

Economic Expectations 2003

22nd Annual
Canadian Survey



W W W . W A T S O N W Y A T T . C O M

WATSON WYATT INVESTMENT CONSULTING PRACTICE

The Watson Wyatt Investment Consulting Practice operates in 30 countries and employs over 350 investment consultants worldwide. In Canada, we have consultants throughout the western, central and eastern markets working in Defined Benefit Pension Plans, Defined Contribution Pension Plans and other Capital Accumulation Arrangements.

Watson Wyatt Canada has tremendous expertise in assisting clients in maximizing their plan's investment performance within a risk-controlled environment.

OUR SERVICES INCLUDE:

- the establishment of a proper governance program;
- the establishment of appropriate investment manager structures;
- the establishment of investment policies and fund manager mandates;
- the selection of asset allocation through the use of asset/liability studies;
- the selection of fund managers; and
- the ongoing measurement of performance.



2003 AT A GLANCE

Economic growth expectation

Participants in Watson Wyatt's Annual Economic Expectations survey expect the Canadian and U.S. economies (GDP) to grow by about 3.0% in 2003. The lowest prediction came in at 2.0% and the highest at 4.5%. Moreover, most participants forecast the Canadian economy to slightly outperform the U.S. economy over the short to medium terms, while the opposite is expected over the long term.

The federal government is expected to remain in a surplus position this year. None of our participants anticipate a deficit for 2003/2004. The median value of the surplus, at \$5 billion, is higher than that expected last year.

The anticipated economic growth will likely also help corporate profits, which are expected to grow by 8.5% in 2003, and the unemployment rate, which should decrease slightly to 7.3%.

Modest return of inflation

Survey participants generally raised their inflation appraisal, estimating 2.5% for 2003 as well as over the medium term for Canada and U.S. However, no major inflation is foreseen at this stage as 75% of predictions over the short, medium and long terms are lower than 3.0%, and none of them exceed 4.0%.

The expected salary increase of 2.2% will not fully cover inflation in 2003. However, personal disposable income is predicted to increase by 3.4% offsetting a portion of this. The difference is likely attributed to previously announced lower taxes.

Upward trend for Canadian dollar

The forecast call on the Canadian dollar is difficult and survey participants essentially kept to the same predictions as those of last year, forecasting a gradual appreciation relative to the U.S. dollar. The median prediction remains at \$0.65 for 2003, the lowest being at \$0.61 and the highest at \$0.69.

The views on the Canadian dollar relative to the Euro are essentially the same (€0.65 for 2003), despite the strong recent performance of the Euro relative to the U.S. dollar.

Flattening yield curve

Survey participants expect the Canadian yield curve to shift upward and flatten, with short-term interest rates increasing more than long term ones. The December 2002 yield of 2.6% for T-Bills (91 days) is expected to increase to 3.3% in 2003, while the yield for ten-year bonds is expected to move from 5.0% to 5.4%.

Lower, but still significant equity growth expectations

For the third consecutive year, the vast majority of participants forecast a positive return for all equity markets over the next 12 months, but with lower rates of return than predicted before. Only one of the participants forecast negative returns. For 2003, the Canadian and U.S. equity markets are expected to achieve 9.5% returns, while 8.5% is expected for the international market. These returns are 150 to 350 basis points lower than those predicted last year.

The forecast Canadian equity risk premium over bonds for the next 12 months has been reduced to 5.5%

from 7.0% last year. However, over the long term, the nominal risk premium is about the same at 2.3%.

Future living standards and employment levels

The expected increase in long term labour productivity is down to 1.7% from 2.0% last year. This suggests a more pessimistic view of future living standards. Based on Watson Wyatt's model for projecting future unemployment levels, the foregoing productivity and GDP projections translate to a falling unemployment rate, leading to an anticipated labour shortage of two million workers in 2020. Attraction/retention and productivity enhancement will be key human resource strategies for employers, and expanded immigration is likely required to meet employment needs.

