Global Economic Environment

World

Lacklustre growth in developed countries and slowing growth in developing countries were the common themes for 2012. The sovereign debt crisis in Europe and policy uncertainty in the U.S. constrained investment and hiring in those regions. Weakness in advanced economies weighed heavily in the developing world, causing demand for manufactured goods to wane and economic growth to slow.

Globally, the International Monetary Fund (IMF) estimated real GDP growth at 3.2% in 2012 and is forecasting 3.5% growth in 2013 (see table).

The softening in economic growth impacted commodities last year. Monthly Brent crude oil prices, the benchmark for globally traded oil, peaked at US$125.45/barrel in March 2012 and fell to US$110.80/barrel by year end, even with civil unrest in Syria and Israeli-Iranian tensions on the rise in the Middle East. For the year, Brent crude averaged US$111.63/barrel, virtually unchanged from 2011. Iron ore spot prices were also volatile in 2012 but trended upward during the last part of the year. Average iron ore prices for 2012 were about 24% below 2011 levels. Likewise, the Bank of Canada's commodity price index was down 5.7% for the year, with the biggest drops coming in energy (-9.4%) and metals and minerals (-3.9%) prices.

GDP Growth (%)

	2011	2012e	2013f
World	**3.9**	**3.2**	**3.5**
Brazil	2.7	1.0	3.5
Russia	4.3	3.6	3.7
India	7.9	4.5	5.9
China	9.3	7.8	8.2
Japan	-0.6	2.0	1.2
Canada	**2.6**	**1.8**	**1.7**
United States	**1.8**	**2.2**	**1.9**
European Union	1.6	-0.2	0.2
United Kingdom	0.9	-0.2	1.0
Euro Area	1.4	-0.4	-0.2
Germany	3.1	0.9	0.6
France	1.7	0.2	0.3
Spain	0.4	-1.4	-1.5
Italy	0.4	-2.1	-1.0

e: estimate; f: forecast
Source: Canada (2011 and 2012e) – Statistics Canada; U.S. (2011 and 2012e) – Bureau of Economic Analysis; Canada (2013f) – average forecast of major Canadian banks; U.S. (2013f) Survey of Professional Forecasters, U.S. Federal Reserve Bank of Philadelphia; all other – International Monetary Fund, January 2013.

Europe

Since 2010 the euro area has been battling a sovereign debt crisis. After Greece announced in late 2009 that deficit estimates would be double previous projections the country's borrowing costs soared. Increased debt burdens across Europe (from stimulus measures to counteract the recession) and soft economic growth fuelled investor trepidation and increased the cost of borrowing to other countries. Bailouts facilitated by the European Commission (EC), European Central Bank (ECB) and IMF had to be arranged for Greece, Ireland and Portugal—a bailout of Spain is still possible.

In response to the rising borrowing costs and growing debt burdens most European countries

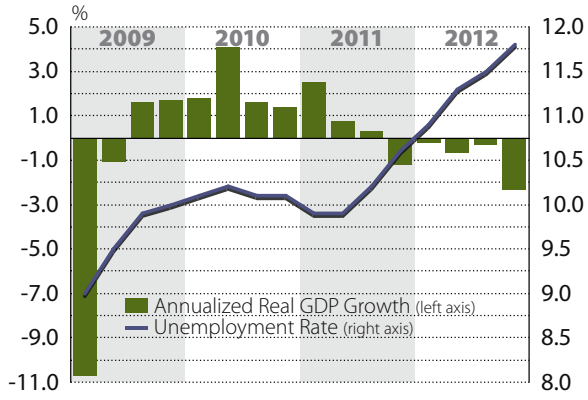

U.S. Capitol Building, Washington D.C

spent 2012 implementing austerity measures. These measures proved successful from a borrower's perspective—among the most troubled nations (Greece, Ireland, Portugal, Spain and Italy) borrowing costs between December 2011 and December 2012 dropped an average of 4.0 percentage points (ppts.), outpacing the 0.6 ppt. drop for the relatively safe haven of Germany. The growth of deficits and debt as a percent of GDP also slowed.

However, austerity has come at a steep price for Europe as it has pushed the euro area into recession and contributed to already high rates of unemployment (see chart). The euro area has experienced five consecutive quarters of negative real GDP growth, while the European Union (EU) as a whole has seen negative growth in three of the last five quarters. As of December 2012, unemployment rates in both the EU and the euro area were the highest on record, while in Spain and Greece rates surpassed 25%. Compounding these issues is growing discontent with austerity measures. In 2012 there were anti-austerity riots in Spain and Greece and the electoral defeat of pro-austerity French president Nicolas Sarkozy. This trend has continued into 2013 as Italian voters sent a disapproving assessment of austerity by electing a minority government in late February. Events such as these underscore the challenges faced by European governments trying to manage the financial crisis.

