

Rating Report

Report Date:

July 27, 2010

Previous Report:

May 7, 2009



Insight beyond the rating.

Government of Canada

Analysts

Travis Shaw

+1 416 597 7582

tshaw@dbrs.com

Eric Beauchemin, CFA

+1 416 597 7552

ebeauchemin@dbrs.com

Recent Actions

May 7, 2009

Confirmed

Rating

Debt	Rating	Rating Action	Trend
Short-Term Liabilities, Cdn & Frgn Currency*	R-1 (high)	Confirmed	Stable
Long-Term Obligations, Cdn Currency*	AAA	Confirmed	Stable
Long-Term Obligations, Frgn Currency*	AAA	Confirmed	Stable

*Ratings and trends also apply to related federal entities. Please see note on page 8.

Rating Update

DBRS has confirmed the ratings of the Government of Canada (the Government or Canada) at AAA and R-1 (high) with Stable trends. While still challenging, Canada's fiscal position remains the envy of many developed nations and its strong credit profile is supported by a manageable debt burden, track record of prudent fiscal management and sound financial system. The Government's efforts to provide fiscal stimulus appear to have contributed to Canada's robust economic performance early in 2010, although considerable risks remain in the form of a further disruption in global demand, the strong Canadian dollar, and the tenuous state of the U.S. economic recovery, which could weigh on Canada's economic and fiscal performance.

Based on the 2010 budget, Canada is forecast to have recorded a sizeable deficit of \$53.8 billion in 2009-10, equivalent to 3.5% of GDP, although DBRS anticipates that final results may have been somewhat better than expected. As fiscal stimulus measures remain in place for another year, another sizeable deficit is expected for 2010-11 of \$49.2 billion, or 3.1% of GDP. DBRS notes that a robust economic recovery through the early part of the year may contribute to better-than-expected fiscal results in 2010-11, although the Government will still be challenged to meet its target of returning to near balance by 2014-15, given the global economic headwinds it faces. As a result of government commitment to not raise taxes or cut transfers, considerable emphasis is being placed on spending discipline, which will require Canada to make difficult choices to ensure that its fiscal plan remains on track. (Continued on page 2.)

Rating Considerations

Strengths

- (1) Manageable debt burden
- (2) Prudent, credible fiscal planning
- (3) Effective debt management strategy
- (4) Strong liquidity position
- (5) Sound financial system

Challenges

- (1) Stagnant productivity growth and ageing population
- (2) Unfunded public sector pension liability
- (3) Challenge from low-cost global manufacturers
- (4) Weak, though improving, fiscal outlook

Summary Statistics and Country Characteristics

	For the year ended December 31			
	2009	2008	2007	2006
Nominal GDP (CAD billions)	1,527	1,600	1,533	1,449
GDP per capita	45,258	48,011	46,549	44,487
Real GDP growth (% change yoy)	(2.9%)	0.6%	2.6%	2.8%
Current account balance (% GDP)	(2.9%)	0.4%	0.8%	1.4%
Inflation (% change year over year)	0.3%	2.3%	2.2%	2.0%
Total external debt (% GDP)	64.5%	59.8%	53.0%	55.6%
General government external debt (% GDP)	13.4%	8.8%	9.6%	9.9%

	For the year ended March 31			
	2009-10*	2008-09	2007-08	2006-07
Central government balance (% GDP)	(3.5%)	(0.4%)	0.6%	0.9%
Primary balance (% GDP)	(1.5%)	1.5%	2.8%	3.2%
Central government debt (% of GDP)	36.6%	32.1%	25.5%	28.6%
General government debt (% GDP)	n.a.	n.a.	48.3%	52.3%
Central government external debt (% of GDP)	0.7%	0.6%	0.6%	0.7%

*projection

Fiscal Management

Debt and Liquidity

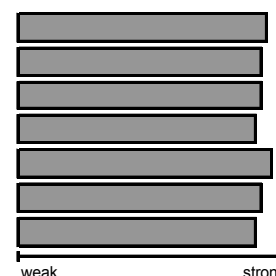
Economic Structure

Economic Performance

Monetary and Financial

External Trade and Finance

Political Environment



Rating Update (Continued from page 1.)