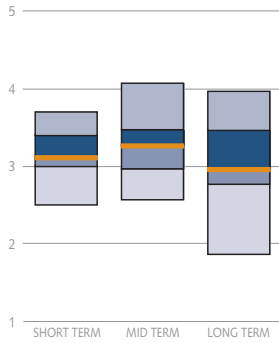
Higher pension costs

The long term real return on a typical pension fund, invested 60% in equities and 40% in bonds, is projected at about 0.5% below last year's predictions. If a defined benefit pension plan sponsor were to lower the assumed discount rate by a similar amount, the actuarial liabilities of the plan could increase by 5.0% to 12.0%. This comes on top of recent investment losses. These losses will be exacerbated in the next few years for those using smoothed asset valuation techniques. Plan sponsors are strongly advised to project funding contributions and pension expense over the next three to five years, evaluate the magnitude of these losses, and what might be done to offset them.

MACROECONOMIC INDICATORS

GROSS DOMESTIC PRODUCT (GDP) (CANADIAN) (REAL)

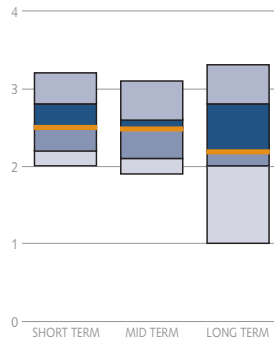
Average Annual Percentage Change Year-Over-Year



The Canadian economy should continue to do well in 2003, growing 3.1% (in real terms). A similar level of growth is expected for the medium and long terms.

CONSUMER PRICE INDEX (CPI) (CANADIAN)

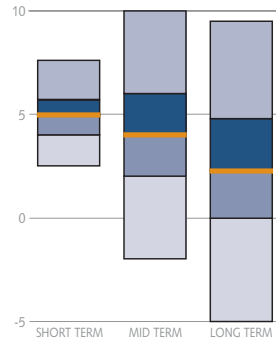
Average Annual Percentage Change Year-Over-Year



Survey participants predict stable inflation. Median rates range from 2.5% in 2003 to 2.2% over the long term. Although similar to last year's median rates, the spread among predictions for the long term is larger.

FEDERAL GOVERNMENT SURPLUS (DEFICIT) 2003/2004

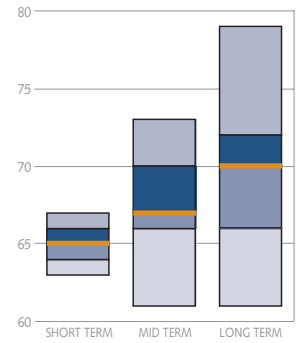
Average Annual Actual Surplus (\$Billions)



Expectations are for the federal government to continue operating with a surplus, the magnitude of which is estimated higher for the short and medium terms than for the long term (medians of \$5, \$4 and \$2.3 billion respectively). This is significantly different from last year's results. The spread among predictions remains large.

CANADIAN DOLLAR (RELATIVE TO U.S.)

Average Annual Value

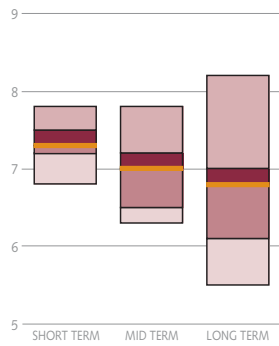


The Canadian dollar is expected to strengthen over time relative to the U.S. dollar. The predictions are very similar to last year's median rates of \$0.65, \$0.67 and \$0.70 respectively. However, the spread has narrowed significantly over the long term.

ACTIVITY INDICATORS

UNEMPLOYMENT RATE (TOTAL)

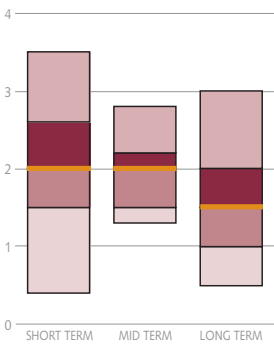
Average Rate Over Period



Similar to last year, participants expect the unemployment rate to be 7.3% in 2003, decreasing to 7.0% and 6.8% for the medium and long terms respectively.

