



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

"As more and more of ... the developing world achieves 'first world' standards of consumption, you can throw all previous benchmarks between the US economy and past commodity cycles out the window."

Out the Window

by Jeff Rubin

With the excess inventory of unsold new and existing homes in the US now equal to a full year's supply of housing starts, housing prices still have a long way to go down, and default rates on subprime mortgages still have a long way to go up.

Monetary and fiscal policy may ease the reset shock, but even at the old teaser rates growing negative home equity will see many mortgagees mailing in the keys. When the dust settles sometime early next year, a 20% decline in US housing prices and a 30% default rate on subprime mortgages will define, by far and away, the steepest US post-war housing correction on record (see pages 4-7).

But where we go from there is far from clear. Whether the US housing market leads to a full-blown recession or our forecast of three essentially flat quarters will depend largely on what happens outside of the housing market. Much will rest on how effectively the Federal Reserve Board can offset "mean reversion" in credit markets by bringing down its own benchmark borrowing rate. A 2% federal funds rate seems in the cards, with rate cuts now being spooled out in 50 basis point doses. But, whatever the final outcome for US GDP growth, what's remarkable is how little difference it makes to world resource markets.

As the focal point of world economic growth continues to shift dramatically from the US to rapidly developing economies overseas and to cash-rich oil producers, investors should follow suit. World resource markets not only

are a safe harbour against the financial fallout of the imploding US subprime mortgage market, but more importantly, provide the greatest opportunities for future growth.

China and the other emerging Asian economies hardly noticed the 2001 US recession (see pages 10-11) and that was still when exports to the American market accounted for 21% of the region's total. After a five-percentage-point drop in export share since then, chances are that the region won't notice this US downturn either. Ditto for Europe and Latin America, where the US market has similarly shrunk as a percentage of total exports. Even in Canada—the United States' largest trading partner—the economic impact has been muted by the enormous resource rents that now fuel domestic spending.

From exploding car ownership rates in Russia, to the construction boom in the Gulf States, and growing demand for protein in Chinese diets, the world has never been hungrier for resources. From oil, to base metals, and grain prices, commodity prices sit at, or near, record highs. There are ten consumers in Brazil, Russia, India and China to take the place of every American one who stops shopping because of home equity woes.

As more and more of what used to be called the developing world achieves 'first world' standards of consumption, you can throw all previous benchmarks between the US economy and past commodity cycles out the window.

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

MARKET CALL

- Whether in recession or just a hair away, the US economy and its financial system need more help. We've lowered our fed funds target by a half-point to 2.0%, with Bernanke forced to ignore inflation readings for the time being. The steepening trade in the bond market may soon have run its course, and we look for Treasuries to gain a bid as investors looking at the mess in credit markets price in a longer sojourn at very low short-term yields.
- The incoming Governor of the Bank of Canada will pick up where his predecessor left off, and the recent cooling in core CPI, coupled with a plunge in exports, opens up room for a more aggressive easing posture. A 50-bp rate cut in March seems more likely than a quarter-point trimming, and either way overnight rates should reach 3% in the second quarter.
- With overnight spreads vs. the US holding at 100 bps, the Canadian dollar is likely to tread water over the first half of the year. The trade balance could improve in nominal terms, even in the face of soft real exports, as Q1 gains in commodity prices boost nominal exports. Improving US growth in the second half and a resulting lift to Canadian real exports should see the C\$ reach US\$1.05 by year-end.

INTEREST & FOREIGN EXCHANGE RATES

END OF PERIOD:	2008				
	20-Feb	Mar	Jun	Sep	Dec
CDA Overnight target rate	4.00	3.50	3.00	3.00	3.00
98-Day Treasury Bills	3.26	3.20	2.85	2.95	3.05
Chartered Bank Prime	5.75	5.25	4.75	4.75	4.75
2-Year Gov't Bond (4.25% 12/09)	3.16	2.85	2.80	3.10	3.25
10-Year Gov't Bond (4% 06/17)	3.94	3.80	3.60	3.70	3.95
30-Year Gov't Bond (5% 06/37)	4.26	4.15	3.95	4.00	4.10
U.S. Federal Funds Target	3.00	2.50	2.00	2.00	2.00
91-Day Treasury Bills	2.19	2.00	1.85	1.90	1.95
2-Year Gov't Note (2.125% 1/10)	2.14	2.00	1.95	2.15	2.50
10-Year Gov't Note (3.5% 02/18)	3.90	3.80	3.50	3.65	4.05
30-Year Gov't Bond (4.375% 02/38)	4.62	4.55	4.30	4.55	4.70
Canada - US T-Bill Spread	1.07	1.20	1.00	1.05	1.10
Canada - US 10-Year Bond Spread	0.04	0.00	0.10	0.05	-0.10
Canada Yield Curve (30-Year — 2-Year)	1.10	1.30	1.15	0.90	0.85
US Yield Curve (30-Year — 2-Year)	2.48	2.55	2.35	2.40	2.20
EXCHANGE RATES					
— (US¢/C\$)	98.7	101.0	101.5	104.7	105.0
— (C\$/US\$)	1.013	0.990	0.985	0.955	0.952
— (Yen/US\$)	108	106	109	110	107
— (US\$/euro)	1.47	1.49	1.45	1.43	1.40
— (US\$/pound)	1.94	1.92	1.91	1.91	1.89
— (US¢/A\$)	91.8	92.5	93.0	88.0	86.0

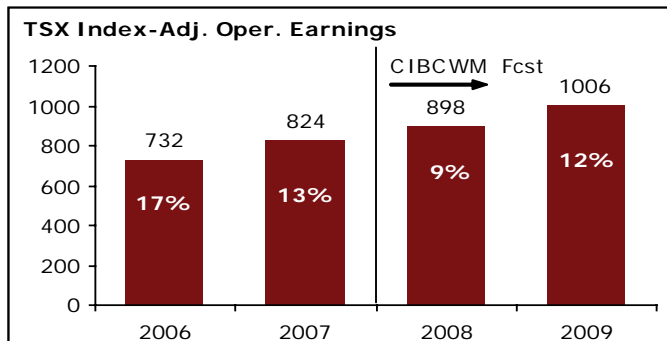
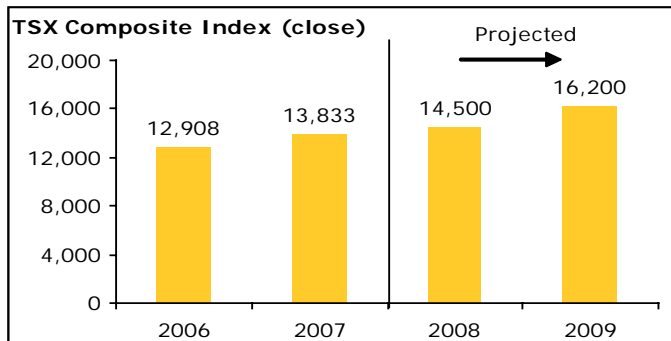
STRATEGY AND EARNINGS OUTLOOK

