

Highlights

- The global recovery seems to be putting down roots. It is now broader-based than just a few months ago. The leading economic indicators of the OECD countries are now sending the strongest recovery signal since 2003. The global economy seems increasingly likely to expand more than 3% next year.
- U.S. employment is ready to start growing again. This development, with support from business investment and a probably sustainable revival in housing, can be expected to put the U.S. recovery on a firmer footing.
- The Canadian economy is likely to end the year considerably stronger than a disappointing July GDP report would suggest. The prospects for sustainable recovery have been brightened by a spectacular improvement in full-time employment. In short, the recovery scenario is materializing. Our forecast for Canadian real growth in 2010 is 2.9%.

	Current Forecast			Change from Previous Forecast	
	2008	2009	2010	2009	2010
United States					
GDP	0.4%	-2.3%	3.0%	unch	unch
CPI inflation	3.8%	-0.4%	2.3%	+0.1pp	+0.3pp
Overnight rate*	0.25%	0.20%	2.00%	unch	unch
Ten-year bond yield*	2.21%	3.85%	4.34%	+1bp	unch
Canada					
GDP	0.5%	-2.2%	2.9%	-0.1pp	unch
CPI inflation	2.4%	0.3%	1.7%	-0.1pp	-0.2pp
Overnight rate*	1.50%	0.25%	2.00%	unch	unch
Ten-year bond yield*	2.68%	3.76%	4.37%	unch	unch
USD/CAD*	0.82	0.92	0.95	+0.04	+0.03

* end of period

ECONOMIC AND STRATEGY GROUP – 514.879.2529
Stéfane Marion, Chief Economist and Strategist

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World: Intensifying signals of recovery

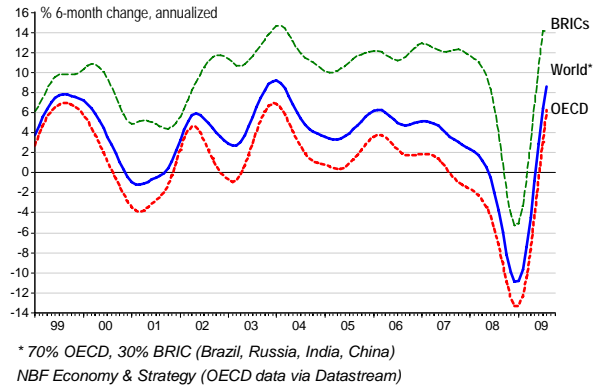
The global recovery seems to be putting down roots. It is now broader-based than just a few months ago. The leading economic indicators of the OECD countries are now sending the strongest recovery signal since 2003. The global economy seems increasingly likely to expand more than 3% next year.

The good news on the global economy keeps coming. The composite leading economic indicator for the advanced economies climbed robustly again in August (1.5%). The six-month change in the indicator has improved greatly and is now the strongest since 2003, suggesting a broader and increasingly solid footing for the recovery now under way.

In response to these signs the International Monetary Fund, in its *World Economic Outlook* of last month, has sharply upgraded its forecast for the global economy in 2010. The IMF sees greater support from the developed economies than it expected only six months ago and now anticipates global expansion on the order of 3% next year.

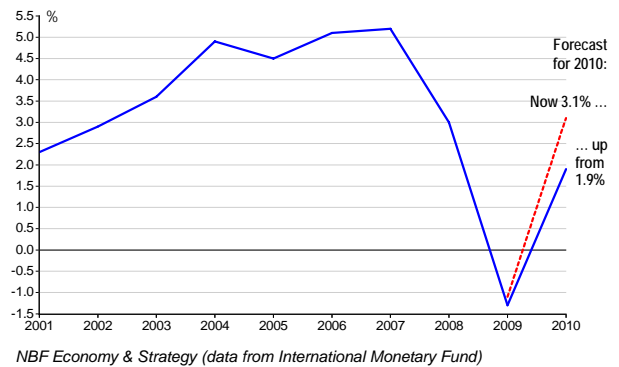
It is not just the developed economies that have been sending a strong recovery signal in the last month. Asia seems to be chugging right along. The latest report on Chinese foreign trade – the hub of world trade – shows September exports up more than 75% from the February low after the largest monthly gain since January 2008. Even after seasonal adjustment, China's exports are now down only 18% from the previous peak.