EMPLOYMENT GROWTH

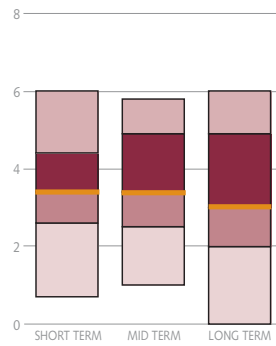
Average Annual Percentage Change Year-Over-Year



Expectations for all three periods have increased significantly. The median rates are 2.0%, 2.0% and 1.5%, as compared to 0.4%, 1.5% and 1.1% last year. The spreads have also narrowed.

PERSONAL DISPOSABLE INCOME (PDI)

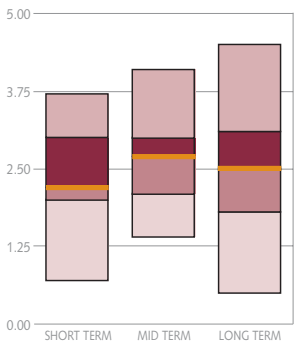
Average Annual Percentage Change Year-Over-Year



As a result of the previously announced lower taxes and the expected employment growth, PDI is expected to grow solidly at 3.4% for 2003 and the medium term, but at a lower rate (3.0%) over the long term.

AVERAGE WEEKLY EARNINGS

Average Annual Percentage Change Year-Over-Year

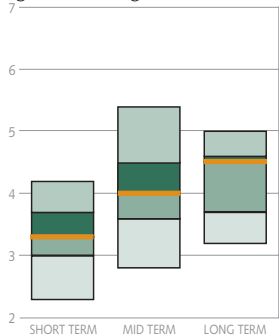


Growth in average weekly earnings is expected to be 2.2%, 2.7% and 2.5% for 2003, the medium and long terms respectively. Using the median inflation predictions, participants expect lower real wage increases than last year (-0.3%, 0.2% and 0.3% respectively).

FINANCIAL INDICATORS

YIELD ON TREASURY BILLS (91 DAYS)

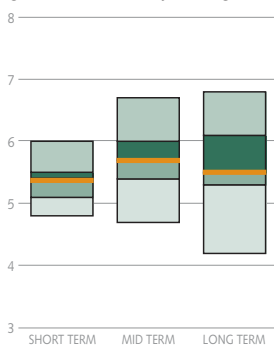
Average Yield During Period



Participants continue to expect increases in the yields on T-Bills (91 days) to 3.3% in 2003, 4.0% in the medium term and 4.5% in the long term.

YIELD ON CANADIAN TEN-YEAR BONDS

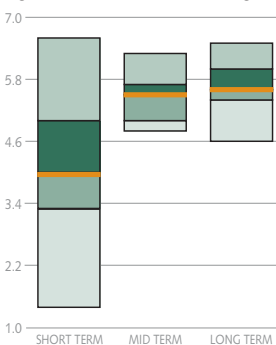
Average Yield to Maturity During Period



Rates are expected to rise to 5.4% in 2003 and 5.7% for the medium term, before decreasing to 5.5% for the long term. These medium and long term predictions are 30 basis points lower than last year.

TOTAL RETURN ON SC UNIVERSE BOND INDEX

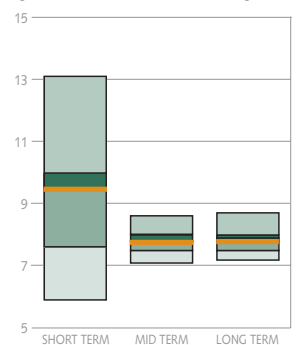
Average Annualized Return During Period



Total return on bonds is expected to be 4.0% in 2003 (100 basis points lower than last year), increasing to 5.5% for the medium term and 5.6% for the long term.

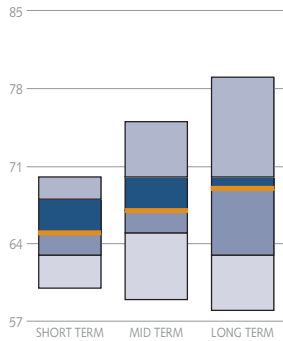
TOTAL RETURN ON CANADIAN EQUITIES (S&P/TSX COMPOSITE)

Average Annualized Return During Period



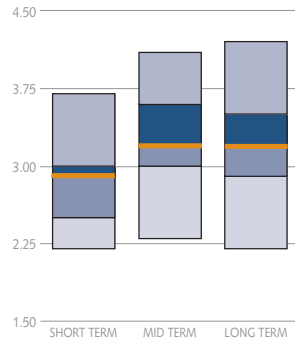
For the third consecutive year, participants expect a turnaround in the Canadian equity market, with a median return of 9.5% for 2003 (significantly less than last year's prediction of 12.0%). The median rates for the medium and long terms (7.8% and 7.9% respectively) are also down from last year (9.0% and 8.0%).