- The Société Générale-triggered equity selloff may have been a head-fake but the imploding US housing market is not. We reduced our weighting in equities to market weight in view of near-term weakness in the US economy and further asset writedowns linked to the US subprime mortgage market.
- In addition, we cut our weightings in banks and telecoms by a half-percentage point each, adding a percentage point of weighting to the high-yielding and relatively low risk utilities sector.
- We now see the Bank of Canada cutting its overnight target rate to 3%, creating 30-40 basis points of rally room at the long end of the Government of Canada yield curve, even with further curve steepening. Accordingly we added 9%-points of weight to our fixed income portfolio.
- The energy and resource side of the stock market provides the best protection against both the subprime mortgage market and North American economic weakness in the short run, and the best growth opportunities past mid-year. The advent of triple-digit oil prices, US\$1,000 per ounce gold, and continued strength in base metals prices should support a 14,500 TSX by year-end and 16,200 by 2009.

ASSET MIX (%)	Benchmark	Strategy Recommendation
Stocks	56	56
Bonds	38	42
Cash	6	2
GICS SECTOR EQUITIES (%)		
Consumer Discretionary	4.7	2.2
Consumer Staples	2.4	2.9
Energy	27.3	31.3
Financials	29.8	28.3
-Banks	16.5	15.0
-Insur., REITs, oth.	13.2	13.2
Healthcare	0.5	0.5
Industrials	5.4	3.4
Info Tech	4.7	3.7
Materials	18.4	20.4
-Gold	8.7	9.7
-Other Metals	4.8	5.8
Telecom	5.1	3.6
Utilities	1.6	3.6

Note: Bold indicates recommended overweight.

TSX - Earnings Outlook & Forward PE						
	Operating Earnings (% ch)				4-qtr Fwd PE	
	2005	2006	2007	2008	Latest	Last 10 yrs.
Energy	1.4	-2.5	9.9	9.9	12.2	17.0
Materials	32.5	89.8	3.1	12.2	22.1	27.5
Industrials	54.5	10.8	9.9	13.8	14.2	13.0
Consumer Discretionary	10.4	15.2	29.3	8.0	16.5	13.9
Consumer Staples	5.7	7.6	15.7	-3.0	14.4	18.6
Health Care	1.4	10.4	-35.4	-12.8	15.3	49.7
Financials	12.8	17.3	14.4	4.5	11.2	10.9
Info Tech	260.9	-47.6	25.2	19.1	23.1	32.3
Telecom Svcs	31.1	7.5	14.2	12.2	8.2	13.0
Utilities	18.7	12.2	-10.0	-10.0	14.5	15.6
TSX Composite	31.2	17.4	12.5	9.0	14.1	17.9



Half-Way Through

Benjamin Tal

The subprime mortgage default swap market may be pricing in a darker picture than the one likely to emerge, but that will not help the valuations of American financial institutions in the coming months. An unprecedented drop in house prices and the resulting surge in negative equity positions will continue to put upward pressure on default rates. When all is said and done, mortgage-related writedowns will reach the US\$300 billion mark. But as opposed to the first wave, the next US\$150 billion of global writedowns will be led by insurance companies and numerous smaller players such as regional banks. This lack of concentration should ease the pain.

House Prices Will Fall by 20% From Late-2006 Peak

We are in the midst of the worst US housing meltdown in the post-war era. Home sales are already down by 30% from their recent peak—the fastest pace of decline seen in any previous housing downturn. And the 50% drop in housing starts to date is already in line with the entire decline seen in the early-1980s housing market correction (Chart 1).

But for this cycle, the bottom is not yet in sight, despite the dramatic slowing in the pace of home construction. The excess number of unsold new and existing homes, based on their typical ratio to the total stock of homes, has now reached the one million mark. To put that in perspective, that represents a full year of construction by the US housing industry (Chart 2).

Chart 1
An Unprecedented US Housing Downturn is Unfolding

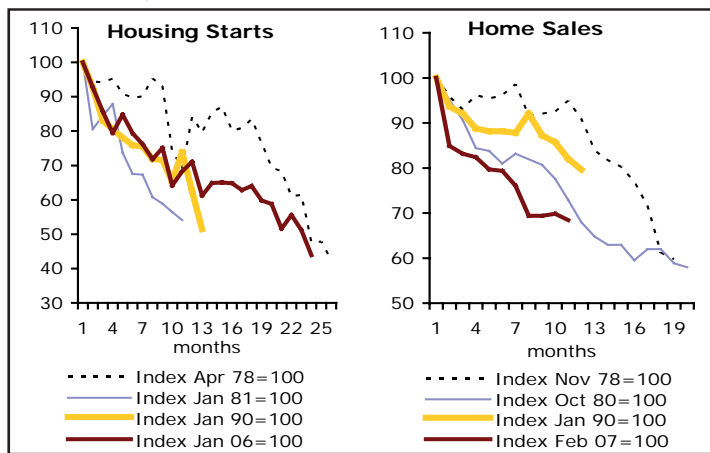
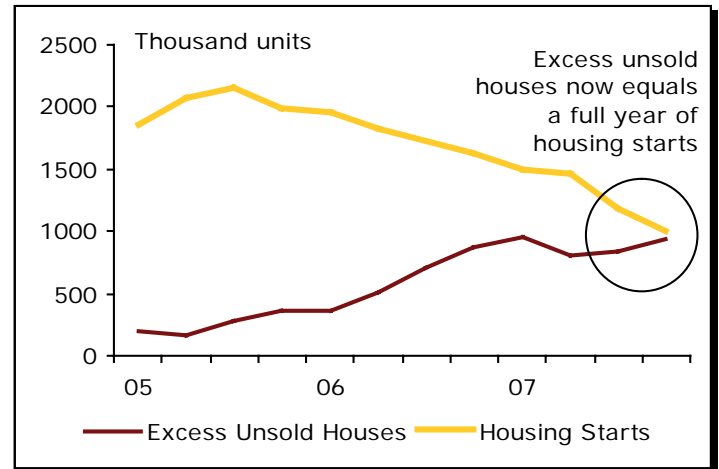


Chart 2
Level of Housing Starts Still Much Too High



What really counts for markets is not the actual level of activity in the housing market, but what it will do to home valuations. Already down by more than 8%, the Case-Shiller House Price Index (CSI) will continue its descent in the coming quarters. Evaluated against benchmarks such as household income (Chart 3), and based on mean revision estimates of some key house price drivers such as inventories, rent and average user cost, we project that by the end of 2008, house prices will be roughly 20% lower than their late-2006 peak, and 12% lower than their current level.