Following a significant contraction in 2009, the budget assumes real GDP growth of 2.6% in 2010, which now appears conservative in relation to the private-sector consensus and recent International Monetary Fund (IMF) forecast. However, the significant difficulties facing economies in the United States and Europe have resulted in reduced growth expectations going forward as the IMF points to real growth in Canada of 2.8% in 2011, compared to the 3.2% assumed in the budget.

The debt-to-GDP ratio (defined by DBRS as unmatured debt) is projected to have finished the 2009-10 year at approximately 37%, up from 32% the prior year. However, this ratio is still low for the rating and by international standards. Debt growth is expected to slow going forward as stimulus measures are unwound and the fiscal deficit reduced; along with a rebound in nominal GDP, this is likely to keep Canada's debt-to-GDP ratio unchanged at 37% in 2010-11. DBRS expects that while Canada may exceed fiscal targets in the current year, slower growth over the medium term, as a result of lingering disruptions in global demand, is likely to require meaningful discipline to ensure fiscal balance is restored in a time frame consistent with the budget plan.

Rating Considerations Details

Strengths

(1) **Manageable debt burden.** Canada's debt burden remains easily manageable, thanks to steady debt reduction through the late 1990s and early 2000s. Unmatured federal government debt was estimated at 37% of GDP for the year ended March 31, 2010, down from a peak of 58% in 1994-95. In addition, Canada's gross debt, as measured by the IMF, compares favourably with other G7 countries.

(2) **Prudent, credible fiscal planning.** The Government maintains a thorough budgeting process and conducts quarterly updates on the fiscal outlook, on top of regular monthly financial statements in accordance with the IMF's *Code of Good Practices on Fiscal Transparency*. In addition, economic assumptions built into the budgeting process are based on a survey of private-sector forecasters.

(3) **Effective debt management strategy.** The Government actively pursues a predetermined debt structure (currently 63% fixed rate) and a well-distributed maturity profile in order to reduce refinancing risk and minimize interest costs. Effort is also made to ensure that the market for government benchmark debt is well functioning and liquid, which has been especially beneficial as borrowing has been ramped up considerably in recent years.

(4) **Strong liquidity position.** Underpinning the solid R-1 (high) short-term rating, liquid financial resources were estimated to be \$72 billion at March 31, 2010, including \$26 billion in operating cash balances and \$47 billion in foreign currency reserves, covering foreign currency debt over five times. DBRS notes that operating cash balances are expected to be drawn down by \$15 billion, which helps to reduce borrowing needs.

(5) **Sound financial system.** A relatively sound financial system has allowed the Government to focus more on precautionary measures to preserve confidence rather than directly intervening to bail out financial institutions. Support was provided to the banking sector through the Insured Mortgage Purchase Program (IMPP) and the Canadian Lenders Assurance Facility (CLAF). The IMPP, which was only partially utilized, expired on March 31, 2010, while the CLAF also expired without being used by any institution.

Challenges

(1) **Stagnant productivity growth and aging population.** Over the past two decades, Canada's productivity growth has underperformed both the United States and many other OECD countries. This has reduced the rate of growth in potential output and, consequently, the standard of living. Stimulating productivity growth will become increasingly important as Canada's population ages and the labour force potentially shrinks. A rising dependency ratio will also require greater productivity increases in order to maintain sufficient economic growth to cover the higher costs of government services.

