



TD Economics

TD Quarterly Economic Forecast

December 19, 2006

NORTH AMERICAN SLOWDOWN, JUST WHAT THE DOCTOR ORDERED

The U.S. economy has been mired in an economic slowdown since the second quarter of this year, and we believe it has only hit the halfway mark. The quarterly pace of real GDP growth has averaged 2.4% since the spring, well below the median quarterly pace of 3.5% over the prior two-and-a-half years. There appears to be little recognition on the part of financial markets that an economic slowdown is, in fact, unfolding. Benchmark U.S. equity indexes have appreciated more than 10% from June to early December. Perhaps market optimism is centered on the fact that the first leg of the slowdown has been relatively pain-free, since it has been led by residential investment with seemingly little contagion to consumer behaviour.

However, we believe consumer spending is showing preliminary signs of softening. The sector is already contributing about half a percentage point less to GDP growth than in prior years. And, this weakness will likely deepen over the next two quarters. The good news is that continued strength in personal incomes limits the risk of an all-out retrenchment in spending. With U.S. economic growth expected to dip below a 2% quarterly pace over the next couple of quarters, the build-up of economic slack should force the Fed off the sidelines, with the first of three 25

HIGHLIGHTS

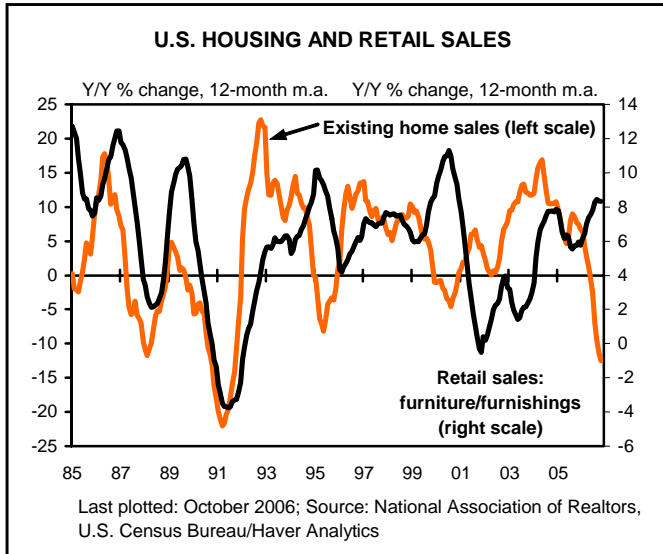
- **U.S. economy slowing to sub-2% quarterly pace over the next two quarters**
- **Canadian economy clearly bearing the scars of slowdown south of the border**
- **Net exports to shave 1.3 percentage points off real GDP growth in 2007**
- **Canadian real GDP likely to hold at or below 2% until the second quarter of 2007**
- **Central banks on both sides of the border won't be able to remain on the sidelines in 2007**
- **In the first half of 2007, we expect 75 basis points in cuts from the Federal Reserve and 50 basis points from the Bank of Canada**

basis point rate cuts to come in March. Lower interest rates combined with a modest degree of pent-up demand will position the economy for a strong bounce back in late 2007 and early 2008.

On the Canadian front, the problem will not lie with domestic spending, but with external demand. The U.S. economic slowdown has already stepped onto Canadian soil, further hobbling exporters and manufacturers who have yet to adjust to the high loonie and elevated resource costs. We believe this will remain a dominant theme over the next 6-9 months, after which exporters will find relief from a recovering American market. Contrary to the U.S. experience, Canadian housing markets appear to have successfully orchestrated a soft landing. This is particularly true of Central and Eastern Canada, but the jury is still out

CONTENTS

Overview	1
Global Economic Outlook	8
U.S. Economic Outlook	10
Canadian Economic Outlook	12
Financial Outlook	14
Canadian Economic Outlook Table	16
U.S. Economic Outlook Table	17



on the Western provinces, where markets may have only recently crested. In any event, the Canadian economy lacks the challenges of its American counterpart when it comes to the housing market. Real consumer spending should show far less moderation, with an average quarterly pace of 3% over the forecast period, compared to 4% in the prior two years.

Consumer spending showing early signs of softening

There is no denying that an ever-deepening housing correction in the U.S. is scarring the economic landscape. A sharp backslide in residential investment single-handedly shaved 1 percentage point off real GDP growth in the third quarter, which marked the largest drag from this sector in 16 years! Given that housing starts plummeted 13% in October, we expect to see a repeat performance in the final quarter of this year.

On the surface, it seems that the tumultuous housing market has left the American consumer unfazed, throwing into question whether a reversal in housing wealth effects will come to bear on consumer spending growth. After all, consumer purchases rose at a respectable 3% annual rate over the second and third quarters. However, this does mark a meaningful downshift from the 3.5-4% annual gain largely held over the prior two-and-a-half years. American shoppers are already contributing about half a percentage point *less* to GDP growth. And, the full weight of higher interest rates and negative wealth effects has yet to be felt, because both operate under long lags. Estimates show that it takes at least one year for the full impact of a change in real estate wealth to feed through to consump-

tion behaviour. For interest rates, the lag can extend even longer. The adjacent graph demonstrates this lagging behaviour through the purchase of home furnishings, which slows about one year following a downturn in home sales.

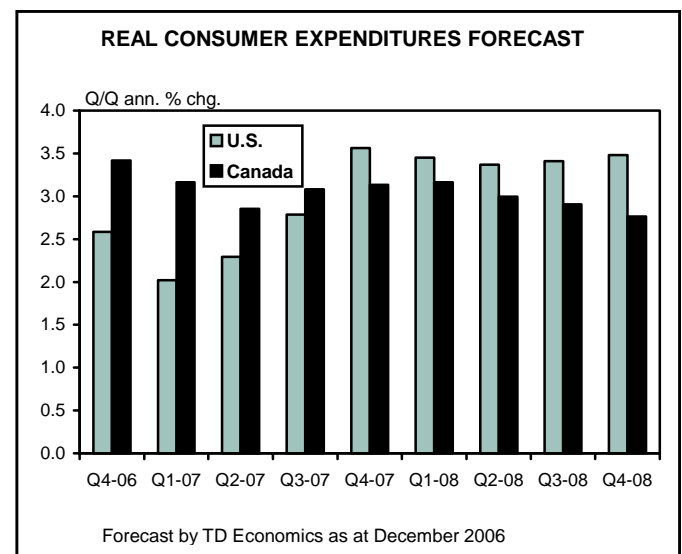
In the current economic cycle, a weakening housing market first took root at the start of the year, and by the spring prices started to follow suit. This means that the risks to consumer spending remain acutely skewed to the downside for another 2-3 quarters. We believe the softening pattern evident in the latest two quarters will deepen with real consumer spending growth likely to track a 2.5% annual rate over 2007.

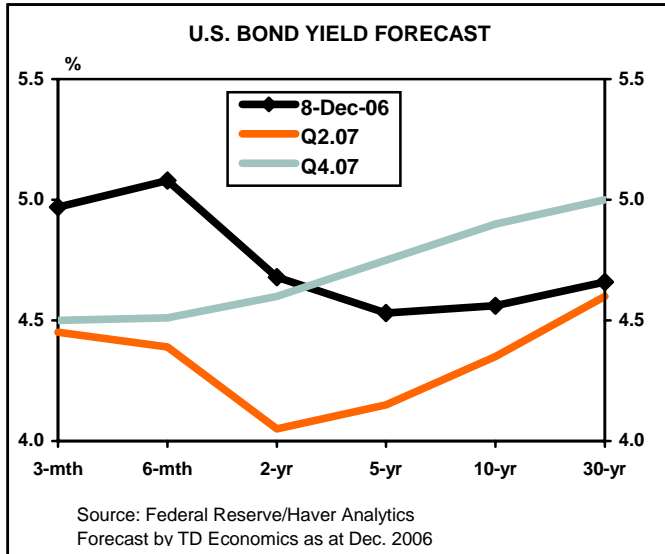
Inverted yield curve = recession?

Given the current deep retrenchment in housing and the knock-on effects to the broader economy, why aren't we expecting an all-out contraction in consumer spending? If this were to occur, history indicates that a recession would surely take hold. And, isn't an inverted yield curve signaling as much?

There is a risk that a credit crunch could materialize due to an inverted yield curve. Over the past 50 years, the interest rate spread between 3-month T-bills and 10-year Treasuries averaged 140 basis points, but since mid-July this spread has been in negative territory. If an inverted yield curve remains in place for an extended period of time, it could stifle investment and make it harder for households to borrow money. That's because lenders might start to show increased trepidation about lending at lower interest rates relative to what they may owe in deposit rates.

While inverted yield curves can make good predictors





of recessions, they certainly do not have perfect records. In every case where a curve inversion preceded a recession, short- and long-term rates were rising, but the former at a faster rate. In the instances where a yield inversion did not correspond with a recession, the long end of the yield curve was being pushed down. This is similar to the situation today, where heavy buying by pension funds and life insurers are pinning down yields. In addition, the global savings imbalance, reflected by the massive U.S. current account deficit, has resulted in a pool of foreign-owned U.S. dollars seeking a home in Treasuries.

Not all doom and gloom

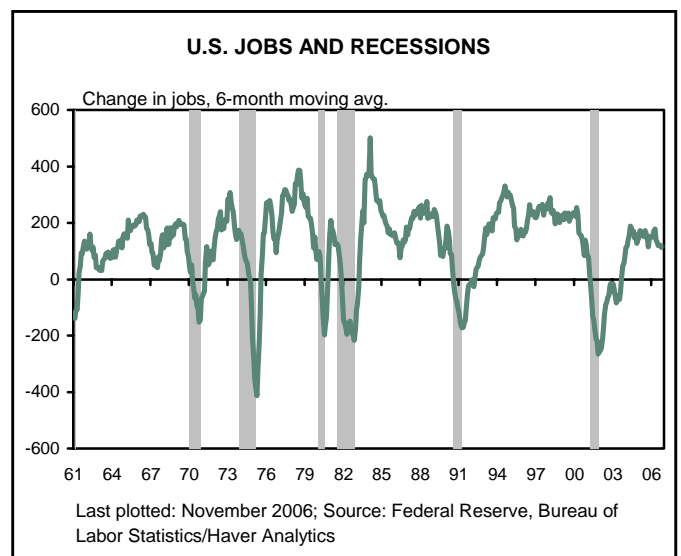
We don't believe the news on the economic front is all doom and gloom either. First, the precipitous decline in housing starts is a necessary evil to shrink the inventory of unsold homes and return the market back to balance, thereby alleviating downward pressure of prices. This drag on GDP growth will likely extend into early 2007, but residential investment as a whole accounts for only 5% of the total economy and it alone does not have the power to cause consumer spending to retreat.

