BMO Financial Group
Economics Department

PROVINCIAL OUTLOOK

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Western Canada, along with Newfoundland and Labrador, will lead the Canadian economic parade in 2006. In 2003, Newfoundland and Labrador was the front runner, thanks to surging oil production, followed by Saskatchewan and then Alberta. In 2004 and 2005, Alberta led the pack, followed closely by British Columbia and then Saskatchewan.

This year, Alberta will lead the way with growth of 5.2%. Alberta's economy is booming, as oil prices set new records and natural gas prices, though well down from recent peaks, are still high by historical standards. High oil prices have unleashed a tsunami of investment in Alberta's oil sands, which is trickling down through the rest of the economy.

Until recently, it looked as though Newfoundland and Labrador would have the highest growth rate in 2006, but offshore oil production problems have nudged the province down to slightly below Alberta. Growth in Newfoundland and Labrador will nonetheless be very strong at 5.0%, as production ramps up from two multi-billion dollar developments — the Voisey's Bay nickel project and the White Rose offshore oil project.

A construction surge will propel British Columbia to a 4.0% gain in economic output in 2006. Public investment in transportation infrastructure and preparations for the 2010 Winter Olympics are at a fever pitch, while BC's housing market has remained strong. We now expect that BC's housing starts will hit a 12-year high this year, before declining next year.

This document is based on information available as of June 30, 2006.

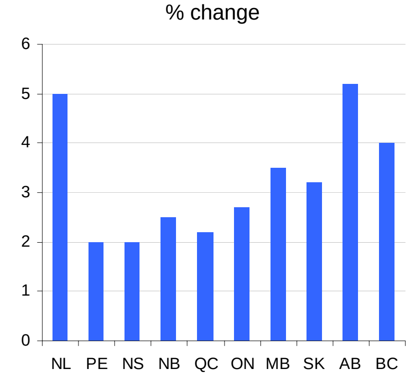
For the past few years, Manitoba has seen the weakest growth within Western Canada, due mainly to its relatively limited oil and gas resources. But this year, Manitoba joins the party. Manitoba is enjoying a construction boom, and is expected to rebound sharply from last year's water-logged agricultural performance. Growth is expected to be 3.5%.

Saskatchewan will drop from third place in the growth rankings in 2005 to fifth place in 2006, but this is not because its economy is growing more slowly. Indeed, at 3.2%, the province's growth rate is expected to be the same as last year, but stronger performances by Newfoundland and Labrador and Manitoba will bump it down two notches in the rankings. Saskatchewan continues to benefit from strong oil and gas prices. Also, as the world's largest uranium producer, Saskatchewan is benefiting from renewed worldwide interest in nuclear power generation.

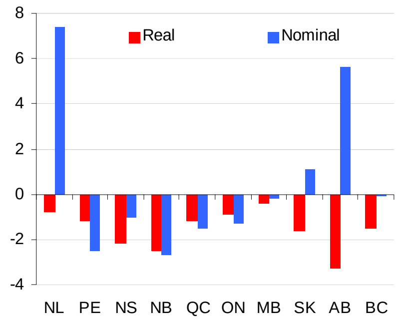
Ontario and Québec, Canada's manufacturing heartland, will see growth below potential for the fourth straight year in 2006, at 2.7% and 2.2%, respectively. Both provinces are suffering from the rise in the value of the Canadian dollar, which has made their manufactured products less internationally competitive. Also, the housing construction surge in both provinces is waning. However, the service sectors are performing well. In Ontario, major investments in the auto sector, transportation infrastructure and electricity generation will keep the economy from slipping too far below potential, while in Québec, a boom in hydroelectric construction will do the same.

The Maritime provinces will have the weakest growth in the country in 2006. Prince Edward Island will see growth of 2.0%. Consumption in PEI will remain strong, investment in construction will exceed last year's growth rate, and government restraint will be less severe in 2006, but this will be largely offset by reduced investment in machinery and equipment and a continuing drag from the external sector. Growth in Nova Scotia and New Brunswick will rebound from unexpectedly poor performances in 2005. The Nova Scotia economy is picking up steam, with growth of 2.0% expected in 2006. Consumers have opened their wallets wider, housing construction continues unabated, non-residential construction is booming, and government spending is strong thanks to solid offshore gas royalties, but the external sector will continue to depress growth in 2006. New Brunswick will see growth of 2.5%. New Brunswick's economy will see some rebound from its dismal manufacturing performance in 2005. In addition, two megaprojects in New Brunswick — a liquid natural gas terminal and the refurbishment of a nuclear generating station — will boost growth even more.

