TD Bank Financial Group

TD Economics

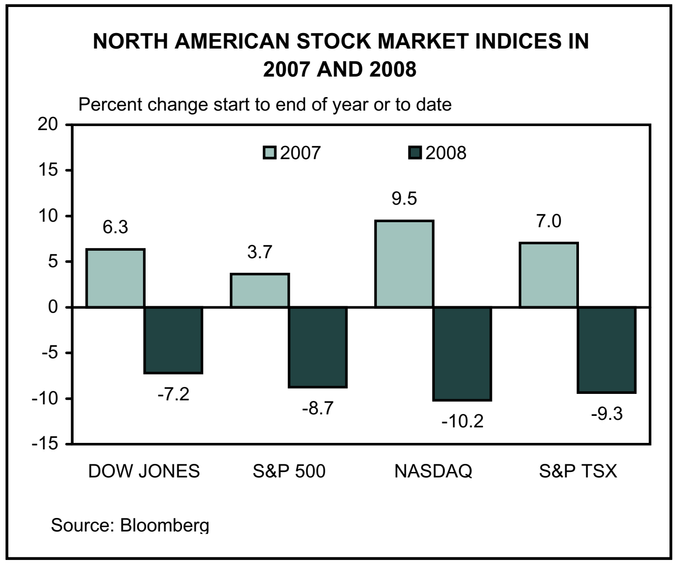
The Weekly Bottom Line

January 18, 2008

HIGHLIGHTS

- **Bernanke endorses a fiscal stimulus package, stock markets fall anyway**
- **Bank of Canada expected to cut rates 25 basis points next week**

With all the talk of a U.S. recession flooding the news waves the past few weeks, all ears were on Fed Chairman Ben Bernanke's testimony to the House Budget Committee this Thursday. For the most part, Bernanke's comments mirrored the message he delivered in a speech last Friday, namely that "the downside risks to growth have become more pronounced" and the Fed "stand[s] ready to take substantive additional action…to support growth." What was new (at least to observers outside of recent closed door meetings on Capital Hill) was his qualified endorsement of a fiscal stimulus package to support economic growth in the next year.



Keynesian economics to the rescue!

Bernanke's comments gave credence to the notion that fiscal policy can be used as an effective tool to stave off a U.S. recession and indeed there is some historical precedence for a stimulus package at least mitigating the impacts of a recession. In 2001 tax refunds of $300 per person were sent to households across the country. A study of the program found it to be quite successful in stimulating consumption with households spending about two-thirds of the rebate in the first six months of receiving it. The jump in consumption provided by the rebates contributed to a rebound in consumption in the final quarter of 2001 and is one factor thought to have helped make the 2001 recession the shortest and mildest on record. However, it should also be noted that at that time the Federal Funds rate was at 1% and consumers were not facing the same kind of negative wealth effects that they are currently. A fiscal stimulus package could prove more limiting in propping up economic growth this time around.

For a stimulus program to work it should follow the three Ts - timely, targeted and temporary. The danger if the policy arrives too late or is too drawn out and threatens the long-term fiscal health of the government is, as Bernanke put it, a policy that "could be helpful in principle" but that "could also prove quite counterproductive." President Bush announced today a spending plan of close to 1% of GDP that would see tax-rebates of up to $800 a person combined with other measures to support business. Current signs out of Washington are that a consensus may be reached that would allow this kind of package to be put together rather soon. Still, in the current heated political environment of a presidential election year, whether Con-

Recent TD Economics Research

January 18, 2008 - Canadian Manufacturing Shipments
January 17, 2008 - The Five Finger Guide: Economic Data that Provide a Heads-up to a U.S. Recession
January 16, 2008 - U.S. Industrial Production and Capacity Utilization
January 16, 2008 - U.S. Consumer Price Index
January 15, 2008 - U.S. Retail Sales

gress and the administration can agree on the specifics in time for the plan to be effective remains to be seen.

