

Economic Developments

MD&A

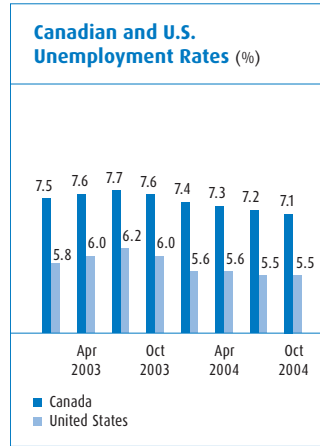
Canadian and U.S. Economic Developments in 2004

After slowing markedly in 2003 in response to a series of shocks, the Canadian economy strengthened in 2004. Consumer spending led the way, with declining interest rates fostering a pickup in personal loans. Demand for housing increased, boosting mortgage growth and residential construction. Business investment strengthened as rising commodity prices improved corporate profitability. Export growth rebounded unexpectedly in 2004 as strong U.S. demand more than offset the negative effects of a higher Canadian dollar. The strengthening economy reduced the unemployment rate in 2004, yet inflation stayed low. The Bank of Canada began raising overnight rates in September to forestall potential cost pressures as the excess capacity in the economy diminished.

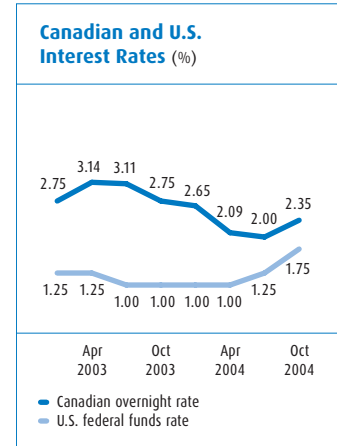
After accelerating in 2003, U.S. economic growth remained strong in 2004. Supported by low interest rates and reductions in personal income taxes, consumer spending moderated only slightly in the face of rising energy costs. Home sales remained brisk, hitting record highs in the spring and spurring strong demand for residential mortgages. Auto sales downshifted modestly from earlier highs, slowing the pace of personal lending. Business spending gathered momentum in 2004, with the export-oriented manufacturing sector benefiting from past weakness in the U.S. dollar. However, demand for business loans remained tepid as firms continued to finance spending from their cash flows and by accessing capital markets. Growing business confidence in the durability of the expansion has led to a pickup in employment. Although inflation remained tame in 2004, in the summer the Federal Reserve began raising overnight rates from 46-year lows to unwind some of the excessive monetary stimulus. Equity markets retained their sharp gains of the previous year, supporting BMO's brokerage businesses and underwriting activity.

Economic Outlook for 2005

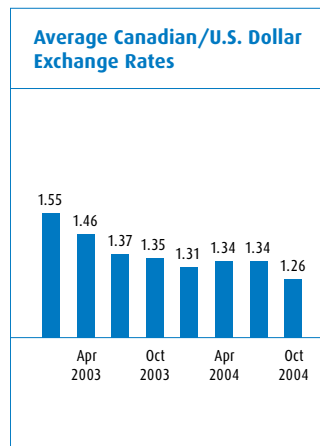
The Canadian economy is expected to grow at a moderate pace in 2005. Personal spending will continue to benefit from historically low, albeit rising, interest rates. Business investment should gather strength amid strong corporate profitability and increased confidence in the economic expansion. However, export growth will slow in response to the higher Canadian dollar. Interest rates should continue to rise gradually toward more normal levels, while the Canadian dollar is projected to strengthen further early in fiscal 2005 but pull back in the second half of the year when commodity prices are expected to moderate. The economic expansion should support growth in residential mortgages, personal loans and business lending. The improved economic climate should stimulate fee-based investment banking activity.



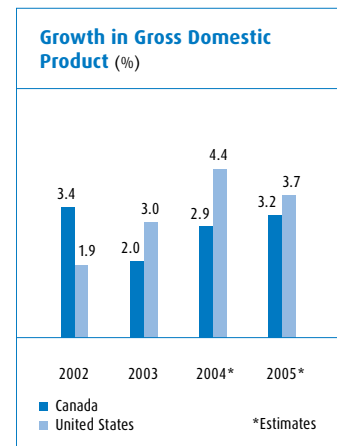
Canadian and U.S. jobless rates declined moderately in 2004.



Canadian short-term interest rates have started to follow their U.S. counterparts higher.



The U.S. dollar continued to weaken relative to the Canadian dollar.



The Canadian economy is expected to underperform the U.S. economy for the third straight year.

The U.S. economy is projected to grow strongly in 2005, led by business investment in productivity-enhancing capital equipment. However, the growth rate will moderate from the rapid pace of 2004 because of past increases in energy costs and waning support from monetary and fiscal policies. Housing market activity should cool down as rising interest rates reduce affordability, thereby lessening demand for residential mortgages. Conversely, continued strength in capital spending should stimulate demand for business loans. Interest rates will likely continue to increase gradually in 2005 as the Federal Reserve reduces the monetary stimulus in the economy.