

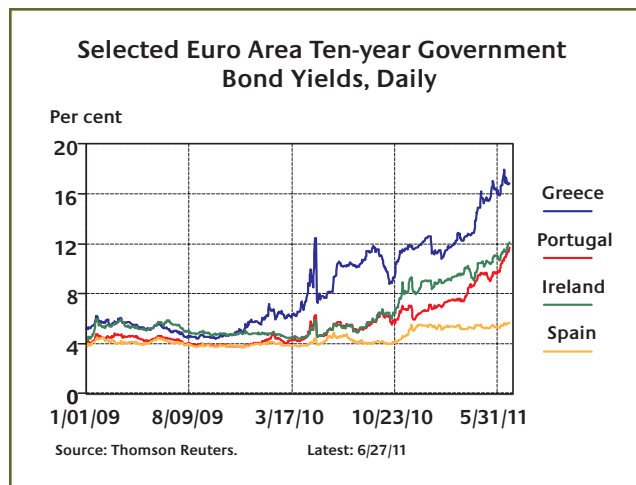
June was a fearful month for financial markets. Heightened concerns about Europe, a slowdown in emerging economies, Japan's fall into recession, tensions in North Africa and high oil prices, the ending of QE2, and a possible double-dip recession sent markets lower. In addition, worries around the U.S. debt ceiling came to the fore. Bond yields fell to their lowest point this year.

On the positive side, there were signs that the U.S. economy is poised for stronger growth with a number of forces behind the recent slowdown reversing, led by Japan returning to normal production. The rate outlook is little changed from last month with the first rate increase by the Bank of Canada slated for late October. The forecast risk remains on the downside and a later central bank move. Market volatility remains high.

Economy

The global economic growth slowdown phase is nearing an end, likely in the second quarter, and set to post higher growth rates in the second half of 2011. This growth pickup will also be temporary as some of the transitory factors fade. The recent pullback in oil prices bodes well for a global growth revival as does lower agricultural prices due to improved harvests this year. Japan's supply-chain disruptions are lessening and another band-aid for the Greece sovereign debt problem buys more time and relieves some market stresses.

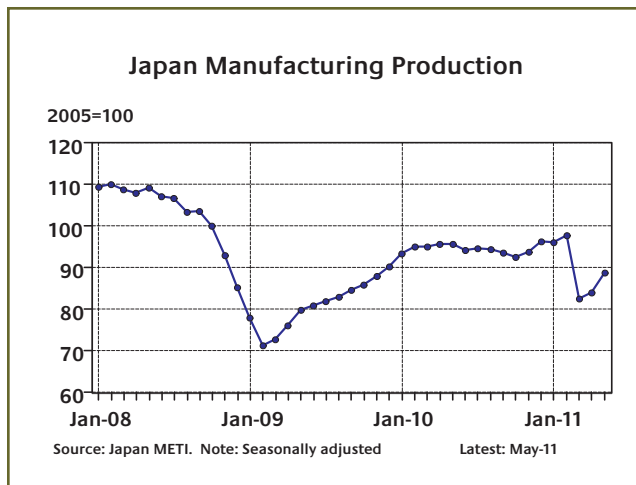
Substantial economic problems and issues remain a backdrop to global growth. A sub-par U.S. economic recovery due to a depressed housing market, high unemployment, and high debt levels; sovereign debt and banking problems in Europe; and high inflation in the emerging economies prompting further tightening by those policymakers are headwinds. The global and U.S. economic recoveries will remain sub-par for another two to four years but with considerable growth variations from inventory adjustments, financial market volatility, and unforeseen political and natural events.



Greece's sovereign debt was in the spotlight this month. EU leaders signed off on the agreement that private sector participation in the financing of Greece would be voluntary and be structured to avoid a selective default. German banks joined French banks to roll over their existing Greek bonds as they mature. An austerity package was approved at month-end, clearing the way for approval of the loan at the July 3 EU meeting. However, doubts continue about whether policymakers will be able to devise a plan to fund Greece through next year that does not trigger a default under CDS contracts or in the views of ratings agencies. S&P issued a warning that Greece would be considered in default if banks rolled over their holdings as proposed.

The Greek drama continues and its problems are far from over. A high debt load and more bond redemptions with an economy recession and poor growth prospects is a bleak fiscal situation. Until Greece's problems are resolved, markets will remain unsettled with a high fear of financial contagion.

Manufacturing production in Japan started to bounce back with industrial output up 5.7% in May, after April's 1.6% rise. Producers also forecast strong increases in June and July, which points to growth momentum in global manufacturing during the second half. Higher production in Japan eases constraints in several Asian economies and in North America as well.