Chart 3
House Prices Overshot Income Growth by a Wide Margin

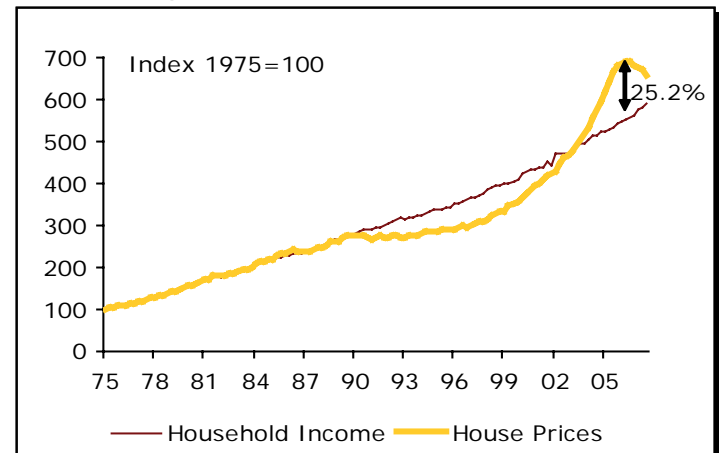
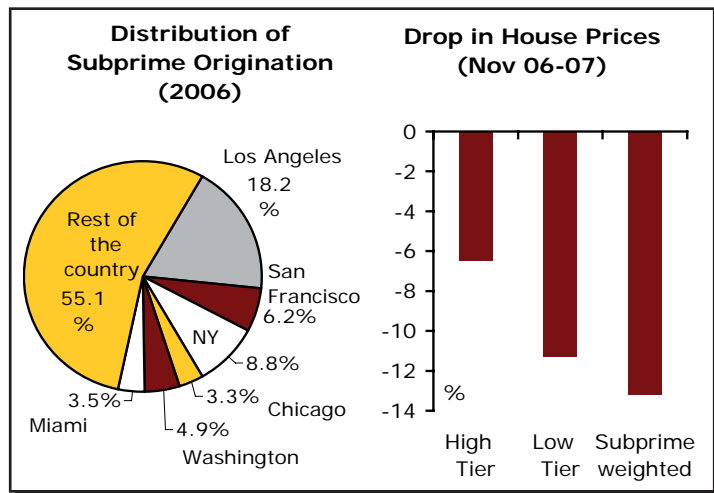


Chart 4

Subprime Exposure is Asymmetrical



Source: Loan Performance, S&P/ICSI, CIBCWM

And the price decline at the low end of the market will be even steeper. The CSI index for low-tier houses (the lowest third in the price spectrum) is already down by more than 11% from its peak vs. only a 6% drop in the high-tier segment of the market. And with the average value of a subprime property at less than US\$250,000, the values of subprime houses are falling fast. Our subprime-weighted CSI (based on the geographical distribution of subprime exposures) is already down by close to 13% (Chart 4), and might fall by a cumulative 30% when all is said and done.

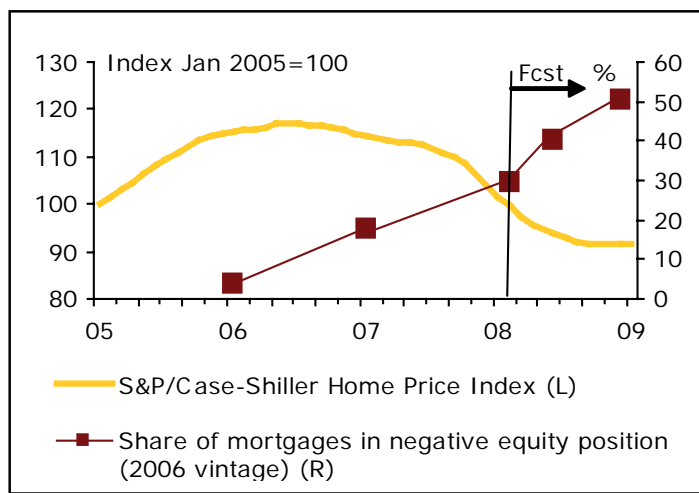
Negative Equity

With every dollar drop in the value of their houses, more and more Americans find themselves in a negative equity position. Zooming in on the 2006 vintage, no less than 30% of households who bought a house in that year are already in a negative equity position. And by the end of the year, with house prices dropping by an additional 10-12%, close to 50% of households in this vintage will find that their mortgages are larger than the value of their houses (Chart 5).

So, negative equity is emerging as a dominant factor behind the current surge in mortgage default rates. If, in 2007, the reset shock (the adjustment of mortgage rates from introductory teaser rates to market rates) was the main driver of delinquencies, that is not the case for 2008. The reason is that the most aggressive Fed easing on record is working to substantially close the gap between the market rate and the teaser rate—single-

Chart 5

Falling House Prices... Rising Negative Equity



Source: First American CoreLogic, CIBCWM

handedly eliminating most of any reset-related pain for this year (Chart 6).

But with rapidly rising negative equity positions, along with the fact that 2006 and 2007 were the most lax mortgage underwriting vintages on record, one doesn't need a reset shock to see a surge in default rates. As illustrated in Chart 7, the pre-reset 60+ day delinquency rate for the 2006 vintage is already higher than the post-reset default rate of any previous vintages. At close to 30%, the delinquency rate for this vintage continues to climb and is likely to reach 40% by year-end. The performance of the 2007 vintage is even worse, with the steepest delinquency curve of any other vintages. The only consolation is that the dollar value of subprime

