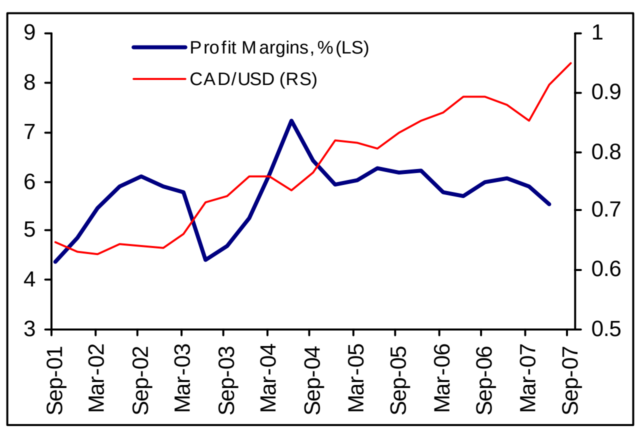
Canadian exporters selling to emerging markets had another banner year in 2007. Exports to the developing world were up by more than 20% in 2007, compared with an average gain of 2.7% for industrialized countries. A sluggish US market accounts for most of this year's weakness in shipments to industrialized 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

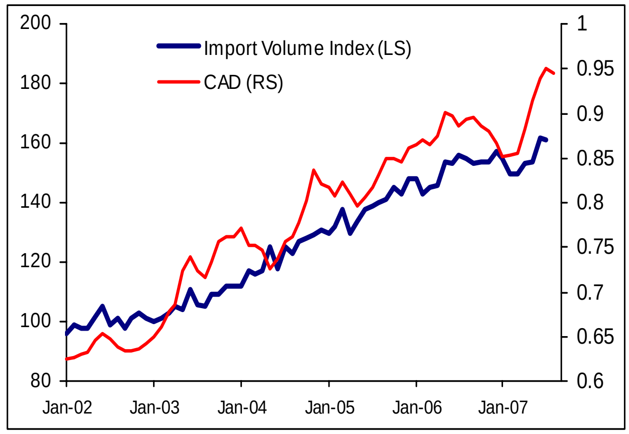


Source: Statistics Canada and Bloomberg.

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

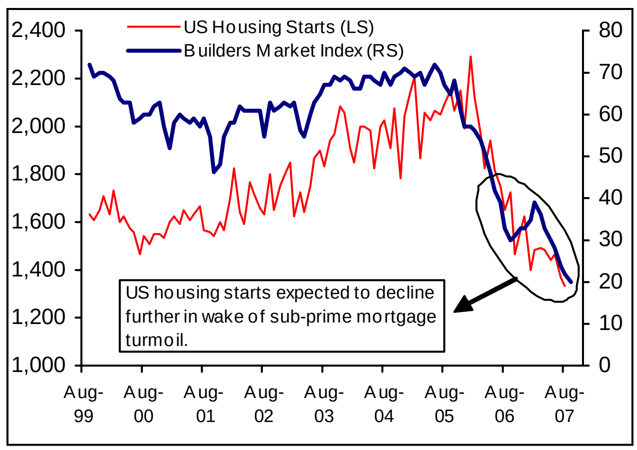


Source: Statistics Canada, Bloomberg.

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.

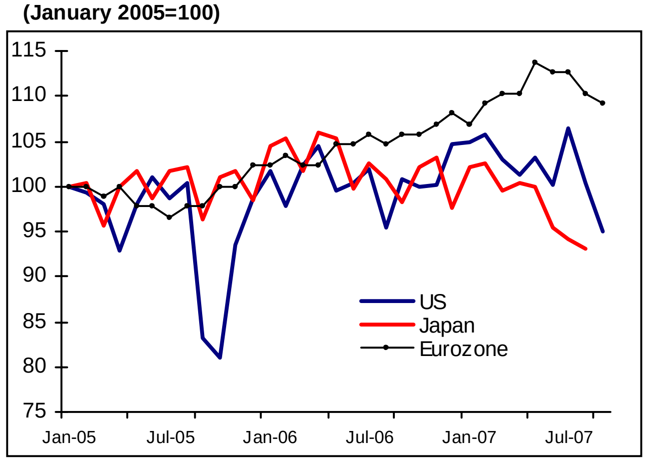
Figure 7: US Housing Starts (mn) and National Association Home Builders' Index



Source: Bloomberg.