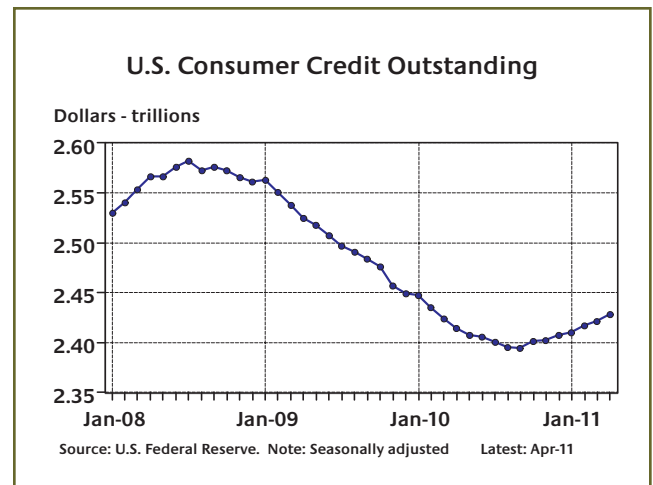
Rising inflation and high growth rates in emerging economies, notably China, has spurred policymakers to raising interest rates, tightening credit availability, and gradual currency appreciation. More monetary tightening and administrative measures are expected in the second half of 2011 but progress on this front and some relief from recent energy and food price highs will see inflation slow. A pause in policy tightening is likely in 2012 allowing economic growth to climb back to its high potential rate.

Jobs and output lost because of the Japanese supply disruptions and high energy prices will return in the second half of 2011, allowing real U.S. GDP growth to reaccelerate to a near 4% annualized pace by year's end.

U.S. industrial production rose by 0.1% in May, including a 0.4% rise in manufacturing output. Auto output fell only modestly as Japan-related supply chain disruptions diminished during the month, which should begin contributing positively to factory growth in June. The inventory build-up when consumers pulled back is causing businesses to slow the pace of production.

The ISM manufacturing reading was up in June and supports view that the weakness in the recovery is temporary. The easing of Japanese supply chain disruptions likely contributed to some of the improvement in manufacturing conditions in June. However, since auto manufacturing makes up a relatively small share of the industry, the broader improvement in manufacturing is sends a more positive signal.

The durability of the coming auto-driven rebound in manufacturing hinges on stronger consumer demand and not a temporary lift from lost supply-chain output or inventory re-stocking. Hence, when supplies of



vehicles become more abundant later this year, sales should rebound. Nondurable goods spending also fell, although not as sharply, as consumers responded to high prices.

Consumers need more income to increase their spending and more income depends on more hiring and jobs. Nonfarm employment increased only 54,000 in May following average gains of more than 200,000 over the prior three months. This will change with an unwinding of some temporary factors, including a return to normal weather conditions. The improving trend in jobless claims since mid-May offers some hope.

A developing positive sign for consumer spending is rising consumer credit. Consumer credit outstanding is up in the last seven months ending April reflecting both improved consumer spending and easier financial conditions from healthier banks.

The Conference Board index of leading indicators rose 0.8% in May more than reversing April's decline. However, the Weekly Leading Index from the Economic Cycle Research Institute continues to slow and while not flashing a recession is sending a conflicting signal. This highlights the possibility that the economy could remain in the slowdown longer than envisioned.

Forecast U.S. 2Q-2011 GDP growth is 2.5% to 3.0% annualized, up from 1.9% in Q1-2011. Economic growth will accelerate to about 3.5% in Q3-2011 with a ramp up in auto production and a boost from lower energy prices assisting consumer spending. Exports remain a source of growth while government spending becomes an increasing drag in 2012 and beyond. The U.S. economy will expand about 2.5% to 3.0% for all of 2011 and 3.0% to 3.5% in 2012.

Canada's economy is following the U.S. into its own slowdown for many of the same reasons and will follow the U.S. economy into a higher growth phase later this year and into 2012.

