

Highlights

- Despite many encouraging global indicators, there is considerable unevenness among regions. In the euro zone, the recovery is on a shaky footing. However, we doubt that the European difficulties will derail the global recovery. We maintain our outlook of 2010 global GDP growth in excess of 4%.
- The economic news of the past month supports our 2010 U.S. growth forecast of 3.4%. Our optimism is based on a shift of support for the economy from the public to the private sector. We are confident that domestic demand will firm in the months ahead.
- The pace of the Canadian economy is quickening. Employment growth remains strong, with the private sector adding 100,000 jobs in three months. Hours worked began the year in strength, auguring the steepest quarterly rise of labour input since 2007. The stage is set for robust Canadian growth in the coming quarters.

	Change from Previous Forecast				
	2009	2010	2011	2010	2011
United States					
GDP	-2.4%	3.4%	2.2%	unch	unch
CPI inflation	-0.3%	2.7%	2.2%	unch	unch
Overnight rate*	0.11%	1.25%	2.25%	unch	unch
Ten-year bond yield*	3.84%	4.34%	4.33%	unch	unch
Canada					
GDP	-2.5%	3.1%	2.2%	unch	unch
CPI inflation	0.3%	1.7%	2.3%	+0.1pp	-0.1pp
Overnight rate*	0.25%	1.75%	2.25%	unch	unch
Ten-year bond yield*	3.61%	4.14%	4.08%	unch	unch
USD/CAD	0.92	0.94	0.95	unch	unch

* end of period

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Stéfane Marion, Chief Economist and Strategist

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World: Disappointment in Euroland

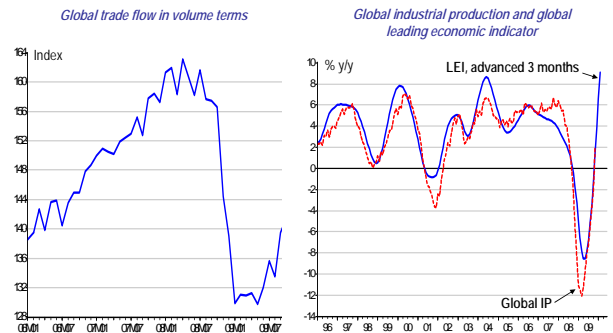
We doubt that the shakiness of the euro-zone recovery will derail the global expansion. Our outlook for world growth in 2010 is unchanged at 4%-plus.

The CPB reports world trade flows up very robustly in November, a rise of more than 1% for the second month in a row. Trade was still down 12% from the April 2008 peak, but was up 10% from last May. With international credit flowing again, further improvement can be expected in the months ahead. No surprise, then, that November industrial production showed an eighth consecutive monthly rise and the first 12-month rise since the Lehman Brothers collapse. The leading economic indicators suggest that industrial production growth could top 6% annually in the first half of the year.

Financial markets are worried that China may reverse its accommodative policies. In mid-December Beijing set a target ceiling of 7.5 trillion yuan (US\$1.1 trillion) for new loans by Chinese banks in 2010. That would be down from 2009 but more than double the volume of 2008. At this writing, the rolling six-month volume of new loans will have to accelerate markedly from its December level to reach the target pace. Thus the lending cap seems unlikely to brake Chinese growth and we are staying with our expectation of a 4.1% expansion of global GDP this year. The IMF recently upgraded its own outlook to almost 4%.

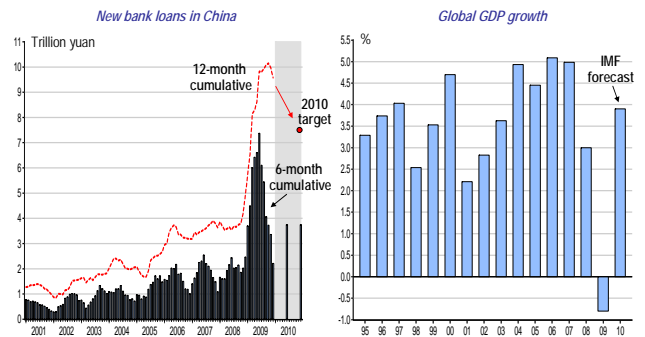
With global recovery gaining momentum, commodity prices are unlikely to correct much. Stockpiles seem high for some commodities, but relative to industrial production they are well below recession peaks and will soon be drawn down by accelerating worldwide demand.