2006 real GDP forecast
% change



External sector contribution to GDP growth, 2005
Percentage points



Canadian overview

Most domestic sectors of the Canadian economy put in strong performances in 2005, with investment leading the way rising 7.1% followed by consumption (3.9%) and government spending (3.2%). Final domestic demand grew 4.3%.

However, real GDP growth was held to only 2.9% as the external sector was a drag on growth. Despite the strength of the Canadian dollar, real exports rose 2.1%, but real imports rose 7.1%. In real terms, the external sector was a drag on growth in every province in 2005. In nominal terms, the external sector fared better, with exports rising 5.1% and imports rising 6.1%. The better performance on a nominal basis was due to high prices for Canada's commodity exports.

The Canadian dollar continued its upward trend of the previous three years in 2005, rising from an average of 83.2¢ US in 2004 to 85.6¢ US in 2005. The Canadian dollar continued to benefit from strong commodity prices.

Canada's performance in 2006 is expected to be slightly stronger than in 2005, with growth estimated at 3.1%. The mainstay will continue to be investment, which is expected to make a slightly greater contribution to growth. The impact of the strong Canadian dollar will be tempered by still high commodity prices. The earlier tightening is expected to have more of a dampening impact on consumption this year.

Going forward, the restraint from the loonie will ease, though the impact of higher interest rates will intensify. Investment will continue to be an important source of growth. In total, GDP is expected to rise 3.1% in 2007 and 3.0% on average over the period 2008-2010.

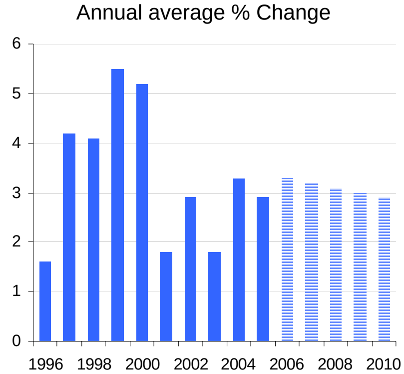
The pace of hiring has picked up from 1.4% in 2005 to 2.0% in 2006, which will contribute to the unemployment rate dropping to 6.3% this year from 6.8% in 2005. However, we don't expect the upward trend in employment growth to continue, with growth of 1.3% in 2007 and 0.8% over the 2008-10 period. This slowing pace of employment growth reflects the expectation that firms will increasingly respond to rising demand by adding capital rather than new workers. This will contribute to an improvement in productivity in the Canadian economy.

The often predicted end of the housing boom has been slow in coming. Housing starts were 225,481 in 2005, which was down 3.4% from 2004, but further expected declines have not materialized. We now expect housing starts in 2006 to be about the same as in 2005. Nonetheless, higher interest rates will eventually move housing starts lower — a development which we now expect to happen starting in 2007.

After bottoming out in the spring of 2004 at 2%, the Bank of Canada raised the target for the overnight rate to 2.5% by the early fall of that year. It then moved onto the sidelines, holding the rate steady until September 2005. Since then, it raised the rate seven times to 4.25%. The Bank of Canada now appears satisfied that the current level of the overnight rate is sufficient to contain inflationary pressures. We therefore expect that the Bank of Canada will hold the overnight rate steady at 4.25% for the foreseeable future.

The Canadian dollar has continued to rise in 2006. In the first six months of 2006, the Canadian dollar averaged 88.3¢ US, up from 85.6¢ US in 2005. We expect the currency to average just over 90¢ US for the year as a whole, then rise to 92¢ in 2007 on general weakness in the greenback, before easing off to 90¢ US in 2008.

Canadian real GDP
Annual average % Change



British Columbia

British Columbia's real GDP growth rate of 3.5% was the second highest in the nation for the second consecutive year in 2005, fueled by a construction boom. Growth will rise to 4.0% in 2006 as the construction boom continues and strengthens, thanks to continued strong housing demand and a myriad of major projects, including preparations for the 2010 Winter Olympics. Over 2007-10, growth will continue to be strong, at well over 3%.

Strong performance in 2005

In 2004, BC posted real GDP growth of 4.0% as the forest products sector — one of the province's traditional economic engines — boomed. Combined, the forestry and logging, wood product manufacturing and pulp and paper manufacturing industries advanced 15.2% in 2004. Remarkably, in 2005, BC's economy grew almost as fast (3.5%) as in 2004 despite the boom in the forest products sector coming to an end. In 2005, the forestry and logging, wood product manufacturing and pulp and paper manufacturing industries combined gained only 1.2%.