World: A broad-based rebound of leading indicators



The IMF has cheered up

Global real GDP growth (World Economic Outlook, October 2009)



An impressive rebound of Chinese exports

Chinese exports and imports



World Economic Outlook

Current Forecast

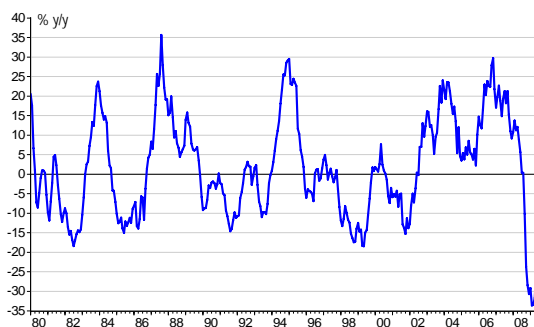
	2008	2009	2010
Industrialized Countries	0.8	-2.8	2.3
<i>(share of world GDP = 50%)</i>			
United States	1.2	-2.3	3.0
Euroland	0.7	-3.2	1.8
Japan	-0.7	-4.0	1.5
UK	0.7	-3.0	1.2
Canada	0.6	-2.2	2.9
Australia	2.1	0.4	1.8
New Zealand	0.0	-1.7	2.0
Asia (excluding Japan)	6.7	5.3	6.9
<i>(share of world GDP = 25%)</i>			
China	9.0	8.4	8.8
Hong Kong	2.5	-2.8	2.6
India	6.4	6.2	7.2
Indonesia	6.1	4.0	4.6
Korea	2.2	-1.3	3.6
Malaysia	4.2	-2.0	3.4
Philippines	4.6	2.1	3.7
Thailand	2.6	-1.2	2.9
Taiwan	0.1	-3.0	2.9
Singapore	1.1	-4.0	3.6
Latin America	4.3	-1.2	2.8
<i>(share of world GDP = 6%)</i>			
Mexico	1.3	-3.4	2.4
Brazil	5.1	-0.2	3.6
Argentina	7.0	-1.5	1.7
Venezuela	4.8	-1.0	-0.6
Chile	3.2	-0.8	3.8
Peru	9.8	3.0	4.6
Eastern Europe	4.1	-3.4	2.1
<i>(share of world GDP = 5%)</i>			
Russia	5.6	-4.0	2.2
Czech Rep.	3.1	-3.3	1.1
Hungary	0.5	-5.6	-0.4
Poland	4.8	-0.2	1.9
Turkey	1.0	-4.0	2.7
World	2.9	-0.5	3.5

Source: NBF Economic Research, Consensus Economics

The improvement in the global economic prospect has pushed up commodity prices. The CRB Metals index has more than recovered from its slide of late 2008 and early 2009 and is now up 10% from a year ago.

World: V-shaped rebound of commodity price growth

CRB Metals index, 12-month change

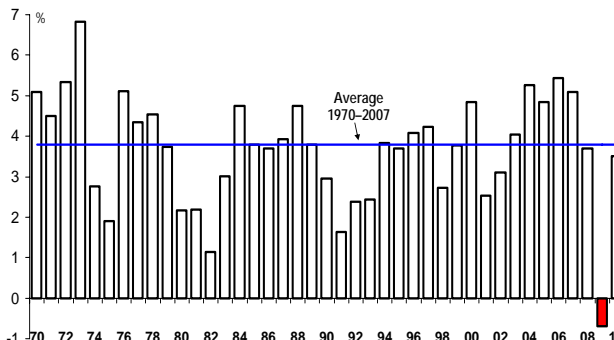


NBF Economy & Strategy (data from Commodity Research Bureau)

With virtually all recent global indicators pointing to a further firming of growth, this climb does not seem at risk in the medium term.

In-sync recovery in 2010

Growth of global real GDP



NBF Economy & Strategy (historical data from IMF)

The V-shaped recovery of Chinese foreign trade and the upbeat notes of the leading indicators suggest that this global recovery now has legs. After the dire contraction of 2009, an expansion of more than 3% next year seems increasingly plausible.