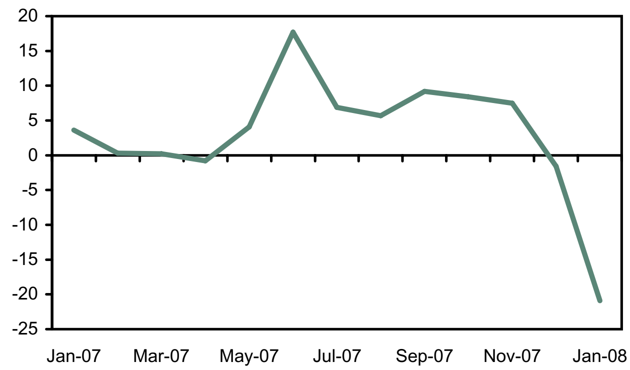
Recession fears + bank losses = stock market plunge

In any case, Bernanke's comments did little to ease the minds of financial market investors, which remained concerned with grim economic predictions and news reports of big bank earning losses. This week the news only got worse. Even as stock markets were still digesting Citigroup's $18 billion asset write off and $9.8 billion fourth quarter net profit loss, Merrill Lynch came out with a $16.7 write off and the same $9.8 billion net loss. Unsurprisingly, equity markets took a beating. By Thursday the S&P 500 lost 5.9%, the NASDAQ 5.3% and the Dow Jones 4.9% from the start of the week. With the S&P 500 and Dow down close to 13% from their October records, benchmark indexes are now approaching bear markets; characterized by 20% declines from highs.

Economic data released this week were also of little help and painted a similarly dour picture. Retail sales showed an uninspired U.S. consumer during the holiday season. In addition, the Fed's Beige Book confirmed the slowdown in consumer spending, adding only that across the country credit quality continues to deteriorate and credit conditions to tighten. Markets got no relief from the Philadelphia Fed Survey, which reported a sharp and vastly worse than expected, contraction in manufacturing activity. Finally, in what can only be called an expected surprise, U.S. housing starts fell 14% to their lowest level since 1991. Perhaps the one semi-positive piece of news to come out this week was on the inflation front where December's CPI report showed some abatement in recent price increases for energy and food. Core inflation, which was up 0.2% on the month, increased slightly on a year-over-year basis from 2.3% to 2.4% in December.

If ever there were time for an economic crystal ball, now would be it. Lacking that, we have been paying close attention to the signposts that signal the move from a slowdown to an outright contraction (please see our Special Report http://www.td.com/economics/special/bc0108_usrec.pdf for a detailed listing). So far the majority of signs continue to point to a yellow light, indicating continued caution but not yet an outright U.S. recession. Nonetheless, the U.S. economy is likely to grow by less than 1% (annualized) in the first quarter and a feeble 1.2% through the first half of year. With growth this close to zero it wouldn't take much to push the economy into two quarters of contraction and a technical recession. Still, given appropriate Fed action and a possible fiscal stimulus package to boot, even a technical recession is likely to be mild and short lived.

PHILADELPHIA FED MANUFACTURING SURVEY - GENERAL BUSINESS INDEX*



* Current versus previous month
Source: Economy.com

Bank of Canada expected to cut rates

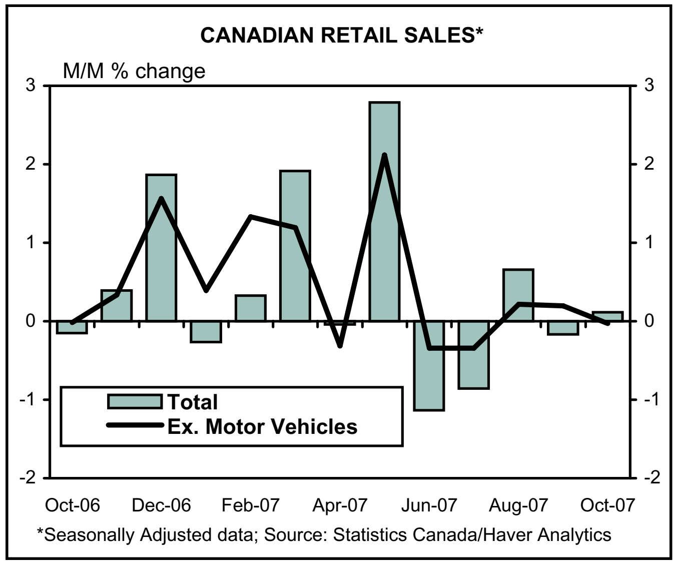
In Canada this week the only major data release was manufacturing sales. The details of the report were mixed. While nominal sales were up 1.1% this was due entirely to price increases, mainly for petroleum and coal products during the month. In real terms, which matter more for calculating GDP, shipments edged down 0.1%. The increase in commodity prices supported manufacturing sales this month but as the U.S. economy slows and the world economy along with it, upward movement in prices is unlikely to continue. Next week we will be focused on the Bank of Canada's interest rate announcement and the release of the Monetary Policy Report Update. The meeting will be the last chaired by Governor David Dodge and we expect he'll leave with a gift, announcing a 25 basis point cut to the overnight rate. For more information about the current outlook for the Bank of Canada please see our Monetary Policy Monitor to be released today on our website.