World: Industrial output likely to expand at 6%



NBF Economy & Strategy (data via CPB and OECD)

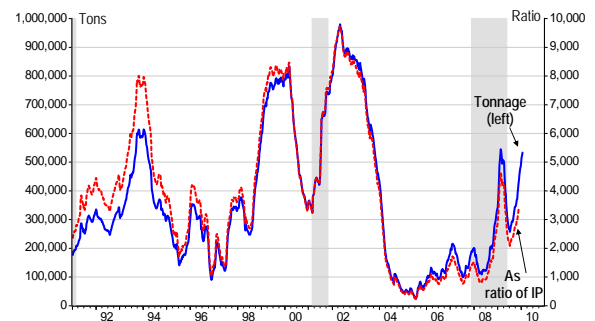
China's 2010 lending cap is not a threat to global recovery



NBF Economy & Strategy (data via Bloomberg and IMF)

Inventories too high?

Copper inventory and copper inventory relative to industrial production



NBF Economy & Strategy (data via Bloomberg)

World Economic Outlook

Current Forecast

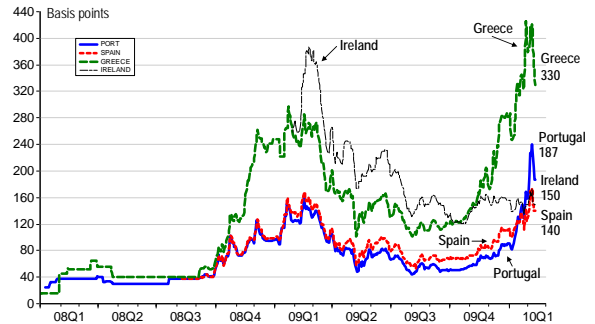
	2009	2010	2011
Industrialized Countries (share of world GDP = 50%)	-3.1	2.5	1.9
United States	-2.5	3.4	2.2
Euroland	-3.2	1.9	1.6
Japan	-5.3	1.5	1.5
UK	-4.5	1.5	1.8
Canada	-2.4	3.1	2.1
Australia	1.1	2.8	2.8
New Zealand	-1.2	2.5	2.2
Asia (excluding Japan) (share of world GDP = 25%)	5.5	7.9	6.9
China	8.5	10.0	8.5
Hong Kong	-2.9	4.5	4.0
India	6.6	7.8	7.2
Indonesia	4.5	5.0	4.2
Korea	0.2	4.7	4.0
Malaysia	-2.2	4.5	3.8
Philippines	1.2	3.7	3.5
Thailand	-3.0	4.2	3.8
Taiwan	-3.4	4.5	4.2
Singapore	-2.1	5.5	4.3
Latin America (share of world GDP = 6%)	-2.7	4.0	2.9
Mexico	-6.9	3.9	2.5
Brazil	-0.1	5.0	3.5
Argentina	-2.5	3.2	2.0
Venezuela	-2.2	-0.5	1.5
Chile	-1.8	4.5	3.5
Peru	0.9	4.8	3.8
Eastern Europe (share of world GDP = 5%)	-5.7	3.2	3.1
Russia	-7.9	4.0	3.3
Czech Rep.	-4.1	1.5	1.8
Hungary	-6.5	0.0	2.0
Poland	1.5	2.0	2.5
Turkey	-5.8	3.5	3.8
World	-1.0	4.2	3.4

Source: NBF Economic Research, Consensus Economics

Within these encouraging global indicators, there is considerable regional unevenness. In the euro zone, for example, the recovery is on a shaky footing.

Fear of sovereign default eases

Sovereign CDS

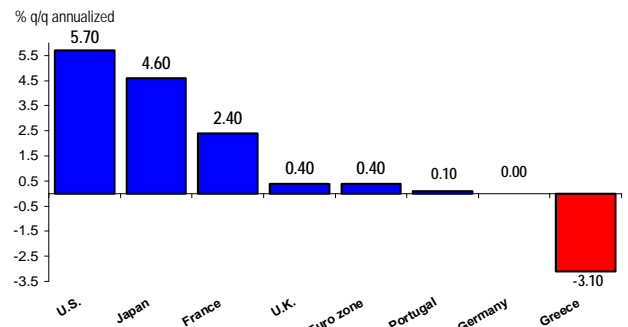


NBF Economy & Strategy (data via Bloomberg)

Risk premiums have widened substantially in CDSs for the sovereign debt of some peripheral euro-zone countries. This comes as no surprise, since the euro zone lagged way behind U.S. in fourth-quarter growth. In some countries real GDP was flat or declining, further amplifying their fiscal difficulties.