Chart 6

Reset is No Longer The Issue

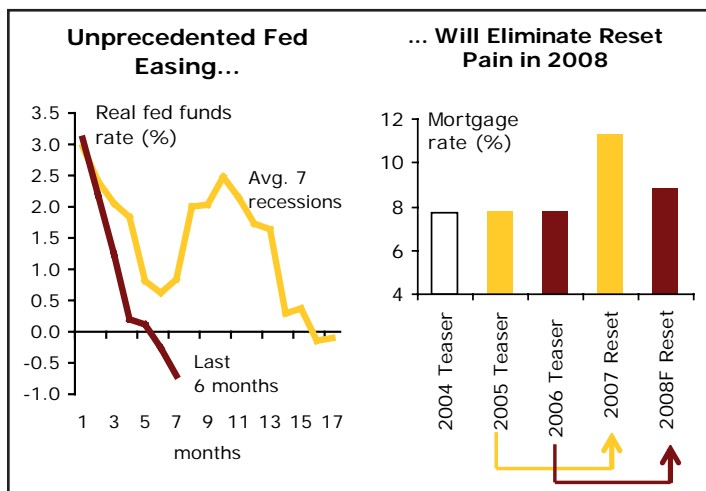
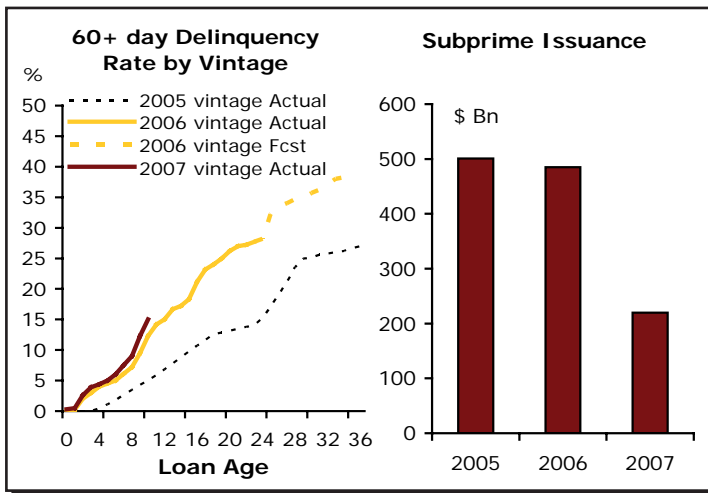


Chart 7
2006 & 2007 — The Worst Vintages on Record

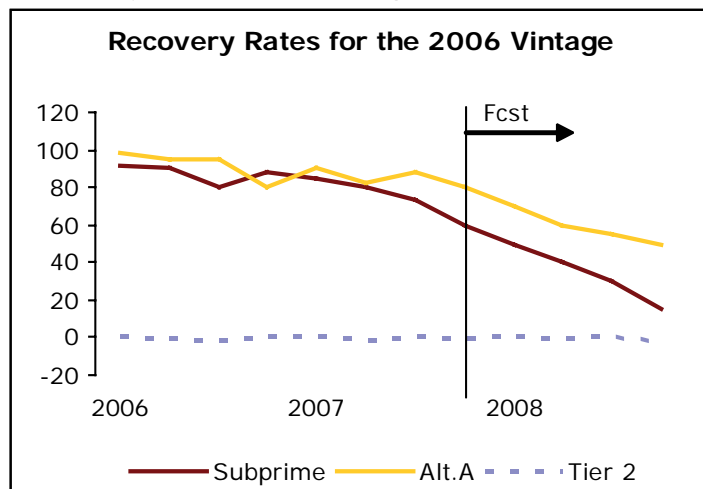


Source: Loan Performance, CIBCWM

issuance in 2007 was less than half the size seen in 2005 and 2006.

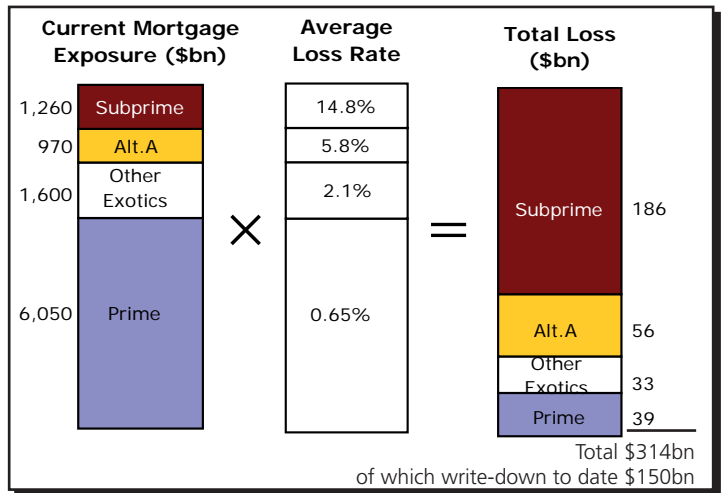
Not only are falling house prices pushing more borrowers into default, but they are also working to lower the amount lenders can recover following the sale of the property. For the 2006 vintage, the recovery rate on subprime mortgages is likely to fall to an unprecedented low of 30% (Chart 8). For Alt-A mortgages (mostly loan with insufficient documentation), which are already experiencing a record high 13% 60+ day delinquency rate, lenders are likely to get only 60 cents on each defaulted dollar. And while the recovery rate on Second Tier mortgages was always around zero, their dollar outstanding has risen dramatically in the past two years.

Chart 8
Recovery Rates Are Falling Fast



Source: Loan Performance, Citi, CIBCWM

Chart 9
The Bottom Line

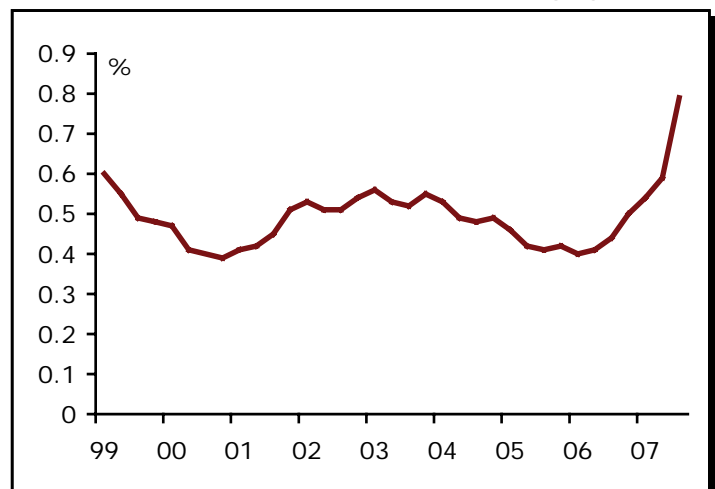


Source: Loan Performance, Mortgage Bankers Association, CIBCWM

Writedowns—How Much? And Who is Holding the Bag?