Government of Canada

Report Date:
July 27, 2010

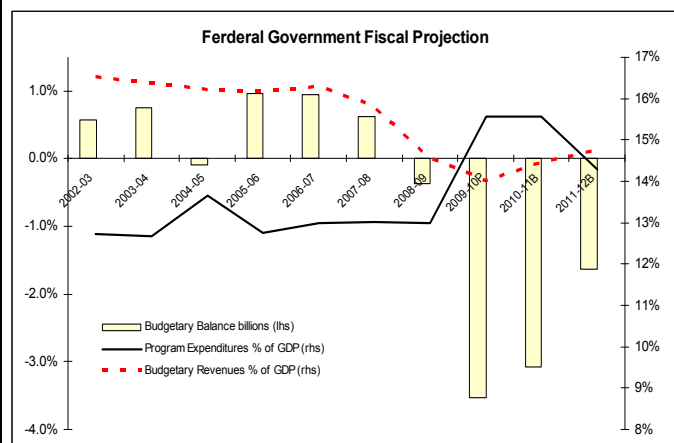
(2) **Unfunded public sector pension liability.** The unfunded pension liability of the federal public sector, along with non-pension future employee benefits, amounts to approximately 12% of GDP. While this is not overly large, the liabilities represent a future strain on government finances and have the potential to increase unmatured government debt.

(3) **Challenge from low-cost global manufacturers.** The emergence of developing economies pursuing export-led growth strategies presents a significant competitive challenge to the Canadian manufacturing sector, the impact of which is even more evident in the current environment. Lower labour and production costs have led to the dislocation of labour-intensive industries like textile, and the relocation of factories and jobs from Canada to abroad. This trend is expected to continue, as developing economies move from lower value-added exports to more complex products such as automobiles and pharmaceuticals.

(4) **Weak, though improving, fiscal outlook.** Following a substantial deficit in 2009-10, the medium-term budget outlook points to another sizeable deficit in 2010-11, followed by declining deficits through to 2014-15. This represents a somewhat weaker fiscal outlook than at the time of DBRS's last review in May 2009, when a return to balance was forecast for 2013-14. DBRS notes that while downside risks to the global economic recovery remain, stronger-than-expected performance through the first part of this year raises the possibility of a return to balance a year or two earlier than currently budgeted.

Fiscal Management and Policy

Based on the budget, fiscal results were projected to be weaker than planned as the Government forecast a preliminary 2009-10 deficit of \$53.8 billion. This is notably weaker than the \$33.7 billion that was originally budgeted, although the March 2010 Fiscal Monitor suggests that the deficit may actually have come in at \$47.0 billion. Total revenues are estimated to have fallen by 8.2% in 2009-10, primarily reflecting the impact of the economic downturn on personal and corporate income tax receipts along with tax relief measures. Meanwhile, total expenditures grew by an estimated 12.1% due to a combination of higher transfers to persons, other governments and higher direct program spending. Higher unemployment and a decision to enhance unemployment benefits resulted in growing transfers to persons while legislated increases in health-care and social spending and other time-limited programs boosted transfers to other governments.



For 2010-11, Canada faces a deficit of \$49.2 billion, or 3.1% of GDP, the lowest level of all G7 countries. As a result of robust economic activity through the early part of the year, DBRS expects that Canada is likely to outperform targets in 2010-11 but considerable effort will still be required to return to balance by 2014-15 as planned.

As stimulus measures largely wind down at the end of the current fiscal year, the deficit is expected to be notably reduced to \$27.6 billion (or 1.7% of GDP) in 2011-12 and continue falling until it reaches a near-balanced position in 2014-15. This forecast

assumes that revenue recovers somewhat faster than the economy, which is projected to grow at an average annual (nominal) rate of 5.1% between 2011 and 2014. Although DBRS views the current economic headwinds and uncertainty surrounding the U.S. recovery as considerable downside risks, Canada's track record of prudent fiscal management and commitment to return to balance provide comfort that its favourable fiscal position will be maintained. Based on the budget, a one percentage point change in real GDP would result in a \$3.1 billion change in the fiscal balance.

The bulk of the effort to return to balance will need to be made on the expenditure side, given the Government's stated intention to not raise taxes or cut transfers. To do this, the Government envisions