Europe the laggard

Annualized fourth-quarter growth, selected economies



NBF Economy & Strategy (data via Global Insight and Datastream)

However, we doubt the European difficulties will propagate in such a way as to derail the global recovery. Risk premiums have narrowed somewhat and in our view a bailout plan may emerge soon.

We maintain our outlook of 2010 global GDP growth in excess of 4%.

U.S.: The private sector takes over

The baton of U.S. recovery is passing from the public to the private sector. Our forecast of 3.4% real growth in 2010 is based on a firming of domestic demand in the months ahead.

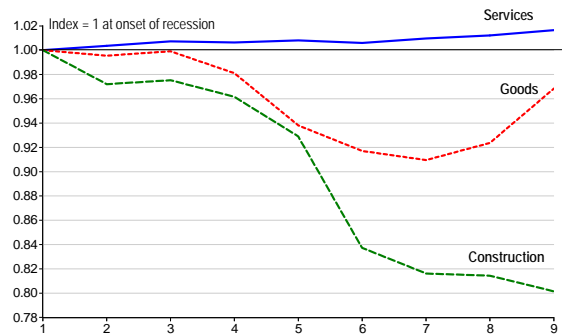
U.S. real GDP growth beat expectations in the fourth quarter at 5.7% annualized, the largest quarterly rise since Q3 2003. Business inventories accounted for 3.4 points of the expansion and final domestic demand grew at 1.7%. After just two quarters of recovery, service sector output (66% of the economy) has passed its pre-recession peak and goods output is two-thirds of the way there. Only construction is still declining, but construction is only 8% of GDP. The U.S. recovery seems on increasingly solid ground.

Our optimism is based on a shift of support for the economy from the public sector to the private sector. Business-sector nominal GDP grew at a strong 7.2% annually in Q4, pushing real business investment in machinery and equipment to a four-year high in Q4. Real M&E investment rose at 13.3% annualized during the quarter. After a decade of investment capital outflows to Asia, there is probably pent-up demand for a rebuilding of capital stock in the U.S., resulting in a much steeper climb in machinery and equipment spending than in the 2001 recovery. In the first quarter so far, indicators of shipments (up 8%) and new orders (up 11%) confirm that M&E spending growth may be even stronger than in Q4. This is a key factor in our U.S. outlook. We are confident that domestic demand will firm in the months ahead as the private sector takes over from the public sector as the growth driver.

Construction is the weak link for two reasons. First, nonresidential construction adds capacity and therefore aggregate supply to the economy. At this point, after the longest contraction since the 1930s, the U.S. does not need more capacity. Second, residential construction is lagging the rest of the economy to an unusual extent because the spread of new-home prices over existing-home prices has been abnormally high since the collapse of the housing bubble. A further runout of existing-home inventory is required before homebuilding can contribute consistently to the recovery.

U.S.: Serious progress

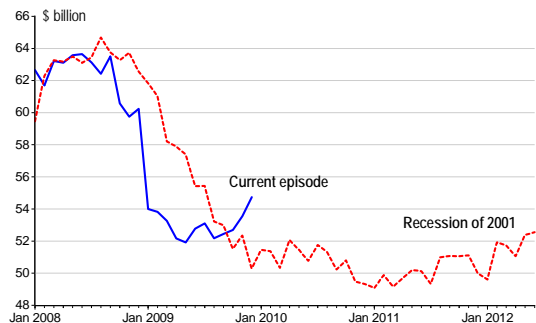
Output of goods, services and construction sectors



NBF Economy & Strategy, Global Insight

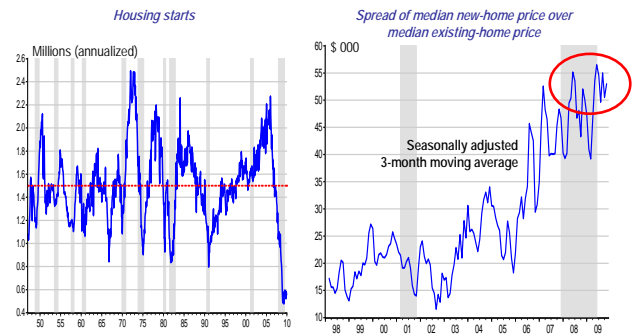
U.S.: Business investment is back

Shipments of nonmilitary capital goods excluding aircraft



NBF Economy & Strategy (Census Bureau data via Global Insight)