CANADIAN DOLLAR (RELATIVE TO EURO)
Average Annual Value



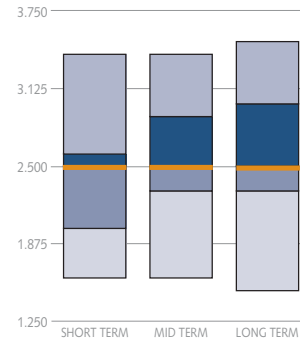
The Canadian dollar is expected to strengthen relative to the Euro at about the same pace as for the U.S. dollar (median rates of €0.65, €0.67 and €0.69), but with a slightly larger spread among predictions.

GROSS DOMESTIC PRODUCT (GDP) (U.S.) (REAL)
Average Annual Percentage Change Year-Over-Year



The U.S. economy is expected to recover in 2003, with a growth rate of 2.9%, increasing to 3.2% for the medium and long terms. These predictions are close to those for the Canadian economy.

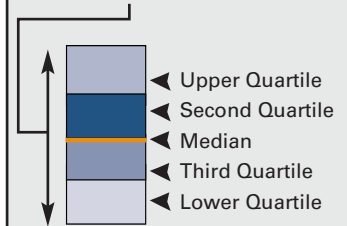
CONSUMER PRICE INDEX (CPI) (U.S.)
Average Annual Percentage Change Year-Over-Year



Participants predict stable inflation rates with a median of 2.5% for all three periods. While very close to predictions for Canadian inflation, the long term rate is slightly higher.

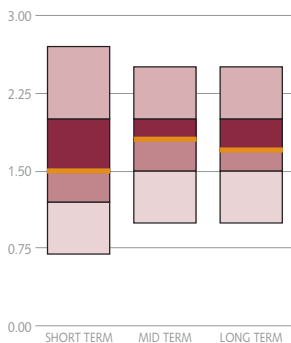
READING THE CHARTS

Indicates difference between highest and lowest responses after an adjustment has been made for outliers



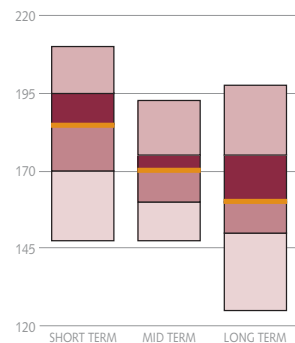
For each indicator, participants were requested to provide predictions for the short (2003), medium (2004–2007) and long term (2008–2017). The bottom and the top of the bar represent the lowest and highest values, respectively, after the removal of outliers; the centre line represents the median response. Fifty percent of the responses fall in the dark portion of the bar (second and third quartiles), with 25 percent on either side of the dark portion.

LABOUR PRODUCTIVITY
Average Annual Percentage Change Year-Over-Year



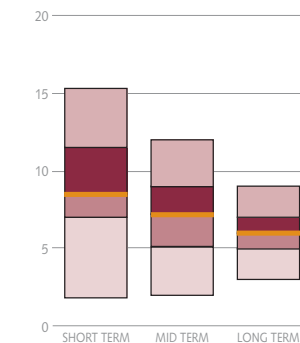
This activity indicator (previously "Output per Person-Year") is a critical driver of international competitiveness and future living standards. Stable growth is expected at 1.5% for 2003, 1.8% for the medium term and 1.7% over the long term.

HOUSING STARTS
Average Annual Level (000's)



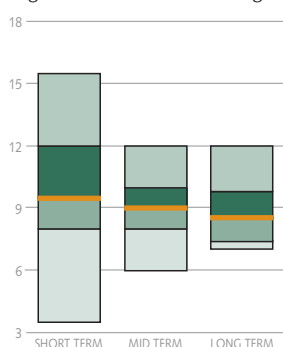
Expected to remain strong for a while, housing starts are forecast at 185,000 in 2003 and 170,000 in the medium term, decreasing to 160,000 thereafter.

