PRESS RELEASE

For immediate release

LAURENTIAN BANK OF CANADA ECONOMIC AND FINANCIAL OUTLOOK FOR 2008

Montréal, December 21, 2007 - Carlos Leitao, chief economist and strategist have disclosed this morning his 2008 economic and financial outlook.

Economic and financial outlook for 2008
By *Carlos Leitao, Chief Economist*

Canadian Economic Outlook: rising downside risks
The Canadian economy in 2008 faces many of the same challenges it did in 2006 and 2007, only compounded by significantly higher energy prices, a stronger Canadian dollar, weaker U.S. domestic demand and worrisome financial market volatility. The economies of Quebec and Ontario, with their large export oriented manufacturing sectors, will find 2008 a more difficult environment than that of the previous two years. The resource oriented economies of Western Canada, on the other hand, will continue to benefit from robust global demand for natural resources.

Soft U.S. demand to put a dent in Canadian growth prospects until mid-2008
After starting 2007 on a strong footing, the pace of economic activity in Canada gradually lost some steam. With the Canadian dollar moving beyond parity with its US counterpart after September 2007 and U.S. domestic demand slowing, exporters' struggles intensified. Domestically, overall business conditions remained sound despite a moderate tightening in credit conditions. This tightening originated from investors' loss of confidence in buying asset-backed commercial paper (ABCP) holding U.S. subprime debt. The unemployment rate hit a near-record low of 5.9% in November 2007 and personal income growth accelerated. Thus, household spending remained the main driver of the economy; housing market activity was also solid. Businesses continued to benefit from lower import prices but investment remained relatively modest. All told, we estimate that Canadian real GDP advance by an annualized 2% in the second semester of 2007, bringing growth for the entire year to 2.5%.

Economic growth to accelerate in the second half of 2008
Looking forward to 2008, we expect economic growth to average a little less, i.e. 2.2%. Nevertheless, unlike 2007, economic growth should start off slowly and accelerate moderately in the second semester as the U.S. consumer slowdown ebbs and financial market stress dissipates. Real output should increase by an annualized 2.0% in the first semester of 2008 before it picks up a notch in the second half (2.4%) and in 2009 (2.6%).

We also anticipate that the loonie will pullback below parity before mid-2008 in tandem with a retreat in crude oil prices, cooling inflation, a narrowing merchandise trade surplus, and modest interest rate cuts by the Bank of Canada in early 2008. Our year-end target for 2008 is 97.5 US cents. Empirical studies suggest that the full impact of currency movements is only felt in the economy one to one and a half years later. This implies that exporters have only fully "digested" the rise in the Canadian dollar to about 85-to-90 US cents, the level prevailing from mid to late 2006. The manufacturing correction, therefore, will intensify markedly in the first half of 2008 with renewed job losses and financial stresses. While manufacturers bear the brunt, firms exporting materials, energy, and agricultural goods should see a moderate increase in business activity. All told, we look for the volume of exports to increase by less than 2%. At the same time, imports are poised to increase at a strong pace of almost 5%, amid sound domestic demand. As a result, net exports – the difference between exports and imports – is set to exert a significant drag on economic growth.

On the positive side, however, interest rates are expected to remain low and the labour market should continue to perform reasonably well, with gains in services sectors offsetting losses in manufacturing. Total employment gains should slow from the super-charged pace of 2007 but will remain positive alongside healthy wage growth. Finally, fiscal policy in Canada will be expansionary in 2008 via the income and consumption tax cuts announced by the federal government, further assisting in the transition and ensuring domestic demand remains healthy.

Rate cuts in early 2008 followed by rate hikes in the later stages of the year

Under such a moderate economic scenario, the Bank of Canada would be expected to keep the overnight rate stable at about 4.25% throughout most of the year. Nevertheless, given renewed uncertainty about short-term economic prospects south of the border, in large part stemming from the intensifying correction of the housing market and renewed financial market turbulence, the central bank may well feel the need to reduce rates early in the new year. In addition, massive price discounts offered by Canadian retailers in order to narrow the gap with US prices will bring inflation down below the 2% target in the first semester of 2008. **In this context, the Bank of Canada has room to cut rates.** We expect at least one more 25 basis points reduction in the overnight rate in January to 4.00%. Further rate cuts could take place if financial market turbulence persists. Having said that, these possible further rate cuts could be quickly reversed, once financial market conditions improve and the U.S. consumer slowdown bottoms out. In fact, we expect Canada's central bank to bring the overnight rate to a more neutral level in the 4.50%-to-5.00% range in 2009.

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