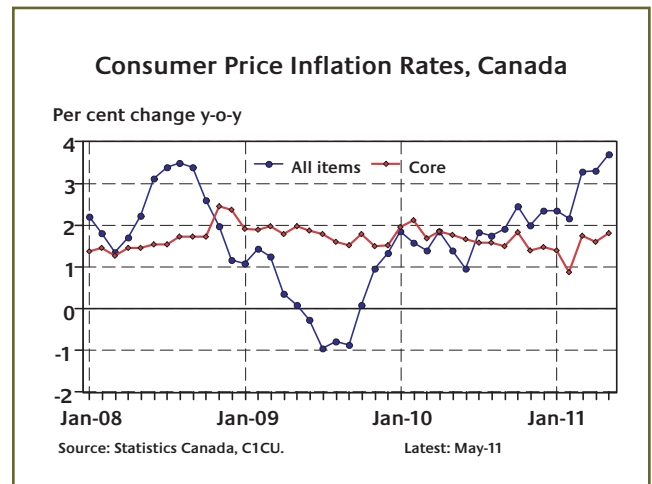
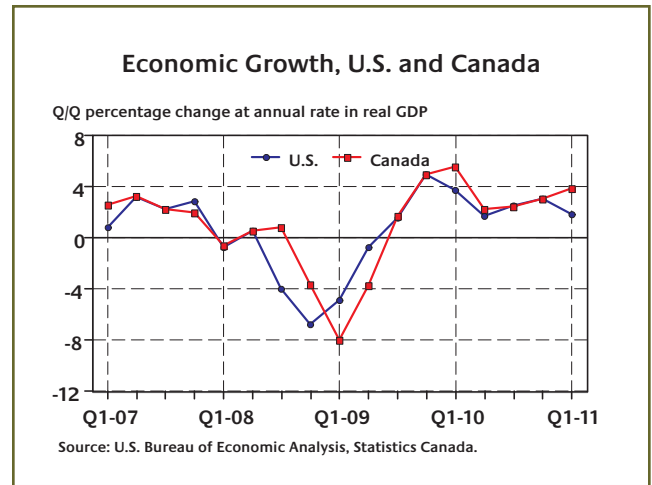
Most recent economic indicators are weaker than in the previous month. Employment rose by 22,000 in May, down from 58,000 in April. The unemployment rate fell to 7.4% in May, from 7.6% in April but largely attributable to a contraction in the labour force. Merchandise exports fell 1.9% with a 1.1% decrease in volume led by the machinery and equipment sector. Residential building permits fell 31% from March while non-residential permit issuance fell 11% in the commercial component and a 63% in the institutional component.

Housing sales slipped further in May though by a smaller margin than in April and the same performance is expected for June sales. The impact of the March 18 tightening to federal mortgage insurance rules will have a lessening impact on trend changes as it becomes entrenched in the marketplace. Recent mortgage rate cuts should provide a modest lift to the sales trend in the near future.

Retail sales rose 0.3% in April after falling 0.1% in March but excluding motor vehicle and parts dealers, retail sales were flat.

An increase in the leading index in May supports the view that the recovery will pick up steam in the second half of 2011. The strong 1.0% increase in May on top of a 0.9% rise in April with nine of the 10 components gaining is a positive sign. The manufacturing sector showed the largest improvement from the previous month while the indicators related to household spending remained mixed.

Canada's real GDP growth in 2011 is 2.8% compared to 3.2% in 2010. The 2012 outlook sees a drag from the government sector with some growth from consumer and business investment spending. The higher 2012 growth forecast at around 3% is an outlier to the consensus view of a slower growth rate of about 0.2 to 0.3 percentage points than in 2011. However, the Canadian consensus forecast for the U.S. is higher 2012 growth than in 2011 but does not translate into higher 2012 growth for Canada despite their close relationship.



Inflation

Year-over-year consumer prices advanced 3.7%, from 3.3% in April, the fastest pace since March 2003. Higher prices for gasoline are responsible for much of the higher May inflation. The 12-month rate of core inflation rose to 1.8%, from 1.6%.

The headline inflation rate raised some eyebrows but knowing that gasoline and some agricultural product prices are declining combined the HST impact from Ontario and B.C. dropping out of the calculation in July points to the headline rate falling below 3% in the near term. Core inflation remains in the lower half of the Bank of Canada's targeted inflation range and is the Bank of Canada's operational guide to monetary settings.

Interest rates

Interest rates are past their lows for this slowdown. Bond yields climbed sharply at month-end on news of the Greek debt austerity measures passing its

parliament. The market is adjusting to the view that growth will be higher in the coming months as well. Clearly several bumps in the road will send bond markets in reverse at times but positive macro growth forces coming out of the slowdown will drive yields higher.

Bond yields in June fell to their lowest point since late 2010 when the market was reacting to another economic growth soft patch and concerns over European banks. Posted mortgage rates were reduced in early June. Ebbs and flows in economic growth will be joined by other developments in European banks or sovereign debt or Middle East political events, or natural disasters making for ongoing volatility and substantial bond yield swings.