The goods sector grew 3.9% in 2005, down sharply from 7.6% growth in 2004. The main reason for the slower growth was forest products, as mentioned above, but the construction sector and the mining and oil and gas sector posted slower growth as well. The construction sector continued to boom in 2005, growing 5.0%, though well down from growth of 8.7% in 2004 and 13.8% in 2003. The utilities sector was the only goods-producing sector that bettered its 2004 performance. It rose 8.4% thanks to an 11.8% increase in electric power generation.

Growth in the services sector, on the other hand, rose from 3.0% in 2004 to 3.5% in 2005. The sharpest gains were in wholesale trade (9.3%), transportation and warehousing (5.8%), information and culture (5.1%), business services (4.7%) and retail trade (4.4%), but every service sector registered positive growth in BC in 2005.

By expenditure category, consumption was strong, government spending weak and investment very strong. The external sector was a significant drag on growth

Strong labour markets supported consumer spending in 2005. Employment rose a nation-leading 3.3% in 2005, and the unemployment rate dropped sharply from 7.2% in 2004 to 5.9% in 2005. Labour income rose 6.3%. Not surprisingly, consumers continued to spend. Retail sales rose 6.0% in 2005, real consumption expenditure rose 4.6%.

Investment was a major source of strength for BC's economy in 2005, with real investment rising 8.2%. Residential investment rose 8.6%, as housing starts rose 5.3% to 34,667 — an eleven-year high. Government investment rose 6.0%. Business investment advanced 9.7%, with spending on machinery and equipment climbing 16.7% but, perhaps surprisingly, spending on non-residential structures declining 1.8% — its second consecutive annual decline.

Despite a 10.0% jump in provincial government spending in 2005-06, real government spending on current goods and services rose only 1.5% in 2005. This is because much of the 2005-06 spending came late in the fiscal year, and will therefore show up in calendar 2006 rather than calendar 2005. Indeed, a $1 billion signing bonus for provincial public service workers was included in 2005-06 spending, even though the fiscal year was over three months ago and the amount has still not been paid out. The provincial government ran a surplus estimated at $1.475 billion in 2005-06, as high natural gas prices boosted natural resource royalties and income tax collections were stronger than expected.

Real exports (international and interprovincial) rose 2.9% in 2005, while real imports rose 6.0%. On a nominal basis, however, export growth slightly exceeded import growth, 6.5% to 6.2%. BC's top five international merchandise exports are, in order by value: lumber, natural gas, coal, pulp, and copper. The value of international merchandise exports increased 10.6% in 2005. The main reason for the advance was higher prices for natural gas and coal.

Growth will bounce back up in 2006

Following the 3.5% increase in 2005, BC's economic growth in 2006 will bounce back up to where it was in 2004 — 4.0%.

The forest products sector is showing stronger growth this year than last. So far this year, timber harvests are up 19.9%, lumber production is up 4.2%, plywood production is up 4.9%, paper production is up 3.5% and pulp shipments are up 4.7%. Despite the higher production, the value of forest product shipments is down due to lower prices. Wood product shipments were down 4.0% year-to-date to April, while paper product shipments (including pulp) were down 2.1% over the same period. A number of government assistance packages for the forest products industry have been announced. The industry should receive a boost from the resolution of the softwood lumber dispute with the US.

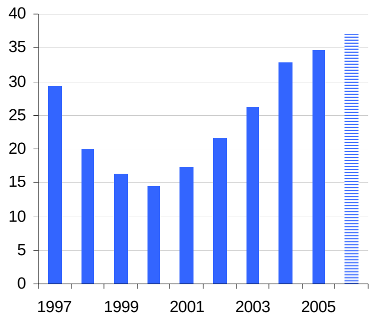
However, production in the mining and energy industries is generally down. Year-to-date, copper production is up 5.6% and gold production is flat, but coal production is down 12.0%, lead is down 50%, zinc is down 37.1%, molybdenum is down 3.8%, silver is down 16.7%, oil is down 8.9% and electricity is down 5.4%. Mineral and energy prices have generally been strong, with copper, gold, silver, zinc and oil prices all well above year-earlier levels.

The impact of production volumes and prices can be seen in international export values. By value, international merchandise exports are up 8.0% (year-to-date to April). Export vales of natural gas, coal and copper have all seen double-digit increases due to high prices, but lumber and pulp have declined.

BC's construction boom is now in its fourth year. The much predicted peak in housing construction has yet to occur. Last year, housing starts rose to 5.3% to 34,667. So far in 2006, housing starts have averaged 38,400 (annualized). We expect some slowing over the remainder of the year, but we still expect the 2006 total to reach 37,000, an increase of 6.7%.