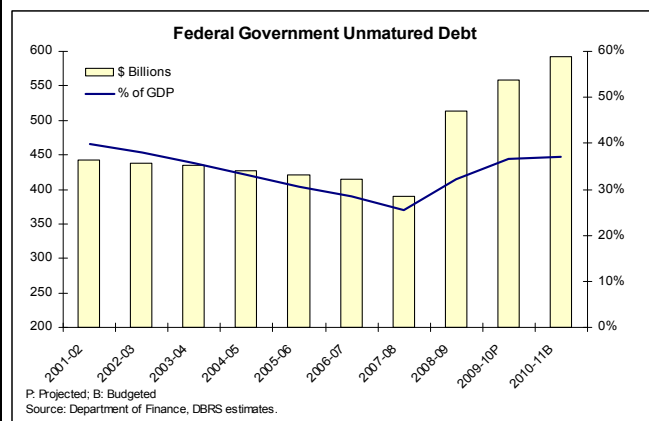
Government of Canada

Report Date:
July 27, 2010

limiting growth in national defense spending, capping international assistance payments at 2010-11 levels, requiring wage increases be met within existing budgets and freezing federal departmental operating budgets at 2010-11 levels. DBRS notes that these efforts, while viewed favourably, were planned in the context of a continued economic recovery, and any potential economic turbulence is likely to require Canada to make greater efforts to limit spending growth or alternatively, raise revenues, to ensure its plan to restore fiscal balance is maintained.

Debt and Liquidity

Based on the March 2010 Fiscal Monitor, Canada’s unmatured debt reached \$559 billion in 2009-10, representing an increase of 8.7% over the prior year. This equates to 36.6% of GDP, still a very manageable level and below what was expected at the time of last year’s review as a result of programs under the Extraordinary Financing Framework (EFF) not being fully utilized. After netting financial assets and including pension liabilities, Canada’s debt-to-GDP level was closer to 46%, as estimated by DBRS. Efforts to provide fiscal stimulus and enhance liquidity in the financial system have been the primary drivers of the debt stock. Based on the budget, growth in unmatured debt is expected to slow to 6.1% in 2010-11, pushing the debt-to-GDP ratio to 37.0% as growth in nominal GDP begins to recover and the deficit is reduced. Despite the meaningful increase in recent years, Canada’s debt-to-GDP ratio remains very manageable and compares favourably with other G7 countries.



Total debt issuance of \$251 billion is planned for 2010-11, \$220 billion of which represents refinancing needs, primarily for treasury bills (t-bills). The remainder relates to the fiscal deficit forecast. The forecasts also incorporate an expected drawdown of \$15 billion, which will help to reduce borrowing needs. Financing requirements for Crown corporations, including the Business Development Bank of Canada (BDC), Canada Mortgage and Housing Corporation (CMHC) and Farm Credit Canada (FCC), whose borrowing programs were consolidated with those of the federal government in 2008-09,

are much reduced from the prior year, forecast at only \$6 billion.

Gross bond issuance of \$95 billion is planned for 2010-11, somewhat reduced from the \$102 billion in forecast issuance for the prior year. Through the use of smaller bi-weekly auctions, the size of the t-bill program is expected to decline and end the current fiscal year with \$150 billion outstanding, roughly \$28 billion lower than at the end of 2009-10.

Economic Structure and Performance

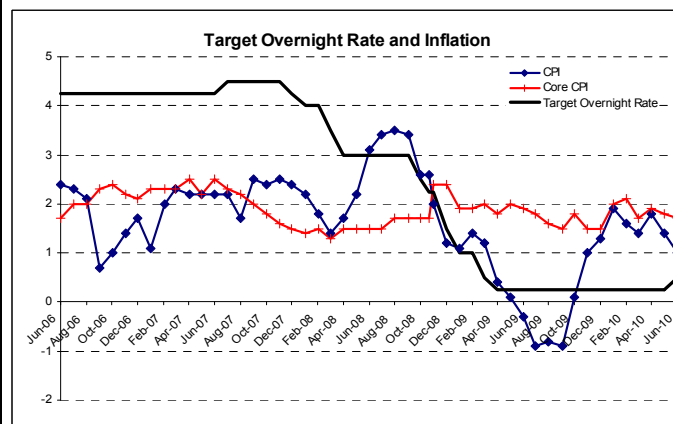
Canada’s economy contracted by 2.5% in 2009, marking the first recession since 1991 and the largest contraction since 1982. The decline experienced by Canada was one of the smallest among G7 countries, as a weak first half was offset by a sound recovery in the final two quarters supported by improving domestic demand and international trade.