CORPORATE PROFITS AFTER TAXES
Average Annual Percentage Change Year-Over-Year



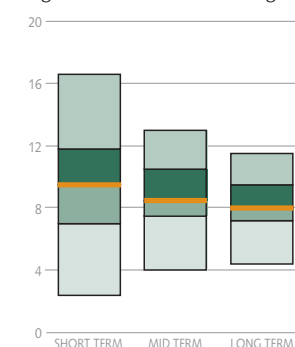
A significant turnaround is expected for corporate profits with an increase of 8.5% for 2003, compared to an expected decrease of 2.0% last year. Medium and long term growth expectations remain substantially unchanged at 7.2% and 6.0% respectively.

TOTAL RETURN ON SMALL-CAP CANADIAN EQUITIES
Average Annualized Return During Period



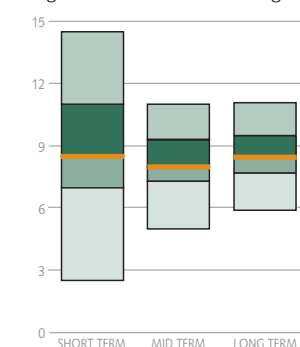
Small-cap Canadian stocks are expected to provide a return of 9.5% for 2003, decreasing to 9.0% for the medium term and 8.5% for the long term. These rates are lower than those predicted last year and the spreads are narrower.

TOTAL RETURN ON U.S. EQUITIES (\$ CDN) (S&P 500 INDEX)
Average Annualized Return During Period



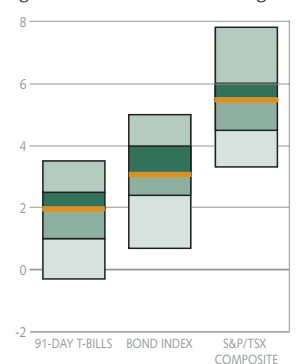
U.S. equities are expected to recover but at a slower pace than predicted last year with median rates of return at 9.5% for 2003 and 8.0% for the medium and long terms. These rates are essentially the same as those predicted for Canadian equities.

TOTAL RETURN ON INTERNATIONAL EQUITIES (\$ CDN) (EAFE INDEX)
Average Annualized Return During Period



Participants expect international equities to underperform Canadian and U.S. equities by 100 basis points in 2003, with a median return of 8.5%. A decrease to 8.0% is expected for the medium term before reverting to 8.5% for the long term.

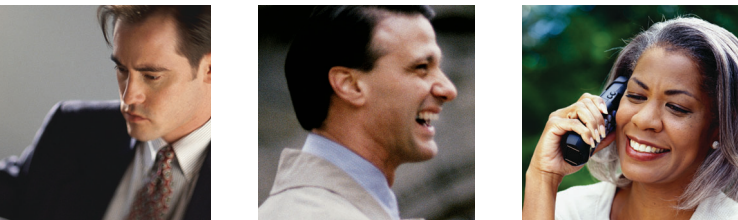
LONG TERM REAL RATES OF RETURN ON CAPITAL MARKETS
Average Annualized Return Over long term



Expected returns for Canadian T-Bills (91 days), bonds, and equities are 2.0%, 3.1%, and 5.5% above inflation for short, medium and long terms respectively, compared to 2.0%, 3.6%, and 6.0% last year — the third consecutive decrease for bonds and equities. The Canadian equity risk premium over bonds remains at 2.4% compared to 3.1% two years ago.