The IMF estimates the EU and euro area contracted 0.2% and 0.4% in 2012, respectively. For 2013, the IMF forecasts growth of 0.2% for the EU and a contraction of 0.2% for the euro area.

Euro Area Real GDP Growth and Unemployment Rate (Quarterly)

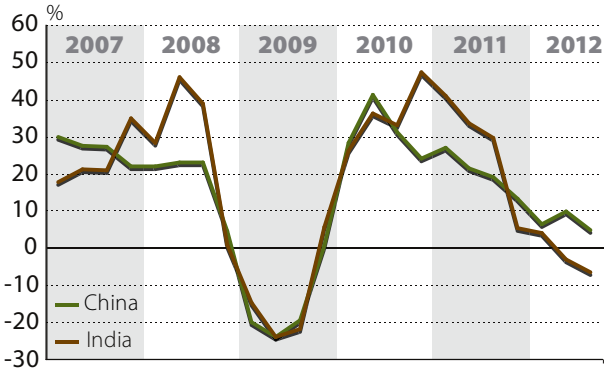


Source: Eurostat

Asia

In 2012, economic conditions in the U.S. and Europe impacted Asia's largest developing economies—China and India—although growth remained robust relative to other nations. Fiscal policy uncertainty in the U.S. and widespread austerity in Europe caused the demand for exports from China and India to wane. From the first quarter of 2011 through to the third quarter of 2012, the year-over-year growth in the value of merchandise and services exports fell from 27.1% to 4.7% in China and from 41.1% growth to a decline of 6.6% in India (see chart above). This caused a deceleration in economic activity in the two countries. The IMF estimates real GDP growth was 7.8% in China in 2012, down from 9.3% in 2011, while in India it slowed to 4.5% from 7.9%.

Year-over-Year Growth in the Value of Exports in China and India



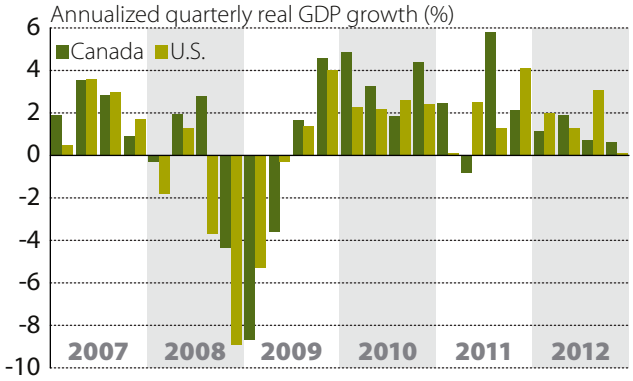
Source: World Trade Organization

However, domestic demand and government intervention are expected to strengthen growth in 2013. In China, for example, the government approved 60 infrastructure projects worth over $150 billion in September 2012 and committed to proactive monetary and fiscal policy in 2013. Consequently, for 2013 the IMF is forecasting real GDP growth of 8.2% in China and 5.9% in India.

United States

In the U.S. economic momentum slowed and then stagnated throughout 2012 (see chart) as fiscal and regulatory policy uncertainty constrained consumer spending and business investment. Real GDP growth climbed to an annualized rate of 4.1% in the fourth quarter of 2011 but then did not top 2% again until the third quarter of 2012 and came to a virtual halt in the fourth quarter at 0.1%. For the year, U.S. real GDP grew 2.2%.

Quarterly GDP Growth



Source: U.S. Bureau of Economic Analysis; Statistics Canada

Financial institutions remained unclear about future regulations while businesses and consumers were uncertain about future tax burdens and government spending. The federal government's "fiscal cliff" loomed at the end of December 2012 but these austerity measures were largely avoided at the last minute by temporary measures. A January 1, 2013 agreement between Republicans and Democrats reached a compromise on tax increases but only postponed across-the-board spending cuts until March. These cuts, called sequestration, came into effect in early March and amount to roughly $85 billion this fiscal year. Furthermore, the U.S. is again bumping up against its debt ceiling, which led Congress to suspend the limit on federal government borrowing until May. Consequently, uncertainty remains at elevated levels in the U.S. economy and continues to detract from efforts to accelerate economic and job growth. Although the unemployment rate fell below 8% in September for the first time in over three years (and has remained there through February 2013), employment growth has barely kept pace with population growth. The employment-population ratio has remained stubbornly below 59% since September 2009, after being over 60% for most of the previous 25 years.

While economic conditions remain tenuous in the United States, some encouraging trends are emerging. In particular, there is a growing resurgence in the housing sector. In December, both housing starts and building permits were at their highest levels since July 2008, and in January new home sales were also near their highest level since July 2008. In addition to these positive signs in the housing market, personal income grew 3.5% in 2012 and real consumer spending growth, at an annualized rate, hit its highest mark in over three years at 6.4% in November. Employment has risen by an average of 191,000 per month over the last three months. Even the beleaguered manufacturing industry has been showing some signs of stabilization and possible turnaround. The industry has regained about 500,000 jobs since employment bottomed out in 2010.