For 2010, the budget assumes real GDP growth of 2.6%, which appears conservative when compared with the 3.4% private-sector consensus forecast tracked by DBRS. The latest IMF forecast also points to robust real growth of 3.6% for Canada in 2010. A strong rebound in labour markets has contributed to upward revisions in growth forecasts, with employment gains of over 300,000 through the first six months of 2010 and a reduction in the unemployment rate to 7.9% recorded as of June. The housing market has also been very resilient, with strong activity in the resale market and moderate activity in new housing starts. However,

there are signs that the real estate market may be beginning to slow through reduced sale activity following the implementation of tighter mortgage lending rules in April and the implementation of the Harmonized Sales Tax (HST) in Ontario and British Columbia.

The strong recovery reported year to date is likely to result in slower growth going forward, as some activity has been pulled forward through economic stimulus measures and historically low mortgage rates. For 2011, the budget assumes real GDP growth of 3.2%, while the recent IMF forecast points to growth of 2.8%. The key risks facing Canada remain the same as those highlighted by DBRS last year, namely, the pace and strength of the global recovery, household deleveraging in the United States and the relative strength of the Canadian dollar – factors that all carry considerable uncertainty going forward.

Monetary Policy and Financial Stability



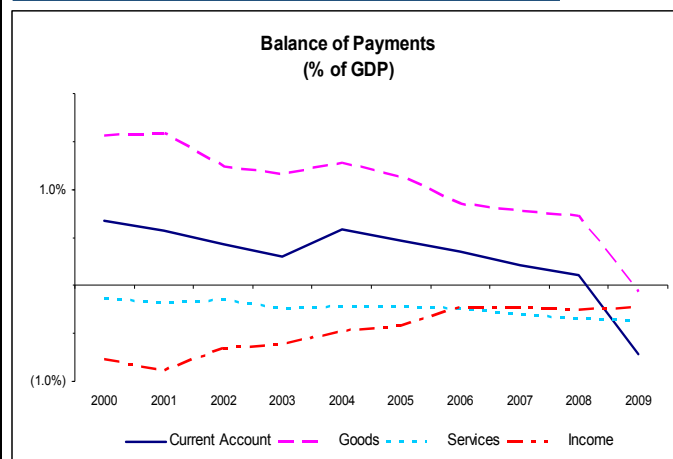
After maintaining the target overnight rate at a historical low of 0.25% for almost fourteen consecutive months, the Bank of Canada raised the target overnight rate by 25 basis points on both June 1, 2010, and July 20, 2010, to 0.75%. The Bank is expected to continue to gradually remove monetary stimulus but may pause periodically to assess the impact of potential global economic turbulence on inflation targets.

The Bank of Canada's latest *Monetary Policy Report* in July 2010 pointed to an output gap of minus 1.5% in the second quarter of 2010, with the economy not expected to return to full capacity until the end of 2011.

quarter of 2010, with the economy not expected to return to full capacity until the end of 2011.

As the financial markets have shown signs of improvement, Canada has allowed a number of measures established in the 2009 budget under the External Financing Framework to expire, including the Insured Mortgage Purchase Program, Canadian Lenders Assurance Facility and Canadian Life Insurers Assurance Facility. However, the Government will continue to support programs offered through the Business Development Bank of Canada and Export Development Canada to ensure adequate credit availability to businesses.

Balance of Payments



For the first time since 1998, the Canadian current account balance reached a deficit position (0.7% of GDP) in 2009, after declining steadily over the last four years. Weakness was particularly evident in industrial goods, energy and agricultural products, reflective of the economic downturn, with the goods deficit accounting for the bulk of the decline in the current account balance. The service deficit was little changed, at 0.4% of GDP, while the investment income deficit experienced a notable decline as smaller deficits in direct investment income and other investment income more than offset a wider portfolio investment income deficit. A strengthening

Canadian dollar in recent years has also had an impact on trade, particularly with the United States, as the goods surplus has declined notably over the last four years.

