TD Bank Financial Group

TD Economics

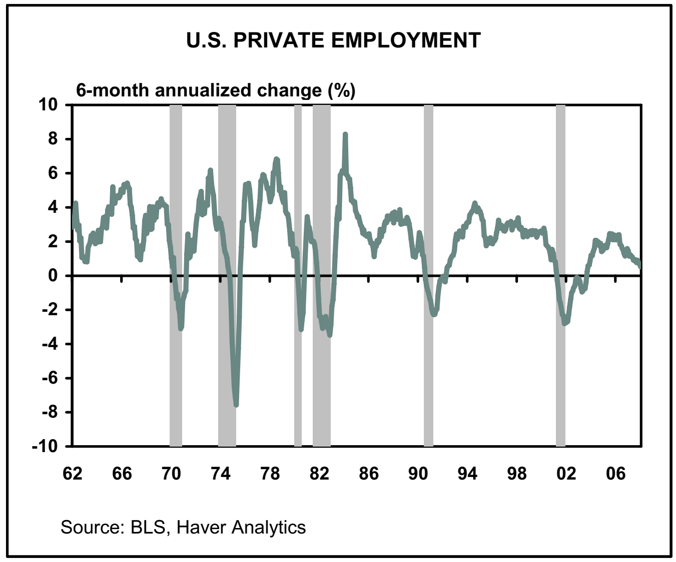
The Weekly Bottom Line

February 1, 2008

HIGHLIGHTS

- **U.S. and Canadian economic conditions weaken**
- **Monetary/Fiscal policy levers being pulled to limit downside**

This week's major data releases confirmed that the North American economy lost considerable momentum in the final quarter of 2007, and most indicators suggest that the slump will continue through the first two or three quarters of 2008. This assessment was not lost on financial markets, which responded with equity market losses, a rally in bonds, and a weakening in the U.S. dollar. However, things are not all bleak. The seeds for an eventual recovery are being planted, and even if the U.S. experiences a recession in the near term there is good reason to believe that it would be quite mild.



U.S. economy is struggling

Talk of a U.S. recession has become deafening, but economic developments are still consistent with the economy slowing to a virtual halt, rather than experiencing a major downturn. Economic growth in the fourth quarter of 2007 came in at a meagre 0.6% annualized, but the headline overstated the weakness. A drawdown in inventories cut a whopping 1.25 percentage points from the change in real GDP. Conversely, final sales (i.e. real GDP less inventories) advanced by 1.9% – a weak performance, but far from a tragedy. The inventory-to-sales ratio has plunged to quite low levels, providing a ray of hope that inventories will not continue to contract. And, much of the drop has been in auto inventories, raising the question of whether the reduction was simply a reversal of inventories stockpiled in the third quarter in advance of union negotiations that could have led to strikes. If so, much of the swing in inventories is simply volatility that won't continue.

A bigger issue is how final sales will hold up in the coming months. On this front, Friday's payroll report for January was discouraging. 17,000 jobs were lost last month, and while data revision made interpreting the report difficult, the Bureau of Labor Statistics cut 136,000 private payrolls from their prior estimates for 2007. Some comfort came from news that the unemployment rate edged down a tenth of a percentage point to 4.9% in January, but this followed a sharp 0.3 percentage point increase in the prior month – so the trend is still up and unemployment is a lagging indicator. A better predictor for where the economy is headed is the 6-month average growth in private employment, and the news here is not favourable, since the pace of growth has tipped down to a mere 0.5% annualized.

For some time, we have stressed that labour market

Recent TD Economics Research

February 1, 2008 - U.S. ISM Manufacturing Index
February 1, 2008 - U.S. Employment
January 31, 2008 - Canadian Real GDP
January 31, 2008 - U.S. Personal Income & Spending
January 30, 2008 - Has The Canadian Dollar Gone Too Far, Too Fast? (pdf)
January 30, 2008 - U.S. FOMC Decision
January 30, 2008 - U.S. Real GDP
January 29, 2008 - U.S. Durable Goods Orders

conditions are key as to how well Americans weather the negative wealth effects from falling home prices, the tightening in credit conditions and the impact of mortgage resets. The latest trends suggest that consumer spending is poised to slow considerably in the coming quarters.