James Marple, Economist
416-982-2557

UPCOMING KEY ECONOMIC RELEASES

Canadian Retail Sales - November

Release Date: January 22, 2008
October Result: total +0.1%; ex-autos 0.0%
TD November Forecast: total 0.0%; ex-autos +0.6%
Consensus: total +0.3%; ex-autos +0.5%

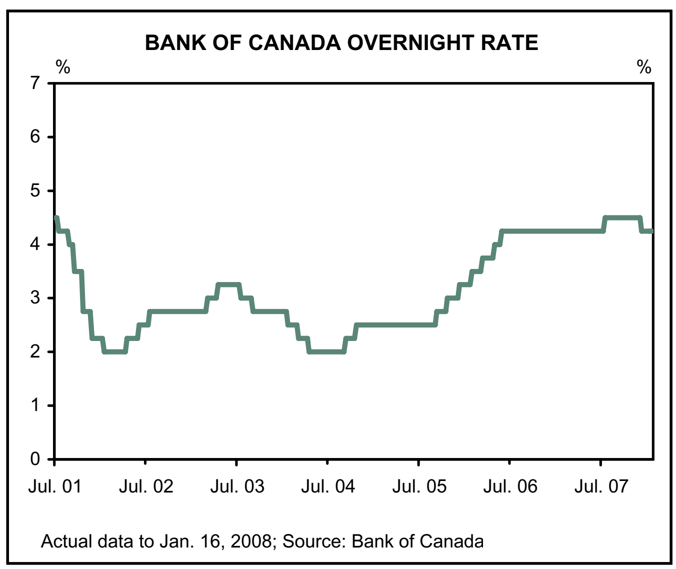


We're expecting to see total retail sales in Canada come in flat in November, but with ex-autos posting a stronger 0.6% increase, due to the nearly 3% fall in new motor vehicle sales during the month. However, price effects are at play here, with gasoline prices up 4% during the month, so real retail sales are likely to be somewhat softer. One reason why retail sales may be somewhat softer in both November and December, despite a high employment rate and strong wage growth, is the one percentage point cut in the GST, effective January 2008. Since it was announced in October, consumers may have delayed some of their big ticket purchases, like cars, appliances, and furniture, until January, as they did in the months leading up to the July 2006 GST cut. Another reason is that with the massive appreciation in the Canadian dollar that occurred through October and the first half of November, some Canadian consumer spending likely shifted towards cross-border shopping in the U.S., although we expect the total impact to be only moderate. So we may see a softer holiday shopping season this year, before spending picks up again in January.

Jacqui Douglas 416-982-7784

Bank of Canada Interest Rate Announcement

Release Date: January 22, 2008
Current Rate: 4.25%
TD Forecast: 4.00%
Consensus: 4.00%