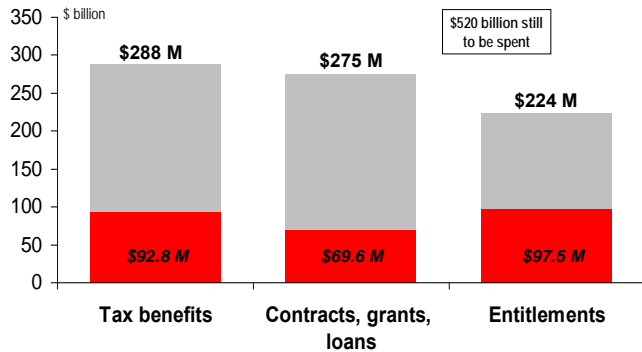
Stiff competition for homebuilders



NBF Economy & Strategy, Global Insight

U.S.: Most of the stimulus is still in the pipeline

American Recovery and Reinvestment Act of 2009



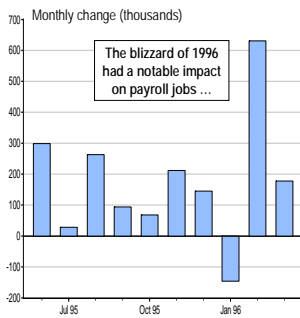
NBF Economy & Strategy (data via Recovery.gov)

In our view, U.S. growth is likely to remain fairly robust over the coming quarters. A repeat of the 5.7% of Q4 is virtually impossible in Q1, but the two quarters are likely to average out near 4%. According to the Congressional Budget Office, about two-thirds of the \$787-billion federal stimulus package remains to be spent. This will add to a boost from 2010 census-taking.

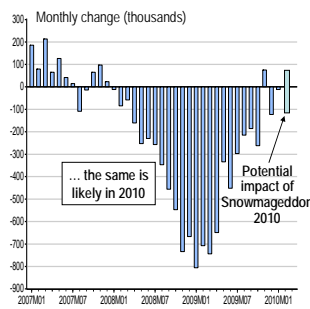
Employment growth has no doubt been crimped in February by unusual weather. January was one of the best months in three years. According to the household survey, 541,000 jobs were added (not taking population revisions into account) and the unemployment rate declined 0.3 points. But the two snowstorms that hit the eastern half of the country in February both came smack in the reference week for the jobs report. A similar shock in January 1996 sharply depressed the monthly number but was followed by an even sharper gain the next month. We see a loss of 100,000 to 200,000 jobs as the most likely February payroll result, followed in March by the first sizeable gains.

February payrolls: Snowed in

Payroll employment growth around blizzard of 1996 (as reported in March 1996 report)



Payroll employment growth (as reported in January 2010 report)



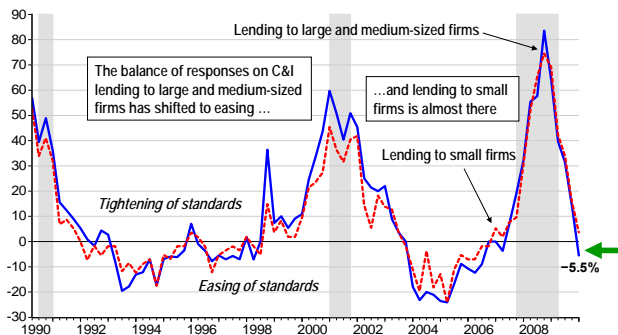
NBF Economy & Strategy (data via Philly Fed and Global Insight)

Meanwhile, there is finally good news from the banking system. For the first time since the onset of the recession, banks report a net easing of their conditions for lending to large and medium-sized businesses. Credit conditions for small business are poised to follow suit, a development that should ease apprehensions about a part of the economy that for lack of credit is still lagging the recovery of large corporations.

All in all, the news of the past month confirms us in our 2010 U.S. growth forecast of 3.4%.

U.S.: First easing of credit standards in this recovery

January 2010 Senior Loan Officer survey of bank lending practices – net % of domestic respondents tightening standards for commercial and industrial loans



NBF Economy and Strategy (data via Federal Reserve)

Canada: The pace quickens

Employment growth remains strong in Canada. The private sector has added 100,000 jobs in three months. Hours worked began the year in strength, auguring the steepest quarterly rise of labour input since 2007. The stage is set for robust growth in the coming quarters.