U.S.: On the verge of job creation?

U.S. employment is ready to start growing again. This development, with support from business investment and a probably sustainable revival in housing, can be expected to put the U.S. recovery on a firmer footing.

The U.S. Bureau of Economic Analysis has revised up its estimate of second-quarter GDP and now reports a contraction of only 0.7% annualized. The second half of the year promises considerable improvement on this result.

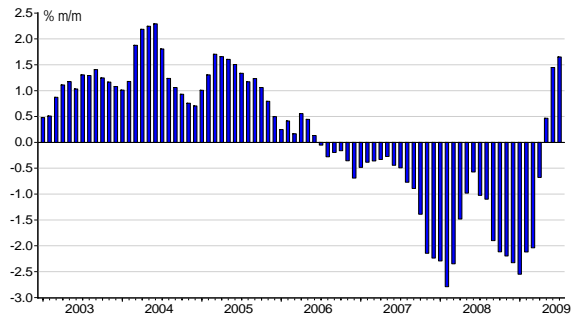
The housing market has emerged for good from a downturn that lasted 14 quarters. U.S. home prices have stopped deflating. The S&P/Case-Schiller 10-city index for July shows a third straight monthly rise in home prices, reflecting a sustainable recovery in housing.

The index of pending home sales was up 6.4% in August from the month before, reaching a 28-month high. It has now recovered almost half its losses since the pre-downturn peak and is consistent with annual sales of almost six million units in the resale market. With the inventory of houses on the market now equal to only eight times current monthly sales, all signs point to a near-term pickup in homebuilding. Residential investment is in many ways a bellwether of the economy as a whole, and we anticipate that the third quarter will show a 25% rise in this GDP component with further gains to follow. Housing is likely to continue contributing to U.S. growth.

There seems to be a widespread belief at present that U.S. business investment is unlikely to recover soon because capacity utilization rates are low. This argument ignores years of economic history. Capital spending rose vigorously after the recessions of 1970, 1973, 1980 and 1982 despite drastically depressed utilization rates. The key determinant of investment is not the utilization rate but profits. And at this point the environment for investment is highly favourable because productivity rose during the recession rather than only after recovery began. The slump of machinery and equipment investment – the worst in at least five decades – has left this type of capital spending with the lowest share of GDP since 1965. We accordingly see pent-up demand for business investment as for residential investment.

U.S.: The end of home-price deflation

Monthly change in Case-Shiller 10-city index of home prices

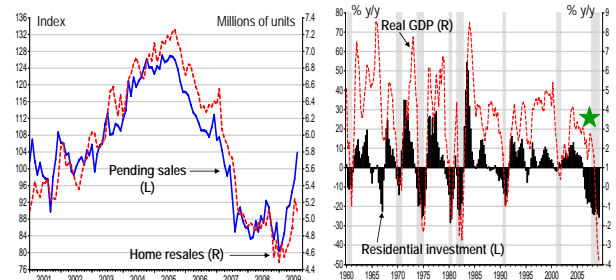


NBF Economy & Strategy (data via S&P/Case-Shiller)

