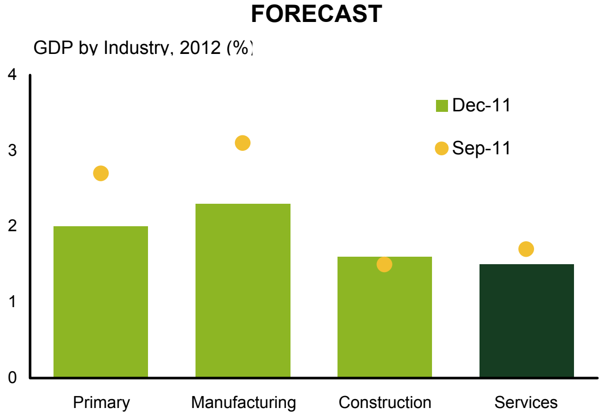
December 23, 2011

DESPITE FORECAST DOWNGRADE, GOODS SECTOR STILL IN THE DRIVER'S SEAT

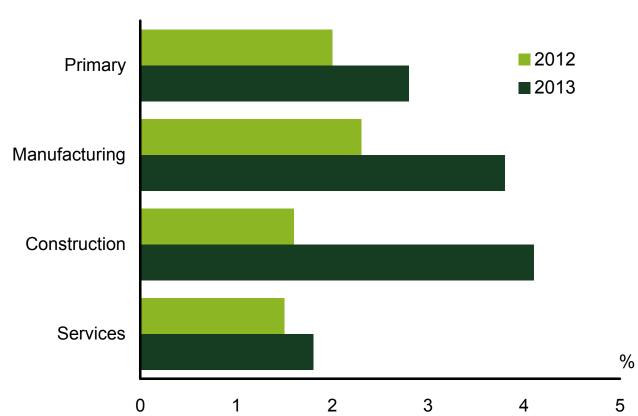
- Canadian industries will likely face volatile business conditions in 2012. In our revised quarterly forecast, released earlier in December, we assume that the debt crisis in Europe escalates again in the first half of 2012, leading to a deepening in Europe's recession and knock-on effects to the global economy. On a plus note, the worsening crisis is expected to lead to emboldened actions by eurozone leaders to take constructive action, setting the stage for an improvement in world economic prospects in the latter part of 2012 and into 2013. For further details on our global outlook please see our *Quarterly Economic Forecast – Global*, available on our website.
- Canada will not be able to escape unscathed from these near-term headwinds. With only a small portion of exports tied to Europe, the Canadian economy will be impacted indirectly through a slow-down in the U.S. economy, as well as a significant pullback in commodity prices during the first half of next year. Indeed, we expect economic activity in the U.S. to expand at a sluggish 1.9% pace in 2012, with much of the weakness concentrated during the first half of the year.
- On the commodity front, prices are expected to drop sharply during the first quarter. WTI crude oil prices are forecast to fall to about US$80 per barrel, gold prices are projected to slide to US$1550, and base metals prices are likely to drop by 10-13%. The fall in forestry and agricultural prices will be much softer. As global economic and financial conditions strengthen in the second half of next year, commodity prices are expected to snap back, with WTI returning to US$100 per barrel.
- Given that the slower growth profile for Canada stems largely from abroad, our revised forecast reflects a much weaker performance in the export-oriented goods-producing sector than we had

GLOBAL GROWTH DOWNGRADE LOWERS FORECAST



Forecast by TD Economics as at December 2011
Source: Statistics Canada, TD Economics

CANADIAN GDP AT BASIC PRICES FORECAST



Forecast by TD Economics as at December 2011
Source: Statistics Canada, TD Economics

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envisaged in our latest outlook in September – with the primary and manufacturing sectors taking the brunt of the downgrade. Still, the projected rebound in commodity prices, as well as a pick up in U.S. demand in the second half of next year and into 2013, will allow these sectors to remain significant contributors to growth over the medium term.