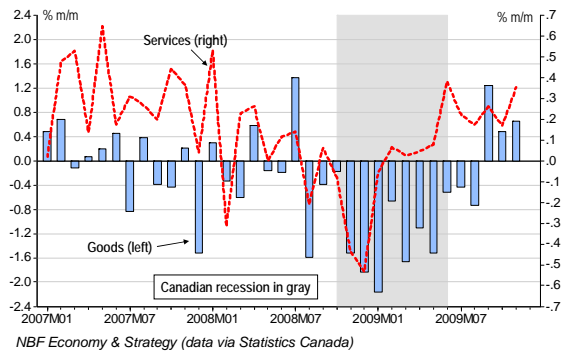
Real Canadian GDP grew a solid 0.4% in November after an October advance of 0.3% (revised up from 0.2%). Goods output rose 0.3%, the third gain in a row, and services output growth accelerated to 0.4%. We are encouraged that both parts of the economy are doing relatively well and are likely to maintain their momentum. With two months of the fourth quarter now reported, output for the quarter is up an annualized 3.3% from the third and many indicators show further growth in December. Thus our forecast of a 4% annual rate is holding up. This would be a sharp acceleration from the 0.4% of the third quarter.

Though the Canadian dollar is high by historical standards, manufacturing has unmistakable momentum. Since inventories of U.S. auto dealers are still low, even relative to current sales, Canadian automotive exports have continued rising strongly even without cash for clunkers. Manufacturing as a whole now has an inventory-to-sales ratio of 1.4 after declines in five of the last seven months. The year-end strength of the Canadian factory sector augurs well for 2010, especially since foreign trade probably contributed to growth in Q4 for the first time in four quarters.

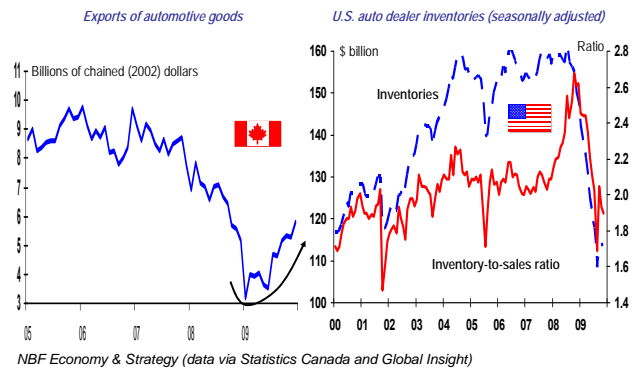
Ultra-low interest rates continue to drive existing-home sales, now up a dazzling 75% from their bottom and well ahead of the U.S. pace. The vigour is spreading to the new-home market. One month into the first quarter, monthly housing starts are up 15% from a very robust second half of 2009. The rise of home prices will probably now be moderated by the pickup in homebuilding as well as by the effect of the government's new rules in the resale market.

Canada: Picking up steam in both goods and services

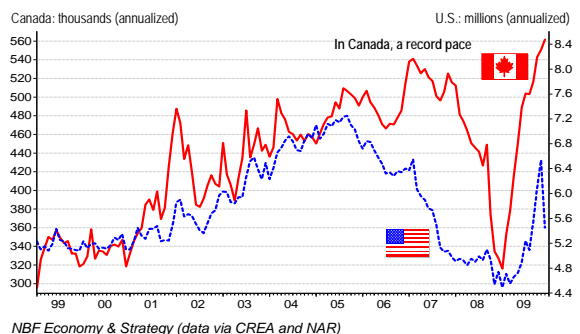
Change in real output (chained dollars)