Other key activity reports were far less negative and suggest that there may be partial offsets to the weakness on the consumer front. U.S. durable goods orders surprised on the upside in December by jumping 5.2%. Core capital goods orders, which are a good leading indicator for business investment in machinery and equipment, rose 4.4%. Meanwhile, the ISM manufacturing index rebounded to 50.7 in January – a reading that is historically consistent with growth in manufacturing and a solid gain for the overall economy. Given that the economic weakness is concentrated in housing, financial services and, soon to be, consumer spending, the level of the ISM manufacturing index is probably overstating the strength in the economy – but it is still consistent with growth and not a recession.

U.S. policy levers being pulled to fuel growth

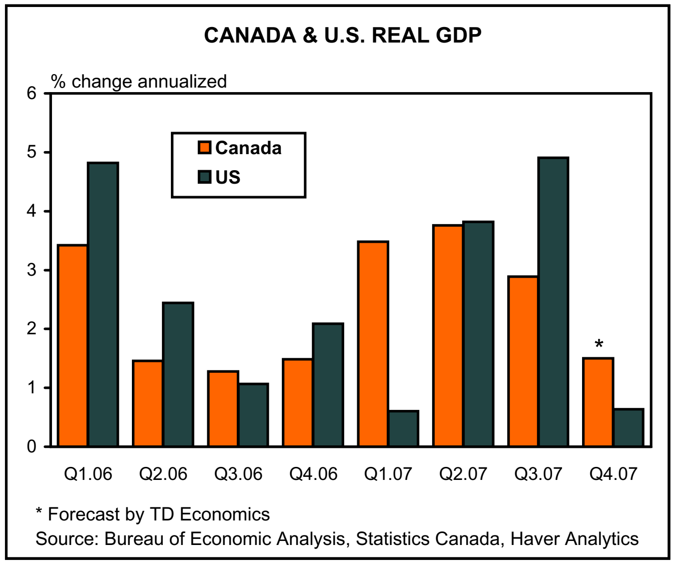
So, the jury is still out on whether the U.S. will have tepid growth or a mild contraction, but U.S. policymakers are taking no chances. The Federal Reserve fulfilled financial market expectations by cutting rates by a further 50 basis points, lowering the fed funds rate to 3%. The Fed has cut by a cumulative 2.25 percentage points since last summer and monetary policy is now clearly pushing on the accelerator. The Fed noted that “downside risks to growth remain.” This is a less negative assessment than last time, but still hints that further easing is in the pipeline.

Meanwhile, fiscal policy is swinging into action. The House of Representatives passed a US$146 billion economic stimulus package. The Senate still has to ratify, but it is only a matter of time before tax rebates and tax breaks are enacted. The details still need to be worked out, but based on the current proposals there could be a significant boost to economic growth in the second half of the year.

The main message is that the next six months could prove quite difficult. Economic growth is likely to slow, and the economy might even contract. Nevertheless, policy measures are rapidly coming into place to help the economy get back on its feet. And, the fallout from the credit crunch should be known by the summer.

Canada to go along for the ride

In Canada, we also received confirmation that an economic slowdown is underway. The economy expanded by a mere 0.1% in November, settting the stage for modest



annualized growth of around 1.5% in the final quarter of last year. The domestic side of the Canadian economy continues to show strength. Service-producing industries recorded solid gains in November. However, conditions in the good-producing sector have deteriorated. Although utilities and construction increased output, the advance in these industries was swamped by declines by natural resources, mining and oil, and manufacturing. This is consistent with the view that the softness in the economy is largely the product of a strong Canadian dollar that is hampering exports and weakness in the U.S. economy that is the destination for the bulk of Canadian international shipments. The news on this front is unlikely to improve. The Business Conditions Survey for manufacturing showed that firms are expecting lower production and employment levels in the next three months. The U.S. developments outlined above also point to a weak export performance.

All of this is in line with the Bank of Canada’s expectations. In the latest Monetary Policy Report, the Bank suggested that economic growth slowed in the fourth quarter and is likely to be only slightly above 1% in the first half of 2008, implying that core inflation will likely remain below the 2% target for some time. This matches our own expectations. Moreover, in a speech this week Bank officials reiterated that, “further monetary stimulus is likely to be required in the near term to keep aggregate supply and demand in balance, and to return inflation to target over the medium term.” In our opinion, this builds the case for rate cuts at the next two fixed announcement dates, with as much as 75 basis points of easing to come.