The latest Federal Reserve Bank of Philadelphia Survey of Professional Forecasters indicates real GDP in the U.S. is expected to grow 1.9% in 2013 and employment gains are expected to average 164,100 per month.

Canada

Economic activity in Canada expanded at a faster pace than in many other major advanced economies in 2012, thanks primarily to favourable commodity market conditions early in the year and easier credit availability. However, growth slowed during the second half of 2012 (see chart), dropping from an annualized rate of 1.9% in the second quarter of 2012 to 0.6% in the fourth quarter. Weaker inventory and government investment in the second half of the year contributed to the disappointing performance but the main reason was weak export growth.

Exports have been slow to recover from the historical high prior to the 2008/09 recession (see chart). In fact, the recent recovery has been slower than any previous recovery following a downturn since at least 1981. This reflects Canada's reliance on the United States, the destination for well over 70% of Canadian exports. It also reflects the strong Canadian dollar in recent years, which has made Canadian goods more expensive for foreign consumers.

The Canadian dollar averaged 100.0 cents US in 2012, down slightly from an average of 101.1 cents US the previous year. Favourable commodity markets (especially high oil prices), easier credit availability, a bullish

housing market, and a high bond rating all combined to keep the loonie near parity with the US dollar over the last two years. Though the Canadian dollar remained steady going into 2013, growing concerns about lower oil prices, the housing market and weak exports finally began to put downward pressure on the currency in mid-February. It reached an eight month low of 96.96 cents US in early March.

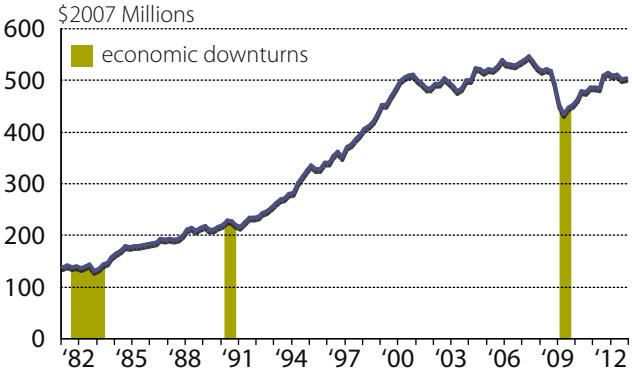
Canadian real GDP grew 1.8% in 2012. Provincially, the Prairie provinces posted the strongest GDP performance last year (see chart) while Newfoundland and Labrador posted the lowest as growth was negatively impacted by lower oil production.

Canadian labour market performance was solid in 2012. Employment in Canada increased by 201,500 (+1.2%) in 2012, while the labour force increased by 176,700 (+0.9%). As a result, the unemployment rate fell from 7.4% in 2011 to 7.2%. On a provincial basis, the strongest employment growth occurred in Alberta (2.7%), Newfoundland and Labrador (2.3%) and Saskatchewan (2.1%). Canadian wages also increased last year, with weekly earnings averaging $897 for the year, up 2.5% from 2011.

Real GDP in Canada is expected to grow 1.7% in 2013, according to an average estimate of forecasters, while employment is expected to increase 1.3%. Among provinces, Newfoundland and Labrador (+3.4%) is expected to see the most robust real GDP growth followed by the Prairie provinces of Saskatchewan (+2.8%) and Alberta (+2.7%). The lowest GDP growth is expected to occur in Quebec and New Brunswick (both at 1.4%). Saskatchewan is expected to lead the country in employment growth (+1.9%) this year.

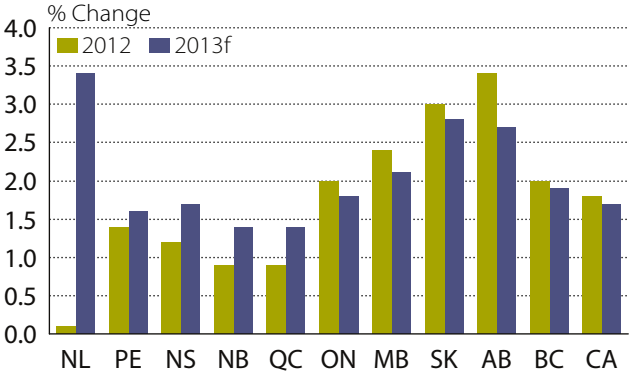
Canada remains exposed to the global economy, especially to any downturn that pushes down commodity prices, as occurred during the last three quarters of 2012. The main external risks pertain to a further escalation of the euro area debt crisis and the fiscal uncertainty in the U.S., especially related to potential spending cuts. On the domestic side, a sharp or sustained decline in housing prices could seriously set back a visibly leveraged household sector, which would impact consumer expenditures. Household debt in Canada, as a per cent of disposable income, reached 167.1% in the fourth quarter of 2012, the highest rate since at least 1990 (see chart). On the positive side, the