**Government of
Canada**

Report Date:
July 27, 2010

Political Environment

Last Election: October 2008

Next Election: October 2012

Party in Power: The Conservative Party of Canada maintains a minority government with 145 of 308 seats

Since the October 2008 election, the Conservative Party of Canada has gained an additional two seats through by-elections in late 2009 but nonetheless remain in a minority position. Two recent polls conducted by Ekos Research Associates and Nanos Research shows that the Liberals continue to trail the governing Conservative party by 4% to 7%.

**Government of
Canada**
Report Date:

July 27, 2010

Selected Indicators

For the year ended March 31, unless otherwise noted

\$ billions unless otherwise noted.

	2009-10**	2008-09	2007-08	2006-07	2005-06	2004-05
Public Debt						
General Government	n.a.	n.a.	739.7	758.4	774.4	791.2
% GDP	n.a.	n.a.	48.4%	52.3%	56.4%	61.3%
Central Government	558.9	514.0	390.7	414.2	421.1	427.4
% GDP	36.6%	32.1%	25.5%	28.6%	30.7%	33.1%
Domestic Debt						
Central Government	548.6	503.6	381.2	403.8	407.1	411.1
% GDP	35.9%	31.5%	24.9%	27.8%	29.6%	31.8%
External Debt						
General Government*	204.0	141.1	146.9	143.9	138.3	140.3
% GDP	13.4%	8.8%	9.6%	9.9%	10.1%	10.9%
Central Government	10.4	10.4	9.5	10.4	14.1	16.3
% GDP	0.7%	0.6%	0.6%	0.7%	1.0%	1.3%
Gross External Debt*	984.2	956.5	812.4	805.6	737.9	728.8
% GDP	64.4%	59.8%	53.1%	55.5%	53.7%	56.5%
Net External Debt*	937.6	904.8	770.1	761.4	697.1	687.9
% GDP	61.4%	56.6%	50.3%	52.5%	50.7%	53.3%
% of Current Account Receipts	186.5%	140.4%	124.3%	127.2%	121.1%	127.5%
Fiscal Balances (% GDP)						
Central Government Balance	(3.5%)	(0.4%)	0.6%	0.9%	1.0%	(0.1%)
Revenues	14.0%	14.6%	15.8%	16.3%	16.2%	16.2%
Expenditures	17.5%	14.9%	15.2%	15.3%	15.2%	16.3%
Interest Payments	2.0%	1.9%	2.2%	2.3%	2.5%	2.6%
Interest Payments (% revenues)	14.3%	13.0%	13.9%	14.1%	15.4%	16.0%
Central Government Primary balance	(1.5%)	1.5%	2.8%	3.2%	3.5%	2.5%
General Government Balance	n.a.	0.2%	2.1%	1.8%	1.9%	1.7%
Balance of Payments & Liquidity*						
Current account balance	(43.5)	6.9	12.8	20.5	25.9	29.8
% GDP	(2.8%)	0.4%	0.8%	1.4%	1.9%	2.3%
Trade balance	(27.2)	23.9	28.6	35.5	50.3	54.8
Foreign direct investment (% GDP)	(1.5%)	(1.7%)	4.0%	1.1%	(0.2%)	(4.4%)
International reserves	46.6	51.7	42.3	44.2	40.8	40.9
International reserves (ratio to short-term external debt)	n.a.	n.a.	13.9%	17.6%	18.9%	21.7%
International Investment Position	n.a.	6.7	(125.7)	(84.6)	(164.9)	(190.4)
External assets	n.a.	1,486	1,199	1,188	996	953
External liabilities	n.a.	1,479	1,324	1,273	1,161	1,143
Other Indicators*						
Real GDP (% change yoy)	(2.9%)	0.6%	2.6%	2.8%	3.0%	3.1%
Inflation (CPI)	0.3%	2.3%	2.2%	2.0%	2.2%	1.8%
Exchange rate index (CERI % change yoy)	1.9%	(0.6%)	4.9%	6.8%	7.3%	6.0%
Exchange rate (end of year CAD/USD)	1.05	1.22	0.99	1.17	1.17	1.20
Credit to private sector (% change yoy)	3.4%	9.8%	8.4%	9.1%	7.0%	7.1%
Government 1-year bond yield	0.6%	2.6%	4.3%	4.2%	3.1%	2.6%

* Based on calendar year-end. **2009-10 government data are projections and not yet finalized. n.a. = not available.

