

Economic Developments

Canadian and U.S. Economic and Financial Services Developments in 2005

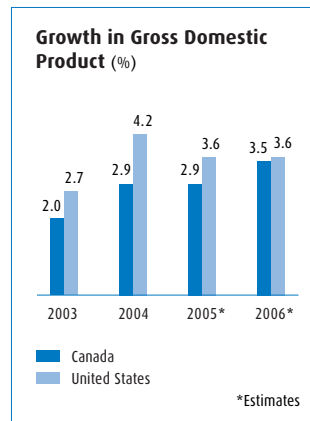
The Canadian economy continued to grow at a moderate pace in 2005, with support from low interest rates offset by the negative effects of a strong Canadian dollar. Consumer spending remained healthy, sustaining growth in personal loans. Housing markets continued to be buoyant, with record-high home sales, low interest rates and rising prices boosting residential construction and mortgage growth. Business investment again strengthened, promoting a pickup in business loans. Canada's unemployment rate fell in 2005 as a result of solid job growth. Despite rising energy costs, the inflation rate stayed low; however, the Bank of Canada began raising overnight rates in September to prevent cost pressures from building. With rising commodity prices shoring up corporate profits in some sectors, Canadian equity markets rose sharply in 2005, providing some support to BMO's brokerage businesses and underwriting activities.

The U.S. economy continued to grow at a healthy rate in 2005, though growth moderated from 2004 as severe hurricanes took a toll on the economies of several Gulf Coast states in the fall. Supported by low long-term interest rates and rising house prices, personal consumption remained strong despite much higher energy costs. Home sales again reached record highs in the summer, sustaining robust demand for residential mortgages, while business spending grew briskly throughout the year, spurring a pickup in business loans. Improved job growth pushed the unemployment rate to a four-year low in the summer. Meanwhile, as in 2004, the Federal Reserve raised short-term interest rates to remove excess monetary stimulus in the economy.

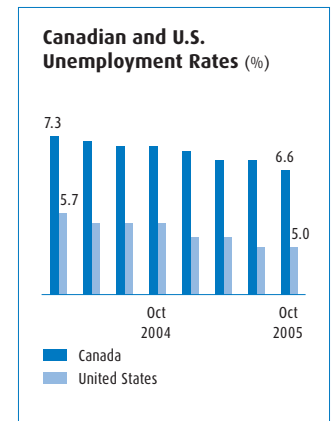
Economic and Financial Services Outlook for 2006

The Canadian economy is expected to grow more strongly in 2006 as the negative impact of the strong Canadian dollar dissipates. Personal spending should continue to benefit from low, albeit rising interest rates, while business investment should remain strong amid increased confidence in the economy's expansion. The Bank of Canada is expected to continue its recent practice of gradually raising interest rates toward more normal levels. An expected moderation in commodity prices should prevent the Canadian dollar from rising further against the U.S. dollar. A more robust economic expansion in 2006 will support further growth in residential mortgages, personal loans and business lending, though higher interest rates will temper the gains. The improved economic climate should also underpin fee-based investment banking activities.

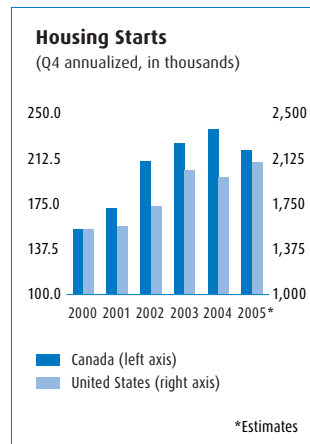
The U.S. economy is expected to again grow at a solid pace in 2006, fuelled in part by rebuilding activities along the Gulf Coast in the wake of severe hurricanes in 2005. Nationwide, business investment in productivity-enhancing capital equipment should stay strong, supporting further growth in business loans. Interest rates are forecast to rise modestly in 2006, reducing housing affordability and thereby lessening housing market activity and residential mortgage demand.



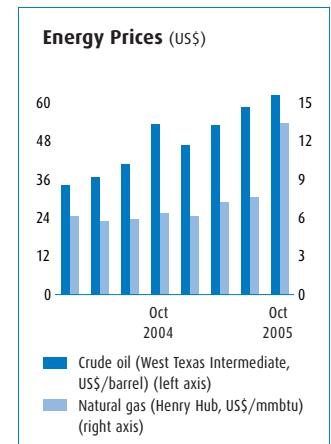
After underperforming for three consecutive years, the Canadian economy is expected to grow on par with the U.S. economy in 2006.



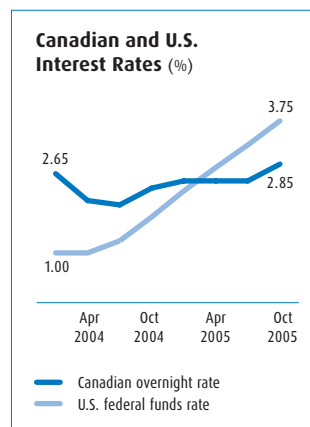
Canadian and U.S. jobless rates continue to decline.



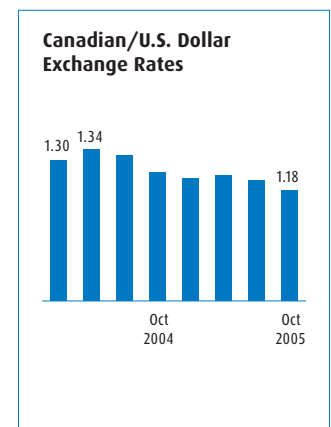
The pace of homebuilding in Canada and the United States remains high.



Energy prices hit record highs in 2005.



U.S. short-term interest rates have increased steadily relative to Canadian rates.



The Canadian dollar continued to appreciate against the U.S. dollar in 2005 with support from rising energy prices.