



Economics & Strategy

Jeffrey Rubin (416) 594-7357 jeff.rubin@cibc.ca

Avery Shenfeld (416) 594-7356 avery.shenfeld@cibc.ca

Benjamin Tal (416) 956-3698 benjamin.tal@cibc.ca

Peter Buchanan (416) 594-7354 peter.buchanan@cibc.ca

Meny Grauman (416) 956-6527 meny.grauman@cibc.ca

Krishen Rangasamy (416) 956-3219 krishen.rangasamy@cibc.ca

"The energy- and resource-rich Canadian economy will manage to sit out this US recession, just as it did back in 2001. Only this time around sitting out will be a more impressive achievement since, unlike in 2001, US consumer spending is now likely to fall."

Sitting This One Out

by Jeff Rubin

The US economic numbers may be getting worse but financial markets are already focusing on an economic recovery. Confidence seems to be slowly seeping back into credit markets that only months ago looked as if they were about to seize up. Stateside, a lot of ammunition is being spent fighting the recession, and that will not be without consequences down the road.

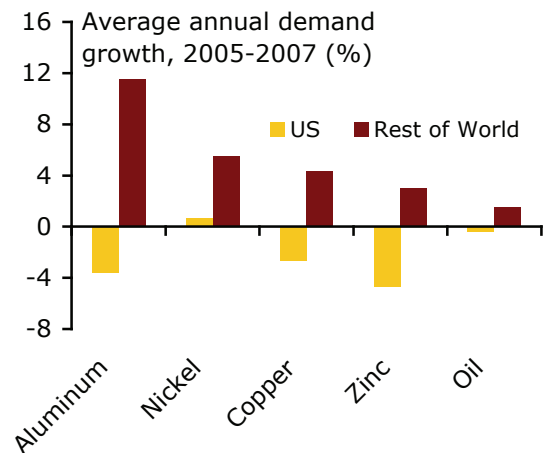
But in the here and now, a plunging federal funds rate, some US\$100 billion in reserve lending from the Federal Reserve Board, and a likely Congressional fiscal bailout of some \$300 billion in subprime mortgages should power the American economy out of recession by the second half of the year. In the interim, North American stock markets will have to hold their nose to some ugly non-farm payroll losses and some real, if modest, shrinkage in GDP, just as a rate-cutting Fed has to hold its nose to the odour of a 4%-and-rising CPI rate in the US.

The energy- and resource-rich Canadian economy will manage to sit out this US recession, just as it did back in 2001. Only this time around sitting out will be a more impressive achievement since, unlike in 2001, US consumer spending is now likely to fall. Certainly there are still parts of the Canadian economy that move very closely to the cyclical rhythms of its much larger trading partner, but the resilience of the resource markets, particularly, energy prices, heralds a new measure of economic independence for Canada. From over US\$100/bbl oil to US\$4.00/lb copper, commodity prices, along with world economic growth, have hardly

noticed the US recession. Even before the implosion of its real estate market, the US contribution to world demand growth in oil, copper, zinc, aluminum and nickel had already been nil-to-negative (Chart 1) over the last three years.

For Canada, the diminished importance of the American economy to global commodity demand has meant downside protection for its resource rents against a US economic downturn. The resource sector still enjoys booming economic conditions, and will continue to do so over the next four quarters, irrespective of the pace or timing of a US recovery. One weak area in the sector, natural gas, has recently joined the party, as environmental opposition to new coal-fired power capacity in North America is pushing utility gas demand through the roof and will soon send natural gas prices well into double-digit territory.

Chart 1 US Hasn't Been Contributing to Increased Resource Demand



http://research.cibcwm.com/res/Eco/EcoResearch.html

Table 1

FORECAST SUMMARY

(% Change Except Where Noted)

	2005A	2006A	2007A	2008F	2009F
CANADA					
GDP at Market Prices	6.5	5.2	5.9	4.9	6.1
GDP in \$2002	3.1	2.8	2.7	1.6	3.0
Consumer Price Index	2.2	2.0	2.2	2.4	3.0
Unemployment Rate	6.8	6.3	6.0	6.2	6.2
Employment	1.4	1.9	2.3	1.5	1.3
Merchandise Trade Balance (C\$ Bn)	63.5	51.3	49.4	41.8	43.1
Current Account Balance (C\$ Bn)	27.9	23.6	14.2	-1.4	2.1
Housing Starts (K)	225	227	228	230	220
Real Disposable Income	2.6	4.9	4.0	3.7	2.7
Personal Saving Rate (% of disposable income)	1.6	2.3	1.5	0.9	0.7
UNITED STATES					
GDP at Market Prices	6.4	6.1	4.9	3.4	4.9
GDP in \$2000	3.1	2.9	2.2	0.9	2.3
Consumer Price Index	3.4	3.2	2.9	4.4	3.3
Unemployment Rate	5.1	4.6	4.6	5.3	5.3
Current Account Balance (US\$ Bn)	-755	-811	-739	-670	-710
Pre-tax Profits (with IVA/CCA)	11.5	13.2	2.7	-3.4	7.6
Housing Starts (Mn)	2.07	1.81	1.34	0.99	1.15