Second, although a decline in the annual growth rate for existing home prices in August, September and October presents a more disconcerting trend, it does not necessarily mean the U.S. is on the cusp of a sharp economic downturn. After all, most homeowners are still enjoying higher home values from the run-up in prices over the 2002-2005 period. Plus there have been a number of instances when a retreat in home prices did not correspond with a recession. For instance, in the mid-1990s, home prices

repeatedly slipped into negative territory as the economy waded through a mid-cycle economic slowdown.

Third, there are no instances when a recession took hold that did not correspond to mass job losses, and the labour market backdrop is standing on firm ground this time around. During the 2001 recession, Corporate America shed 1.7 million jobs and in the two years that followed the economic recovery, payrolls were scaled back by an additional 1.8 million jobs. This was an unusual occurrence because post-recession periods are typically accompanied by a boom in the job market. With labour restructuring efforts having been completed just three short years ago, there should be little job overhang remaining in the economy. And, corporate balance sheets are strong enough to withstand some moderation in demand without resorting to mass job cuts. (For detailed information comparing and contrasting past recession cycles, see http://www.td.com/economics/special/bc1006_ushsg.pdf)

Lastly, past recession cycles have often been preceded by sharp increases in interest rates, where the real fed funds rate climbs an average of 2 percentage points over the course of one year. Naturally, this can shock financial markets and damage the finances for households leveraged to variable interest rates. But we see nothing of the sort in the current cycle. It has taken two years to produce an equivalent amount of tightening, and the level of real interest rates is still well below that seen heading into prior recessions, so there is little threat that consumer and investment demand will be stifled. What's more, the benchmark fed funds rate is likely to head lower over the next 6-9 months. We believe the Fed will cut rates by 75 basis

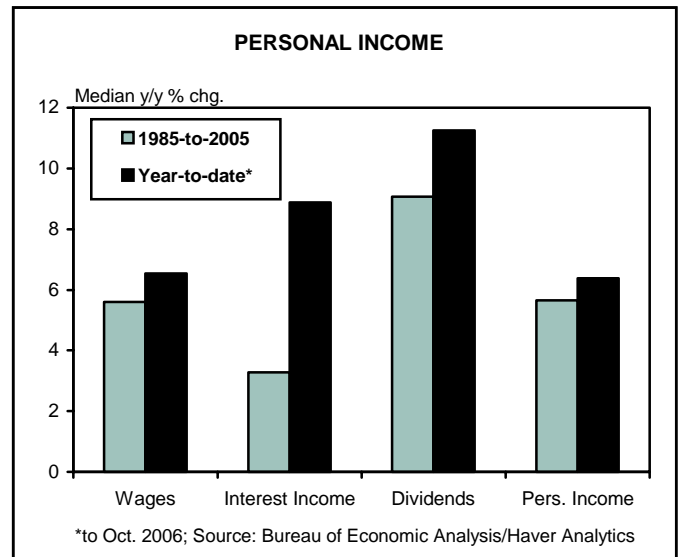
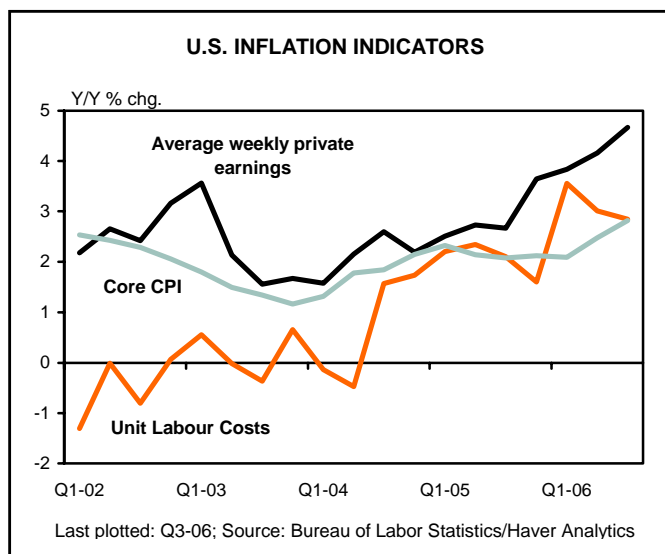


points in the first half of 2007 in order to reinvigorate economic activity.

Some argue that inflation is heating up in the U.S. economy and this could restrain the Fed from lowering rates next year to soothe economic woes. We agree that inflation readings have been running a little hot these days. For instance, core CPI sat at 2.6% in November, slightly above the Fed's comfort zone believed to be in the 2-2.5% range. Meanwhile, growth in unit labour costs has accelerated from last year and average hourly earnings are expanding just north of 4%. In fact, inflation indicators are likely to remain elevated and outside the Fed's comfort zone, even as a crumbling housing market heightens the downside risks to consumer spending. This could cause greater debate within the financial community over the degree and timing of rate cuts. However, given the lags with which interest rate changes impact the economy (12-18 months), if the Fed conducted monetary policy on the basis of near-term inflation data, it would always be playing catch up. So it is unlikely that the Fed will wait to see a marked deceleration in inflation before cutting rates in March because the balance of risks will be tilted in favour of increasing economic slack. (For further details see http://www.td.com/economics/special/bc1106_uscpi.pdf)

Household incomes get some relief

While robust income growth raises a red-flag over possible wage-push inflation, it also offers a counterweight to household finances that are now absorbing slower growth in real estate assets. The increase in income is occurring in both nominal and inflation-adjusted terms.

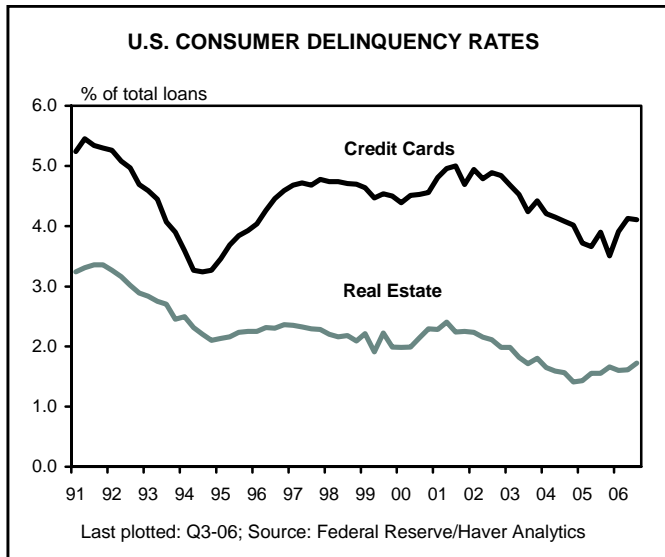


Real after-tax income growth accelerated to a 7% annualized pace (3-month basis) in October, bolstered by higher investment income and wages. The slide in energy prices from a high of \$78/bbl in the summer has also freed up roughly \$35 billion in household incomes in September and October. We believe households will continue to benefit from downward pressure on oil prices into 2007, as softened demand from the world's largest consumer – the U.S. – causes it to hit a trough of \$50/bbl by the second quarter. The corresponding boost to incomes will provide consumers with an extra financial cushion to meet near-term debt obligations and other future expenditures.

Meanwhile, even though the interest rate cycle appears to have peaked, household finances are showing little sign of stress. Many market participants have correctly pointed out that the debt-service-ratio (DSR: the amount of after-tax income required to meet debt obligations) is climbing, such that any hiccup in household income could result in higher default rates. In fact, there has already been an up tick in delinquency rates for both consumer and residential loans. However, delinquency rates are rising from extremely low levels and remain well below the average recorded over the last decade. So once again we return to the hypothesis that if household finances are not strained due to job losses, then individuals should continue to be able to meet their debt obligations, especially since interest rates are anticipated to fall in 2007.

Concluding thoughts on U.S. economy

While we expect growth in consumer purchases to continue to lose momentum in the coming two quarters, the



economic and financial backdrop leaves little reason to believe that it will collapse. The gradual unwinding of consumer strength should also result in less disruptive adjustments to labour and production, such that real GDP will still be able to expand by a 2.1% annual rate over the first half of 2007. This marks only a temporary lull in economic activity. The combination of slightly more stimulative interest rate settings and some degree of pent up demand should kick the economy into high gear by the end of 2007 and into 2008, back towards a 3.6% annual pace.