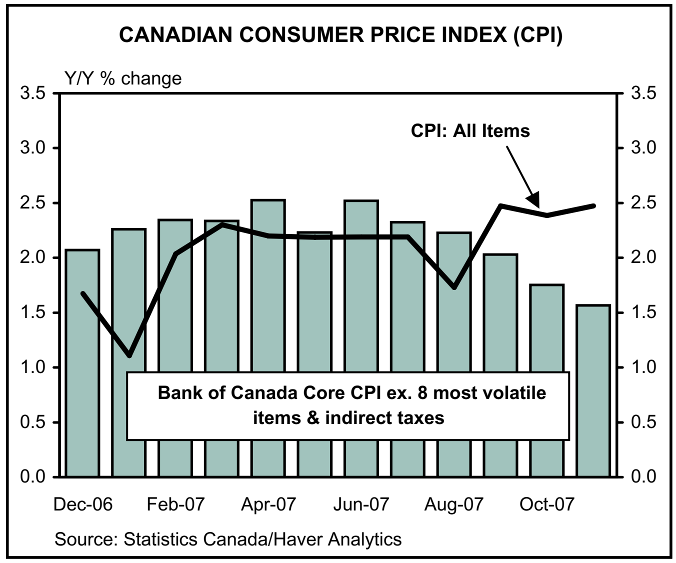


At the next Fixed Announcement Date on January 22, we're expecting the Bank of Canada to deliver a 25bps rate cut. Since the last interest rate decision on December 4, we don't think that economic or financial conditions have improved sufficiently to change the fact that the risks to the inflation outlook remain to the downside. Inflation continues to come in lower than expected, financial markets are still fairly volatile, and the outlook for U.S. economic growth still poses a risk to the demand for Canadian exports. However, with the unemployment rate near a record low and wage growth in Canada at a record high, upside risks do remain, so we do not expect to see a deep, protracted rate cut cycle from the Bank of Canada. Instead, we expect to see just one further 25bps rate cut at the next FAD on March 4, with just a moderate amount of monetary stimulus required to help the Canadian economy get through the slowdown in the U.S.

Jacqui Douglas 416-982-7784

Canadian Consumer Price Index - December

Release Date: January 25, 2008
November Result: all-items +0.3% M/M, 2.5% Y/Y; core 0.0 M/M, 1.6% Y/Y
TD December Forecast: all-items +0.1% M/M, 2.4% Y/Y; core -0.2% M/M, 1.6% Y/Y
Consensus: all-items +0.2% M/M, 2.4% Y/Y; core -0.1% M/M, 1.7% Y/Y



Canadian core inflation is expected to experience another soft month in December, falling by 0.2% M/M, keeping the Y/Y rate constant at 1.6%. However, monthly core CPI is not quite as soft as it appears, since there are seasonal factors at play here, and on a seasonally-adjusted basis, core CPI is expected to come in flat. There are two major factors that are likely to put downward pressure on core CPI. One is that retailers were likely offering bigger discounts than usual during the holiday shopping season, since with the Canadian dollar sitting near parity with the U.S. dollar, retailers were fighting to keep Canadian consumers shopping on this side of the border. And two, with the GST cut coming on January 1, some retailers started offering the discount early to prevent consumers from putting off their major purchases. As for all-items CPI, we're forecasting a somewhat stronger 0.1% M/M increase, with the Y/Y rate falling to 2.4% Y/Y. This measure should be a little bit stronger than core CPI because of differing seasonal factors, higher gasoline prices, and likely further upward pressure from mortgage interest costs.

Jacqui Douglas 416-982-7784

RECENT KEY ECONOMIC INDICATORS
January 14-18, 2008

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
Jan. 14	New Motor Vehicle Sales	Nov.	% change	-2.9	-1.9	R▼
Jan. 17	International Securities Transactions	Nov.	$C, blns	-4.8	-24.3	
Jan. 18	Manufacturing Shipments	Nov.	% change	1.1	0.0	R▼
United States						
Jan. 15	Producer Price Index (PPI)	Dec.	% change	-0.1	3.2	
Jan. 15	PPI excl. food and energy	Dec.	% change	0.2	0.4	
Jan. 15	Retail Sales	Dec.	% change	-0.4	1.0	R▼
Jan. 15	Retail Sales ex. autos	Dec.	% change	-0.4	1.7	R▼
Jan. 15	Empire Manufacturing Survey	Jan.	Index	9.0	9.8	R▼
Jan. 16	Consumer Price Index (CPI)	Dec.	% change	4.1	4.3	
Jan. 16	CPI - excl. food and energy	Dec.	% change	2.4	2.3	
Jan. 16	Industrial Production	Dec.	% change	0.0	0.3	
Jan. 16	Capacity Utilization	Dec.	Per cent	81.4	81.6	R▲
Jan. 17	Housing Starts	Dec.	Thousands	1,006	1,173	R▼
Jan. 17	Building Permits	Dec.	Thousands	1,068	1,162	
Jan. 17	Weekly Initial Jobless Claims	12-Jan	Thousands	301	322	
Jan. 17	Philadelphia Fed Index	Jan.	Index	-20.9	-5.7	
Jan. 18	U. Michigan Consumer Confidence (prelim.)	Jan.	Index	80.5	75.5	
Jan. 18	Leading Indicators	Dec.	% change	-0.2	-0.4	