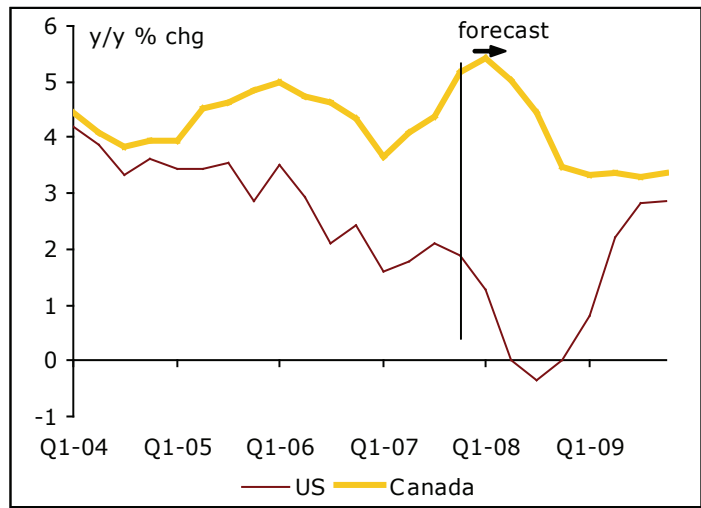
Table 2

INTEREST AND EXCHANGE RATE FORECAST

END OF PERIOD:	2008				2009	
	11-Apr	Jun	Sep	Dec	Mar	Jun
CDA Overnight target rate	3.50	2.75	2.75	2.75	2.75	3.00
98-Day Treasury Bills	2.34	1.85	2.50	2.65	2.70	2.80
Chartered Bank Prime	5.25	4.50	4.50	4.50	4.50	4.75
2-Year Gov't Bond (3.75% 6/10)	2.67	2.40	2.70	3.10	3.35	3.50
10-Year Gov't Bond (4% 06/17)	3.55	3.30	3.45	3.70	3.80	4.00
30-Year Gov't Bond (5% 06/37)	4.06	3.75	3.90	4.10	4.15	4.20
U.S. Federal Funds Target	2.25	1.50	1.25	1.25	1.25	1.75
91-Day Treasury Bills	1.19	0.80	0.70	0.90	1.20	1.65
2-Year Gov't Note (1.75% 3/10)	1.75	1.30	1.20	1.65	2.00	2.80
10-Year Gov't Note (3.5% 02/18)	3.47	3.15	3.10	3.50	3.70	4.20
30-Year Gov't Bond (4.375% 02/38)	4.30	4.00	3.95	4.20	4.25	4.45
Canada - US T-Bill Spread	1.15	1.05	1.80	1.75	1.50	1.15
Canada - US 10-Year Bond Spread	0.08	0.15	0.35	0.20	0.10	-0.20
Canada Yield Curve (30-Year — 2-Year)	1.39	1.35	1.20	1.00	0.80	0.70
US Yield Curve (30-Year — 2-Year)	2.55	2.70	2.75	2.55	2.25	1.65
EXCHANGE RATES						
— (US¢/C\$)	97.8	101.5	104.7	105.0	103.1	102.0
— (C\$/US\$)	1.022	0.985	0.955	0.952	0.970	0.980
— (Yen/US\$)	101	93	94	100	98	96
— (US\$/euro)	1.58	1.60	1.58	1.49	1.45	1.44
— (US\$/pound)	1.97	2.00	2.01	1.91	1.90	1.88
— (US¢/A\$)	92.9	95.0	92.0	90.0	90.0	91.0

Chart 2

Domestic Demand Growth: Canada vs US



Record strength in commodity and energy prices translates into soaring growth in Canadian personal and corporate income. Those gains show up in very healthy growth in domestic spending, even if they are not nearly as apparent in real GDP. While the US economy has relied on its trade sector to offset a contracting domestic economy, north of the border, the opposite has held. The trade sector has acted as a drag on GDP growth in the face of huge, largely resource-driven gains in domestic spending. It is in domestic demand growth, much more than in GDP growth, that the relative strength of the Canadian economy is most apparent against the US (Chart 2).

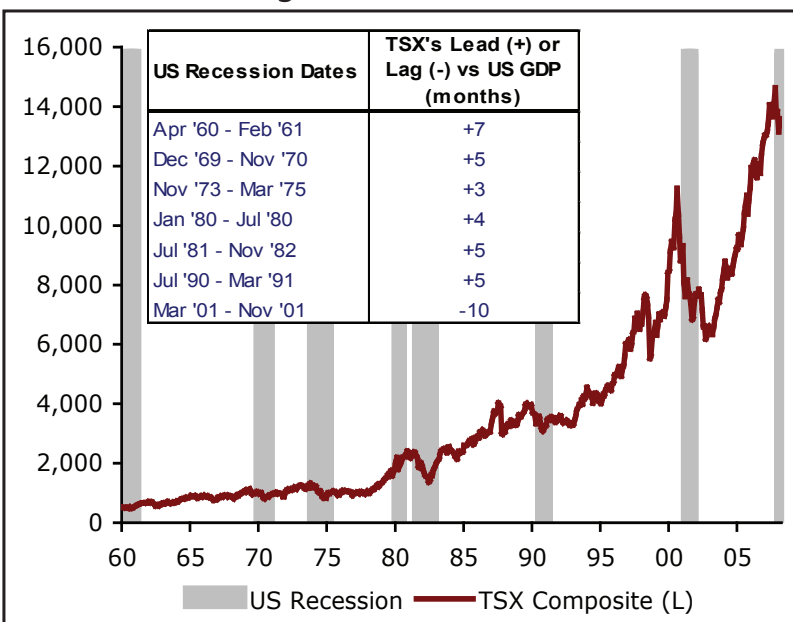
Nevertheless manufacturing—and in particular, autos and parts—remains vulnerable, both to a US recession and a parity exchange rate. Weakness in the Ontario economy, which will likely come the closest to outright recession of any of the provinces, will likely spur further Bank of Canada rate cuts, particularly in light of another 100 basis points in cuts expected from the Fed. When the smoke clears, the Bank of Canada's target rate should fall by another 75 basis points to as low as 2.75%, but settle 150 basis points above the fed funds target, giving the Canadian dollar significant positive carry against US rates (Table 2). In addition, continued strength in energy and resource prices should push the Canadian dollar to as high as US\$1.05 against the greenback by year-end.

Holders of government bonds will still benefit from further interest rate cuts by the Fed and the Bank of Canada but investors should be nimble to lighten up on their bond portfolio when the US economy and overnight rates come close to hitting bottom. Core inflation may still be at acceptable rates, but core CPI is rapidly losing its relevance in the face of a secular rise in food and energy prices. All-items CPI inflation in the US is already ugly at 4% and will get uglier as both energy and food prices keep climbing. While a rising loonie has moderated the increase in largely US-dollar-denominated food and energy prices, the Canadian dollar may be hard pressed to keep pace with further increases coming in food and energy prices. If the currency can't offset those US dollar price hikes, the same pressures that have pushed up US CPI inflation will begin to push the Canadian rate up as well.

With the sole exception of the 2001 recession and the bursting of the tech bubble, North American stock markets have typically rallied four to six months in advance of an economic recovery (Chart 3). By that benchmark the recent TSX rally is consistent with the current US recession ending in the third quarter. We expect the energy sector to lead the TSX to a record high 16,200 in 2009 as oil prices average US\$110/bbl and natural gas averages US\$11.00/MnBtu.

Chart 3

TSX to Hit New Highs in 2009



The US Economy: The Great Save

Meny Grauman

There is no denying the obvious. America's economy has finally succumbed to the double blows of the worst housing downturn since the great depression and an unprecedented credit crunch. While the preponderance of data now bears out this conclusion, and current indicators are pointing down, there is a clear body of evidence suggesting that this downturn will be both brief and mild (Chart 4). The US economy spent most of 2007 confounding the markets with its resiliency, and 2008 should be no different.

The 2008 Recession in Perspective

Over the past 40 years US recessions have typically seen peak-to-trough declines in real GDP of 1.3%, and have usually lasted for 5 quarters. However, more recently

Chart 4

Second Mildest Recession on Record

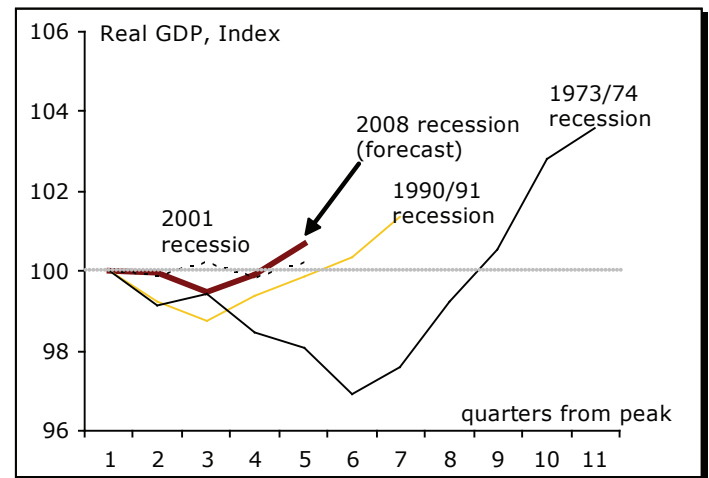


Table 3

US FORECAST DETAIL

(real % change, s.a.a.r., unless otherwise noted)