With total subprime exposure at close to US\$1.3 trillion and a weighted average loss rate of just under 15%, we project that total cumulative subprime related losses will reach US\$186 billion (Chart 9)—of which more than 90% are concentrated in the vintage years of 2005-2007. But the story goes beyond subprime. Alt-A mortgages, which have seen their share in total mortgage originations rising quickly in the past few years, will add an additional US\$56 billion to the loss tally. And even prime mortgages, where foreclosure rates are already 60% higher than the rates seen in the 2001 recession, will add to the pain (Chart 10). Sum it all up and you get a projected total

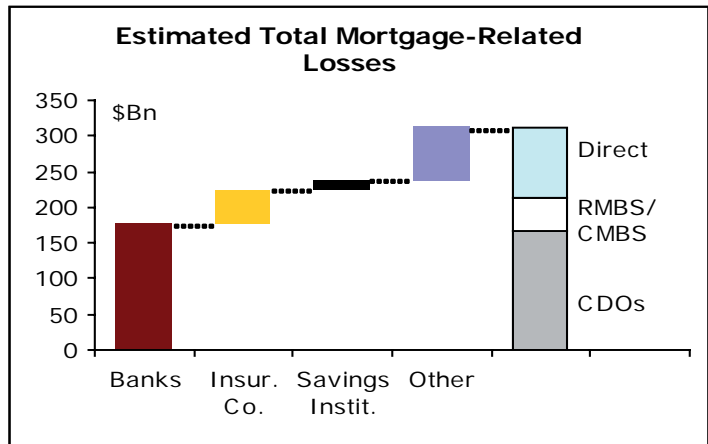
Chart 10
Foreclosure Rates on US Prime Mortgages



6 Source: Mortgage Bankers Association

Chart 11

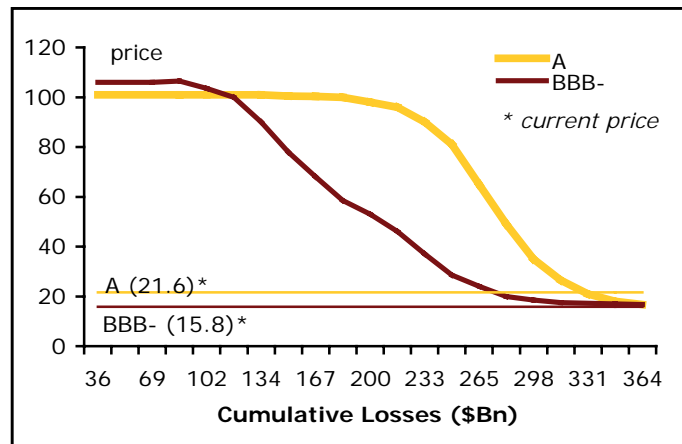
Who is Losing?



Source: Loan Performance, Mortgage Bankers Association, Goldman Sachs, CIBCWM

Chart 12

Performance Profile (Avg ABX 2005-2007)



CIBCWM calculations based on MARKIT, Barclays Capital, Credit Suisse and Andrew Davidson & Co

mortgage market-related loss of close to US\$315 billion. With global financial institutions writing down roughly US\$150 billion of mortgage-related losses to date, we are half-way through.

Where will the next wave of losses come from? Banks and brokers will end up assuming more than half of total mortgage-related losses (Chart 11). But this group has been aggressive in writing down assets against those losses. With total cumulative writedowns of close to US\$135 billion to date, banks and brokers have already recognized more than three-quarters of their total projected losses. However, insurance companies, which will end up losing roughly US\$50 billion on their mortgage exposure, have recognized to date only a fraction of that loss. Ditto for savings institutions and other players such as pension funds.

Also note that the lion's share of the losses recognized to date were by large household-name banks, and most of these writedowns were on their CDO exposures, which account for roughly 50% of total projected losses (take another look at Chart 11). And with the ABX index currently pricing in the equivalent of close to US\$330 billion in losses on subprime paper alone (Chart 12)—well above our US\$186 billion estimate for the subprime

component—banks, which have been forced to mark to the ABX, may eventually benefit from write-backs if the index recovers and they continue to hold their positions.

Although there are also concerns regarding leveraged loans, falling home prices and worsening mortgage credit conditions will remain the dominant themes for US financials in the coming quarters. Niche players in commercial real estate and consumer credit will see their valuations damaged even further, as losses on these products are rising fast.

But with most of the focus still on the residential mortgage market, once the bulk of the next US\$150 billion has been written down, markets will begin to sense the end of these troubles. And the distribution of those losses will be different than what we have seen to date. Large banks will play a secondary role in recognizing losses in the coming quarters, with smaller regional banks as well as insurance companies and other players taking over as the leaders in the writedown parade. This lack of concentration suggests that while the total amount of losses yet to be recognized is as large as the amount written down to date, the ultimate impact on the market will not be as severe.

Provincial Outlook: Where the Punches Fall

Avery Shenfeld

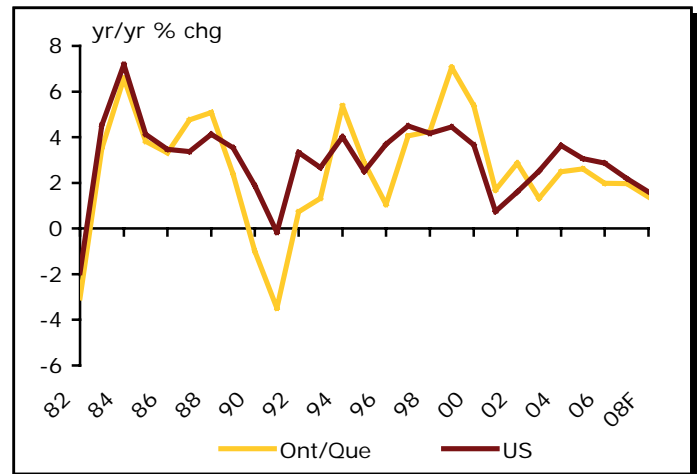
Canada's growth outlook has dimmed somewhat since our last *Provincial Outlook*, issued back in October 2007. Domestic demand has held up well, and employment has rocketed ahead, but downside risks from a US stall have seen us trim our national 2008 real GDP forecast by nearly a point, from 2.8% to 2.0%. That middling pace will mask tougher times in industries and regions bearing the brunt of the US exposure.

Central Canada has a disproportionate stake in the country's manufacturing sector, and historically its GDP has moved more closely to the beat of the US economy than other regions (Chart 1). Together, they haven't diverged much from the US directionally, underperforming the American economy in the 1990 recession when the C\$ was strong, but outperforming in 2001 when the C\$ was weak (Chart 2). Ontario's job growth has held up well in the past year, but we could be at the tipping point for currency-challenged manufacturers, with the province's companies reporting the most gloomy outlook for factory output in the latest Statistics Canada survey. Both Ontario and Québec could see a soft first-half in 2008 that will hold annual growth to the 1½% range (Table 1).

West remains best when it comes to economic growth prospects for 2008. The only major constraint on another banner year is that the four western-most provinces are, as a group, essentially at full employment

Chart 2

Central Canadian and US Real GDP



(Chart 3), leaving output gains driven by in-migration and productivity. Job prospects have encouraged population inflows, which we expect to continue in 2008, helped by improved housing availability in some cities that had earlier seen builders falling behind demand.