Non-residential construction is also booming. In Statistics Canada's investment intentions

BC's housing boom continues
Housing starts, thousands



survey, respondents reported an expected 9.5% increase in capital expenditures for non-residential construction in 2006, up from 5.8% in 2005. As was the case last year, almost all of the increase is coming from public investment, which is expected to jump 20.0% in 2006, rather than private investment, which expected to rise only 2.6%. This trend is confirmed in the building permits data. Year-to-date to April, industrial and commercial building permits were down 0.9% and 5.4%, respectively, while institutional and governmental building permits were up 25.2%. Capital expenditure on machinery and equipment, both public and private, is expected to rise 4.6%.

Consumers continue to be major source of strength in 2006. So far in 2006, retail sales are up 7.0%, surpassing last year's gain of 6.0%. Retail sales will receive a further boost from the $1 billion signing bonus being paid to provincial government workers, and the one percentage point drop in the GST on July 1.

Employment gains — up 3.4% year-to-date to May — continue to be impressive. And the unemployment rate keeps dropping, from 5.9% in 2005 to an average of 4.7% so far this year. The unemployment rate hit an all-time low of 4.4% in March, though it has crept up a bit since. Of the 62.900 new jobs created in BC between May 2005 and May 2006, 55,000 were in the service sector. Of these, 35,400 were in wholesale and retail trade and 29,000 were in health care and social assistance.

Provincial government spending is budgeted to rise only 0.6% in 2006-07, yet it will still make a significant contribution to growth in 2006. This is partly because, as noted earlier, much of the spending in fiscal 2005-06 came late in the fiscal year and so will impact calendar 2006 more than calendar 2005. The provincial government surplus is budgeted to decline from $1.5 billion in 2005-06 to $600 million in 2006-07. The 2006-07 surplus includes an $850 million forecast allowance, to guard against forecast errors. This may turn out to be needed, as natural gas royalties look set to come in below budget. The budget included only small, targeted tax cuts.

Medium-term outlook

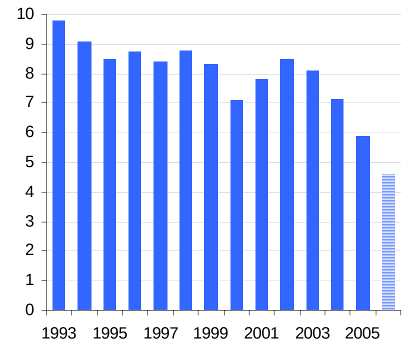
We expect growth to fall back to 3.5% in 2007 and 3.2% over the 2008-10 period. The gradual decline in growth will result in both consumption and investment moderating to more sustainable levels. The flurry of construction projects now underway or soon to begin will wind down as the 2010 Winter Olympics approaches.

There are many major projects currently under construction or expected to start over the medium term that should keep the construction boom going in BC for several years. A new $500 million container terminal is being built at the Port of Prince Rupert. A $1 billion expansion at the Port of Vancouver will begin this year and continue until 2010. Further, road and rail networks to handle the increased traffic at the Port of Vancouver will be built under the province's Gateway program, including the $650 million Golden Ears Bridge over the Fraser River, the $800 South Fraser Perimeter Road, and the $1.5 billion Port Mann Bridge expansion.

Other transportation infrastructure projects include the ten-year $1.8 billion expansion of the Vancouver Airport, the $1.7 billion Richmond-Airport-Vancouver rapid transit line, the planned $800 million Coquitlam light rail service, the $626 million upgrade of the Sea-to-Sky Highway, and the $960 million upgrade of the TransCanada Highway through the Kicking Horse Canyon.

Many of these transportation infrastructure projects are timed to be completed just before the 2010 Winter Olympics. The Olympics itself has a $580 million infrastructure budget for various sports venues, athletes villages, and other facilities. Though not part of the Olympics capital budget, the Vancouver Convention Centre, which is currently undergoing a $615 million expansion, will serve as the Olympic Broadcast Centre.

Unemployment keeps dropping
Unemployment rate, %



There are a several major energy infrastructure projects in the pipeline. Kinder Morgan has begun the first phase of a proposed expansion of its pipeline from Edmonton to Vancouver to the BC lower mainland. All proposed phases of the expansion are estimated to cost $1.6 billion for the BC portion of the line. The company is also considering building a $600 million spur from the main line terminating in Kitimat. Enbridge has proposed another pipeline, with an estimated cost of $4 billion, running from Edmonton to Kitimat. There are two proposals to build LNG terminals (one at Kitimat, the other at Prince Rupert). Further, if built, the proposed Alaska Pipeline would go through northern BC.

Other ongoing or proposed major projects ($500 million or more) include several ski resorts, a hydro generating station and a water treatment plant. Continuing investment in the forest products, mining and oil and gas industries will provide further impetus to business investment over the medium term.