	07:4A	08:1F	08:2F	08:3F	08:4F	2007A	2008F	2009F
GDP At Market Prices (\$Bn)	14,074	14,162	14,185	14,360	14,562	13,841	14,318	15,024
% change	3.0	2.5	0.7	5.0	5.7	4.9	3.4	4.9
Real GDP (\$2000 Bn)	11,676	11,671	11,614	11,664	11,758	11,567	11,677	11,949
% change	0.6	-0.2	-1.9	1.7	3.2	2.2	0.9	2.3
Final Sales	2.4	-0.5	-2.3	1.0	2.5	2.5	0.9	2.3
Personal Consumption	2.3	0.5	-2.9	1.2	3.4	2.9	0.8	2.6
Total Govt. Expenditures	1.9	1.7	1.2	2.7	2.4	2.0	2.2	1.8
Residential Construction	-25.2	-23.0	-18.0	-9.0	-2.0	-17.0	-18.8	-2.7
Business Fixed Investment	6.0	-5.3	-3.2	0.4	1.2	4.7	1.0	1.9
Inventory Change (\$2000 Bn)	-18.3	-7.5	4.7	25.3	46.9	4.6	17.4	27.2
Exports	6.5	1.9	3.8	3.6	3.1	8.1	5.8	4.0
Imports	-1.4	-0.6	-0.7	3.1	4.8	1.9	0.5	3.2
GDP Deflator	2.4	2.7	2.6	3.2	2.4	2.7	2.5	0.7
CPI (yr/yr % chg)	4.0	4.2	4.3	4.5	4.0	2.9	4.4	3.3
Unemployment Rate (%)	4.8	4.9	5.3	5.5	5.5	4.6	5.3	5.3
Housing Starts (AR, Mn)	1.15	1.05	0.90	0.90	0.98	1.34	0.99	1.15

the business cycle has become less volatile. Notable characteristics of the last two US recessions have been their relative mildness and brevity, and we believe that the current slowdown will follow this same pattern. The 2008 recession should only last two quarters as an unprecedented wave of monetary and fiscal intervention along with strong export demand help push economic growth back above trend towards the end of 2008.

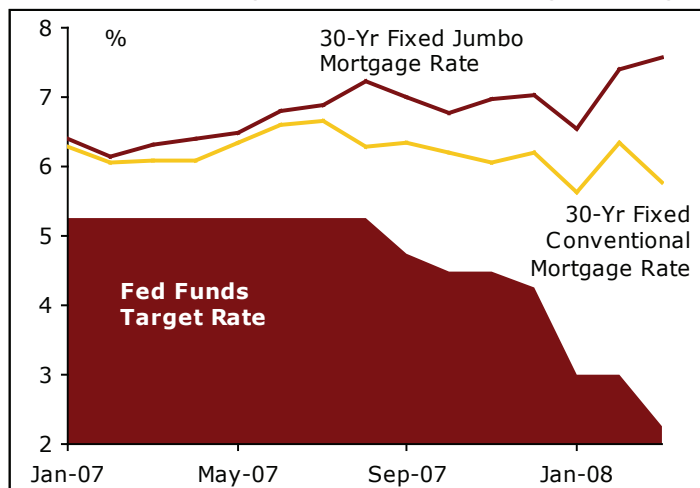
We see this current downturn as rivalling the 2001 slump in intensity, but not in character (Chart 5). Whereas the slowdown in 2001 was primarily driven by a sharp decline in private nonresidential investment, a distinguishing feature of this current episode will be a decline in personal spending that was not present in the wake of the collapse of the tech bubble. In fact, we expect personal spending to fall in the second quarter of 2008 for the first time since 1991.

That decline is being driven not just by the deterioration in the housing market, but by a slew of negative factors that have been building over the last few months. These include declines in equities, a contracting labour market, and constrained access to credit. Despite substantial Fed easing, fixed mortgage rates are only slightly lower, and in the case of jumbo mortgages (Chart 6), even elevated.

Breaking Out the Monetary Textbook

To date, FOMC rate action since August has been in line with other ultimately-mild recessionary periods (Chart 7). Since administered rates peaked at 5.25%, the fed funds target rate has dropped by 300 bps. We saw similar easing after rates started falling just before the 2001

Chart 6
Rate Cuts Having Hard Time Filtering Through



recession, and during the 1980s. Where policy makers have distinguished themselves has been in turning to an alphabet soup of other policy measures that have reached deep into the esoteric and technical details of monetary policy and given both banks and brokerages unprecedented access to liquidity.

This dual-tracked monetary policy gets at the heart of the current crisis, which is distinguished by an unprecedented financial crisis, coupled with a mild macro-economic slowdown.

Washington Heeds the Call

To be sure, a lack of liquidity in the credit markets is already making a significant dent in real economic performance in what Fed officials have aptly characterized