U.S.: A rapid recovery in housing

Home resales and pending home sales

Homebuilding growth and real GDP growth

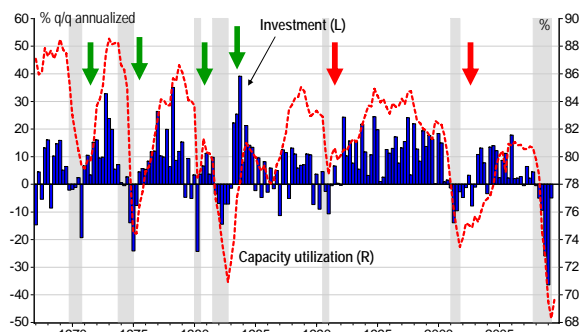


★ Forecast growth of homebuilding in Q3: 25% annualized

NBF Economy & Strategy

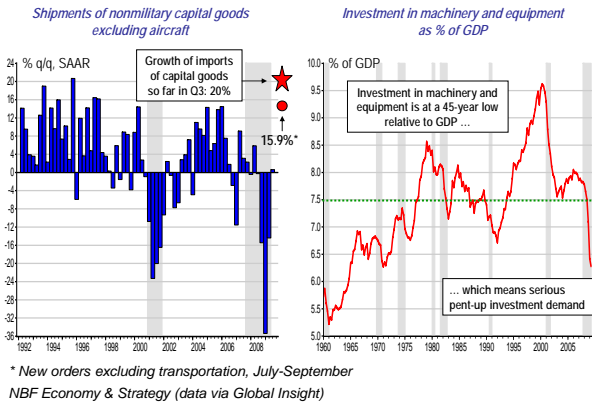
How is this possible?

U.S. capacity utilization rate and investment in machinery and equipment



NBF Economy & Strategy, Global Insight

U.S.: New orders up sharply in Q3

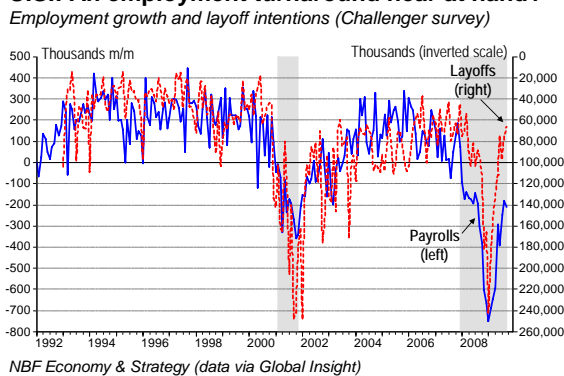


A sharp rise of new orders in the third quarter – more than 15% annualized – attests to the confidence of business managers. These orders herald a fourth quarter of buoyant capital spending.

Consumer spending will show good growth in the third quarter, driven by factors including a 40% annualized jump in motor vehicles sales induced by the cash-for-clunkers program. We think consumption is likely to remain strong after the end of the program because there is reason to believe that employment is about to start growing again.

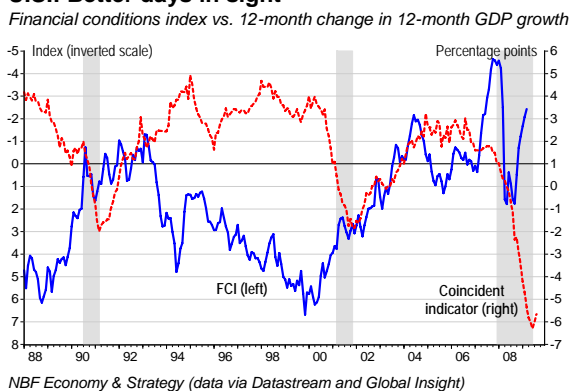
This expectation is far from the consensus view at this point. We see our optimism as only realistic. The high-frequency employment indicators are more and more encouraging. New unemployment insurance claims are running in the neighbourhood of 500,000 weekly, the lowest in 10 months. Moreover, the Challenger survey suggests that employers are now planning to hire more workers than they did in 2008. Layoffs have diminished to the point that payrolls are about to start growing again. This will be consistent with historical experience: U.S. payrolls have always expanded after two consecutive quarters of growth in business capital spending.

U.S.: An employment turnaround near at hand?



A rapid decline of interest rates in private capital markets, the rally in equity prices and depreciation of the U.S. dollar have combined to produce a substantial turnaround in our index of U.S. financial conditions in recent months, allowing the economy to take full advantage of the multi-faceted easing orchestrated by the Federal Reserve.

U.S.: Better days in sight



With additional support from business investment and a sustainable recovery in housing, the coming labour market turnaround is likely to result in U.S. growth of 3% next year.

Canada: Liftoff

The Canadian economy is likely to end the year considerably stronger than a disappointing July GDP report would suggest. The prospects for sustainable recovery have been brightened by a spectacular improvement in full-time employment.

Canadian GDP for July came in disappointingly flat. But that was due to temporary factors including low utility output during a month of below-normal temperatures. That drag probably turned into lift in August.

