

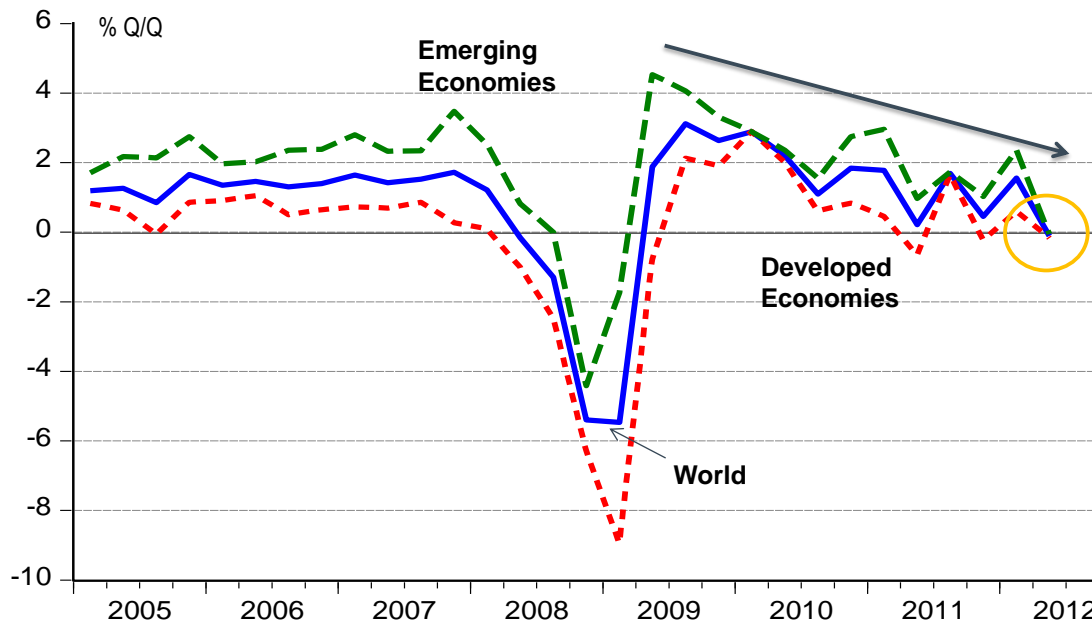


ECONOMIC OUTLOOK

The global economy has lost momentum in recent months with the rate of increase of industrial production falling to zero in both developed and emerging economies. Some signs of improvement can be seen, especially in the United States, but global economic growth remains weak and downside risks prevail.

Since 2008, central banks, notably the Federal Reserve in the United States, have provided important support to the global economy by implementing non-conventional monetary policies. However, the efficacy of these policies seems to be diminishing. With policymakers' margin of manoeuvre becoming increasingly narrow, a return to sustainable growth for the world economy will require the authorities to make sound policy decisions. More important, the capacity to execute such decisions with efficacy and credibility will be crucial.

The global economy decelerates Quarterly percentage increase in industrial production



Sources: Caisse de dépôt et placement du Québec, CPB Netherlands Bureau for Economic Policy Analysis, Datastream

In Europe, the policy response to the sovereign debt/banking crisis has repeatedly arrived at the last minute, often after acrimonious debate, and has been difficult to implement. Consequently, the European debt crisis has escalated to the point that it represents a genuine threat not only for Europe but also for the global economy.

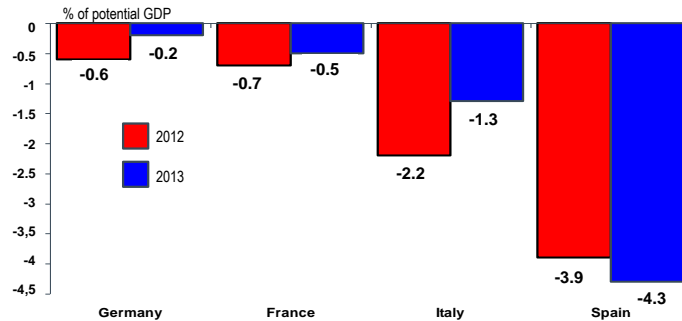
The euro-area economy fell back into recession in the second quarter of 2012 as a result of unprecedented fiscal austerity in several countries, most notably Italy and Spain, whose economies have been contracting sharply.