Chart 5
Consumers To Play Big Role in 2008 Recession

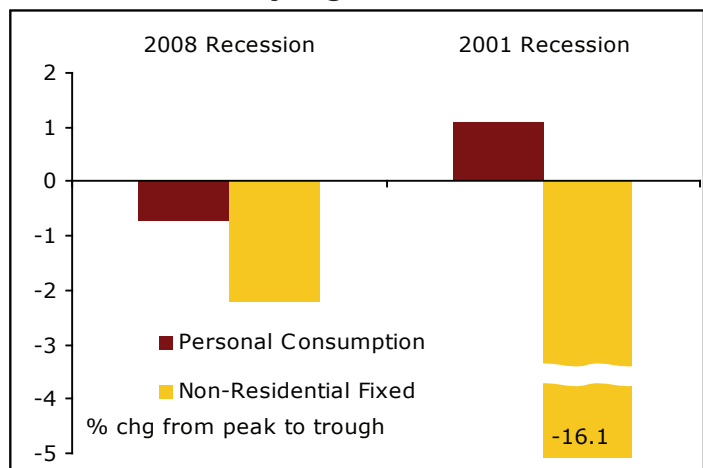


Chart 7
Easing in Line With Past Mild Downturns

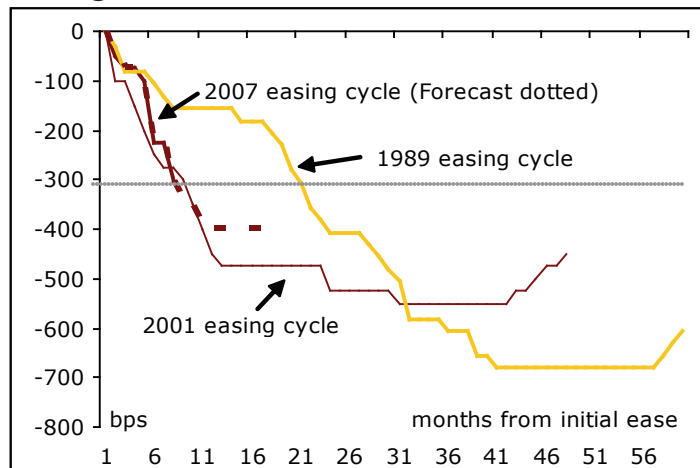
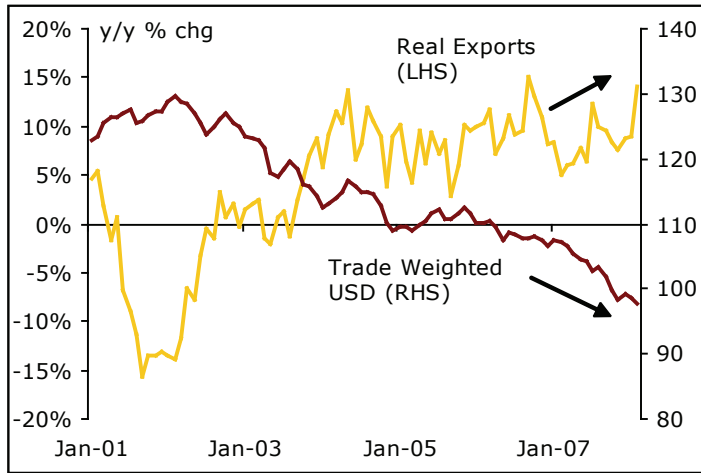


Chart 8

Real Trade Balance Improves

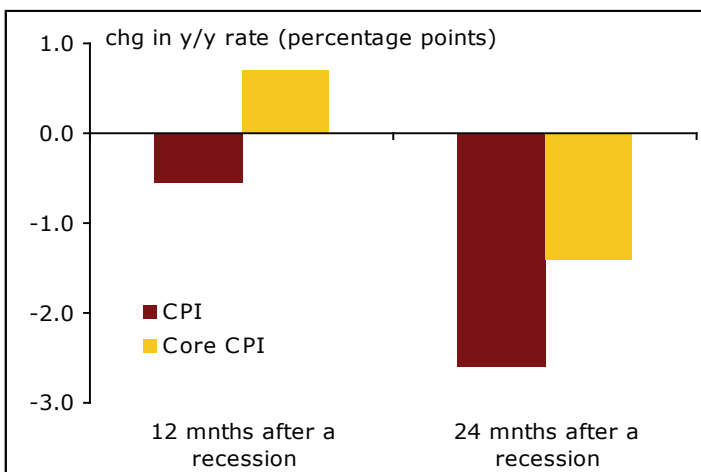


as a “negative feed-back loop”. But a nascent third-quarter recovery will be supported by the President’s \$150 bn fiscal stimulus package, which was signed into law earlier this year, and will begin to show up in Americans’ mailboxes starting in May. This action should boost real GDP growth by over 1 percentage point for the year, and there is talk of an additional stimulus package making its way to tax payers as well.

At the same time, this direct stimulus is likely to be supplemented by more active government help for troubled homeowners. This is not only an important pillar of a speedy economic recovery, but a necessary outcome for an orderly resolution to the current credit crunch. The outright collapse of home prices along with widespread mortgage defaults is the single largest threat to both the US economy and the global financial system.

Chart 9

It Takes Time For Inflation to Lose Steam



The prospect of direct government intervention in the financial markets has many modern-day precedents and has garnered a significant amount of bipartisan support from both policy makers and academics alike. Although there are a number of competing proposals floating around Washington, the one plan that stands out is the Frank-Dodd proposal. According to this scheme the government would use a beefed-up Federal Housing Administration (FHA) to guarantee \$300 bn in new mortgages for roughly 2 million borrowers. To put this number in context there are now close to 3 million delinquent mortgages in the United States, meaning that this plan does have the necessary heft to make a difference.

Trading Up

Another important pillar of a quick US economic recovery is the ongoing strong world demand for US goods (Chart 8). This trend continues to be driven by a materially weaker greenback and a global growth profile that is less sensitive to the gyrations of a US business cycle that is centred on its unique mortgage crisis. On the import side, a weaker consumer along with lower expected industrial production will also continue to place downward pressure on import growth. Net exports added 0.6 percentage points to real GDP growth in 2007, and that contribution should rise as personal consumption slumps in the first half of 2008.

A Complicating Factor

Looking farther out into our forecast period the positive impact of trade does begin to wane as the US dollar regains its bearings next year in the wake of a sustained economic recovery. But our outlook for inflation and its subsequent implication for monetary policy is more troubling. While headline inflation is typically lower by 0.6 percentage points twelve months after the start of a recession (Chart 9) (and over 2½ percentage points 24 months out) the brevity of this latest US downturn coupled with the growing demand for energy and food from the developing world should keep CPI above 4% y/y heading into 2009. Meanwhile, core inflation should continue to be buffeted by rising medical and education costs, along with sustained pressure from rental prices, despite the housing slump. Although the Fed will remain focused on the substantial downside risks to growth for most of 2008, policymakers are likely to take aggressive action to bring price gains back into their comfort zone by 2009.

Canada Not Immune, But Less Stricken

Avery Shenfeld

The debate will rage on whether Europe or Asia can decouple from the US, but there can be no such talk for America's largest trading partner. Every American recession in the last half century has produced at least a material slowdown in Canada. But Canada doesn't march in lock-step, having more moderate slowdowns when the initial shock hit where the US was more vulnerable, as was the case in the OPEC oil recession of 1974, the tech bubble burst in 2001, and now the mortgage crash of 2008. A regression of annualized two-quarter growth rates (often the period over which output has to fall to be a true recession) shows a standard error of more than 2%-points (Chart 10).

As a result, a modest drop over two quarters stateside leaves room for Canada to continue to grow, and our projections for the first half of 2008 lie well within the one-standard deviation (68% confidence) band.

Since there was no comparable disaster in Canada's less-risk-taking mortgage market, the initial shock to GDP north of the border has been entirely external. If Canada were an island unto itself, the talk would be about a boom, not a recession risk, given the strength of final domestic demand, and particularly, consumer spending, up more than 7% annualized in Q4 (Table 4). After such a surge, we're bound to see a moderation, but household income fundamentals, and further interest rate cuts, should be enough to sustain a 3% pace to real consumption, even with a temporary rise in the jobless rate over the summer.

The boom in energy and metals has obviously been a plus to Western Canada, but less discussed is its broader role in national growth, extending far beyond jobs in the oil patch. Government revenue overshoots, for example, tied in no small part to resource royalties and soaring corporate income taxes, funded a national public sector hiring spree, huge infrastructure spending and fresh tax-cutting initiatives.

That is part and parcel of another consequence of the commodities boom, the widened gap between real GDP—which counts barrels of oil, tons of nickel, bushels of wheat, and so on—and nominal income or GDP, which tracks the market value of the goods and services produced. Typically, we think of the inflation component in any series as undesirable, but that's not the case where it's being driven by the price index on net exports. High export prices hit the foreign buyer, while the cheap import prices are Canada's benefit.

It's not real GDP, then, that captures what Canadians can buy with the money earned from what they sell to the world. That's better tracked by taking Canada's nominal output, and adjusting it for inflation in consumer, business and government purchases, leaving out the rise in our export prices, but adding in the benefits of cheap imports. That alternative measure has seen a steadily rising gap with the traditional real GDP benchmark, with the former running at 4.9% in the past four quarters (Chart 11). With resource prices still heading higher, domestic spending has plenty of fuel to give Canada the edge over US growth.