Craig Alexander, VP & Deputy Chief Economist
416-982-8064

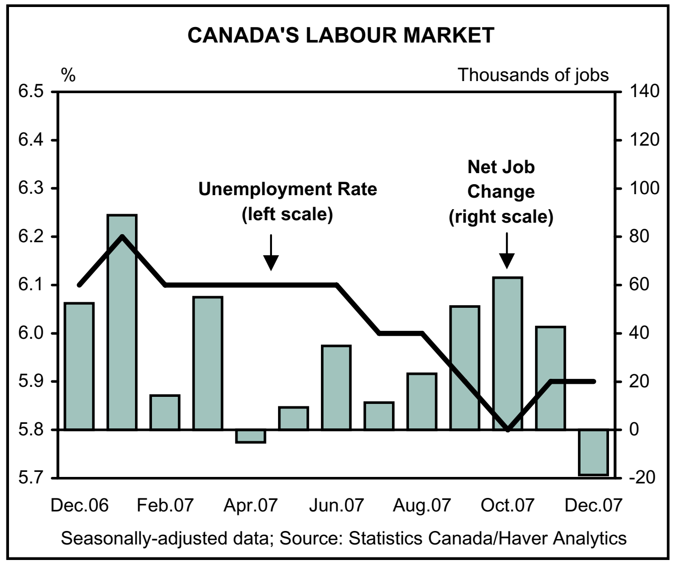
UPCOMING KEY ECONOMIC RELEASES

Canadian Employment - January

Release Date: February 8/08
December Result: -19K; unemployment rate 5.9%
TD Forecast: 10K; unemployment rate 6.0%
Consensus: 10K; unemployment rate 5.9%

We're expecting to see Canadian employment improve from the 19K loss in January, but still come in below-trend at 10K. The Canadian economy has averaged about 25K new jobs per month over the last ten years, and an even stronger 30K for the last two years. But given the slowdown in economic growth that we're expecting over the next couple of quarters, we may see a period of somewhat weaker job growth, accompanied by a moderate increase in the unemployment rate. We're expecting to see the unemployment rate rise to 6.0% in January, an increase from its recent record-low levels.

Jacqui Douglas 416-982-7784

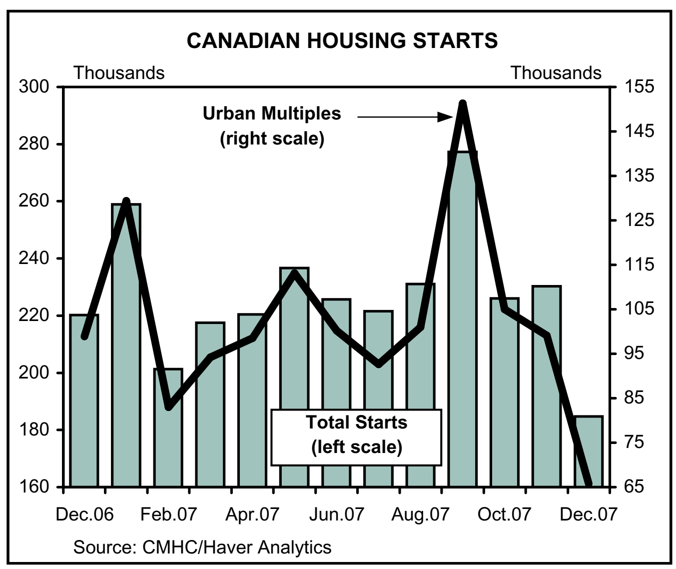


Canadian Housing Starts - January

Release Date: February 8/08
December Result: 185K
TD Forecast: 215K
Consensus: 210K

We're expecting to see housing starts rebound in January to 215K, after falling to only 185K in December. The December report mentioned that a lot of the weakness in housing starts was due to bad weather, which is unlikely to be a negative factor again in January, since the temperature was actually a little higher than usual. Residential building permits have remained strong and general economic conditions in Canada remain healthy, so we believe that the extreme softness in December was a one-off event, and that housing starts will slow only gradually through 2008.