Productivity should also boost western growth in the coming years, as major oil and mining projects come onstream, in essence bearing the fruit of earlier hours worked. Alberta's growth in 2007 was held back a bit due

Chart 1

Central Canada Most Tied to US

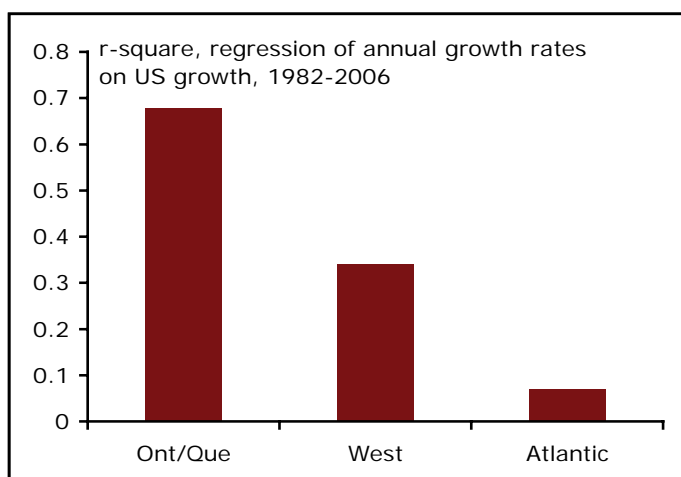


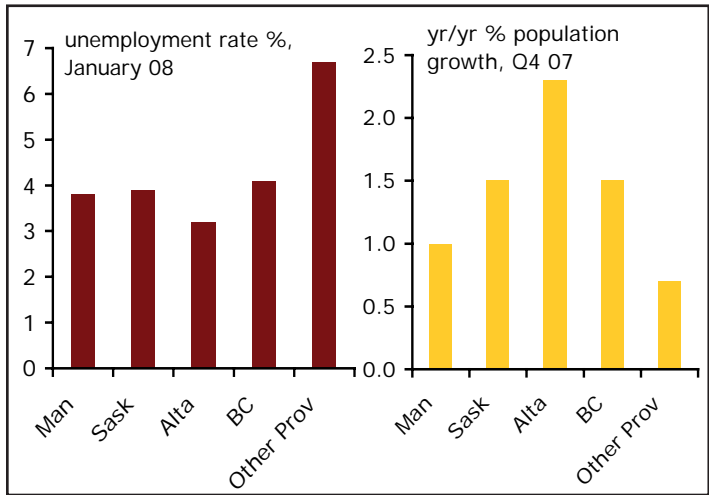
Table 1

Provincial Real GDP Forecast

Y/Y % Chg	06A	07F	08F
British Columbia	3.3	3.3	3.3
Alberta	6.6	3.8	3.5
Saskatchewan	-0.4	4.2	4.0
Manitoba	3.2	2.9	2.4
Ontario	2.1	2.0	1.3
Québec	1.7	1.9	1.6
New Brunswick	3.0	2.3	1.9
Nova Scotia	0.9	1.8	2.1
Prince Edward Island	2.6	1.7	1.8
Newfoundland & Lab.	3.3	8.3	1.2
Canada	2.8	2.5	2.0

Chart 3

West's Tight Job Market and Population Boom



to a less favourable climate for natural gas, but firming prices and some adjustments to the new royalty regime should be more supportive in 2008. Saskatchewan's building boom, its resource base, and the impact of climbing crop prices on both the farming and fertilizer sectors, position it for solid 2008 growth, particularly if crop volumes improve on a flat, below-forecast result for 2007.

Manitoba's mixed economy leaves it with an exposure to manufacturing, but recent indicators point to greater resiliency in the province's factory sector than we are seeing nationally. Local firms were decidedly optimistic about first-quarter output prospects, which could reflect the province's smaller share of exports that are US-bound as compared to Ontario. Our outlook for Atlantic Canada is only marginally weaker than our October forecast. Newfoundland and Labrador will return to less spectacular growth after one-time resource output gains boosted 2007 results. New Brunswick's economy has a larger-than-average manufacturing base with close ties to the US, but its recent employment and retail results show healthy year-on-year job growth and the resulting support for consumer spending. Nova Scotia, being less US dependant, looks likely to match the national pace, with major capital projects not likely to kick in until 2009.

Inflation rates are gradually converging after being heavily tilted to the upside in western Canada, a reflection of booming house prices in that region. Looking at a 3-month average, Alberta and Saskatchewan still have much higher wage and price inflation than the country

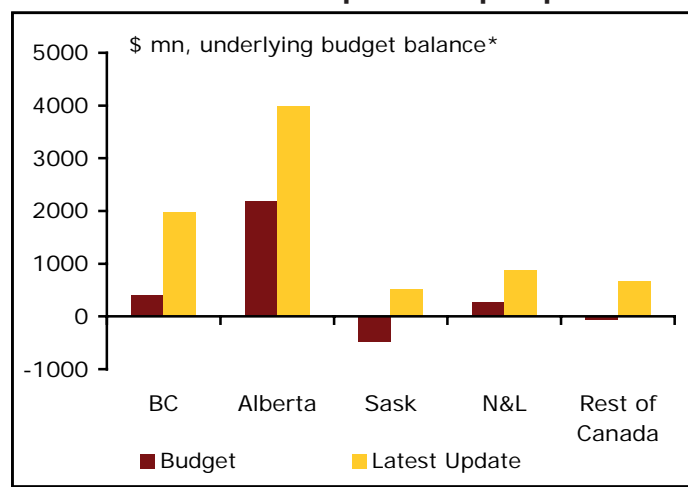
as a whole. But in some parts of Alberta, housing supply appears to be catching up with demand, slowing recent monthly price gains in markets like Calgary, while Saskatchewan's house inflation also looks unlikely to be sustained at its frenetic recent pace, given the implications for affordability.

The marked-down growth outlook hasn't yet produced budgetary stresses for the provincial sector, because the revenue base coming into fiscal 2008/09 looks much healthier than earlier projected. Real GDP growth was typically only a touch above budget assumptions, but nominal GDP and associated revenues again surprised to the upside. Revenues associated with natural gas and lumber were lighter, but other resource revenues, federal transfers and income taxes generally topped expectations. After stripping out an accounting change in Québec, all provinces except PEI have reported upside improvements to the underlying budget balance for 2007/08. In total, provincial budgets are aiming at an \$8 billion surplus (excluding transfers to fiscal stabilization funds), a nearly \$6 billion improvement from budget projections.

While the bulk of the gains were registered in four provinces benefiting from resources—Alberta, British Columbia, Saskatchewan and Newfoundland (Chart 4)—both Ontario and Québec have seen significant revenue improvements, and Ontario no longer expects a deficit for the outgoing year. Provinces will generally budget for leaner revenue gains in 2008, but the resource producers could again get a pleasant surprise from globally driven commodity prices.