Chart 10
US, Canadian GDP Growth: Not a Tight Fit

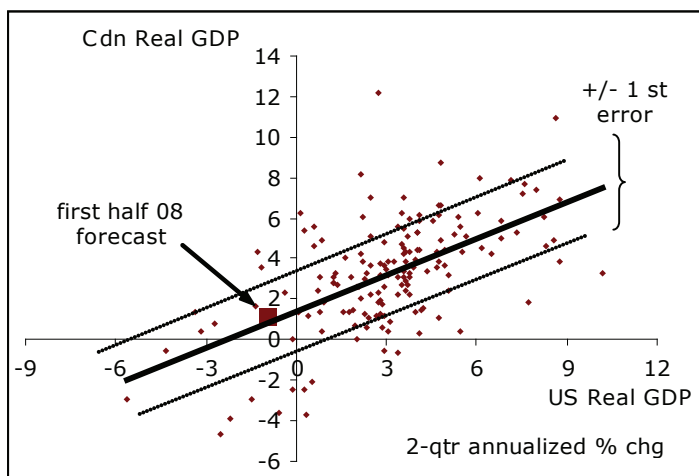
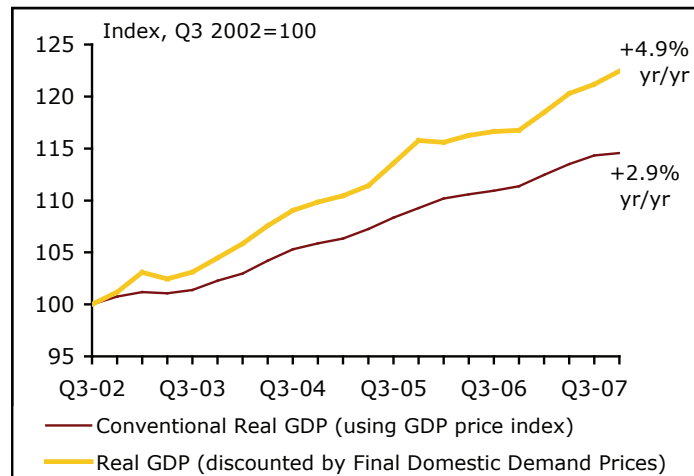


Chart 11
Real Output: Conventional Measure Understated



Inflation In Check... For Now

Inflation developments have also opened a further gap between US and Canadian household spending power, and there too, part of the credit goes to resource prices. The Canadian dollar has climbed in step with the improvement in the country's terms of trade—the ratio of export prices to import prices. That, and a 1% cut in the GST, has resulted in a record gap in goods price inflation between the US and Canada (Chart 12). As a result, Canada's real wage and salary growth looks impressive relative to that stateside, where consumers are being more heavily squeezed by food and energy price shocks.

Moreover, it is only that gap in inflation, which also shows up in core prices, that will enable the Bank of Canada to cut interest rates and boost sensitive sectors like housing, where prices and activity remain relatively healthy. While the current 3.5% overnight rate is already low by historical standards, Canada is sharing in the global stress on bank capital and funding spreads. As a result, market interest rates will not reach the levels typically seen at any given overnight rate target. Ottawa is pushing through

changes that will allow the central bank more options in dealing with wide spreads at the front end, but to bring longer yields down, a further 75 bps in overnight cuts is likely forthcoming.

Chart 12

Unprecedented Gap in Goods Inflation Can't Last

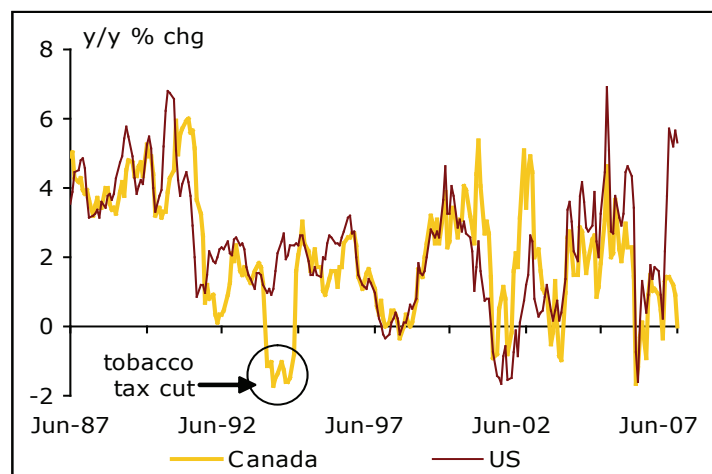


Table 4

CANADA: GDP FORECAST DETAIL

(real % change, s.a.a.r., unless otherwise noted)

	07:4A	08:1F	08:2F	08:3F	08:4F	2007A	2008F	2009F
GDP At Market Prices (\$Bn)	1,559	1,579	1,593	1,611	1,642	1,532	1,606	1,705
% change	5.4	5.1	3.7	4.7	7.9	5.9	4.9	6.1
Real GDP (\$2002 Bn)	1,326	1,329	1,332	1,338	1,350	1,316	1,337	1,377
% change	0.8	1.0	0.7	1.8	3.8	2.7	1.6	3.0
Final Domestic Demand	6.9	4.5	3.6	3.0	3.0	4.3	4.6	3.4
Personal Consumption	7.4	3.3	3.2	3.0	3.0	4.7	4.3	2.9
Total Govt. Expenditures	6.7	5.0	2.7	2.2	2.1	3.7	4.5	3.0
Residential Construction	2.4	2.2	3.5	-0.5	0.0	3.2	2.7	0.9
Business Fixed Investment*	7.2	9.4	6.6	5.6	5.6	4.4	6.9	6.5
Inventory Change (\$2002 Bn)	18.7	8.7	6.4	6.6	8.0	10.8	7.4	7.8
Exports	-8.5	-4.5	-2.3	1.3	5.8	0.9	-2.5	3.4
Imports	10.9	-2.5	3.3	4.3	4.5	5.7	5.4	4.2
GDP Deflator	4.5	4.0	3.0	2.8	4.0	3.1	3.2	3.1
CPI (yr/yr % chg)	2.4	1.9	2.1	2.7	2.9	2.2	2.4	3.0
Unemployment Rate (%)	5.9	5.8	6.2	6.5	6.4	6.0	6.2	6.2
Employment (m/m avg, K)	28	28	2	5	21	30	16	23
Goods Trade Balance (AR, \$bn)	37.1	46.4	42.7	37.8	40.1	49.4	41.8	43.1
Housing Starts (AR, K)	214	238	231	221	229	228	230	220