Jacqui Douglas 416-982-7784



RECENT KEY ECONOMIC INDICATORS
January 28 - February 1, 2008

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
Jan. 29	Business Conditions Orders	Jan.	Index	2.0	-3.0	
Jan. 31	Real GDP at Basic Prices	Nov.	% change	0.1	0.2	
Feb. 1	Industrial Product Price Index	Dec.	% change	1.1	0.6	
Feb. 1	Raw Materials Price Index	Dec.	% change	0.2	3.4	
United States						
Jan. 28	New Home Sales	Dec.	Thousands	604	634	R▼
Jan. 29	Durable Goods Orders	Dec.	% change	5.2	0.5	R▲
Jan. 29	S&P/CS Composite-20	Nov.	Index	-7.7	-6.1	
Jan. 29	Consumer Confidence	Jan.	Index	87.9	90.6	R▲
Jan. 30	ADP Employment Change	Jan.	Thousands	130	37	R▼
Jan. 30	Real Gross Domestic Product (advance)	Q4-07	Ann. % chg.	0.6	4.9	
Jan. 30	Personal Consumption (advance)	Q4-07	Ann. % chg.	2.0	2.8	
Jan. 30	*FOMC Rate Decision*	*Jan. 30*	*Overnight Rate*	*3.00*	*3.50*	
Jan. 31	Personal Income	Dec.	% chg.	0.5	0.4	
Jan. 31	Personal Spending	Dec.	% chg.	0.2	1.0	R▼
Jan. 31	PCE Deflator	Dec.	Y/Y % chg.	3.5	3.6	
Jan. 31	PCE Core	Dec.	Y/Y % chg.	2.2	2.2	
Jan. 31	Weekly Initial Jobless Claims	26-Jan	Thousands	375	306	R▲
Jan. 31	Employment Cost Index	Q4-07	Q/Q % chg.	0.8	0.8	
Jan. 31	Chicago Purchasing Managers Index	Jan.	Index	51.5	56.4	R▼
Feb. 1	Change in Non-farm Payrolls	Jan.	Thousands	-17.0	82.0	R▲
Feb. 1	Unemployment Rate	Jan.	Per cent	4.9	5.0	
Feb. 1	Average Hourly Earnings	Jan.	% change	0.2	0.4	
Feb. 1	ISM Index (manufacturing)	Jan.	Index	50.7	48.4	R▲
Feb. 1	Construction Spending	Dec.	% change	-1.1	-0.4	R▼
Feb. 1	Total Vehicle Sales	Jan.	Millions	n/a	16.3	
Feb. 1	Domestic Vehicle Sales	Jan.	Millions	n/a	12.5	

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR
February 4-8, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
	Canada				
Feb. 6	Building Permits	Dec.	% change	-0.5	-9.9
Feb. 6	Ivey Purchasing Managers Index	Jan.	Index	46.0	45.9
Feb. 8	Unemployment Rate	Jan.	Per cent	5.9	5.9
Feb. 8	Net Change in Employment	Jan.	Thousands	10.0	-18.7
Feb. 8	Housing Starts	Jan.	Thousands	210.0	184.7
	United States				
Feb. 4	Factory Orders	Dec.	% change	2.4	1.5
Feb. 4	*Fed Governor Kroszner speaks at a securitization forum in Las Vegas, NV*				
Feb. 5	*Richmond Fed President Lacker speaks on the U.S. economy in Charleston, WV*				
Feb. 6	Non-farm Productivity (prelim.)	Q4-07	Ann. % chg.	1.0	6.3
Feb. 6	Unit Labour Costs (prelim.)	Q4-07	Ann. % chg.	3.1	-2.0
Feb. 6	*Richmond Fed President Lacker speaks at Marshall University in Huntington, WV*				
Feb. 6	*Fed Governor Kroszner speaks to mortgage brokers in Washington, D.C*				
Feb. 6	*Philadelphia Fed President Plosser speaks on the economic outlook in Birmingham, AL*				
Feb. 7	Weekly Initial Jobless Claims	2-Feb	Thousands	n/a	375
Feb. 7	*Atlanta Fed President Lockhart speaks to the Association of Corporate Growth in Atlanta, GA*				
Feb. 7	*Dallas Fed President Fisher speaks on economic stability in Mexico City, Mexico*				
Feb. 8	*San Francisco Fed President Yellen speaks on the economy in Honolulu, Hawaii*				
Feb. 8	Wholesale Inventories	Dec.	% Chg.	0.3	0.6
Feb. 8	*Atlanta Fed President Lockhart speaks on financial markets and the economy in Atlanta, GA*				