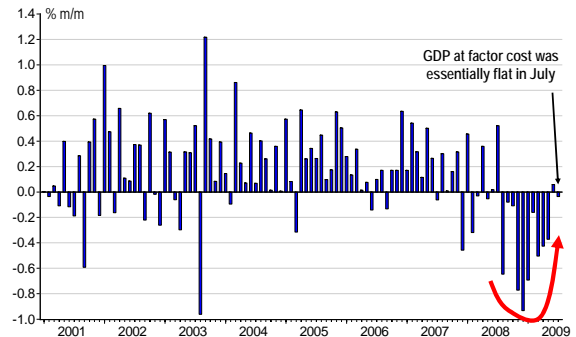
Also, there was more to the July numbers than aggregate GDP. Canadian manufacturing output started growing again for the first time since the recession began, spurred by a 17% jump in production of autos and parts.

Despite a major deterioration of the trade deficit in August, to \$2 billion, economic growth is unlikely to suffer greatly because the increase in volume imports came from domestic demand growth and inventory rebuilding. The third quarter will show the largest increase in capital goods imports since 1998. Two months into the quarter, machinery and equipment imports – which tend to track business capital spending – were up a spectacular 50% annualized. The rise of the loonie has helped by making capital goods cheaper to import. In the fourth quarter, output will also be buoyed by housing – starts have been rising sharply.

However, the show-stealer of the month was a spectacular jump in full-time employment. The economy added no fewer than 91,000 full-time jobs in September, the largest monthly gain since May 2006.

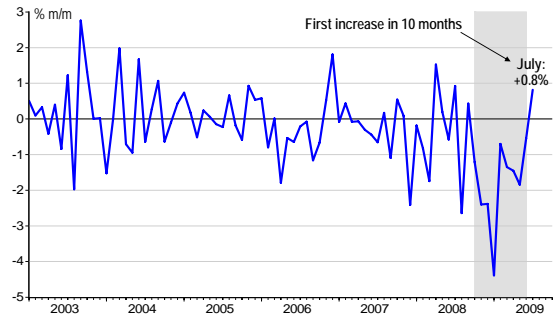
Canada: Disappointing July GDP

Real GDP at factor cost, monthly change



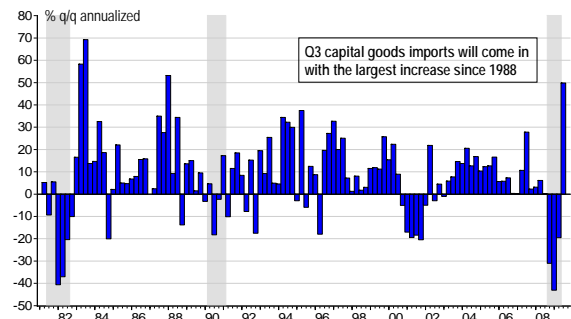
Canada: Manufacturing growth back from the abyss

Monthly change in manufacturing output



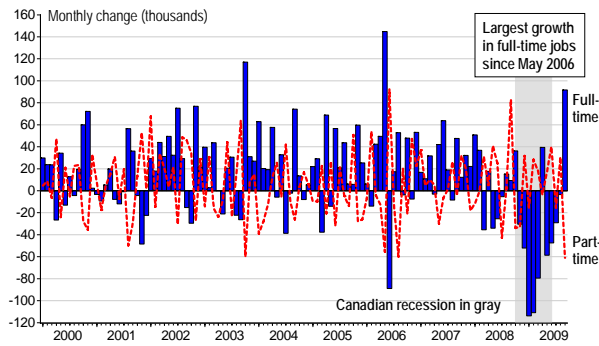
Canada: Business investment on the rebound

Real change in machinery and equipment imports



NBF Economy & Strategy (Statcan data via Global Insight)