* Machinery & Equipment plus Non-Residential Structures

Chart 13
Food CPI Low Relative to Other Metrics

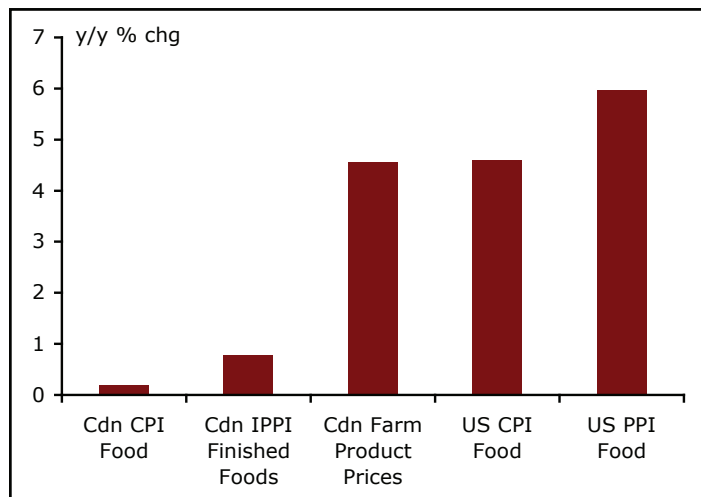
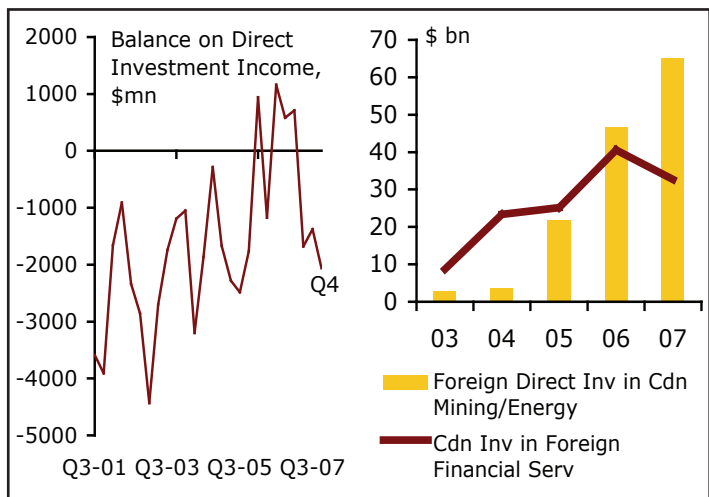


Chart 14
Direct Investment and Related Income Balance



But Canada will start to feel the pain from global food and energy prices in 2009. Retail (CPI) food inflation has been non-existent in Canada, but rising sharply stateside (Chart 13). A price war between new US entrants and domestic chains battling for market share has depressed margins to unsustainably weak levels. As well, more stable dairy and egg marketing board prices have yet to capture rising costs, which has wholesale (IPPI) food prices still tame relative to the US (PPI). By next year, cost recovery at the wholesale and retail level will have Canadian food prices soaring to catch up, leaving the CPI at 3%, the upper end of the Bank of Canada's 1-3% band.

America's recovery will lift the US\$ globally, and a faster rebound in US interest rates will see the C\$ levelling off in 2009, reducing its anti-inflation benefits. That's not to say that the loonie is doomed for a major retreat—not with oil en route to US\$150/bbl over the next several years. But the damage to manufacturing competitiveness, including a large deficit in automotive trade, will see the Canadian current account in a very small deficit this year, down from a \$14 bn surplus in 2006. Part of that owes to Canada having made what will be, at least in the near term, an unfavourable swap of assets in terms of cross border M&A activity. Foreigners bought out several of Canada's largest mining concerns, while Canadians were net buyers of now-challenged foreign banks. Add in a weaker profit picture abroad, and the translation of foreign earnings into fewer loonies, and Canada now finds itself in a direct investment income deficit (Chart 14).

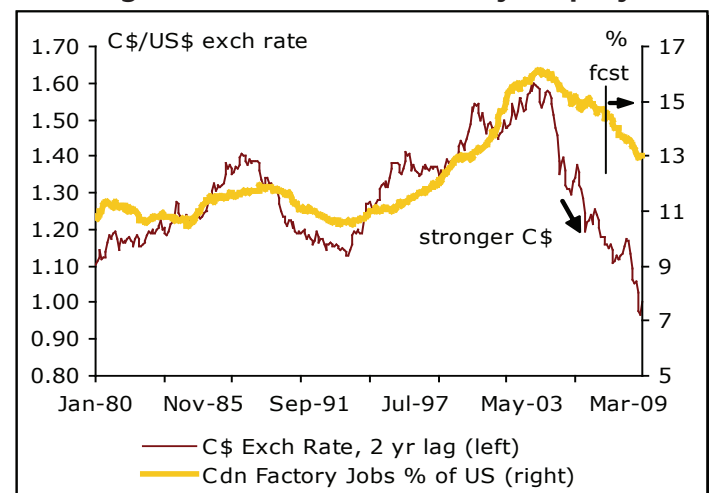
Where Are We in the Factory Meltdown?

Exports will remain a sore spot, both cyclically and, for manufacturing, structurally. As always, a US economic

rebound will generate a cyclical improvement in real net exports late this year, after a factory sector recession that will hit central Canada hard in the first half.

But for some manufacturers, the structural change associated with living with a strong currency has a long way to run. Relative to the US, Canadian manufacturing was loading up on workers during the cheap C\$ era of the last half of the 1990s (Chart 15). While a US rebound will improve real net exports later this year, manufacturing will continue to lag on a structural basis. Judging by Canada's role in factory employment prior to 1995, and the further shift in the terms of trade that will draw labour and capital to the resource sector, we could see years of slow bleeding in factory jobs and activity, even after the US recession ends.

Chart 15
Exchange Rate & Relative Factory Employment



A US Recession, Not a Global One

Peter Buchanan

Despite fears of a domino-like collapse, the global economy continues to exhibit decoupled behaviour, with few signs to date that a housing- and finance-led US recession seriously threatens continued recovery in most other economies. While we expect global growth to decelerate markedly to a 4.0% pace this year and 4.2% in 2009, well above the 2 -3% pace typically deemed a global recession (Chart 16).

Asia's Growth has Diverged Markedly from US in Last Decade

Although the subprime meltdown will continue to fuel broad financial volatility, the US economy's declining

global footprint suggests fears of equally far-reaching economic contagion may well be overstated. Asia's share of world imports has risen by about 6 percentage points since the beginning of the decade, largely at the expense of the US. The importance of the US market for most regions has consequently declined. About 13% of Europe's exports go to the US today for example, versus nearly 18% in 2000 (Chart 17). Emerging Asia's correlation with the US, in particular, has fallen over time, following the US into recession in the early 1990s but barely missing a beat during the last US slump in 2001 (Chart 18). What's true of growth and trade is even truer of commodity demand. While the weak dollar accounts for some of the strength in commodity prices, it's also

Chart 16

World GDP Growth (Historical & Projected)