Source: Bloomberg, TD Economics

G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
Feb. 3	19:50	Japan	Monetary Base (YoY)	Jan.	Y/Y % chg.	0.2	0.4
	20:30	AU	Trade Balance	Dec.	AU, blns	-2.0	-2.3
Feb. 4	5:00	EU	Euro-Zone PPI	Dec.	% change	0.1	0.8
	10:00	U.S.	Factory Orders	Dec.	% change	2.4	1.5
	11:20	*U.S.*	*Fed Governor Kroszner speaks at a securitization forum in Las Vegas, NV*				
	19:30	AU	Retail Sales	Dec.	% change	0.6	0.8
	22:30	*AU*	*RBA Cash Target*	Feb.	*Cash Rate*	*7.00*	*6.75*
Feb. 5	3:50	France	Services Index	Jan.	Index	57.7	58.9
	3:55	Germany	Services Index	Jan.	Index	50.6	51.2
	4:30	U.K.	Services Index	Jan.	Index	52.0	52.0
	5:00	EU	Retail Trade	Dec.	% change	0.2	-0.5
	12:15	*U.S.*	*Richmond Fed President Lacker speaks on the U.S. economy in Charleston, WV*				
Feb. 6	1:00	Japan	Leading Economic Index (prelim.)	Dec.	Index	40.0	18.2
	1:00	Japan	Coincident Index (prelim.)	Dec.	Index	66.7	30.0
	8:30	U.S.	Non-farm Productivity (prelim.)	Q4-07	Ann. % chg.	1.0	6.3
	8:30	U.S.	Unit Labour Costs (prelim.)	Q4-07	Ann. % chg.	3.1	-2.0
	8:30	Canada	Building Permits	Dec.	% change	-0.5	-9.9
	10:00	Canada	Ivey Purchasing Managers Index	Jan.	Index	46.0	45.9
	10:00	U.S.	*Richmond Fed President Lacker speaks at Marshall University in Huntington, WV*				
	10:30	U.S.	*Fed Governor Kroszner speaks to mortgage brokers in Washington, D.C*				
	10:30	U.K.	Leading Economic Index	Dec.	Index	n/a	-0.3
	10:30	U.K.	Coincident Index	Dec.	Index	*n/a*	*0.2*
	13:40	*U.S.*	*Philadelphia Fed President Plosser speaks on the economic outlook in Birmingham, AL*				
	18:45	NZ	Unemployment Rate	Q4-07	Per cent	3.6	3.5
Feb. 7	2:00	Japan	Machine Tool Orders (prelim.)	Jan.	Y/Y % chg.	n/a	3.7
	2:45	France	Trade Balance	Dec.	Eur$, blns	-4.2	-4.8
	4:30	U.K.	Industrial Production	Dec.	% Chg.	0.2	-0.1
	4:30	U.K.	Manufacturing Production	Dec.	% Chg.	0.1	-0.1
	6:00	Germany	Factory Orders	Dec.	% change	-2.0	3.4
	7:00	*U.K.*	*Bank of England rate announcement*		*Base rate*	*5.25*	*5.50*
	7:45	*EU*	*European Central Bank rate announcement*		*Refin. rate*	*4.00*	*4.00*
	8:30	U.S.	Weekly Initial Jobless Claims	2-Feb	Thousands	n/a	375
	8:30	*U.S.*	*Atlanta Fed President Lockhart speaks to the Association of Corporate Growth in Atlanta, GA*				
	13:00	*U.S.*	*Dallas Fed President Fisher speaks on economic stability in Mexico City, Mexico*				
	18:50	Japan	Machine Orders	Dec.	Y/Y % chg.	-1.1	0.9
	18:50	Japan	Money Supply (M2+CD)	Jan.	Y/Y % chg.	2.1	2.1
	18:50	Japan	Broad Liquidity	Jan.	Y/Y % chg.	3.5	3.6
Feb. 8	0:25	*U.S.*	*San Francisco Fed President Yellen speaks on the economy in Honolulu, Hawaii*				
	2:00	Germany	Trade Balance	Dec.	Eur, blns	16.8	19.3
	2:00	Germany	Current Account Balance	Dec.	Eur, blns	17.0	20.0
	6:00	Germany	Industrial Production	Dec.	% Chg.	1.0	-0.9
	6:00	EU-12	OECD Leading Indicators	Dec.	Index	n/a	98.1
	7:00	Canada	Unemployment Rate	Jan.	Per cent	5.9	5.9
	7:00	Canada	Net Change in Employment	Jan.	Thousands	10.0	-18.7
	8:15	Canada	Housing Starts	Jan.	Thousands	210.0	184.7
	10:00	U.S.	Wholesale Inventories	Dec.	% Chg.	0.3	0.6
	13:00	*U.S.*	*Atlanta Fed President Lockhart speaks on financial markets and the economy in Atlanta, GA*				

* Eastern Standard Time; Sources: Bloomberg, TD Economics