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR
January 21-25, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Jan. 21	Wholesale Sales	Nov.	% change	0.3	0.5
Jan. 22	Retail Sales	Nov.	% change	0.3	0.1
Jan. 22	Retail Sales - excl. autos	Nov.	% change	0.5	0.0
Jan. 22	*Bank of Canada interest rate announcement*		*Overnight rate*	*4.00*	*4.25*
Jan. 23	Leading Indicators	Dec.	% change	0.0	0.0
Jan. 24	*The Bank of Canada Monetary Policy Report update released*				
Jan. 25	*Consumer Price Index (CPI)*	Dec.	Y/Y % chg.	2.4	2.5
Jan. 25	CPI - excl. 8 most volatile items	Dec.	Y/Y % chg.	1.7	1.6
United States					
Jan. 22	Richmond Fed Index	Jan.	Index	n/a	-4.0
Jan. 24	Weekly Initial Jobless Claims	19-Jan	Thousands	320.0	301.0
Jan. 24	Existing Home Sales	Dec.	Millions	5.0	5.0
Jan. 24	*Former Fed Chairman Greenspan speaks on the economy in Vancouver, B.C.*				

Source: Bloomberg, TD Economics

G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
Jan. 20	23:00	Japan	*Bank of Japan monetary policy meeting held*				
Jan. 21	8:30	Canada	Wholesale Sales	Nov.	% change	0.3	0.5
	---	*Japan*	*Bank of Japan Target Rate*		*Overnight rate*	*0.50*	*0.50*
Jan. 22	1:00	*Japan*	*Bank of Japan monthly report released*				
	6:00	*U.K.*	*CBI January Quarterly Industrial trends released*				
	8:30	Canada	Retail Sales	Nov.	% change	0.3	0.1
	8:30	Canada	Retail Sales - excl. autos	Nov.	% change	0.5	0.0
	9:00	*Canada*	*Bank of Canada interest rate announcement*		*Overnight rate*	*4.00*	*4.25*
	10:00	U.S.	Richmond Fed Index	Jan.	Index	n/a	-4.0
	19:30	AU	Real Gross Domestic Product (prelim.)	Q4-07	Q/Q % chg.	1.0	0.7
Jan. 23	4:00	EU	Purchasing Managers Index (Man.)	Jan.	Index	52.1	52.6
	4:00	EU	Services Index	Jan.	Index	52.8	53.1
	4:30	*U.K.*	*Bank of England minutes released*				
	4:30	U.K.	Real Gross Domestic Product (advance)	Q4-07	Q/Q % chg.	0.5	0.7
	8:30	Canada	Leading Indicators	Dec.	% change	0.0	0.0
	15:00	NZ	*RBNZ Official Cash Rate*		*Cash Rate*	*8.25*	*8.25*
	19:50	Japan	Trade Balance	Dec.	¥, blns	943.0	791.7
Jan. 24	4:00	Germany	IFO Business Climate Survey	Jan.	Index	102.3	103.0
	4:00	Germany	IFO Survey - Current Assessment	Jan.	Index	107.4	108.1
	4:00	Germany	IFO Survey - Business Expectations	Jan.	Index	97.5	98.2
	8:30	U.S.	Weekly Initial Jobless Claims	19-Jan	Thousands	320	301
	10:00	U.S.	Existing Home Sales	Dec.	Millions	4.95	5.00
	10:30	*Canada*	*The Bank of Canada Monetary Policy Report update released*				
	14:30	*U.S.*	*Former Fed Chairman Greenspan speaks on the economy in Vancouver, B.C.*				
	19:30	Japan	Tokyo CPI excl. perishables	Jan.	Y/Y % chg.	-0.1	-0.1
	19:50	*Japan*	*Bank of Japan Monetary Policy meeting minutes for December released*				
Jan. 25	2:45	France	Business Confidence Indicator	Jan.	Index	109.0	110.0
	2:45	France	Production Outlook Indicator	Jan.	Index	3.0	4.0
	7:00	Canada	Consumer Price Index (CPI)	Dec.	Y/Y % chg.	2.4	2.5
	7:00	Canada	CPI - excl. 8 most volatile items	Dec.	Y/Y % chg.	1.7	1.6

* Eastern Standard Time; Sources: Bloomberg, TD Economics