Note: General Government consists of federal, provincial and local governments; General Government total debt is calculated as financial liabilities minus financial assets. Central Government debt (also known as unmatured debt) consists of marketable bonds, notes and bills, Canada Savings Bonds, Canada Investment Bonds, Canada Premium Bonds, Canadian Pension Plan (CPP) bonds and foreign currency bills, bonds and notes, obligations related to capital leases, amortization and foreign currency valuation adjustments. General Government balance includes the CPP and Québec Pension Plan.



Government of Canada

Report Date:
July 27, 2010

Rating

Debt	Rating	Rating Action	Trend
Short-Term Liabilities, Cdn & Frgn Currency	R-1 (high)	Confirmed	Stable
Long-Term Obligations, Cdn Currency	AAA	Confirmed	Stable
Long-Term Obligations, Frgn Currency	AAA	Confirmed	Stable

Rating History

	Current	2009	2008	2007	2006	2005
Short-Term Liabilities, Cdn & Frgn Currency	R-1 (high)	R-1 (high)	R-1 (high)	R-1 (high)	R-1 (high)	R-1 (high)
Long-Term Obligations, Cdn Currency	AAA	AAA	AAA	AAA	AAA	AAA
Long-Term Obligations, Frgn Currency	AAA	AAA	AAA	AAA	AAA	AAA

Notes:

All figures are in Canadian dollars unless otherwise noted.

The ratings and trends of the Government of Canada apply to the debt of the following entities guaranteed by the Government of Canada either explicitly or implicitly through agency status:

Business Development Bank	Farm Credit Canada
Canada Mortgage & Housing Corp.	NHA Mortgage-Backed Securities
Canada Post Corporation	The Canadian Wheat Board (only guaranteed debt)
Export Development Canada	

Copyright © 2010, DBRS Limited and DBRS, Inc. (collectively, DBRS). All rights reserved. The information upon which DBRS ratings and reports are based is obtained by DBRS from sources believed by DBRS to be accurate and reliable. DBRS does not perform any audit and does not independently verify the accuracy of the information provided to it. DBRS ratings, reports and any other information provided by DBRS are provided "as is" and without representation or warranty of any kind. DBRS hereby disclaims any representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability, fitness for any particular purpose or non-infringement of any of such information. In no event shall DBRS or its directors, officers, employees, independent contractors, agents and representatives (collectively, DBRS Representatives) be liable (1) for any inaccuracy, delay, loss of data, interruption in service, error or omission or for any damages resulting therefrom, or (2) for any direct, indirect, incidental, special, compensatory or consequential damages arising from any use of ratings and rating reports or arising from any error (negligent or otherwise) or other circumstance or contingency within or outside the control of DBRS or any DBRS Representative, in connection with or related to obtaining, collecting, compiling, analyzing, interpreting, communicating, publishing or delivering any such information. Ratings and other opinions issued by DBRS are, and must be construed solely as, statements of opinion and not statements of fact as to credit worthiness or recommendations to purchase, sell or hold any securities. A report providing a DBRS rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. DBRS receives compensation for its rating activities from issuers, insurers, guarantors and/or underwriters of debt securities for assigning ratings and from subscribers to its website. DBRS is not responsible for the content or operation of third party websites accessed through hypertext or other computer links and DBRS shall have no liability to any person or entity for the use of such third party websites. This publication may not be reproduced, retransmitted or distributed in any form without the prior written consent of DBRS. ALL DBRS RATINGS ARE SUBJECT TO DISCLAIMERS AND CERTAIN LIMITATIONS. PLEASE READ THESE DISCLAIMERS AND LIMITATIONS AT <http://www.dbrs.com/about/disclaimer>. ADDITIONAL INFORMATION REGARDING DBRS RATINGS, INCLUDING DEFINITIONS, POLICIES AND METHODOLOGIES, ARE AVAILABLE ON <http://www.dbrs.com>.