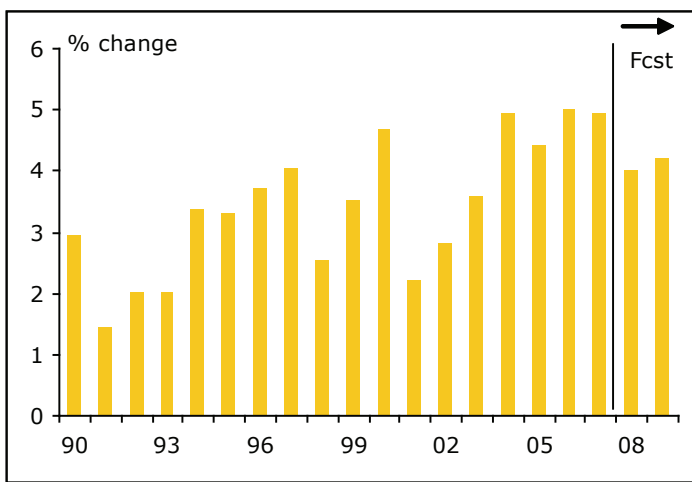


Chart 17

US Market Becoming Less Important

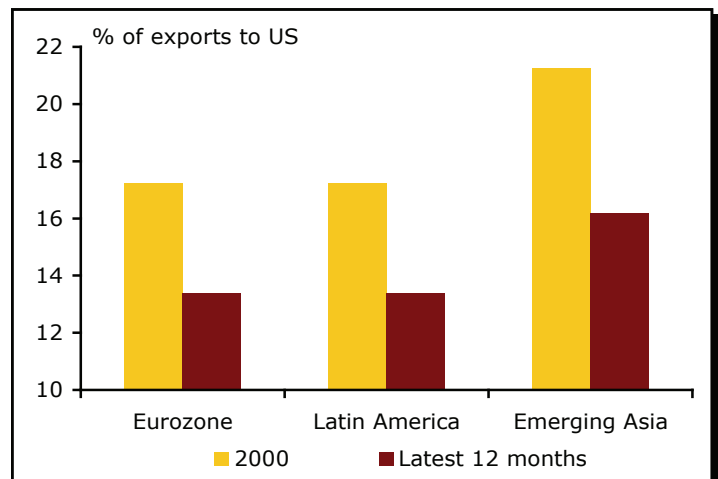


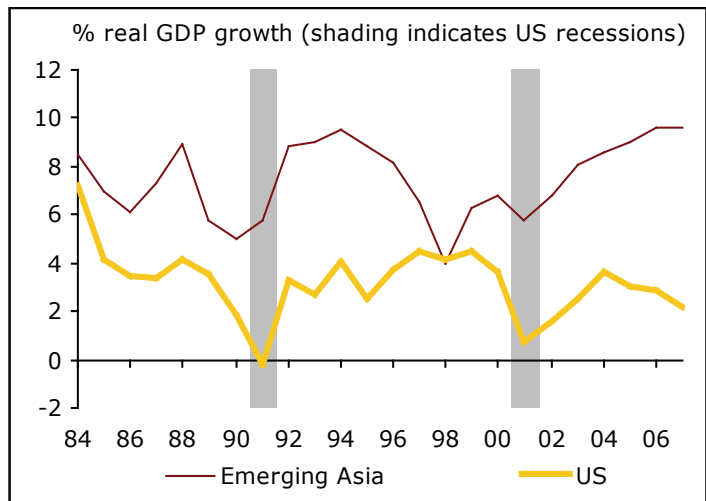
Table 5

REAL GDP GROWTH RATES					
	2005A	2006A	2007A	2008F	2009F
World GDP*	4.4	5.0	4.9	4.0	4.2
Key Overseas Economies					
Eurozone	1.6	2.8	2.6	1.7	2.0
UK	1.8	2.9	3.1	1.6	2.0
Japan	1.9	2.4	2.1	1.6	2.1
China	10.4	11.1	11.4	10.0	9.8
India	9.1	9.7	9.2	7.8	8.5
Latin America	4.6	5.5	5.6	4.6	5.2

*at purchasing power parity weights

Chart 18

Asia's Growth Increasingly De-Linked From US



due to the fact that the US today consumes just half-to-a-third the volume of base metals as China, and is far less important to new oil demand than either that nation or the Middle East producing countries. Energy and other resource equities will remain one of the better places for riding out US economic weakness.

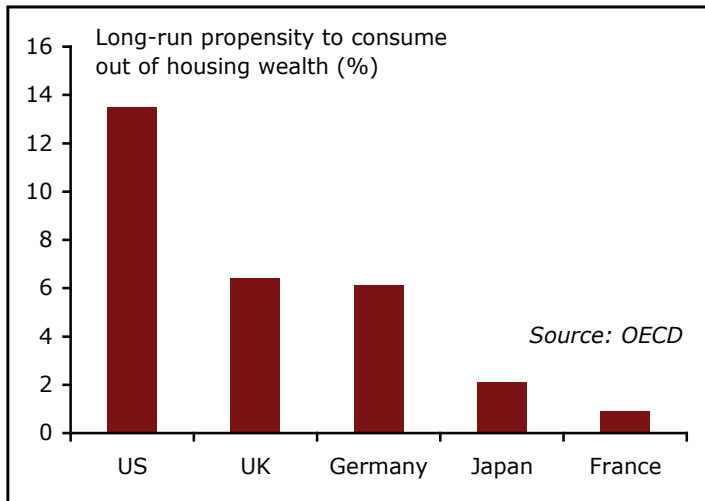
Looking only at trade flows, we estimate that a US recession matching the severity of what we expect will shave 0.1-0.8% from GDP growth in a number of key markets. Based on the export sector's economic weight and historical correlation with US GDP growth, those estimates generally imply a measured, as opposed to debilitating, hit to economic performance. A 0.4% impact on China is modest for an economy that has grown at an average 10% rate for the last decade (see February 2008 issue of StrategEcon, pages 10-11).

Overseas Rate Cuts Will Also Sustain Growth, Underpinning Greenback

Beyond historical trade shifts, overseas monetary easing should also help contain the financial and economic fallout from the subprime shock. To date, overseas banks have not rushed to match the Fed's aggressive easing. But further rate hikes are now off the table in Euroland and we expect a gradual easing in inflation and uninspiring growth to prod the ECB into an easing policy late this year. Rates in Japan are also unlikely to rise. The greenback's selloff against the other majors has outpaced fundamentals. While bad US data limits any near-term upside, more favourable spreads should help

Chart 19

Overseas Consumers Less Leveraged to Housing Than US



the greenback claw its way back to the 1.49-euro and 100-yen level during the second half of the year.

Home prices have risen in a number of countries in the last decade, but difficulties borrowing against home wealth means consumers have not relied on their homes as ATMs to the degree that their US peers have. A less-housing-leveraged consumer limits the potential threat to growth from a housing market correction. The propensity to consume out of housing wealth in most European countries is a quarter-to-half that of that US (Chart 19).