- Despite the choppy price environment, oil and gas extraction will continue to lead primary industries in 2012, due in part to a rebound in output after plant shutdowns earlier this year. In 2013, the forestry sector will be the top performer, as an uptick in the U.S. housing market will underpin higher lumber prices.
- The expansion in manufacturing output is largely attributable to industries related to business investment – namely machinery and computer and electronics – as demand for these products is expected to grow robustly over the next few years. The auto sector will also give manufacturing a boost, as output is set to rise on the back of increased U.S. demand for new automobiles, and a rebound in production from Japanese automakers that were hindered by the earthquake this year.
- The outlook for the construction sector remains largely unchanged. After expanding rapidly in recent years, housing activity is expected to moderate over the forecast horizon. Nonetheless, construction is likely to be a significant engine of growth in 2013, as a robust expansion in non-residential expenditures far outweighs the drop in residential investment.
- Growth in the services sector was downgraded slightly, as export-related services will be hit during the first half of the year. Waning consumer and business confidence will likely hold back private domestic-oriented industries in the near term, and they will continue to be constrained further out, given that Canadian consumers will likely be facing weak wage growth and a record level of indebtedness. Meanwhile, public sector services will be a particular soft spot over the medium term, as governments at all levels rein in their deficits.
- Notwithstanding these forecast adjustments, the storyline for the Canadian economy remains largely intact, with the key drivers of growth shifting from highly indebted consumers and governments to businesses and exports over the next few years.

CANADIAN INDUSTRIAL OUTLOOK
REAL GROSS DOMESTIC PRODUCT (GDP) BY INDUSTRY*

	Level	Share of	Annual Average				Q4/Q4 % change			
	$billions	Output	Actual	Forecast			Actual	Forecast		
	2010	2010	2010	2011	2012	2013	2010	2011	2012	2013
ALL INDUSTRIES (GDP)	**1234**	**100.0%**	**3.3**	**2.5**	**1.7**	**2.2**	**3.5**	**2.2**	**1.5**	**2.5**
GOODS INDUSTRIES	**352**	**28.6%**	**5.4**	**3.3**	**2.1**	**3.4**	**6.0**	**3.0**	**2.3**	**3.5**
PRIMARY INDUSTRIES	**85**	**6.9%**	**5.1**	**3.5**	**2.0**	**2.8**	**7.6**	**2.8**	**1.5**	**3.3**
MANUFACTURING	**158**	**12.8%**	**5.2**	**2.1**	**2.3**	**3.8**	**5.2**	**2.6**	**2.7**	**4.0**
CONSTRUCTION	**73**	**6.0%**	**8.0**	**4.4**	**1.6**	**4.1**	**8.5**	**2.7**	**2.7**	**3.9**
Residential	**23**	1.9%	11.8	1.8	0.3	-0.7	5.7	4.4	0.2	-1.9
Non-res. & Engineering	**50**	4.1%	6.3	5.6	2.2	6.2	9.8	1.9	3.9	6.4
UTILITIES	**33**	**2.6%**	**1.3**	**5.7**	**2.9**	**1.2**	**1.0**	**6.7**	**1.8**	**0.8**
SERVICE INDUSTRIES	**887**	**71.9%**	**2.5**	**2.2**	**1.5**	**1.8**	**2.5**	**1.9**	**1.2**	**2.1**
Wholesale Trade	69	5.6%	5.4	3.5	2.6	3.4	3.2	3.5	2.1	4.2
Retail Trade	76	6.1%	3.9	1.2	1.8	2.1	3.8	0.9	1.8	2.2
Transportation & Warehousing	58	4.7%	4.0	3.9	2.3	3.0	3.6	4.2	1.9	3.6
Information & Cultural Industries	45	3.7%	0.9	1.4	0.3	0.9	2.1	0.3	0.7	1.0
Finance, Insurance & Real Estate	247	20.0%	2.6	2.8	1.5	1.4	2.2	2.5	1.1	1.6
Professional Services	60	4.9%	0.5	2.3	1.7	3.5	2.1	1.8	2.0	4.2
Accommod. & Food Services	27	2.2%	2.0	2.6	1.4	1.8	3.7	2.5	0.7	2.4
Public Services**	221	17.9%	2.2	1.6	0.8	0.7	2.0	1.2	0.6	0.8
Other Services	85	6.9%	1.1	1.1	1.5	2.4	2.4	1.1	1.3	3.1

*Measured in chained 2002 dollars; Forecast by TD Economics as at December 2011. Source: Statistics Canada / Haver Analytics, TD Economics.

**Includes Public Administration, Health Care, & Education Services.