Chart 4

2007/08 Provincial Surpluses Top Expectations



* excludes transfers to/from stabilization & other funds

Global Decoupling: Not Just Wishful Thinking

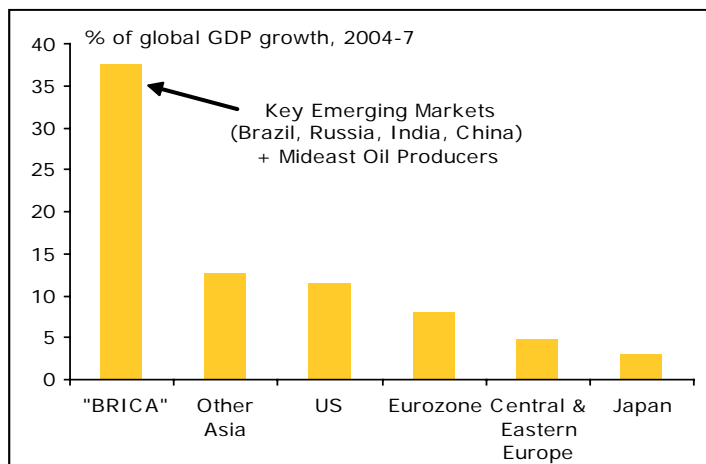
Peter Buchanan

Regardless of whether the US is already in recession, risks on that score are clearly rising as the housing collapse erodes household wealth and spending, and writedown-saddled financial institutions tighten lending standards. The rest of the world isn't immune to the gloom stateside. We still, however, expect world growth to hold up at a 4.2% pace in 2008 even in the likely event that the US picture darkens further.

Contributing to this guarded optimism is the decline in the US economy's global footprint in recent years. Outside the US, the data are also still generally mixed, with Europe cooling but Japan's growth doubling expectations in the latest quarter.

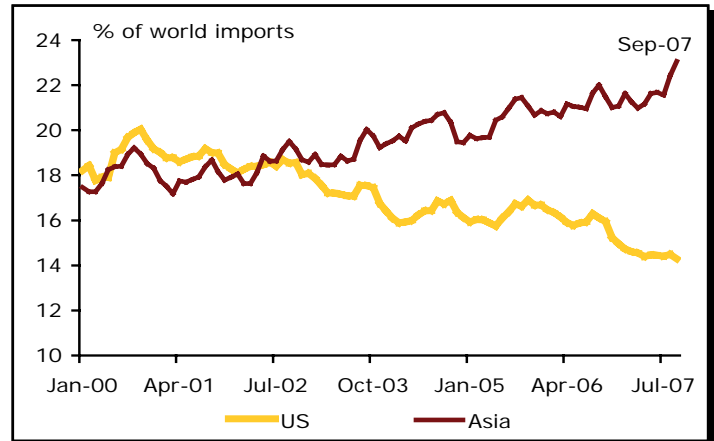
The US may have been the world economy's locomotive in the second-half of the 1990s but it hasn't provided much leadership for either global GDP or commodity markets in recent years, and bad news stateside consequently doesn't create the same broad downside risks as it once did. In the last three years, the so-called BRICA economies—combining the largest emerging markets and Middle East oil exporters—have accounted for about 40% of global growth, three-to-four times the US share (Chart 1). Global trade patterns tell a similar story. A 6% rise in Asia's share of global imports since the start of the decade, largely at the expense of the US (Chart 2), means the latter is not as important for most areas as it was even a decade ago (Chart 3).

Chart 1
Shares of Global GDP



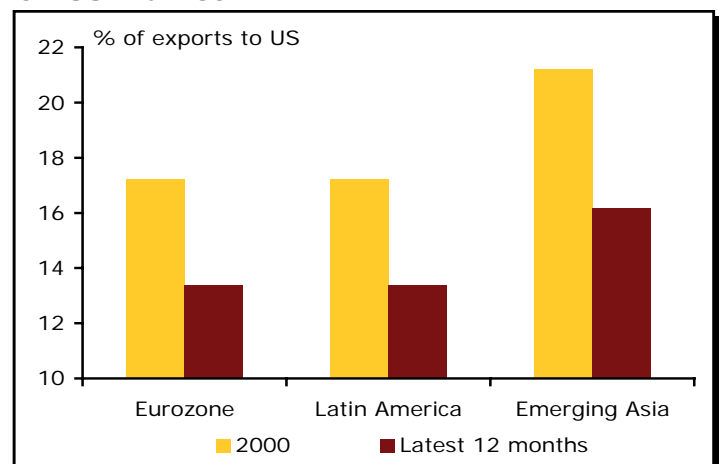
Source: CIBC WM calculations, IFF, World Bank

Chart 2
US Import Share Has Fallen Sharply as Asia's Has Risen



Commodity prices—a useful forward-looking indicator of the overall global economy's health—also remain at record levels according to widely watched indicators like the CRB index. That's not as improbable or unsustainable as might appear. Though still the world's largest crude market, US oil demand has been flat in the last two years even with the economy faring decently. China is already two-to-three times as important a base metals user as the US is and its consumption has been growing at a double-digit pace, as demand stateside has stagnated or even declined.

Chart 3
All Major Regions Less Dependent on US Market

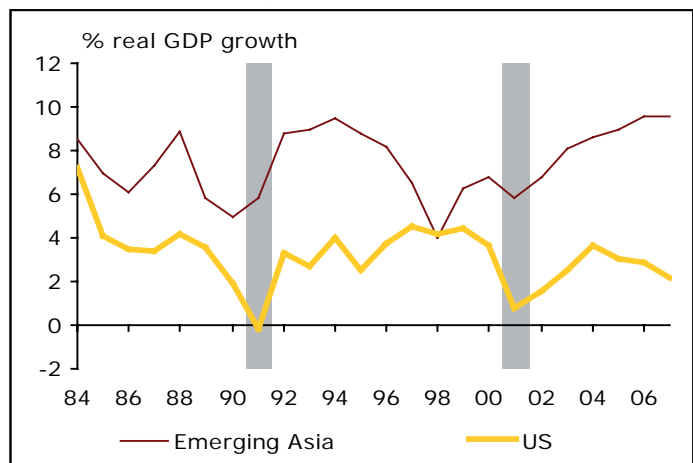


While decoupling is often presented by critics as a wishful hypothesis, Emerging Asia, the key driver of global commodity prices, has in fact shown growing signs of delinking economically from the US in the last 10-15 years (Chart 4). The region's economy slumped with the US in the early 1990s, but barely skipped a beat during the last US recession in 2001. Growth there moreover has held up of late, even as the US has faltered. China's fast-growing economy has actually shown a negative correlation with the US economy in the last decade.