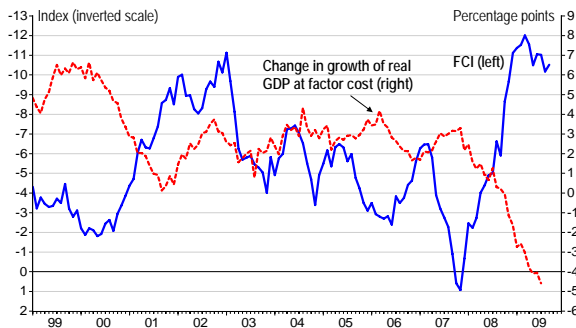
Canada: September surge in full-time employment



With this news the recovery of the Canadian labour market is off to an auspicious start. In just one month, almost 20% of all the full-time jobs lost in the last recession have been restored. This report has considerably strengthened the prospects for a sustainable recovery in Canada. The return of employment growth will support continued gains in total hours worked, in aggregate wages and in consumer spending. The prospect is further brightened by an increase in the personal savings rate (almost as great as the U.S. increase, though Canadian home prices have deflated only modestly) and a corresponding increase in option room for household spending on consumption.

Financial conditions favourable despite the loonie

Financial conditions index vs. 12-month change in 12-month GDP growth



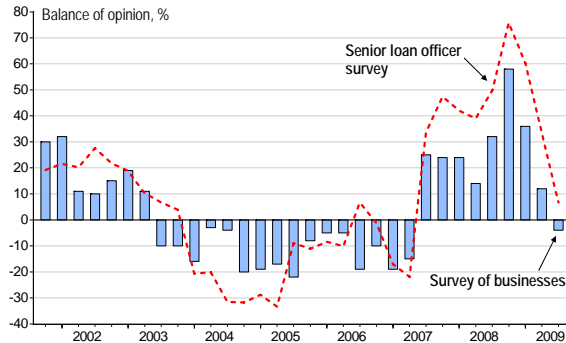
NBF Economy & Strategy (data via Datastream and Global Insight)

Of course the Canadian dollar has also been surging. At this writing it has appreciated about 5% in a month. We doubt that the resulting squeeze on exporter profit margins will derail the recovery. As our financial conditions index shows, the rise of the loonie is partly offset by the stock market rally and the decline of interest rates for corporate borrowing.

Despite the stronger currency, Canadian businesses report that credit conditions have improved, a first since mid-2007. The latest Bank of Canada survey of bank behaviour reports less and less tightening of lending conditions, a development that will support continuing recovery.

Bank of Canada: Credit conditions have stabilized

Lenders are tightening less, businesses see improved credit conditions



NBF Economy and Strategy (data from Bank of Canada)

The flat GDP of July leads us to expect that growth will be stronger in the fourth quarter than the third. This expectation is strengthened by the rebound of the Canadian leading economic indicator, which has risen 4% over the last three months. We nevertheless anticipate respectable expansion in the third quarter – 2% to 3% annualized.

In sum, the recovery scenario is materializing. Our forecast of Canadian real growth in 2010 is 2.9%.

Yanick Desnoyers
Assistant Chief Economist

Canada Economic Forecast

Annualized rate of change*							Q4/Q4	
	2006	2007	2008	2009	2010	2009	2010	
Gross domestic product (2002 \$)	2.9	2.5	0.4	(2.2)	2.9	(0.7)	3.0	
Consumption	4.1	4.6	3.0	0.1	2.5	1.5	2.3	
Residential construction	2.0	2.9	(2.7)	(7.1)	4.2	2.4	0.6	
Business investment	10.0	3.7	0.2	(12.7)	6.9	(7.5)	7.5	
Government expenditures	3.3	3.7	4.8	3.5	3.0	4.0	2.4	
Exports	0.8	1.1	(4.7)	(14.0)	4.3	(8.7)	4.2	
Imports	4.7	5.8	0.8	(13.6)	7.4	(4.5)	4.0	
Change in inventories (millions \$)	12,122	14,990	12,241	(2,655)	8,000	6,000.0	8,000.0	
Domestic demand	4.5	4.1	2.6	(1.3)	3.3	1.0	2.9	
Real disposable income	5.8	3.6	4.2	0.3	2.0	(0.0)	2.5	
Employment	1.9	2.3	1.5	(1.5)	0.8	(1.6)	1.1	
Unemployment rate	6.3	6.0	6.2	8.2	8.1	8.4	8.0	
Inflation	2.0	2.2	2.4	0.3	1.7	0.8	2.0	
Before-tax profits	5.1	4.1	5.7	(34.7)	13.6	(19.8)	15.0	
Federal balance (Public Acc., bil. \$)	\$13.8	\$9.6	\$0.0	(\$45.0)	(\$30.0)	
Current account (bil. \$)	\$20.3	\$15.6	\$8.1	(\$21.9)	\$4.5	\$0.0	\$5.0	