While fiscal austerity is a necessary part of the solution to the debt problem, the escalating weakness of the European economy calls into question the aggressiveness of the current austerity packages. Since the Euro Area Summit, held at the end of June, a comprehensive strategy for resolving the debt crisis appears to be taking shape. Europe needs an effective, well-executed plan to restore economic growth soon.

The United States is also in the process of reducing its indebtedness. Historically, episodes of deleveraging have been measured in years rather than in quarters and have been characterized by slow, fragile growth. To date, American households have made significant progress in repairing their balance sheets. There is also convincing evidence that the housing sector has bottomed and is beginning to improve. But government debt has increased markedly since the onset

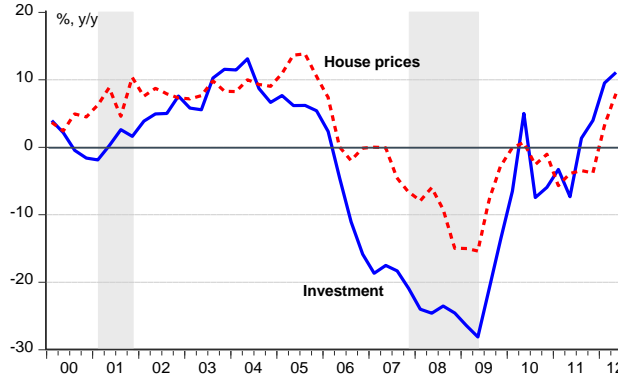
of the financial crisis and the next administration will have to begin to restore order to the public finances. The aggressiveness and content of the deficit-reduction plan will have major implications for the economy. Even if the so-called fiscal cliff is resolved by a multi-year plan of fiscal austerity, the result will be a U.S. economy that grows modestly at best. Strong political will and improved collaboration between the political parties will be required to manage the situation. The risk of political dysfunction in the United States remains omnipresent.

Fiscal austerity in the four principal economies of the euro area
Fiscal tightening as a percentage of potential GDP



Sources: Caisse de dépôt et placement du Québec, International Monetary Fund

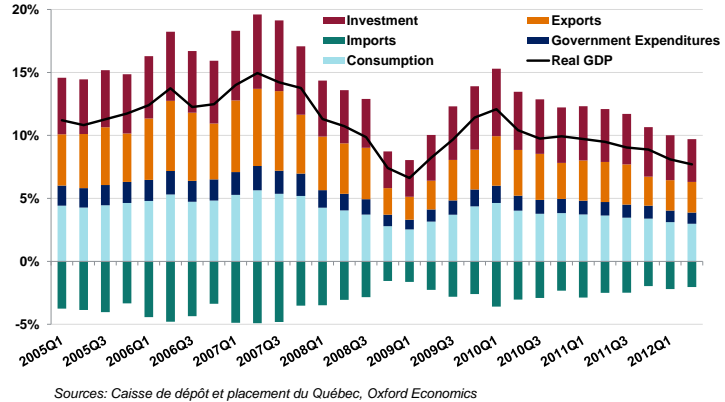
United States housing market: the worst has passed
Residential investment in constant dollars and the median price of single family homes



Sources: Caisse de dépôt et placement du Québec, Datastream

The growth rate of the Chinese economy has fallen from about 10 per cent to around 7.5 per cent in the past 18 months. The slowdown is largely attributable to a tightening of monetary policy in 2010 and early 2011 and weaker demand from Europe recently. Commencing last November, the Chinese authorities have responded with a series of measures to boost growth. The fruits of these efforts should become apparent soon. Nevertheless, China faces a major challenge. Going forward, it is clear that Chinese growth must be based much more on domestic consumption and much less on investment and exports. Given the importance of the Chinese economy for the Canadian economy, and especially Canadian financial markets, it is important that this challenge be deftly managed.

China: growth decelerates
Contributions to the increase in real GDP



Other emerging economies, such as Brazil and India, have also experienced sharp decelerations in economic growth in recent months. They will need to revitalize reform efforts in order to restore more rapid growth.

The prices of many food commodities have increased in recent weeks because of poor weather in many growing regions. Recently, the price of Brent crude oil has also risen considerably, owing, at least in part, to rising geopolitical tensions in the Middle East and the embargo imposed by the United Nations on imports of Iranian oil. Global economic growth could be weakened if these prices increase further – or even if they remain at current levels.

The prices of oil and food commodities surge
Prices of Brent crude oil and food index of the Commodity Research Bureau (CRB)