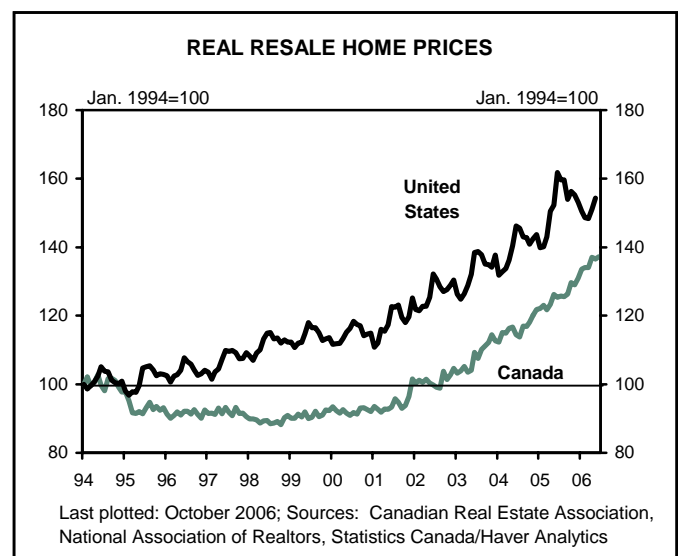
Canadian economy caught in the cross fire

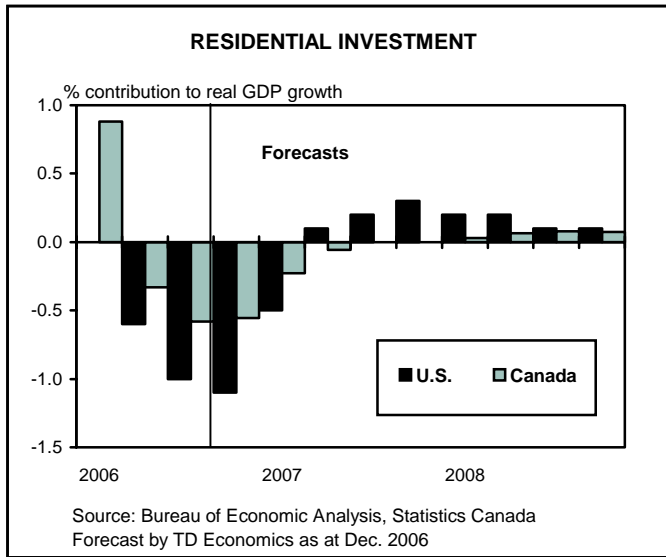
The economic slowdown south of the border will be paralleled in Canada, with real GDP growth expected to average 2.1% over the next three quarters. However, the dampening forces will differ in many important ways. Canadian consumers should be less affected by developments in domestic housing markets, which were never bloated to the extent of their American counterparts. Likewise, the Canadian economy has not been confronted with a severe adjustment in home construction, inventories, sales or prices, as has been the case in the U.S. Even on a regional basis, this holds true. For instance, the red-hot Alberta housing market has grabbed the media spotlight this year, where home prices have been rising in the 40-50% range relative to last year. But, even cooling housing markets in central Canada continue to sustain price gains in the 3-5% range. We believe existing home price growth will remain in the black across the nation in 2007. Meanwhile, residential construction is only marginally lower

today than it was at the start of the year. Any drag from cooling housing construction will be mild in comparison to the U.S., shaving an average of 0.3 percentage points off real GDP growth over each of the next three quarters.

The Canadian housing cycle has a distinct affordability advantage over the American market. Mainly, the housing boom occurred much later in the game. The graph below shows that inflation-adjusted home prices stagnated throughout the mid-1990s. It wasn't until 2002 that real prices returned to 1994 levels. Also, similar to the U.S., Canadians are benefiting from tight labour markets and solid income growth. Real after-tax income growth accelerated in the first half of this year to an average annual pace of 4.5% following several years of being constrained at an average annual pace of 2.5% (2001-2005). It is for these reasons that even in the hottest market – Calgary – homeowners dedicate 24% of their pre-tax incomes to the carrying cost of a home, which is in line with national statistics and historical norms. Over the next two years, real after-tax incomes are likely to hold within a 3-4.5% range.

This is not to say that the Canadian economy is free and clear of housing risks. Residents in Vancouver dedicate an inordinate amount of pre-tax income (+50%) to housing costs, and double-digit price growth in Alberta is simply unsustainable. However, a boom-bust cycle can be avoided if price growth cools in the near-term, which seems quite possible given ongoing supportive fundamentals. For instance, inventories in both provinces are exceedingly tight, with Alberta at a record low. B.C. has the added challenge of land constraints, while Alberta faces a

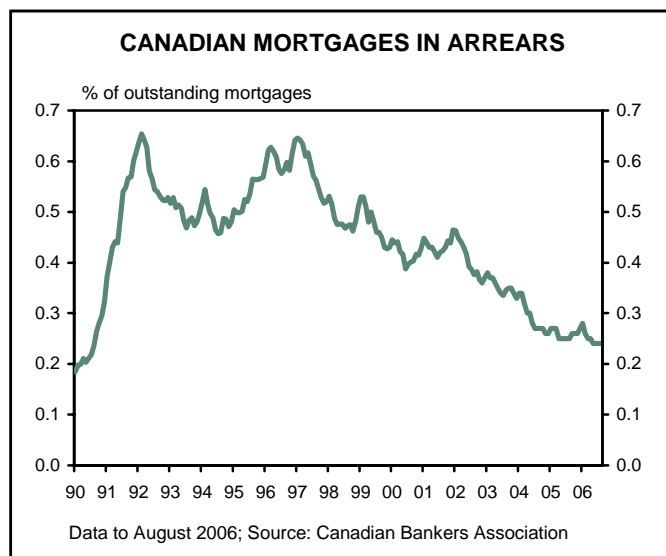




high degree of inter-provincial migration and resource shortages. More than 3,500 migrants are flowing into Calgary every month and the city recently hit the 1,000,000 mark on population. Even though both provinces are strictly a sellers' market, some hopeful signs for a potential soft landing have emerged. New listings are up substantially in Calgary (51% y/y), Edmonton (27% y/y) and Vancouver (19% y/y), which should help alleviate price pressures in time. If a hard landing in housing were to befall the western provinces, it would likely be due to the ripple effect of an unexpected collapse in the U.S. economy, rather than a reversal of domestic fundamentals.

Household finances looking good

Consumer finances certainly look healthy enough to

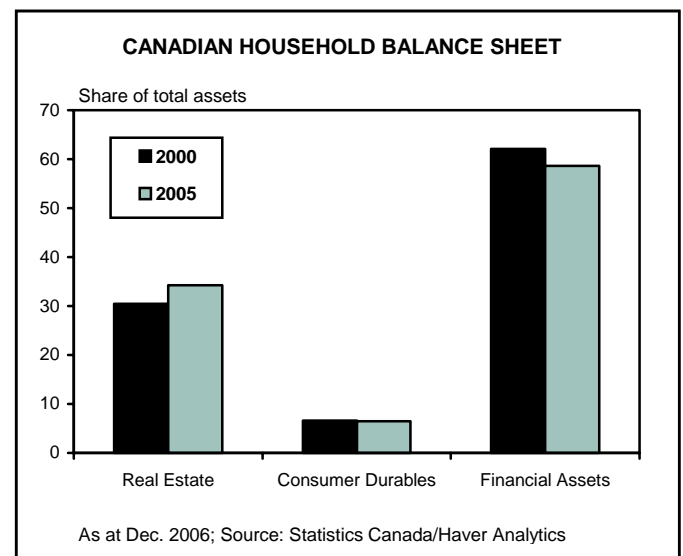


withstand the expected moderation in economic growth, especially if gauged by 90-day mortgage delinquency rates, which currently remain at a more than 15-year low. Mortgages account for nearly 61% of total household liabilities. The asset side of the ledger sheet has also increased at a faster rate than debt, such that personal wealth (assets minus liabilities) has climbed steadily. As expected, growth in real estate assets has played a key role in wealth accumulation, representing more than one-third of total household assets and growing at a 7-9% annual clip since 2001. The cooling housing market will take some zip off of real estate appreciation in the coming year, but the absence of a market collapse should position national real estate assets to still rise by a 6-7% clip in 2007, which is consistent with historical norms. (Detailed information on household finances available in the upcoming Consumer Pulse)

Economic challenges coming from the south

Overall, domestic demand faces a less challenging environment in Canada, such that we expect consumer spending growth to sustain an average quarterly pace of 3.3% (annualized) over the coming year. The problem won't be with the consumer in Canada, but rather with the consumer in America.

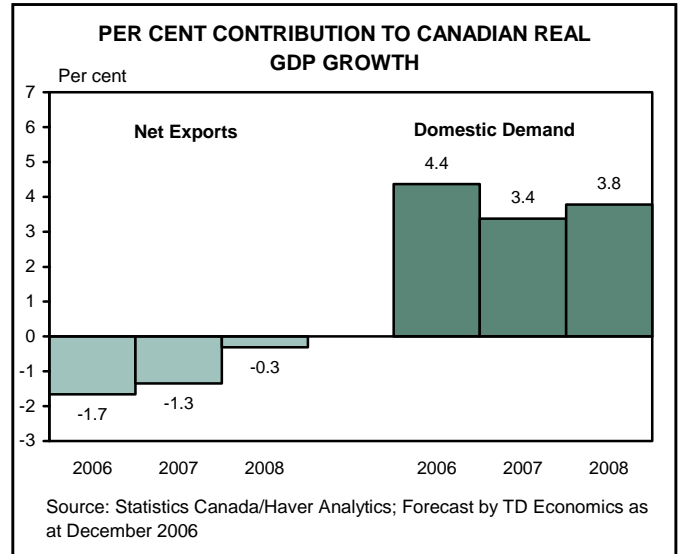
Recent data suggest the Canadian economy may have stalled. Quarterly GDP figures show that growth has slowed to a 1.9% pace since the spring, with the weakness concentrated in the goods sector. This is not a new story. Exports have been limping along all year, due to a perfect storm of slowing U.S. demand, high resource costs and an elevated Canadian dollar – a situation that is not going to



reverse course over the next three quarters. Exports will be hard-pressed to expand at even a meager 1% rate in the New Year, while import growth should remain reasonably firm underpinned by domestic demand. As such, the trade balance is expected to shave 1.3 percentage points from the accounting of real GDP growth in 2007. The silver lining is that once exporters make the proper competitive adjustments to the 85-90 cent loonie in the current economic cycle, they should not be confronted with another spike in the currency. Aside from usual month-to-month volatility, we believe most of the adjustment in the Canadian dollar vis-à-vis the U.S. dollar is already in the past. We see limited opportunity for the loonie to sustain a break above the 90 cent mark in the coming two years.