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



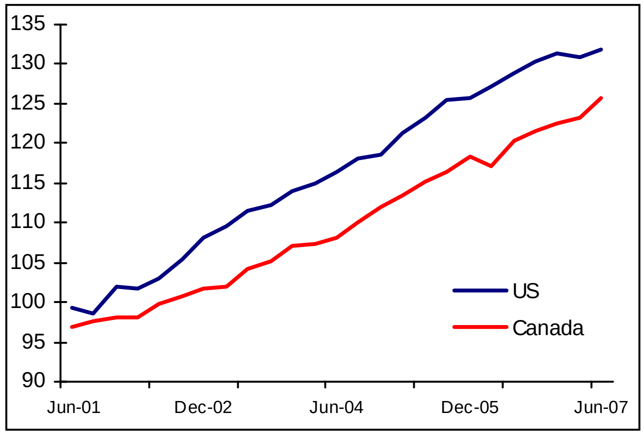
Source: Bloomberg, EDC Economics.

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.

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.

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



Source: Bloomberg, EDC Economics.

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.

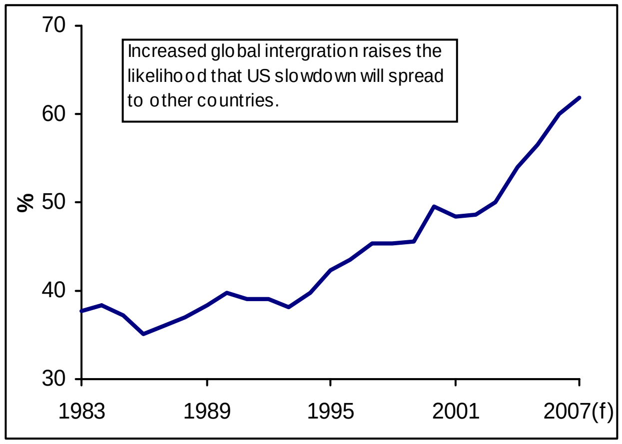
From the US consumer to developing markets

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 (%)



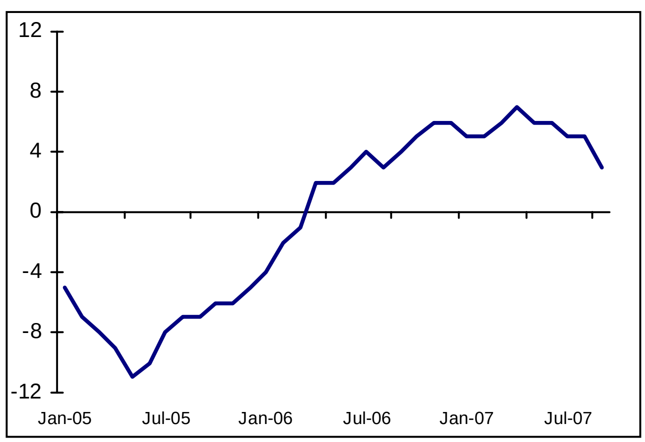
Source: EIU, EDC Economics.

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



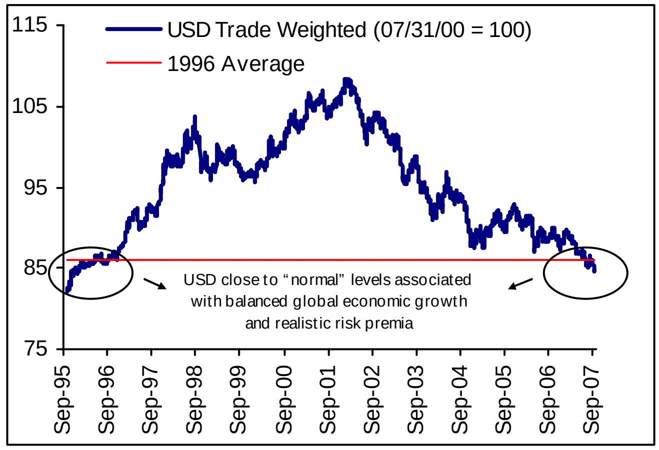
Source: Bloomberg.

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.

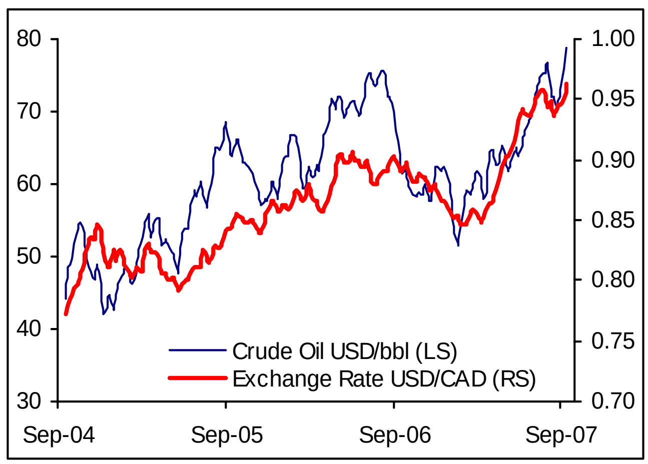
Figure 12: US Dollar – Weakness Is in the Eye of the Beholder



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.

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.

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.

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.

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.