

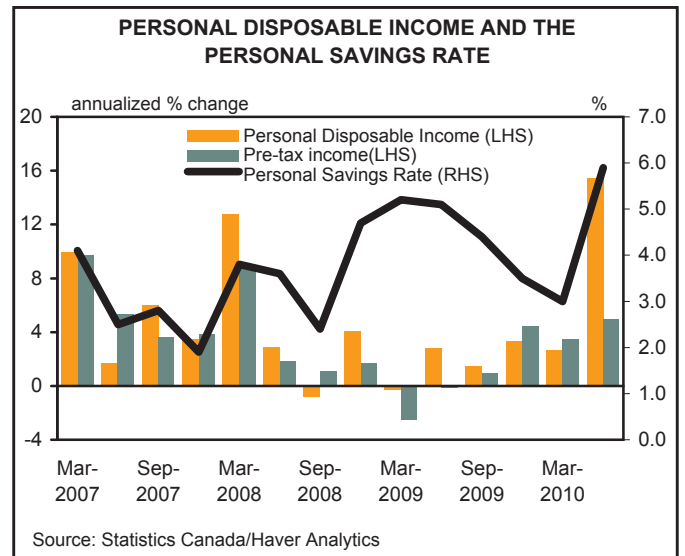


TAX MAN LIFTS HOUSEHOLD INCOME AND SAVINGS RATE IN Q2

This morning's release of the National Economic Accounts brought with it news that the Canadian economic recovery switched gears in the second quarter of 2010, with economic growth of just 2.0% annualized, less than half the growth experienced in the previous two quarters. Slower economic growth, coupled with moderate price growth – commodity prices in particular – meant that nominal GDP advanced at a tepid 2.8%- down from almost 10% growth in the prior two quarters. But, the most interesting aspect of this morning's report was that despite the sharp deceleration in national income, personal disposable income (PDI) rose a whopping 15.4%, and the purchasing power of Canadians, as measured by real PDI, rose by an equal amount, which was the largest growth rate since 1984. In combination with a marked moderation in consumer spending, the rise in incomes resulted in the doubling of the personal savings rate to 6%, up from 3% in the prior quarter. This is worth exploring.

While employment growth was healthy in the quarter, the jump in personal disposable income was largely driven by a 27% annualized decline in household transfers to governments, as Canadian households paid less personal income taxes this quarter than they have since 2005. Statistics Canada attributed the drop in personal income taxes paid to an increase in income tax refunds for the 2009 tax year. Indeed, the Federal Government stimulus package announced in March of last year, planned for over \$5 billion in personal income tax relief to households in fiscal year 2010/2011. In particular, the Federal Home Renovation Tax Credit and First Time Home Buyer's Tax Credit offered over \$3 billion to help support the economy – and it certainly worked.

A sharp pick-up in renovation activity, the strength in the existing home market, and increased purchases of housing-related goods and services helped to pull the Canadian economy out of the 2008/2009 recession with blockbuster growth rates. We estimated that the Federal Renovation Tax Credit helped spur an additional \$4.3 billion of renovation activity than would have occurred absent of the tax credit. For more information please see TD Economic's Special Report "Strength in Renovation Spending Running on Borrowed Demand". Meanwhile, the Bank of Canada estimated that approximately half of the existing home sales over 2009 were driven by first time home buyers. The spending frenzy



resulted in a sharp drop in the personal savings rate to 3.0% by the first quarter of 2010 – as Canadian households were saving less than their U.S. counterparts, where the personal savings rate was 5.1% in the quarter.

So, as the 2009 tax year came to an end, it came time for the federal government to pay up. Typically, such strong growth in personal income would lead to surge in personal spending. But this wasn't the case, with real PCE coming in at less than 3%. As noted, this reflected the fact that the refunds were to some extent driven by spending that took place in 2009 and early 2010. What's more, economic theory supports the notion that one-time (rather than permanent) rebates tend to be saved, consistent with the jump in the savings rate. With the rebates falling out of the equation in Q3 2010 and employment growth likely to moderate, look for both PDI and the savings rate to return to more sustainable 3-4% trends in the second half of the year. This suggests that household spending will be constrained to a modest pace of 2-2.5%. Stay tuned for more in our upcoming quarterly forecast.

Diana Petramala, Economist
416-982-6420



**Bank
Financial
Group**

Observation

August 31, 2010

TD Economics

www.td.com/economics

This report is provided by TD Economics for customers of TD Bank Financial Group. It is for information purposes only and may not be appropriate for other purposes. The report does not provide material information about the business and affairs of TD Bank Financial Group and the members of TD Economics are not spokespersons for TD Bank Financial Group with respect to its business and affairs. The information contained in this report has been drawn from sources believed to be reliable, but is not guaranteed to be accurate or complete. The report contains economic analysis and views, including about future economic and financial markets performance. These are based on certain assumptions and other factors, and are subject to inherent risks and uncertainties. The actual outcome may be materially different. The Toronto-Dominion Bank and its affiliates and related entities that comprise TD Bank Financial Group are not liable for any errors or omissions in the information, analysis or views contained in this report, or for any loss or damage suffered.