The scars of the export sector are plain to see on manufacturing. Year-to-date, real manufacturing production has shown no progress relative to last year. In an attempt to maintain profitability and competitiveness, the sector has shed nearly 200,000 jobs in just over two years. While globalization and the high Canadian dollar have exerted a negative influence on manufacturing job growth, these same influences should also keep a fire lit under companies to invest throughout the economic slowdown.

The overwhelming majority of machinery and equipment (80%+) is imported from the U.S., so the high loonie actually works in favour of cheapening the cost of investment. Real investment in machinery and equipment has expanded for the past 10 consecutive quarters and a continuation through 2007 and 2008 will offer a partial offset to the weakness we expect to see from exporters and manufacturers.



All told, the Canadian economy is expected to expand at an average 2.1% quarterly pace over the next three quarters. Although the quarterly economic profile mirrors that of the U.S., Canada will only marginally underperform its potential pace of 2.8%. In contrast, the U.S. economy will fall short of its potential pace (3.3%) by a full percentage point, resulting in a greater degree of economic slack. As such, we believe the Bank of Canada will ease rates by a lesser extent in 2007 (50 basis points, the first of two cuts coming in April). This should be viewed as a precautionary move on the part of the central bank. By the second half of 2007 and into 2008, a revitalized American economy should help lift the Canadian economy back to an average 3.2% quarterly pace in late 2007 through 2008.

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GLOBAL ECONOMIC OUTLOOK

How much wood would a woodchuck chuck if a woodchuck got a raise? The prospects for the world economy in 2007 hinge on the answer. Is it better to have a few well-motivated woodchucks, or an army of woodchucks chucking their wares? With firms more willing to entertain flexibility in every facet of their structure, local labour pools have leaked together into a giant ocean. Competition among workers has limited wage growth throughout the world. Since 2002, Italy is the only G-7 country to see wages grow faster than before (hourly wages adjusted for inflation). And given that Italy was the only European country to see wages fall in the five years prior to 2002, one could argue it was just making up for lost ground. Even fast growing economies like Spain and Ireland have seen real wages grow at just one-third to one-quarter of their previous clip. But firms that pay lower wages can afford more workers. This is why, almost without exception, national unemployment rates sit at near record lows.

Nevertheless, when danger arises, woodchucks burrow into the ground for safety. So do consumers. So will weak wage gains translate into hesitant consumers in the new year, or will individual hesitancy be eclipsed by the larger masses? We believe the latter. Our forecast for global growth to slow one percentage point to 4.1% in 2007 represents an expected slowdown in investment, some fiscal belt-tightening in Europe and Japan, but only a brief and mild tapering in global consumer spending. In this last regard, the large level of global employment will provide a critical mass of demand to support consumer spending, offsetting to a large extent the paucity of wage gains to date.

Japan – Whither the wages?

There has been a vocal anxiety among market participants that the Bank of Japan is tightening too quickly. In our opinion, if the Japanese economy stumbles, it will not be because the Bank of Japan increased interest rates by 50 basis points over six months. The quarter point increase last July will filter through the economy until at least the summer of 2007. The impact from the next increase – expected some time in the next three months – will not have a noticeable impact until autumn. By that time, the global economy will once again be abuzz with promise. In the meanwhile, real interest rates in Japan will remain negative and will continue to provide ample kick to the local economy.

The concern for Japan is not interest rates, but expect-

WORLD ECONOMIC OUTLOOK					
Annual per cent change unless otherwise indicated					
Real GDP	2005 Share* (%)	2005	Forecast		
			2006	2007	2008
World	99.2	4.8	5.1	4.1	4.8
North America	23.7	3.2	3.3	2.3	3.5
United States	20.1	3.2	3.3	2.4	3.6
Canada	1.8	2.9	2.7	2.2	3.2
Mexico	1.8	3.0	4.4	2.0	3.1
European Union (EU-25)	20.4	1.8	3.0	2.1	2.6
Euro-zone (EU-12)	14.8	1.3	2.7	1.7	2.3
Germany	4.1	1.1	2.6	1.2	2.0
France	3.0	1.2	2.0	1.7	2.3
Italy	2.7	0.1	1.8	1.0	1.5
United Kingdom	3.0	1.9	2.5	2.6	3.0
EU accession members	1.8	4.6	5.5	3.9	3.8
Asia	40.5	7.2	7.1	6.2	6.8
Japan	6.4	1.9	2.0	1.5	2.3
Asian NIC's	3.2	4.6	5.1	3.7	4.9
Hong Kong	0.4	7.3	6.4	4.5	6.0
Korea	1.6	4.0	4.9	4.0	5.5
Singapore	0.2	6.4	7.6	4.2	5.3
Taiwan	1.0	4.1	4.3	3.1	3.4
Russia	2.6	6.4	6.6	5.7	6.1
Australia & New Zealand	1.2	2.5	2.3	2.8	3.1
Developing Asia	27.1	9.0	8.9	7.9	8.4
ASEAN-4	3.7	5.2	4.9	4.3	4.6
China	15.4	10.2	10.3	9.3	9.8
India	6.0	8.5	8.1	6.8	7.2
Central/South America	5.7	4.6	4.5	3.6	4.4
Argentina	0.9	9.2	7.0	4.0	6.0
Brazil	2.6	2.3	3.0	3.3	3.9
Other Developing	9.0	5.8	5.7	4.8	4.6

*Regional wts. do not sum to 100% because some countries omitted
Forecast as at December 2006
Source: International Monetary Fund, national statistical agencies

tations. The expectation of falling prices and wages creates a painful self-reinforcing slowdown. As such, Japanese businesses and consumers must be convinced that the corrosive presence of deflation will not return. The Japanese expansion since 2004 marks the first time since 1992 that both consumer prices and earnings have avoided falling. This is a positive development for future consumer spending. Although wages are likely to remain flat for the first half of 2007, consumer spending should be buoyed by rising pay by the end of the year.

On average, recent revisions to Japanese GDP knocked a quarter of a percentage point off of economic growth in each of the last seven quarters. These revisions also showed the private sector was more mouse than man. With just a brief respite expected from American demand, for-

ward-looking Japanese firms should look past the current soft patch. Consumer spending in the fourth quarter of 2006 will rebound from a weak third quarter, and by the end of 2007, we expect the Japanese consumer will be spending in stride.

Europe will be slow out of the blocks

The European economy is enjoying a bumper year. The integration of the eastern accession nations into the EU has loosened up the typically rigid European labour market, increasing productivity and driving down unemployment. This has come without significant wage gains. As a result, labour unions, especially in Germany, are digging in to ensure fatter wallets in 2007. Some gains are justified and will be a welcome boost to local retailers.

It is, however, too early to declare structural reforms completed and the region able to expand by 3.0% from here on out. Economic growth in Italy slowed through each of the first three quarters of 2006 – with investment spending and exports turning in outright contractions in the third quarter. As a result, the Italian economy is likely to average just a 1% annualized pace of growth through the first half of 2007. Nearby, French sentiment has certainly soured after the economy failed to grow in the third quarter. While exports did contract, much of France's recent standstill was driven by a reduction in inventories that will reverse in the fourth quarter. Overall, consumer spending should prove more resilient than the current glum mood would suggest. Across the channel, the British continue to ride the strongest real wage gains in Europe. In spite of a quarterly fall in exports, consumer and investment spending are growing at or above average and should lead the economy to post faster growth in 2007 than 2006.

For Europe, the two question marks are German consumers and a slowing housing market. German consumers have ramped up purchases in the third and fourth quarters before new taxes take effect January 1. On balance, we expect a sluggish start to 2007, but see no reason to be startled by this outturn. Consumers merely frontloaded some purchases into 2006. Meanwhile, five quarter-point hikes by the European Central Bank in 2006 have noticeably slowed home price increases. For example in Spain, 97% of all mortgages are variable rate and housing prices are now growing by single digits for the first time since the 1990's. There may be a marginal trickle-down effect on consumer confidence, but housing wealth exerts a much smaller impact on consumer spending on the Continent than in Canada and the United States.

Much the same in the rest of the world

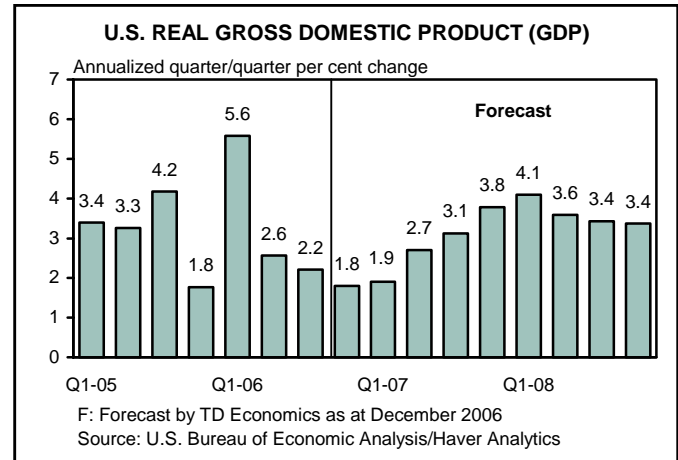
The rest of the world's woodchucks remain much the same from our previous forecast. Chinese consumers have not been a major force behind global economic growth up to this point, nor will that change in the coming year. Increases to the required reserves that Chinese banks must keep on hand are slowing investment spending as hoped. This is a positive sign for a soft landing – with dampened inflation increasing local consumers' purchasing power. But Chinese growth in 2006 has been nothing short of phenomenal and is likely to slow only from 10.3% to 9.3% in 2007. Likewise, the Indian economy looks poised to post its second consecutive year of above 8% growth before slowing by about one percentage point in 2007. A similar pattern will play itself out throughout the world as the band of woodchucks keep 2007 on track.