Real Canadian Exports



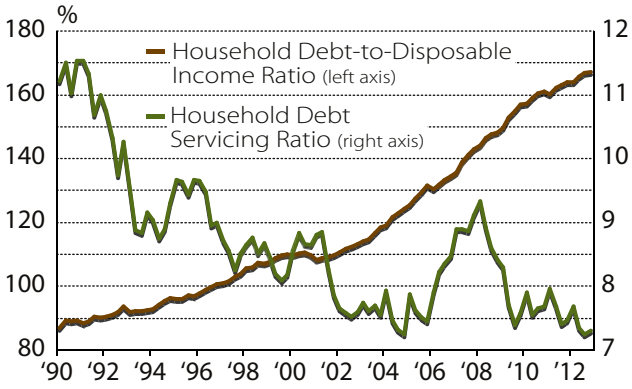
Source: Statistics Canada

GDP Growth



Source: Statistics Canada (2012 Canada), all others are based on an average of the major banks and Conference Board of Canada

Canadian Household Debt Indicators



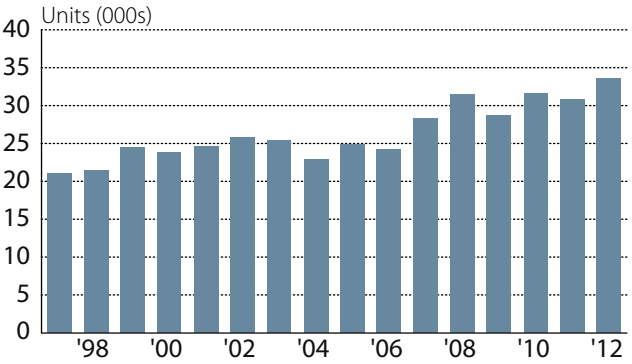
Source: Statistics Canada

household debt servicing ratio—the ratio of debt payments to disposable income—has been on a downward trajectory since 2008, which is a function of both rising incomes and falling borrowing costs. However, this trend is highly sensitive to changes in interest rates.

Provincial Economic Overview

Economic conditions in Newfoundland and Labrador were robust throughout 2012. The development of major projects increased investment spending to record levels, generating employment throughout the province and raising consumer spending. The strong investment and consumer spending, boosted provincial domestic demand by 10.5%. However, real GDP declined slightly, (-0.4%) due to a decline in exports stemming from maintenance shutdowns in the oil industry. A table of selected economic indicators for the province is contained on the next page.

New Motor Vehicle Sales



Source: Statistics Canada

Capital investment totaled $10.0 billion in 2012, a 33.0% increase over 2011. Continued development of major projects underpinned this growth. Vale's nickel processing facility in Long Harbour was the single largest contributor to investment in 2012, with an estimated $1.2 billion spent. Advancement of projects in the oil, mining and hydro-electric sectors, as well as solid commercial and residential expenditures, also contributed to high levels of investment spending. Housing starts totaled 3,885, the highest level in 36 years.

Consumer spending was strong last year with the value of retail sales increasing by 4.8% compared to 2011. While gains were recorded in most sales categories, the growth in retail sales was largely attributed to strong car sales. Over 33,600 new cars were sold in the province in 2012, 9.1% more than in 2011 (see chart). New car sales posted the highest number ever recorded in the province, surpassing the previous high registered in 2010. Employment and wage gains, combined with high levels of consumer confidence and low interest rates, continue to support consumer spending.

Exports had a dampening effect on GDP growth in 2012. Total exports (in real terms) are estimated to have declined by 3.7% due primarily to lower oil production resulting from maintenance shutdowns at the Hibernia, Terra Nova and White Rose projects (see *Oil and Gas* for more details). Exports of iron ore and refined petroleum saw significant increases while more modest growth was reported in newsprint. Exports of fish products declined.

Labour Market

Labour market performance in 2012 continued to be strong. Employment increased by 2.3% to a record high of 230,500. Employment growth in Newfoundland and Labrador was the second highest among provinces after Alberta. Job gains were concentrated in full-time employment. The strength in the labour market was driven in large part by major project development activity in the resource sector and related spin-offs.

Growth in employment and increasing wages enticed more people to participate in the labour market, reflected in a 1.4 percentage point increase in the participation rate in 2012. This resulted in a 2.1% increase in the labour force. The unemployment rate declined slightly as employment gains offset the increase in the labour force. The rate averaged 12.5% in 2012, 0.2 percentage points lower than 2011.