SUMMARY TABLE

	SHORT TERM 2003						MID TERM 2004 - 2007						LONG TERM 2008 - 2017					
	NUMBER OF RESPONDENTS	LOWEST	LOWER QUARTILE	MEDIAN	UPPER QUARTILE	HIGHEST	NUMBER OF RESPONDENTS	LOWEST	LOWER QUARTILE	MEDIAN	UPPER QUARTILE	HIGHEST	NUMBER OF RESPONDENTS	LOWEST	LOWER QUARTILE	MEDIAN	UPPER QUARTILE	HIGHEST
MACROECONOMIC INDICATORS																		
Gross Domestic Product (GDP) Canadian (Real)	38	2.0	3.0	3.1	3.4	4.5	33	2.5	3.0	3.3	3.5	4.1	30	0.5	2.8	3.0	3.5	4.0
Consumer Price Index (CPI) (Canadian)	37	2.0	2.2	2.5	2.8	3.2	33	1.5	2.1	2.5	2.5	3.5	30	-0.4	2.0	2.2	2.8	4.0
Federal Government Surplus (Deficit)	27	2.0	4.0	5.0	5.7	15.0	21	-3.5	2.0	4.0	6.0	10.0	22	-9.0	0.0	2.3	4.8	10.0
Canadian Dollar (Relative to U.S.)	37	0.61	0.65	0.65	0.66	0.69	33	0.60	0.66	0.67	0.70	0.75	29	0.55	0.66	0.70	0.72	0.80
Canadian Dollar (Relative to Euro)	29	0.60	0.63	0.65	0.68	0.70	27	0.57	0.65	0.67	0.70	0.79	26	0.50	0.63	0.69	0.70	0.85
Gross Domestic Product (GDP) U.S. (Real)	35	1.0	2.5	2.9	3.0	3.8	32	1.5	3.0	3.2	3.6	4.1	30	0.7	2.9	3.2	3.5	5.0
Consumer Price Index (CPI) (U.S.)	35	1.0	2.0	2.5	2.6	4.0	31	1.0	2.3	2.5	2.9	3.7	29	-0.4	2.3	2.5	3.0	3.5
ACTIVITY INDICATORS																		
Unemployment Rate (Total)	32	5.5	7.2	7.3	7.5	8.0	28	4.5	6.5	7.0	7.0	8.5	27	4.0	6.1	6.8	7.0	8.8
Employment Growth	24	-1.0	1.5	2.0	2.6	7.9	21	1.0	1.5	2.0	2.0	7.1	20	0.5	1.0	1.5	2.0	6.9
Personal Disposable Income (PDI)	26	-2.0	2.6	3.4	4.4	6.0	22	1.0	2.5	3.4	4.9	5.8	22	0.0	2.0	3.0	4.9	6.0
Average Weekly Earnings	25	-1.0	2.0	2.2	3.0	4.2	23	0.5	2.1	2.7	3.0	4.3	23	-0.5	1.8	2.5	3.1	4.5
Labour Productivity	25	0.7	1.2	1.5	2.0	3.0	22	1.0	1.5	1.8	2.0	3.2	22	0.7	1.5	1.7	2.0	3.5
Housing Starts (000's)	25	125	170	185	195	210	22	100	160	170	175	200	21	125	150	160	175	200
Corporate Profits after Taxes	25	-10.0	7.0	8.5	11.5	19.4	22	2.0	5.1	7.2	9.0	12.0	21	1.7	5.0	6.0	7.0	14.0
FINANCIAL INDICATORS																		
Yield on Treasury Bills (91-Day)	35	2.0	3.0	3.3	3.7	4.5	33	2.8	3.6	4.0	4.5	5.5	30	0.4	3.7	4.5	4.6	5.0
Yield on Canadian Ten-Year Bonds	35	3.0	5.1	5.4	5.5	6.5	33	4.0	5.4	5.7	6.0	7.5	29	4.0	5.3	5.5	6.1	9.5
Total Return on SC Universe Bond Index	27	-4.5	3.3	4.0	5.0	7.0	25	3.5	5.0	5.5	5.5	6.6	24	1.0	5.4	5.6	6.0	7.0
Total Return on Canadian Equities	30	-4.0	7.6	9.5	10.0	15.0	26	5.5	7.5	7.8	8.0	11.0	23	3.5	7.5	7.9	8.0	10.0
Total Return on Small-Cap Canadian Equities	24	-6.0	8.0	9.5	12.0	20.0	22	5.5	8.0	9.0	10.0	13.0	19	7.0	7.4	8.5	9.8	15.0
Total Return on U.S. Equities (\$ CDN)	30	-7.0	7.0	9.5	11.8	25.0	28	4.0	7.0	8.0	10.0	13.0	24	3.0	7.2	8.0	9.5	13.0
Total Return on International Equities (\$ CDN)	28	-2.0	7.0	8.5	11.0	15.0	27	4.0	7.3	8.0	9.3	12.0	23	4.0	7.7	8.5	9.5	12.0
Yield on Treasury Bills (91-Day) (Real)	35	-1.0	0.5	1.0	1.3	2.3	32	-0.5	1.0	1.8	2.5	3.3	29	-0.5	1.0	2.0	2.5	3.5
Total Return on SC Universe Bond Index (Real)	27	-6.7	0.3	1.9	2.5	4.9	24	0.5	2.5	3.0	3.4	4.7	24	-1.0	2.4	3.1	4.0	5.0
Total Return on Canadian Equities (Real)	30	-6.0	5.0	6.8	7.9	12.8	25	2.0	5.0	5.5	5.8	8.5	23	2.0	4.5	5.5	6.0	8.5