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ECONOMIC INDICATORS FOR THE G-7 AND EUROPE					
	2004	2005	Forecast		
			2006	2007	2008
Real GDP (Annual per cent change)					
G-7 (41.17%)*	3.0	2.3	2.8	2.0	2.9
U.S.	3.9	3.2	3.3	2.4	3.6
Japan	2.7	1.9	2.0	1.5	2.3
EU-12	1.7	1.4	2.7	1.7	2.3
Germany	0.8	1.1	2.6	1.2	2.0
France	2.1	1.2	2.0	1.7	2.3
Italy	0.9	0.1	1.8	1.0	1.5
United Kingdom	3.3	1.9	2.5	2.6	3.0
Canada	3.3	2.9	2.7	2.2	3.2
Consumer Price Index (Annual per cent change)					
G-7	2.0	2.3	2.3	1.8	2.0
U.S.	2.7	3.4	3.2	2.0	2.5
Japan	0.0	-0.3	0.3	0.4	0.9
EU-12	2.1	2.2	2.2	2.3	2.0
Germany	1.8	1.9	1.7	2.9	2.0
France	2.3	1.9	1.9	1.4	1.7
Italy	2.3	2.2	2.2	2.0	1.8
United Kingdom	1.3	2.0	2.3	2.1	2.2
Canada	1.8	2.2	2.2	1.5	2.1
Unemployment Rate (Per cent annual averages)					
U.S.	5.5	5.1	4.6	5.0	5.1
Japan	4.7	4.4	4.1	4.0	3.8
EU-12	8.9	8.5	7.8	7.7	7.8
Germany	10.6	11.7	8.4	8.6	8.8
France	10.0	9.9	9.2	8.6	8.5
Italy	8.1	7.7	6.9	7.1	7.4
United Kingdom	2.7	2.8	5.3	5.5	5.3
Canada	7.2	6.8	6.3	6.4	6.4
*Share of 2005 world gross domestic product (GDP)					
Forecast as at December 2006					
Source: National statistical agencies, TD Economics					

U.S. ECONOMIC OUTLOOK

Since it's been relatively painless, you might have missed the fact that the U.S. expansion has been in a funk since the second quarter of this year. The quarterly pace of real GDP growth has averaged 2.4% (annualized) since the spring, well below the median quarterly pace of 3.5% over the prior two-and-a-half years. Stripping away the trade balance reveals an even more sanguine economic landscape, with total domestic demand expanding by just 2.1% in each of the two quarters. So where is the expansion headed? We believe the economic slowdown will deepen to 1.8% growth in the final quarter of this year and will remain slightly below 2% in the first quarter of 2007. A gradual recovery thereafter should see economic



growth pop back above 3.5%, but not until the final quarter of 2007.

Consumer spending still vulnerable to slowdown

Once the Federal Reserve announced that it would leave interest rates unchanged at 5.25% in June, a key element of uncertainty was removed, as financial markets bet that interest rates would not be driven to levels that would stifle investment and consumer demand. Since then, the NYSE and S&P500 stock exchanges have appreciated more than 10%. It seems to us that financial markets have got it right in believing that the economic slowdown will be shallow and short-lived. However, the ongoing resiliency of the economy may now be fueling too much optimism over the near-term prospects for consumer spending growth.

So far, the bulk of the economic slowdown has been concentrated in residential investment, with seemingly little contagion to other sectors. For instance, residential investment shaved a full percentage point from real GDP growth in the third quarter (and we believe there will be a repeat performance in the fourth quarter). Meanwhile, consumer spending expanded at nearly a 3% clip in the same quarter. But, we feel the headline figure is a little deceptive. The quarterly pattern reveals that a slowdown is underway within this critical component. Real consumer spending has been contributing about half a percentage point less to the annual growth of real GDP than in the prior two-and-a-half years. And, the lagged effects of higher interest rates and diminishing wealth effects have yet to fully kick in. Both of these operate under 1-to-2

U.S. ECONOMIC INDICATORS					
Annual per cent change unless otherwise indicated					
			Forecast		
	2004	2005	2006	2007	2008
Real GDP	3.9	3.2	3.3	2.4	3.6
Consumer Expenditure	3.9	3.5	3.1	2.5	3.3
Durable Goods	6.4	5.5	4.7	2.5	5.2
Business Investment	5.9	6.8	7.7	5.7	5.8
Non-Residential Structures	2.2	1.1	9.0	7.3	6.7
Machinery & Equipment	7.3	8.9	7.1	5.1	5.4
Residential Construction	9.9	8.6	-4.2	-8.4	4.5
Govt. Exp. on Goods & Svcs.	1.9	0.9	2.1	1.7	0.9
Final Domestic Demand	4.0	3.6	2.9	2.1	3.2
Exports	9.2	6.8	8.6	6.9	6.8
Imports	10.8	6.1	6.0	2.6	3.5
Change in Non-Farm Inventories (\$96 Bn.)	47.0	19.6	48.3	28.6	32.1
Final Sales	3.5	3.5	3.0	2.6	3.6
Int'l Curr. Acct. Bal. (\$Bn.)	-665	-792	-861	-824	-828
% of GDP	-5.7	-6.4	-6.5	-5.9	-5.6
Pre-tax Corporate Profits	19.1	12.5	21.0	4.8	9.1
GDP Chain-type Deflator	2.8	3.0	2.9	2.3	2.2
Employment	1.1	1.5	1.4	0.8	1.2
Unemployment Rate (%)	5.5	5.1	4.6	5.0	5.0
Productivity *	3.0	2.3	2.1	1.9	2.9
Real Pers. Disp. Inc. (PDI)**	3.6	1.2	2.7	3.4	3.4
Real PDI** Per Person	2.6	0.2	1.7	2.4	2.5
Consumer Price Index (CPI)	2.7	3.4	3.2	2.0	2.5
Housing Starts ('000 units)	1,950	2,073	1,813	1,617	1,676
Real GDP: Real gross domestic product; * Real private non-farm business output per hour; ** After-tax income adjusted for inflation; Forecast by TD Economics as at Dec 2006; Source: Bureau of Labor Statistics, Bureau of Economic Analysis, TD Economics					

year lags. As such, consumer spending growth is expected to downshift to a 2-2.5% quarterly pace over the next three quarters. Heading into 2008, however, some pent-up demand from the prior year should help propel consumer expenditure growth back to the familiar 3.4% quarterly pace.

Inventories present a big downside risk

The near-term outlook will also be dampened by a swing in inventories. A significant rise in inventory levels in the second and third quarters appears to be an ominous sign of some involuntary build-up, setting the stage for slower production growth. A deterioration below the break-even 50-mark in the November ISM index may have already hinted at this possibility. Meanwhile, new orders among manufacturers have fallen in three of the last four months, and a 4.7% retreat in October was the largest monthly drop in over six years. Slower inventory accumulation is expected to shave 0.3-0.4 percentage points off real GDP growth in each of the next two quarters. Keep in mind that inventories are highly volatile and adjustments can often be swift. So the recent unexpected accumulation does pose a downside risk to our near-term U.S. outlook.

Household incomes to the rescue

Fortunately, the news isn't all bad, which is why we are not overly concerned that the economic slowdown will take a turn for the worst. While some areas of the economy have collapsed – like residential investment – others are holding strong – like non-residential investment. And, perhaps most important of all, employment and income growth have been solid.

Ongoing strength in income growth provides some reassurance that there won't be a sharp pull back to consumer spending in the coming year. There are predominantly 3 factors supporting incomes that should remain in place. First, incomes should continue to get a boost from lower energy costs. The slide in energy prices since the summer has already freed up roughly \$35 billion in household incomes in September and October. With the U.S. representing the number one world consumer of energy, we believe the noose around household finances will further loosen as energy prices soften into early 2007. Second, households are getting an extra kick from strong growth in investment income. Dividend and interest payments make up about 15% of total household income and

U.S. ECONOMIC INDICATORS						
Fourth-quarter-over-fourth-quarter per cent change						
				Forecast		
	Q4-03	Q4-04	Q4-05	Q4-06	Q4-07	Q4-08
Real GDP	3.7	3.4	3.1	3.0	2.9	3.6
Real Final Sales	3.7	3.1	3.2	3.0	3.1	3.6
Employment	-0.1	1.6	1.4	1.4	0.6	1.6
Real GDP: Real gross domestic product; Forecast by TD Economics as at Dec 2006; Source: Bureau of Labor Statistics, Bureau of Economic Analysis, TD Economics						

have been rising at a rapid annual rate of 11.6% and 7.6%, respectively. With corporate balance sheets expected to remain in fine form, these two sources of income should not face an interruption in growth. Lastly, the largest segment of household incomes – wages and salaries – has benefited from a healthy labour market. Nominal wages and salaries are growing at a 6% annual pace and the persistence of tight labour markets will remain a supportive factor. We also don't foresee mass job layoffs by corporations, since substantive job restructuring efforts were completed just three short years ago.

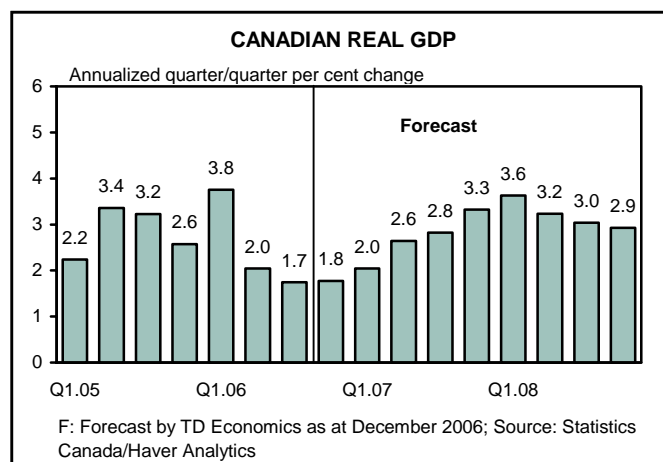
Exports to provide modest lift to economy

Another positive influence on the U.S. economy will come on the trade front. A 27% slide in the trade-weighted dollar since 2002 has definitely brought some relief to exporters by automatically improving their competitiveness. Real exports have consistently expanded within a 7-9% range over the past two-and-a-half years, a far cry from the 2-5% annual retreat registered during the greenback's strong days earlier in the decade. This robust export trend will remain in place over our forecast horizon, especially since the U.S. dollar is expected to remain under pressure due to ongoing global imbalances. Meanwhile, import growth will likely come in on the soft side – in line with the domestic demand landscape – which positions the trade balance to modestly contribute (0.2-0.4 percentage points per quarter) to the real economy over our forecast period. Likewise, the current account deficit should shrink as a share of GDP. However, don't get too excited that a swift turnaround is in the offing. Even with the upbeat export growth profile, the current account deficit only narrows from 6.5% of GDP in 2006 to a still-hefty 5.7% by the end of 2008.