Given that China's trade prowess largely rests on its burgeoning number of assembly operations, which rely heavily on imported components, the economy there is not as sensitive to changes in export demand as is sometimes made out. Value-added in the export sector accounts for only about 10-15% of China's GDP, when the high import content of many of the country's assembled manufactured goods exports is netted out. Recent year-on-year gains of 20% or more in both retail spending and fixed asset investments suggest that domestic spending, which accounts for 80-90% of overall demand, remains in good shape. As with Japan, which saw exports contribute to GDP in Q4 even as the US slowed, China's exports these days go increasingly to the rest of Asia rather than the US.

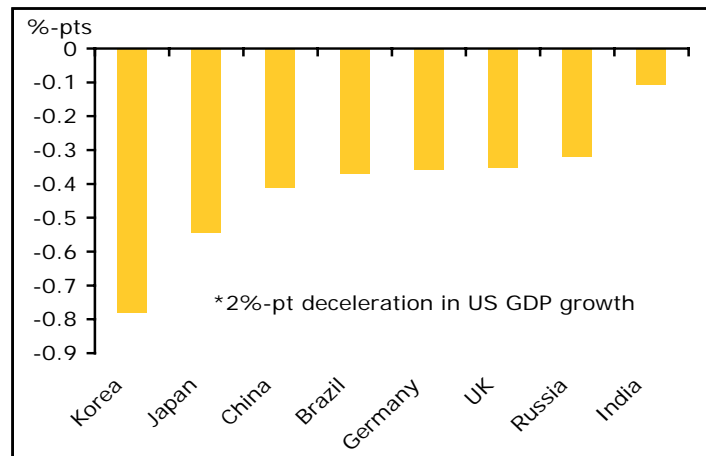
Although a deep US recession would have greater implications, our calculations suggest only a measured hit to a number of key overseas markets from a modest US recession comparable to the 2001 one. A comparable 2%-pt slowdown in GDP growth from 2006's 2.9% pace, to 0.9% would pare about 6% from US imports, given historical evidence that import demand is about three times as cyclically sensitive as the overall economy. Our

Chart 4
Asia is Becoming Increasingly Decoupled From US Economy



Shading denotes US recessions

Chart 5
Overseas GDP Impact of Modest US Recession*

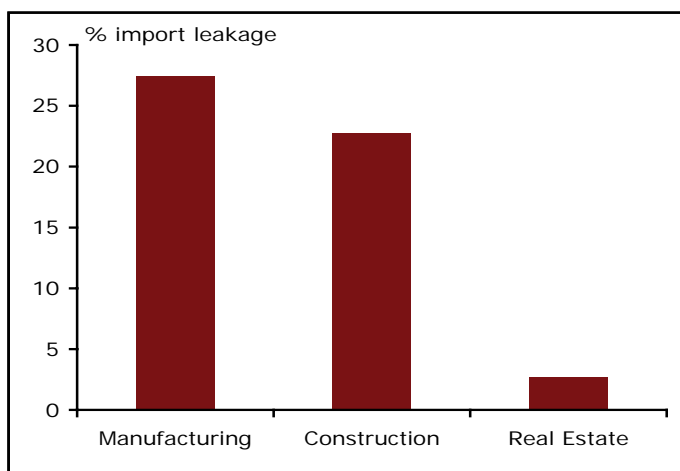


Source: CIBC WM calculations, De Backer & Yamano, OECD (Jan-08)

estimates, taking into account the sensitivity of different countries' exports to US GDP and the export sector's share in overall valued-added, suggests a negative GDP hit of 0.1%-0.8% for a number of key overseas economies (Chart 5). A hit of about 0.4%-pts would still leave China's economy growing at a 10% or better rate. And that may overstate things since the housing sector's trade links are not as great as for manufacturing, the dominant player in past US recessions (Chart 6).

While the economic news from the US will almost certainly get worse, respectable growth prospects overseas should keep prices for a range of commodities at historically high levels. That may not help resource stocks much in the near term, with markets focused on bad news stateside, but it should help to create headroom for TSX energy and resource groups in the second half of 2008.

Chart 6
Lower Leakages to US Imports Than From a Traditional Factory-Driven Recession



Source: Bureau of Economic Analysis

ECONOMIC UPDATE

	07Q3A	07Q4F	08Q1F	08Q2F	08Q3F	2006A	2007F	2008F
CANADA								
Real GDP Growth (AR)	2.9	1.3	0.9	1.9	2.8	2.8	2.5	2.0
Real Final Domestic Demand (AR)	4.6	5.1	3.9	3.3	3.0	4.7	3.9	4.0
All Items CPI Inflation (Y/Y)	2.1	2.4	1.9	1.9	2.5	2.0	2.1	2.3
Core CPI Ex Indirect Taxes (Y/Y)	2.2	1.6	1.3	1.1	1.1	1.9	2.1	1.3
Unemployment Rate (%)	6.0	5.9	5.9	6.1	6.2	6.3	6.0	6.1
Merchandise Trade Balance (C\$ Bn)	41.9	36.8	35.2	35.6	40.3	51.3	49.7	39.4
U.S.								
Real GDP Growth (AR)	4.9	0.6	0.2	0.7	2.0	2.9	2.2	1.6
Real Final Sales (AR)	4.0	1.9	-0.2	0.8	1.5	2.8	2.5	1.6
All Items CPI Inflation (Y/Y)	2.4	4.0	4.2	3.5	4.2	3.2	2.9	4.0
Core CPI Inflation (Y/Y)	2.2	2.3	2.6	2.3	2.2	2.5	2.3	2.5
Unemployment Rate (%)	4.7	4.6	5.0	5.2	5.3	4.6	4.6	5.2

CANADA

We've cut our Canadian GDP outlook for both Q4 and 2008 as a whole in light of a downgraded assessment for the US, and fresh evidence of the severity of the hit to Canadian real exports. Rising commodity prices suggest that the nominal trade surplus could improve slowly from December's nadir, but real export volumes will remain lackluster. Still, even if the US dips slightly into negative territory, recent job gains point to enough domestic demand to keep Canadian growth on the plus side.

UNITED STATES

We continue to brace ourselves for a consumer led economic slowdown in the first half of the year, but a recent stream of bearish indicators have prompted us to increase our bet. Our call for first-quarter real GDP growth remains essentially flat, but we have now taken down our second-quarter forecast below an annualized 1%. Trade continues to be a bright spot for our US outlook, but a weakening labour market does not bode well for domestic spending. Inflation should remain uncomfortably high over our forecast period. However, core CPI should remain tamer, given the lower economic growth profile in 2008.

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