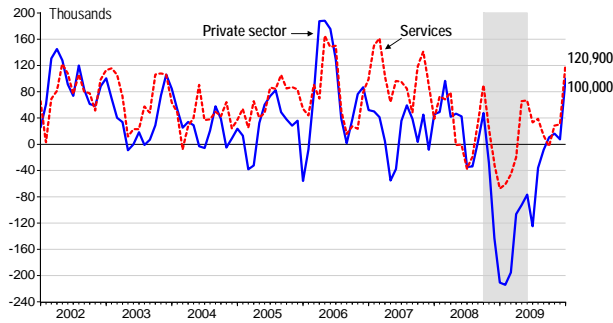
Manufacturing: Still down from peak



Existing-home sales: Divergent paths

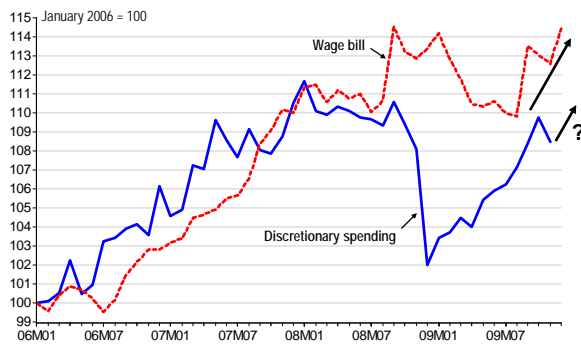


Strong job growth in private sector and in services
Three-month change in employment



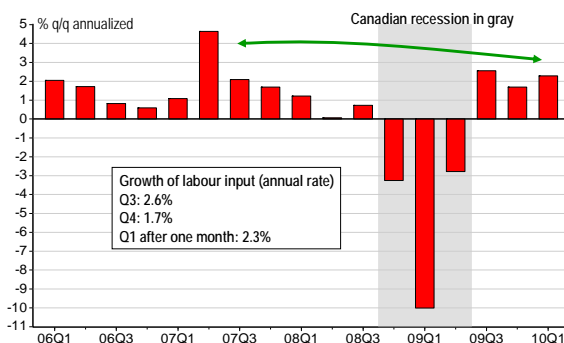
NBF Economy & Strategy, Global Insight

Aggregate wage bill points to spending growth
Discretionary consumer spending and aggregate wage bill*



* Excludes sales of service stations, supermarkets, pharmacies and personal-care stores

... with GDP likely to follow
Total hours worked – all sectors



NBF Economy & Strategy, Statistics Canada

Canadian employment growth shows no sign of flagging. The January gain of 43,000 jobs brings the three-month total to 86,000. Though most of the January growth was in part-time work, full-time employment is up 149,000 from the bottom of last July while part-time employment is down 12,000. It should also be kept in mind that the private sector added 100,000 jobs from November through January, its best three-month gain since July 2006. As in previous months, the service sector was strong, adding 66,000 jobs to bring its three-month total to 121,000. Service employment has grown by 186,000 jobs or 1.4% since the beginning of the recovery. In short, Canada's labour market is in better shape than that of the United States.

With this support, the aggregate wage bill is also gaining momentum. Just one month into Q1, it is up a spectacular 3.5%. The resulting growth of household incomes will keep retail sales rising over the months ahead, after a 1% decline in November that was due in part to unusually mild weather. In contrast to the U.S. picture, volume retail sales are back where they were before the recession and can be expected to continue growing faster on this side of the border as a result of labour market firmness. The November dip notwithstanding, retail sales for the fourth quarter as a whole were up 5.1% annualized from the third. In short, consumer spending will continue to fuel the Canadian economy.

As for GDP, the 0.2% rise of hours worked in January after a solid gain in December is promising. That one-month result puts the first quarter up 2.3% annualized from the fourth. The quarter could end with the largest rise in labour input since 2007. Fourth-quarter real GDP growth is likely to come in at 4% annualized and the stage is set for further solid expansion in the quarters ahead. Our expectation of 2010 growth slightly above than 3% remains on track.

Yanick Desnoyers
Assistant Chief Economist

Canada Economic Forecast

<i>(Annual % change)*</i>	<i>As of 02/26/2010</i>					<i>Q4/Q4</i>	
	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2010</i>	<i>2011</i>
Gross domestic product (2002 \$)	2.5	0.4	(2.5)	3.1	2.2	3.8	1.4
Consumption	4.6	3.0	0.1	2.7	2.6	2.6	2.7
Residential construction	2.9	(2.7)	(8.4)	2.4	1.2	0.6	1.0
Business investment	3.7	0.2	(14.9)	1.5	7.1	7.3	6.3
Government expenditures	3.7	4.8	3.9	3.1	2.6	2.4	2.5
Exports	1.1	(4.7)	(13.9)	5.0	2.1	4.2	1.0
Imports	5.8	0.8	(13.9)	6.7	5.1	4.0	5.7
Change in inventories (millions \$)	14,990	12,241	(6,874)	5,875	9,750	8,000.0	10,000.0
Domestic demand	4.1	2.6	(1.6)	2.7	3.1	3.0	3.0
Real disposable income	3.6	4.2	1.2	2.1	2.3	2.5	2.2
Employment	2.3	1.5	(1.6)	0.9	1.2	1.1	1.2
Unemployment rate	6.0	6.2	8.3	8.2	7.9	8.0	7.8
Inflation	2.2	2.4	0.3	1.7	2.2	1.9	2.5
Before-tax profits	4.1	5.7	(34.8)	13.3	8.6	15.0	5.0
Federal balance (Public Acc., bil. \$)	\$9.6	\$0.0	(\$45.0)	(\$30.0)	(\$20.0)
Current account (bil. \$)	\$15.6	\$8.1	(\$41.3)	(\$12.3)	\$1.5	(\$5.0)	\$2.0