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CANADA'S ECONOMIC OUTLOOK

The fortunes of the Canadian economy are expected to mirror the developments south of the border in 2007 and 2008. The key theme is that: the current moderation in economic growth will be reasonably short lived and relatively shallow. All told, the Canadian economy is forecast to deliver three more quarters of below-trend economic growth before a combination of domestic resilience and a cyclical pick-up in the U.S. economy fosters a recovery through the second half of next year and into 2008. Measured on an annual average basis, the growth rate of real gross domestic product (GDP) in 2006 is expected to ease to 2.7% from the 2.9% recorded in 2005. Given the



deceleration of the economic expansion over the course of 2006, growth in the second half of the year (1.8%) is more than a percentage point below the first half (2.9%). Although the pace of economic expansion will remain weak in the first quarter of 2007, it should begin to regain momentum quickly, as real GDP is expected to increase by 2.3% in the first half of 2007 and by 3.1% in the second half. By 2008 the annual average growth rate for real GDP stands at an above-trend 3.2%.

While the forecasts of real GDP growth in Canada and the United States dovetail nicely, the source of the cyclical volatility is different in each country. As fully documented in the previous chapter, falling residential investment and its knock-on effects to consumer spending are driving the mid-cycle slowdown in the United States. By comparison, it is this very weakness in the U.S. economy which is responsible for the moderation in Canada, primarily through weaker export growth. So with the U.S. economy poised for a further three quarters of below-trend growth, Canadian exports are unlikely to see any sustained momentum during this period. Indeed, inflation-adjusted exports are expected to fall both in the final quarter of this year and in the first quarter of 2007.

In terms of the effect on the overall economy, the retrenchment in exports is expected to shave 1.5 percentage points from annualized real GDP growth in Q4 and 0.4 of a percentage point in the first quarter of 2007. From that point on, exports are forecast to gradually firm over the next four quarters as fortunes in the U.S. economy improve. The health of exports will also benefit from a pe-

CANADA'S ECONOMIC INDICATORS				
Annual per cent change unless otherwise indicated				
	2005	Forecast		
		2006	2007	2008
Real GDP	2.9	2.7	2.2	3.2
Consumer Expenditure	3.9	3.9	3.3	3.0
Durable Goods	5.8	5.9	3.8	3.0
Business Investment	9.4	8.2	7.4	7.9
Non-Residential Structures	7.9	7.5	5.5	6.6
Machinery & Equipment	10.5	8.8	8.6	8.6
Residential Construction	3.2	2.2	-2.6	0.6
Govt. Exp. on Goods & Svcs.	2.7	3.4	2.8	3.1
Final Domestic Demand	4.5	4.5	3.5	3.7
Exports	2.1	1.0	0.3	4.2
Imports	7.1	5.1	3.6	4.6
Change in Non-Farm Inventories (\$97 Bn.)	12.4	13.8	14.4	11.4
Final Sales	2.5	2.8	2.2	3.5
Int'l Curr. Acct. Bal. (\$Bn.)	31.8	24.6	17.1	17.0
% of GDP	2.3	1.7	1.2	1.1
Pre-tax Corporate Profits	10.6	5.3	3.1	4.2
GDP Chain-type Deflator	3.2	2.1	1.0	1.9
Employment (%)	1.4	1.9	1.2	1.3
Employment ('000)	220	308	195	213
Unemployment Rate (%)	6.8	6.3	6.4	6.3
Productivity*	2.0	0.8	1.1	1.9
Real Pers. Disp. Income (PDI)**	2.5	4.6	3.3	3.1
Real PDI** Per Person	1.5	3.6	2.2	3.1
Consumer Price Index	2.2	2.0	1.6	2.1
Core CPI	1.6	1.9	1.8	2.1
Housing Starts ('000 units)	224	230	205	195

Real GDP: Real gross domestic product; *Real GDP per employee
 **After-tax income adjusted for inflation; Forecast by TD Economics as at December 2006; Source: Statistics Canada, Bank of Canada, Canada Mortgage and Housing Corporation, Haver Analytics

riod of relative stability in the value of the Canadian dollar. This contrasts sharply with the first half of 2006 when the loonie appreciated dramatically in a very short time period, imposing a significant challenge to exporters who were also grappling with the effects of higher energy prices and strong international competition.

Domestic demand a beacon of light

One of the factors minimizing the disruptive effect of falling exports on the rest of the economy is the expectation that the growth rate of domestic demand will remain robust. While the auto-focused 4.2% increase in third-quarter consumer spending is unlikely to be sustained, personal expenditure growth is expected to remain close to a healthy 3.0% over the coming quarters. A large part of this resilience can be traced to solid gains in personal disposable income, which, in turn, reflects the expectation that Canada's labour market will remain tight, putting further upward pressure on wages. Consumers also stand to benefit from the low level of interest rates and they will receive an extra boost from an expected 50 basis points of rate cuts administered by the Bank of Canada in the second quarter of 2007 (for more information, see the next chapter on the financial outlook).

Business investment is also expected to play a key role in sustaining economic growth over the next two years. Investment in non-residential structures will be supported by further growth in Western Canada, including the development of further infrastructure related to accommodating the influx of workers and new projects in the oil patch. Investment in machinery and equipment is also expected to remain robust as firms take advantage of the high dollar to import and implement new capital equipment. This flow of new investment should help boost Canada's productivity in the quarters to come.

The one element of weakness on the domestic demand

CANADA'S ECONOMIC INDICATORS						
Fourth-quarter-over-fourth-quarter per cent change						
	Q4-03	Q4-04	Q4-05	Forecast		
				Q4-06	Q4-07	Q4-08
Real GDP	1.5	3.7	2.8	2.4	2.7	3.2
Real Final Sales	1.4	2.3	3.6	2.3	2.9	3.4
Employment (%)	1.8	1.5	1.6	1.8	1.0	1.3
Real GDP: Real gross domestic product; Forecast by TD Economics as at December 2006; Source: Statistics Canada, Haver Analytics						

side is residential investment, which has fallen outright in each of the last two quarters. While a further decline is expected in each of the next three quarters, activity will level off by the second half of 2007. Despite this decline, Canada's housing market is on track for a soft landing with little direct impact on the consumer. For instance, housing starts are only expected to decelerate slightly and they will be supported by relatively tight supply, reasonable levels of affordability, and strong secular demand from the echo demographic cohort who are now entering the housing market as first-time buyers. Furthermore, with far less speculative activity, home prices are unlikely to experience the declines in the United States. As a result, household wealth will continue to rise, but at a slower pace than in recent years, which will temper consumer spending on housing-related items relative to years past.

Overall, we expect slow economic growth in Canada over the near term as the pace of expansion in the U.S. economy eases over the coming quarters. Fortunately, this weakness will be both fairly shallow and short-lived as an outright U.S. recession is not the likely outcome. And even if the U.S. economy did experience an unexpected downturn, there is some comfort that the continued strength on the domestic front would help Canada weather the corresponding greater-than-expected weakness in exports.

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FINANCIAL OUTLOOK

Market sentiment towards the U.S. economy has soured in recent weeks, and both the U.S. dollar and the Treasury market have reacted in sync. In particular, the greenback retreated sharply against most of the major currencies in late November and early December, losing significant ground against the Euro, Sterling, and the Yen. We do not believe the correction has run its course. Similarly, the U.S. 10-year Treasury yield broke through the 4.50% level, tumbling briefly to 4.42% — its lowest level since January 2006, when the Fed funds rate was 100bps below its current level. Meanwhile, Canadian bonds were towed along for the ride, as was the Canadian dollar. Canada's 10-year dropped as low as 3.87%, and defying the conventional wisdom, the loonie lost ground against the U.S. dollar even as the greenback was sinking against all the other major currencies. Although there was nothing dramatic about the Canadian dollar's slide against its U.S. counterpart, the plunge against the crosses – Euro, Sterling and Yen – has been a real eye-opener. Even if the

For monthly updates and a more in-depth discussion of the interest rate and foreign exchange rate forecasts, please see the monthly Global Markets report, available at www.td.com/economics.

wave has reversed course somewhat, there is no question that there has been a noticeable shift in market sentiment in recent weeks.

That begs two questions. First, what has prompted the shift in market perception? And second, is this as far as it goes or is it poised to continue?

Markets Looking for Lower Rates

The answer to the first question is clear cut – the recent souring in market sentiment is the direct result of a round of weak economic data, which has led the markets to price in meaningful odds of rate cuts from the Fed in 2007. Hopes that the U.S. housing market had bottomed out have proven to be little more than wishful thinking.