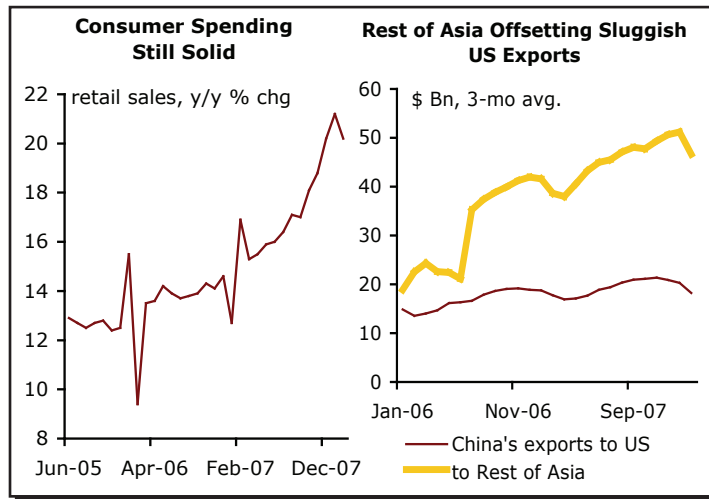
Firm Domestic Demand, Exports to Asia Buttress China's Prospects

Glancing at prospects for some key economies, China's GDP growth rate should slow from last year's 13-year high to a still-impressive 10% pace this year and 9.8% in 2009. Limiting the economy's trade vulnerability, value-added in the export sector still accounts for only about 10-15% of China's GDP, when the high import content of many of the countries' exports is netted out. The lunar New Year makes the tea leaves at this time of year hard to decipher. Even so, February's 19.1% annual retail sales rise (Chart 20, left) suggests domestic demand, the economy's main driver in recent years, remains healthy.

Rising exports to the rest of Asia, up 20% on the year so far in 2008, also appear to be countering slacker US demand (Chart 20, right). Robust investment and the impact of strong wage and employment growth on consumer spending, meanwhile, limits the downside risks for another key emerging market, India.

Chart 20

Prospects Still Look Decent in China



Japan's economy likely contracted in Q1. But that comes after Q4's outsized 3.5% annualized increase, leaving GDP on course for an 1.6% rise this year and an expected gain of just over 2% in 2009. As in China, domestic demand should provide a partial offset to external weakness. Housing construction was restrained by new tighter building standards in 2007 and should thus firm appreciably this year, in contrast to many other countries. Consumer spending has also shown a bit more strength than might be expected recently, rising by 1.1% in real terms in February after a 0.4% gain in January.

Euroland Holding Up Better than Expected

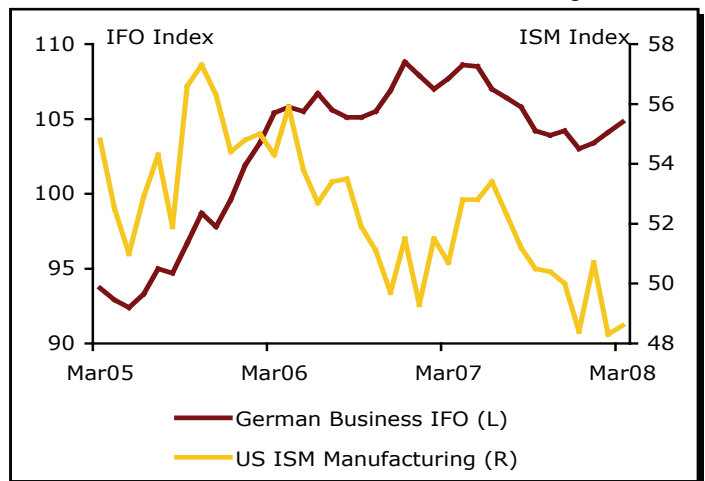
Falling home prices have accentuated pessimism in the UK. Prospects that slower growth will cool inflation have seen

the Bank of England back on the easing track in April, and we expect further modest cuts in coming months. That could place downward pressure on sterling.

In contrast, strengthening year-on-year production growth suggests Euroland is holding up better than expected, so far, to the challenges of a strong currency and slackening US demand. For a change, prospects look better in the core Euroland economies than the periphery. Germany, in particular, is well positioned to capitalize on stronger global infrastructure spending. Firms there have been adding jobs even as their US peers retrench, pointing to support for consumer spending, which ended 2007 on a soft note. Business confidence indicators show a similar divergence (Chart 21). While 2008 won't be a banner year for the Eurozone economies, a 1.7% rise in GDP should still modestly surpass consensus forecasts.

Chart 21

Business Sentiment Better in Germany Than US



Conflicts of Interest: CIBC World Markets' analysts and economists are compensated from revenues generated by various CIBC World Markets businesses, including CIBC World Markets' Investment Banking Department. CIBC World Markets may have a long or short position or deal as principal in the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. The reader should not rely solely on this report in evaluating whether or not to buy or sell the securities of the subject company.

Legal Matters: This report is issued and approved for distribution by (i) in Canada by CIBC World Markets Inc., a member of the IDA and CIPF, (ii) in the UK, CIBC World Markets plc, which is regulated by the FSA, and (iii) in Australia, CIBC World Markets Australia Limited, a member of the Australian Stock Exchange and regulated by the ASIC (collectively, "CIBC World Markets"). This report is distributed in the United States by CIBC World Markets Inc. and has not been reviewed or approved by CIBC World Markets Corp., a member of the New York Stock Exchange ("NYSE"), NASD and SIPC. This report is intended for distribution in the United States only to Major Institutional Investors (as such term is defined in SEC 15a-6 and Section 15 of the Securities Exchange Act of 1934, as amended) and is not intended for the use of any person or entity that is not a major institutional investor. Major Institutional Investors receiving this report should effect transactions in securities discussed in the report through CIBC World Markets Corp. This report is provided, for informational purposes only, to institutional investor and retail clients of CIBC World Markets in Canada, and does not constitute an offer or solicitation to buy or sell any securities discussed herein in any jurisdiction where such offer or solicitation would be prohibited. This document and any of the products and information contained herein are not intended for the use of private investors in the United Kingdom. Such investors will not be able to enter into agreements or purchase products mentioned herein from CIBC World Markets plc. The comments and views expressed in this document are meant for the general interests of clients of CIBC World Markets Australia Limited. This report does not take into account the investment objectives, financial situation or specific needs of any particular client of CIBC World Markets Inc. Before making an investment decision on the basis of any information contained in this report, the recipient should consider whether such information is appropriate given the recipient's particular investment needs, objectives and financial circumstances. CIBC World Markets Inc. suggests that, prior to acting on any information contained herein, you contact one of our client advisers in your jurisdiction to discuss your particular circumstances. Since the levels and bases of taxation can change, any reference in this report to the impact of taxation should not be construed as offering tax advice; as with any transaction having potential tax implications, clients should consult with their own tax advisors. Past performance is not a guarantee of future results.

The information and any statistical data contained herein were obtained from sources that we believe to be reliable, but we do not represent that they are accurate or complete, and they should not be relied upon as such. All estimates and opinions expressed herein constitute judgements as of the date of this report and are subject to change without notice. Although each company issuing this report is a wholly owned subsidiary of Canadian Imperial Bank of Commerce ("CIBC"), each is solely responsible for its contractual obligations and commitments, and any securities products offered or recommended to or purchased or sold in any client accounts (i) will not be insured by the Federal Deposit Insurance Corporation ("FDIC"), the Canada Deposit Insurance Corporation or other similar deposit insurance, (ii) will not be deposits or other obligations of CIBC, (iii) will not be endorsed or guaranteed by CIBC, and (iv) will be subject to investment risks, including possible loss of the principal invested. The CIBC trademark is used under license.

(c) 2008 CIBC World Markets Inc. All rights reserved. Unauthorized use, distribution, duplication or disclosure without the prior written permission of CIBC World Markets Inc. is prohibited by law and may result in prosecution.