* or as noted

Financial Forecast*

	<i>Current</i>	<i>Q1/10</i>	<i>Q2</i>	<i>Q3</i>	<i>Q4</i>	<i>2010</i>	<i>2011</i>
	<i>2/19/10</i>						
Overnight rate	0.25	0.25	0.75	1.25	1.75	1.75	2.25
Prime rate	2.25	2.25	2.75	3.00	3.50	3.50	4.00
3 month T-Bills	0.23	0.53	0.96	1.44	2.02	2.02	2.22
Treasury yield curve							
2-Year	1.40	1.45	1.97	2.22	2.43	2.43	2.70
5-Year	2.59	2.87	3.24	3.48	3.52	3.52	3.60
10-Year	3.50	3.73	3.99	4.19	4.14	4.14	4.08
30-Year	4.08	4.23	4.35	4.51	4.45	4.45	4.37
Exchange rates*							
USD per CAD	0.96	0.97	0.95	0.93	0.92	0.94**	0.95**

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* end of period

** annual average

United States Economic Forecast

(Annual % change)*	As of 02/26/2010					Q4/Q4	
	2007	2008	2009	2010	2011	2010	2011
Gross domestic product (2005 \$)	2.1	0.4	(2.4)	3.4	2.2	3.1	1.9
Consumption	2.7	(0.2)	(0.6)	2.1	1.7	2.2	1.5
Residential construction	(18.5)	(22.9)	(20.4)	7.6	6.3	9.5	5.0
Business investment	6.2	1.6	(17.7)	4.1	6.2	7.7	4.7
Government expenditures	1.7	3.1	1.9	1.9	2.0	2.1	2.0
Exports	8.7	5.4	(9.6)	10.6	3.9	6.7	3.0
Imports	2.0	(3.2)	(13.9)	10.6	5.7	9.2	4.5
Change in inventories (bil. \$)	19.5	(25.9)	(107.6)	48.0	77.5	70.0	85.0
Domestic demand	1.7	(0.4)	(2.7)	2.4	2.3	2.9	2.0
Real disposable income	2.2	0.5	0.9	2.1	2.3	2.9	1.8
Household employment	1.2	(0.5)	(3.8)	(0.0)	1.7	2.0	1.5
Unemployment rate	4.6	5.8	9.3	9.7	9.3	9.5	9.3
Inflation	2.9	3.8	(0.3)	2.7	2.2	2.2	2.4
Before-tax profits	(4.1)	(11.8)	(5.2)	13.2	5.5	8.0	4.0
Federal balance (unified budget, bil)	(\$161.0)	(\$459.0)	(\$1,800.0)	(\$1,200.0)	(\$900.0)
Current account (bil. \$)	(\$746.0)	(\$690.0)	(\$410.0)	(\$490.0)	(\$450.0)	(\$450.0)	(\$450.0)

* or as noted

Financial Forecast

	Current					2010	2011
	2/19/10	Q1/10	Q2	Q3	Q4		
Fed Fund Target Rate	0.13	0.16	0.23	0.75	1.25	1.25	2.25
3 month Treasury bills	0.10	0.07	0.42	0.93	1.33	1.33	2.18
Treasury yield curve							
2-Year	0.92	1.04	1.57	1.77	2.04	2.04	2.60
5-Year	2.45	2.55	3.09	3.30	3.41	3.41	3.66
10-Year	3.78	3.85	4.16	4.38	4.34	4.34	4.33
30-Year	4.71	4.74	4.88	5.03	4.99	4.99	4.99
Exchange rates*							
U.S.\$/Euro	1.36	1.38	1.35	1.30	1.25	1.33**	1.30**
YEN/U.S.\$	92	98	102	108	110	105**	104**

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* end of period

** annual average