INTEREST RATE OUTLOOK														
	Spot Rate 12/18/2006	2006				2007				2008				
		Q1	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	
CANADIAN FIXED INCOME														
Overnight Target Rate (%)	4.25	3.75	4.25	4.25	4.25	4.25	3.75	3.75	3.75	3.75	3.75	3.75	4.00	4.25
3-mth T-Bill Rate (%)	4.16	3.91	4.32	4.17	4.20	4.00	3.75	3.75	3.75	3.75	3.85	4.05	4.25	
2-yr Govt. Bond Yield (%)	3.96	4.01	4.41	3.91	3.85	3.70	3.60	4.05	4.10	4.20	4.30	4.45	4.65	
5-yr Govt. Bond Yield (%)	3.91	4.16	4.47	3.88	3.85	3.75	3.70	4.15	4.25	4.35	4.45	4.55	4.70	
10-yr Govt. Bond Yield (%)	4.01	4.26	4.58	4.00	3.90	3.90	4.00	4.40	4.45	4.50	4.60	4.70	4.80	
30-yr Govt. Bond Yield (%)	4.08	4.26	4.61	4.09	4.00	4.05	4.20	4.55	4.55	4.55	4.65	4.75	4.85	
10-yr-2-yr Govt. Spread (%)	0.05	0.25	0.17	0.09	0.05	0.20	0.40	0.35	0.35	0.30	0.30	0.25	0.15	
U.S. FIXED INCOME														
Fed Funds Target Rate (%)	5.25	4.75	5.25	5.25	5.25	5.00	4.50	4.50	4.50	4.50	4.50	4.75	5.00	
3-mth T-Bill Rate (%)	4.91	4.60	5.03	4.88	5.00	4.70	4.45	4.50	4.50	4.50	4.60	4.80	5.00	
2-yr Govt. Bond Yield (%)	4.72	4.82	5.15	4.68	4.55	4.15	4.05	4.50	4.60	4.75	4.85	5.05	5.25	
5-yr Govt. Bond Yield (%)	4.56	4.81	5.09	4.58	4.45	4.15	4.15	4.60	4.75	4.90	5.00	5.15	5.30	
10-yr Govt. Bond Yield (%)	4.58	4.85	5.14	4.63	4.50	4.25	4.35	4.80	4.90	5.00	5.10	5.25	5.35	
30-yr Govt. Bond Yield (%)	4.70	4.89	5.19	4.76	4.60	4.45	4.60	4.95	5.00	5.10	5.20	5.35	5.45	
10-yr-2-yr Govt. Spread (%)	-0.14	0.03	-0.01	-0.05	-0.05	0.10	0.30	0.30	0.30	0.25	0.25	0.20	0.10	
CANADA-U.S. SPREADS														
3-mth T-Bill Rate (%)	-0.75	-0.69	-0.71	-0.71	-0.80	-0.70	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	
2-yr Govt. Bond Yield (%)	-0.76	-0.81	-0.74	-0.77	-0.70	-0.45	-0.45	-0.45	-0.50	-0.55	-0.55	-0.60	-0.60	
5-yr Govt. Bond Yield (%)	-0.65	-0.65	-0.62	-0.70	-0.60	-0.40	-0.45	-0.45	-0.50	-0.55	-0.55	-0.60	-0.60	
10-yr Govt. Bond Yield (%)	-0.57	-0.59	-0.56	-0.63	-0.60	-0.35	-0.35	-0.40	-0.45	-0.50	-0.50	-0.55	-0.55	
30-yr Govt. Bond Yield (%)	-0.62	-0.63	-0.58	-0.67	-0.60	-0.40	-0.40	-0.40	-0.45	-0.55	-0.55	-0.60	-0.60	

f: Forecast by TD Economics as at Dec. 18, 2006; All forecasts are for end of period. Source: Bloomberg, TD Economics

Housing starts plunged dramatically in October, posting a stunning 14.6% drop, and the declining value of residential construction has accelerated. New home sales dropped by 3.2%, belying hopes that sales had stabilized. As a result, residential construction is gearing up to be another huge drag on GDP growth in the final quarter of the year.

But what really got the markets sweating is the fact that the business sector has also started to soften up. Durable goods orders were down by 8.2% in October, and core capital goods orders – an indicator of investment intentions – slipped by 4.9%. More important, is the fact that the manufacturing ISM index has now slipped below the key 50 threshold, suggesting that the manufacturing sector is contracting.

As a result, the markets are now firmly pricing in rate cuts from the Fed – and rightly so. At the same time, however, the Fed is certainly not signalling that it is set to ease policy anytime soon – in fact, it is still sticking with its tightening bias. Inflation is still running at levels with which Fed officials are uncomfortable, and the new Chairman does not want to be seen as being soft on inflation. Nonetheless, there are tentative signs of cooler inflation – most notably the most recent round of CPI data, which were exceptionally tame — and as the U.S. economy continues to downshift, inflation pressures should continue to come off the boil. Our best bet is that the Fed will start to cut interest rates at the end of the first quarter of 2007. While that is bullish for Treasuries, and is likely to lead to some steepening of the yield curve, it is not good news for the U.S. dollar.

Bank of Canada to ease as well

Markets are also increasingly looking at the odds of rate cuts from the Bank of Canada – which explains in large part why the Canadian dollar has weakened against its U.S. counterpart even amid this episode of U.S. dollar weakness. In a nutshell, Canada and the U.S. are seen as

being in the same boat. Canada's economy is also underperforming, not only relative to its potential growth rate, but also relative to the Bank of Canada's expectations. In comments after a recent speech, Governor David Dodge not only expressed the view that fourth-quarter growth could fall short of the Bank of Canada's forecast of 2.8% – which it had already stated in the press release following the December 5th Fixed-Announcement Date – but that it could fall short of the Bank's expectations in the opening quarter of 2007 as well.

We would certainly concur – we are looking at growth of 2% or less in the next two quarters, well below what the Bank is expecting. Still, the odds that the Bank will ease soon are remote. Inflation is running above the Bank of Canada's 2% target at 2.2%, and the Bank is still of the view that the Canadian economy is operating close to its capacity limits. While Canada's export sector is still reeling the domestic side of the Canadian economy is doing well. And, the Bank continues to indicate that it views the current level of its policy rate as appropriate.

Nonetheless, we believe that the Bank will eventually throw in the towel. But for that to happen, it will have to be convinced that an output gap is opening up and that the economic backdrop is likely to be weaker than it was expecting. That will not happen overnight. As a result, we do not expect the Bank to ease before the second quarter of the year, and the Bank will cut by less than the Fed.

The implication? The Canadian bond market is likely to rally, but with the Bank easing later and less than the Fed, Canada's market will underperform. As for the Canadian dollar, we expect it to weaken slightly against the greenback. But the real story is the loonie's value against the crosses, which will continue to lose ground.

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FOREIGN EXCHANGE OUTLOOK												
Currency	Exchange Rate	Spot Price 12/18/2006	2006		2007				2008			
			Q3	Q4F	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Canadian dollar	USD per CAD	0.865	0.895	0.875	0.870	0.860	0.870	0.875	0.885	0.890	0.890	0.895
Canadian dollar	CAD per USD	1.156	1.118	1.143	1.149	1.163	1.149	1.143	1.130	1.124	1.124	1.117
Japanese yen	JPY per USD	118.1	118	115	112	109	105	104	105	106	107	107
Euro	USD per EUR	1.306	1.267	1.330	1.330	1.340	1.340	1.330	1.330	1.320	1.310	1.300
U.K. pound	USD per GBP	1.943	1.873	1.979	1.979	1.985	1.976	1.950	1.933	1.919	1.912	1.906
Swiss franc	CHF per USD	1.225	1.251	1.188	1.180	1.164	1.160	1.165	1.158	1.159	1.164	1.169
Australian dollar	USD per AUD	0.780	0.746	0.800	0.820	0.840	0.800	0.770	0.770	0.760	0.750	0.750
Mexican peso	MXN per USD	10.79	10.98	11.00	11.00	11.20	11.30	11.40	11.50	11.60	11.65	11.70

f: Forecast by TD Economics as at Dec. 18, 2006; All forecasts are for end of period; Source: Federal Reserve of New York, TD Economics