METHODOLOGY

The results of our 22nd Annual Canadian Survey of Economic Expectations are based on the projections of 41 of the country's leading business economists and portfolio managers in organizations such as chartered banks, investment management firms, and other corporations. Participants were requested to provide forecasts in their areas of expertise.

The 2003 Survey provides forecasts for 24 indicators based on the results of a questionnaire sent in November 2002. The results have been compiled to give a consensus opinion on Canada's economic prospects over the short (2003), medium (2004-2007) and long terms (2008-2017).

In the graphs, the collective opinion or central tendency is shown by the median – half of the responses are higher than the median and half are lower. The lower and upper quartiles show the variability in responses.

Twenty-five percent of all responses are below the third quartile and 25% are above the second quartile.

Therefore, half of all responses lie between the lower and upper quartiles. The top and bottom of each bar show the highest and lowest response after a statistical adjustment for “outliers” has been made.

Outliers are values either so high or so low as to be atypical of the rest of the data. These aberrant values have been removed from the charts to highlight the consensus nature of the survey. Thus, the graphs do not necessarily show the highest and lowest values reported by respondents.

The summary tables, however, present all data as actually collected and without corrections for outliers.

The median for each Survey indicator was calculated independently after the responses from each institution were

checked for internal consistency. This means that care should be exercised in interpreting the results. For example, the median real rate of return on equities will not be the difference between the medians of the total return on equities and the Consumer Price Index. Rather, it is the median of the differences calculated for each respondent on these indicators.

SURVEY PARTICIPANTS

- AIG Global Investment Corporation (Canada)
- Altamira Investment Services Inc.
- AMI Partners Inc.
- Aurion Capital Management
- Bissett Investment Management
- BMO Financial Group
- BMO Nesbitt Burns
- Brascan Financial Corporation
- Citizens Bank of Canada
- Canadian Manufacturers & Exporters
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- Connor, Clark & Lunn Investment Management Ltd.
- Credit Union Central of British Columbia
- CYF Consulting Ltd.
- Elantis Investment Management Inc.
- Fédération des caisses Desjardins du Québec
- Foyston, Gordon & Payne Inc.
- Global Insight Canada Ltd.
- Greystone Managed Investments Inc.
- Guardian Capital Inc.
- Integrated Asset Management Corp.
- Jones Howard Investment
- KBSH Capital Management Inc.
- Laketon Investment Management Ltd.
- Leith Wheeler Investment Counsel Ltd.
- Liquor Control Board of Ontario
- London Life Investment Management Ltd.
- McLean Budden Ltd.
- Montrusco Bolton Inc.
- Morrison Williams Investment Management Ltd.
- Mulvihill Capital Management Inc.
- M. Murenbeeld & Associates Inc.
- Ontario Municipal Employees Retirement System
- Ontario Teachers' Pension Plan Board
- Petro-Canada
- Pictet International Management
- Pinnacle International Management
- Royal Bank of Canada
- Scotiabank
- Standard Life Investments Inc.
- UBS Bunting Warburg Inc.

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We combine human capital and financial expertise to deliver business solutions that drive shareholder value. Our consulting is grounded in the most extensive research in the business. This translates into unique perspectives and forward-thinking solutions.

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FOR MORE INFORMATION

Internet: www.watsonwyatt.com

Toll Free: 1-866-206-5723

E-mail: infocanada@watsonwyatt.com

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