* or as noted

Financial Forecast

	Current					2009*	2010*
	10/16/09	Q4	Q1/10	Q2	Q3		
Overnight rate	0.25	0.25	0.75	1.25	1.75	0.25	2.00
Prime rate	2.25	2.25	2.75	3.25	3.75	2.25	3.75
3 month T-Bills	0.31	0.31	0.96	1.46	1.92	0.31	2.17
Treasury yield curve							
2-Year	1.60	1.76	2.43	2.69	2.93	1.76	3.22
5-Year	2.80	2.93	3.43	3.59	3.79	2.93	4.04
10-Year	3.48	3.76	4.06	4.15	4.24	3.76	4.37
30-Year	3.95	4.15	4.34	4.41	4.47	4.15	4.54
Exchange rates*							
USD per CAD	0.95	0.92	0.90	0.91	0.92	0.88	0.92

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* end of period

** NBF forecast

**United States
Economic Forecast**

<i>(Annual % change)*</i>	2006	2007	2008	2009	2010	Q4/Q4	
						2009	2010
Gross domestic product (2005 \$)	2.7	2.1	0.4	(2.3)	3.0	0.2	2.8
Consumption	2.9	2.6	(0.2)	(0.6)	1.9	1.0	2.2
Residential construction	(7.3)	(18.5)	(22.9)	(19.8)	8.1	(10.5)	8.5
Business investment	7.9	6.2	1.6	(17.2)	4.8	(13.1)	7.8
Government expenditures	1.4	1.7	3.1	2.0	3.0	2.2	2.5
Exports	9.0	8.7	5.4	(10.9)	5.6	(5.3)	5.2
Imports	6.1	2.0	(3.2)	(14.5)	7.8	(8.4)	7.7
Change in inventories (bil. \$)	59.4	19.5	(25.9)	(98.5)	7.5	(20.0)	15.0
Domestic demand	2.5	1.7	(0.4)	(2.6)	2.6	(0.6)	3.0
Real disposable income	4.0	2.2	0.5	0.8	2.6	1.4	3.1
Household employment	1.7	1.3	(0.5)	(3.3)	1.2	-2.4	2.0
Unemployment rate	4.6	4.6	5.8	9.1	9.1	9.4	8.9
Inflation	3.2	2.9	3.8	(0.4)	2.3	1.2	2.4
Before-tax profits	10.5	(4.1)	(11.8)	(9.3)	8.7	13.7	8.0
Federal balance (unified budget, bil. \$)	(\$248.2)	(\$161.0)	(\$459.0)	(\$1,800.0)	(\$1,200.0)
Current account (bil. \$)	(\$811.5)	(\$746.0)	(\$690.0)	(\$490.0)	(\$490.0)	(\$300.0)	(\$450.0)

* or as noted

Financial Forecast

	Current						
	10/16/2009	Q4	Q1/10	Q2	Q3	2009*	2010*
Fed Fund Target Rate	0.19	0.20	0.75	1.25	1.75	0.20	2.00
3 month Treasury bills	0.07	0.30	0.96	1.46	1.92	0.30	2.17
Treasury yield curve							
2-Year	0.96	1.35	2.33	2.57	2.81	1.35	3.04
5-Year	2.36	2.84	3.44	3.62	3.79	2.84	3.92
10-Year	3.42	3.85	4.09	4.20	4.29	3.85	4.34
30-Year	4.25	4.42	4.48	4.52	4.53	4.42	4.56
Exchange rates*							
U.S.\$/Euro	1.50	1.45	1.40	1.35	1.30	1.38	1.32
YEN/U.S.\$	91	95	100	105	110	95	110

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* end of period

** NBF forecast