CANADIAN ECONOMIC OUTLOOK

Period-Over-Period Annualized Per Cent Change Unless Otherwise Indicated

	2006			2007				2008				Annual Average				4th Qtr/4th Qtr			
	Q2A	Q3A	Q4F	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	05	06F	07F	08F	05	06F	07F	08F
Real GDP	2.0	1.7	1.8	2.0	2.6	2.8	3.3	3.6	3.2	3.0	2.9	2.9	2.7	2.2	3.2	2.8	2.4	2.7	3.2
Consumer Expenditure	3.8	4.2	3.4	3.2	2.9	3.1	3.1	3.2	3.0	2.9	2.8	3.9	3.9	3.3	3.0	3.8	4.2	3.1	3.0
Durable Goods	5.0	8.9	2.3	3.5	2.8	2.9	3.0	3.1	3.0	2.9	2.8	5.8	5.9	3.8	3.0	4.5	7.0	3.0	2.9
Business Investment	5.4	7.0	7.7	7.4	7.4	8.0	8.5	8.2	7.7	7.6	7.5	9.4	8.2	7.4	7.9	9.8	7.3	7.8	7.7
Non-Res. Structures	3.0	4.7	5.5	5.5	5.6	6.7	7.2	6.9	6.3	6.2	6.0	7.9	7.5	5.5	6.6	10.3	5.4	6.2	6.3
Machinery & Equipment	7.4	8.9	8.8	8.4	8.3	8.7	9.1	8.8	8.4	8.3	8.2	10.5	8.8	8.6	8.6	9.3	8.3	8.6	8.4
Residential Construction	-4.8	-8.2	-3.0	-2.0	-1.0	0.0	0.0	0.8	1.2	1.5	1.4	3.2	2.2	-2.6	0.6	1.8	-0.8	-0.8	1.2
Government Expenditure on Goods & Services	4.9	0.7	3.8	2.8	2.6	2.8	3.2	3.5	3.2	3.0	2.8	2.7	3.4	2.8	3.1	3.0	3.2	2.8	3.1
Final Domestic Demand	3.8	3.2	4.0	3.4	3.3	3.6	3.8	3.9	3.7	3.6	3.5	4.5	4.5	3.5	3.7	4.6	4.2	3.5	3.7
Exports	-1.7	3.6	-3.6	-1.0	1.1	3.2	4.8	4.8	4.3	4.2	4.2	2.1	1.0	0.3	4.2	4.5	-1.4	2.0	4.4
Imports	8.6	4.1	2.1	3.3	3.4	3.6	4.2	5.1	5.0	5.0	4.8	7.1	5.1	3.6	4.6	6.9	3.2	3.6	5.0
Change in Non-Farm Inventories (\$97 Bn)	17.4	13.9	14.1	15.2	16.0	14.2	12.1	12.0	11.8	11.3	10.6	12.4	13.8	14.4	11.4	---	---	---	---
Final Sales	-0.4	2.9	1.5	1.7	2.4	3.5	4.1	3.7	3.4	3.2	3.2	2.5	2.8	2.2	3.5	3.6	2.3	2.9	3.4
International Current Account Balance (\$Bn)	18.7	20.3	17.3	16.4	16.0	16.7	19.2	17.6	16.9	16.8	16.5	31.8	24.6	17.1	17.0	---	---	---	---
% of GDP	1.3	1.4	1.2	1.1	1.1	1.1	1.3	1.2	1.1	1.1	1.0	2.3	1.7	1.2	1.1	---	---	---	---
Pre-tax Corp. Profits	2.6	11.2	1.1	0.8	2.6	3.4	3.9	5.7	4.3	3.4	3.2	10.6	5.3	3.1	4.2	14.8	0.0	2.7	4.2
% of GDP	13.7	14.0	14.0	13.9	13.9	13.8	13.8	13.8	13.7	13.7	13.6	13.8	13.9	13.8	13.7	---	---	---	---
GDP Deflator	-0.3	0.7	1.1	0.8	1.4	1.5	1.8	2.0	2.2	2.0	1.8	3.2	2.1	1.0	1.9	4.1	0.3	1.4	2.0
Nominal GDP	1.6	2.3	3.0	2.8	4.1	4.3	5.2	5.7	5.5	5.1	4.8	6.2	4.9	3.3	5.2	7.2	2.6	4.1	5.3
Labour Force	2.0	1.6	1.0	1.5	1.2	1.2	1.2	1.2	1.2	1.2	1.2	0.9	1.4	1.3	1.2	0.9	1.5	1.3	1.2
Employment (%)	3.1	0.4	1.8	0.9	0.8	1.1	1.4	1.2	1.2	1.2	1.2	1.4	1.9	1.2	1.3	1.6	1.8	1.0	1.3
Employment ('000s)	127	18	75	36	34	46	57	60	54	50	51	220	308	195	213	260	286	173	215
Unemployment Rate (%)	6.2	6.4	6.3	6.3	6.3	6.4	6.4	6.3	6.3	6.4	6.4	6.8	6.3	6.4	6.3	---	---	---	---
Personal Disp. Income	-1.9	5.7	5.2	3.7	3.2	4.7	5.8	4.1	3.9	4.3	4.4	4.2	6.1	4.0	4.4	4.5	5.7	4.3	4.2
Pers. Savings Rate (%)	1.2	1.5	1.7	1.7	1.7	1.8	2.0	1.9	1.8	1.9	1.9	1.2	1.9	1.8	1.9	---	---	---	---
Cons. Price Index (Y/Y)	2.6	1.7	1.4	1.5	0.8	1.4	2.6	2.2	2.4	2.2	1.6	2.2	2.0	1.6	2.1	2.3	1.4	2.6	1.6
Core CPI (Y/Y)	1.8	2.1	2.2	1.9	1.8	1.8	1.8	1.9	2.1	2.1	2.1	1.6	1.9	1.8	2.1	1.6	2.2	1.8	2.1
Housing Starts ('000s)	229	220	222	215	207	202	197	193	193	195	200	224	230	205	195	---	---	---	---
Productivity:																			
Real GDP / worker (Y/Y)	0.7	0.6	0.7	0.3	1.1	1.2	1.6	1.9	1.9	2.0	1.9	2.0	0.8	1.1	1.9	1.2	0.7	1.6	1.9

F: Forecast by TD Economics as at December 2006

Source: Statistics Canada, Bank of Canada, Canada Mortgage and Housing Corporation, Haver Analytics

U.S. ECONOMIC OUTLOOK

Period-Over-Period Annualized Per Cent Change Unless Otherwise Indicated

	2006			2007				2008				Annual Average				4th Qtr/4th Qtr			
	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	05	06E	07F	08F	05	06E	07F	08F
Real GDP	2.6	2.2	1.8	1.9	2.7	3.1	3.8	4.1	3.6	3.4	3.4	3.2	3.3	2.4	3.6	3.1	3.0	2.9	3.6
Consumer Expenditure	2.6	2.9	2.6	2.0	2.3	2.8	3.6	3.5	3.4	3.4	3.5	3.5	3.1	2.5	3.3	2.9	3.2	2.7	3.4
Durable Goods	-0.1	6.0	0.4	1.7	2.0	4.0	5.8	5.3	5.7	5.8	6.4	5.5	4.7	2.5	5.2	2.5	6.2	3.4	5.8
Business Investment	4.4	10.0	3.4	6.9	5.4	4.6	5.1	6.1	6.6	6.3	6.0	6.8	7.7	5.7	5.8	5.6	7.8	5.5	6.3
Non-Res. Structures	20.3	16.7	0.2	7.6	6.0	5.7	6.0	7.0	7.8	7.3	6.4	1.1	9.0	7.3	6.7	1.8	11.2	6.3	7.1
Machinery & Equipment	-1.4	7.2	4.8	6.6	5.1	4.2	4.7	5.7	6.1	5.8	5.9	8.9	7.1	5.1	5.4	7.0	6.4	5.1	5.9
Residential Construction	-11.1	-18.0	-20.1	-10.4	2.6	5.2	6.3	5.1	4.0	2.7	2.1	8.6	-4.2	-8.4	4.5	9.0	-12.7	0.7	3.5
Govt. Consumption & Gross Investment	0.8	2.2	3.2	1.4	1.2	1.3	1.2	0.8	0.7	0.7	0.9	0.9	2.1	1.7	0.9	1.2	2.8	1.3	0.8
Final Domestic Demand	1.6	2.1	1.5	1.7	2.4	2.8	3.4	3.3	3.3	3.2	3.2	3.6	2.9	2.1	3.2	3.2	2.6	2.6	3.2
Exports	6.2	6.3	6.9	7.5	7.2	6.8	6.7	7.1	6.6	7.0	6.7	6.8	8.6	6.9	6.8	6.7	8.3	7.0	6.8
Imports	1.4	5.3	1.1	2.5	2.0	3.3	3.3	3.6	3.8	3.8	4.0	6.1	6.0	2.6	3.5	5.2	4.2	2.8	3.8
Change in Non-Farm Inventories (\$96 Bn)	52.2	56.0	48.3	37.4	26.7	26.1	24.2	35.1	35.3	31.5	26.6	19.6	48.3	28.6	32.1	---	---	---	---
Final Sales	2.1	2.1	2.1	2.2	3.0	3.2	3.8	3.7	3.6	3.5	3.5	3.5	3.0	2.6	3.6	3.2	3.0	3.1	3.6
International Current Account Balance (\$Bn)	-874	-905	-814	-815	-821	-829	-830	-832	-832	-828	-822	-792	-861	-824	-828	---	---	---	---
% of GDP	-6.6	-6.8	-6.1	-6.0	-6.0	-5.9	-5.9	-5.8	-5.7	-5.6	-5.5	-6.4	-6.5	-5.9	-5.6	---	---	---	---
Pre-tax Corporate Profits including IVA&CCA	5.9	17.7	-9.0	3.5	7.2	9.3	12.8	11.1	6.9	6.1	5.4	12.5	21.0	4.8	9.1	12.8	16.2	8.1	7.3
% of GDP	12.1	12.4	12.0	12.0	12.1	12.2	12.4	12.5	12.5	12.6	12.5	10.7	12.2	12.2	12.5	---	---	---	---
GDP Deflator (Y/Y)	3.3	2.9	2.5	2.4	2.1	2.2	2.3	2.2	2.2	2.2	2.3	3.0	2.9	2.3	2.2	3.1	2.5	2.3	2.3
Nominal GDP	5.9	4.0	3.5	5.0	4.8	5.3	5.9	6.6	5.7	5.7	5.7	6.3	6.3	4.7	5.9	6.4	5.6	5.2	5.9
Labour Force	1.7	1.7	1.4	1.2	1.1	0.9	0.9	0.9	1.0	1.0	1.0	1.3	1.4	1.2	0.9	1.4	1.4	1.0	1.0
Employment	1.2	1.3	1.3	0.5	0.3	0.7	0.9	1.5	1.5	1.6	1.7	1.5	1.4	0.8	1.2	1.4	1.4	0.6	1.6
Change in Empl. ('000s)	407	448	434	161	95	251	312	495	516	559	583	2,035	1,900	1,088	1,691	1,917	1,849	820	2,812
Unemployment Rate (%)	4.7	4.7	4.5	4.7	4.9	5.1	5.2	5.1	5.0	5.0	4.9	5.1	4.6	5.0	5.0	---	---	---	---
Personal Disp. Income	2.5	6.2	5.4	6.4	5.1	5.3	5.2	6.3	5.7	5.7	5.8	4.1	5.5	5.5	5.7	3.4	5.2	5.5	5.9
Pers. Savings Rate (%)	-1.4	-1.3	-0.5	-0.1	-0.1	0.0	-0.2	0.0	0.0	0.0	0.1	-0.4	-0.9	-0.1	0.0	---	---	---	---
Cons. Price Index (Y/Y)	4.0	3.3	2.0	2.2	1.6	1.6	2.7	2.6	2.5	2.4	2.4	3.4	3.2	2.0	2.5	3.7	2.0	2.7	2.4
Core CPI (Y/Y)	2.5	2.8	2.7	2.5	2.2	2.0	2.1	2.2	2.4	2.5	2.5	2.2	2.5	2.2	2.4	2.1	2.7	2.1	2.5
Housing Starts (mils)	1.87	1.72	1.54	1.60	1.60	1.63	1.64	1.67	1.68	1.68	1.68	2.1	1.8	1.6	1.7	---	---	---	---
Productivity:																			
Real Output per hour (y/y)	2.4	1.5	1.6	1.0	1.5	2.0	2.9	3.2	3.0	2.8	2.4	2.3	2.1	1.9	2.9	2.5	1.6	2.9	2.4

F: Forecast by TD Economics as at Dec 2006

Source: U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Analysis, TD Economics