Monetary policy

The Federal Reserve's so-called QE2 ends June 30 after \$600 billion in Treasury-bond purchases since last October with the goal to lower mortgage rates and bond yields thereby encouraging investment, increasing confidence and spending. Its effectiveness will be debated for many months, if not years.

The end of QE2 means the private sector will have to buy more government bonds and that will take higher yields to make them attractive. However, the Fed will continue to buy Treasuries with the repayments on the remaining mortgage-backed and Treasury debt it owns.

The FOMC announced no changes to monetary policy at its June meeting but downgraded its economic outlook from mid-April.

There was no rate announcement by the Bank of Canada in June nor was there any hint of a change to monetary settings in a speech delivered by the Governor or Deputy Governors.

Interest rate forecast

No major change to this month's rate forecast. The next rate increase by the Bank of Canada remains at its October 25 meeting. The overall increase in rates during the next eight quarters is mild with another pause along the way when the next growth slowdown occurs.

The futures market for three-month Bankers Acceptances is assigning a higher probability of a rate

increase than only one week ago and is giving a 100% probability of a 25 basis point increase by December. The odds of a rate increase in October are up to 80% versus 50% last month. By the end of March 2013, the market puts short rates about 100 bps higher while this forecast puts it at 200 bps.

The next bump in the road is the U.S. debt ceiling deadline of August 2. If the ceiling is not raised the U.S. government can no longer borrow funds and may not be able to pay some of its bills. The consequences would be wide-ranging putting markets in turmoil and sending the U.S. dollar lower. The economic outlook would turn negative taking some pressure off bond yields but the risk or uncertainty premium would remain high. Standard & Poor's has said it would lower the U.S. credit rating from AAA to D — its lowest rating — if there is no debt ceiling deal.

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Target Overnight Rate Forecast

Meeting Date	Rate (%)
May 31 (a)	1.00
July 19	1.00
Sept. 7	1.00
Oct. 25	1.25
Dec. 6	1.50
Jan. 2012	1.75
Mar.	2.00
Apr.	2.00
June	2.00
July	2.25
Sept.	2.50
Oct.	2.50
Dec.	2.50
Jan. 2013	2.75
Mar.	3.00
(a) actual	

Interest Rate Forecast

Item	2011 Q1a	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1
Target Overnight Rate	1.00	1.00	1.00	1.25	1.75	2.00	2.25	2.50	2.75
Prime Rate	3.00	3.00	3.00	3.25	3.75	4.00	4.25	4.50	4.75
1-mo. T-Bill	0.89	0.90	0.90	1.15	1.55	1.85	2.10	2.35	2.65
3-mo. T-Bill	0.95	0.95	0.95	1.30	1.70	2.00	2.25	2.40	2.75
6-mo. T-Bill	1.09	1.05	1.10	1.45	1.85	2.10	2.40	2.55	2.90
1-year T-Bill	1.36	1.30	1.30	1.65	2.10	2.30	2.65	2.75	3.10
2-year GoC Bond	1.77	1.65	1.60	1.85	2.25	2.40	2.75	2.85	3.20
3-year GoC Bond	2.05	1.95	1.90	2.20	2.55	2.70	3.05	3.15	3.55
5-year GoC Bond	2.62	2.45	2.40	2.65	2.95	3.05	3.40	3.45	3.85
10-year GoC Bond	3.31	3.15	3.15	3.35	3.70	3.80	4.15	4.10	4.55

Note: Quarterly average based on daily data. a = actual, all others forecast.

Deposit Rate Forecast

Item	2011 Q1a	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1
1-year GIC	1.15	1.10	1.00	1.15	1.40	1.45	1.65	1.75	2.00
3-year GIC	1.43	1.45	1.45	1.65	1.80	1.85	2.05	2.05	2.35
5-year GIC	1.98	2.00	2.00	2.15	2.25	2.25	2.40	2.40	2.75

Note: Quarterly average based on weekly data. a = actual, all others forecast. Redeemable rates.

Mortgage Rate Forecast

Item	2011 Q1a	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1
1-year Mortgage	3.42	3.65	3.55	3.85	4.25	4.35	4.70	4.75	5.05
3-year Mortgage	4.25	4.45	4.40	4.60	4.85	5.00	5.30	5.35	5.75
5-year Mortgage	5.32	5.60	5.45	5.65	5.90	5.95	6.15	6.15	6.35

Note: Quarterly average based on weekly data. a = actual, all others forecast. Posted fixed term rates.