



# TD Economics

## The Weekly Bottom Line

August 1, 2008

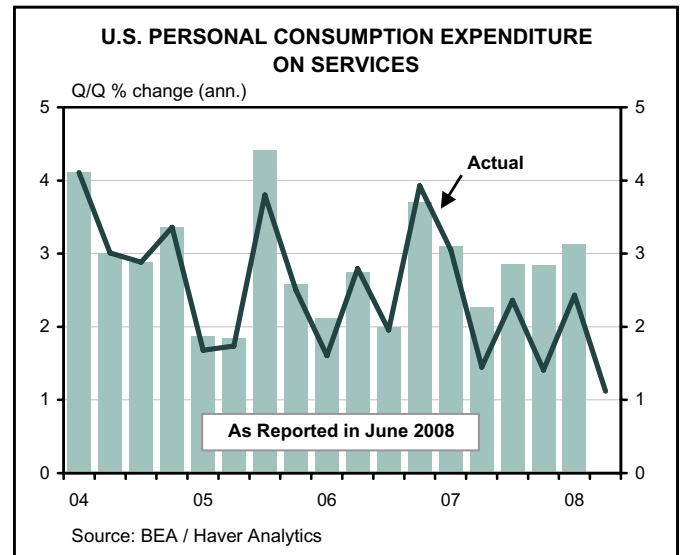
### HIGHLIGHTS

- U.S. and Canada GDP growth figures disappoint
- Past estimates of U.S. growth take a hit – has the recession already begun?

The current state of the Canadian and U.S. economies was on display this week and the results were nothing to cheer about. In Canada analysts were caught off guard by a fall in economic activity in May, which brought the tally of monthly GDP declines to three out of the last four. And in the U.S. it wasn't just the advanced estimate of second quarter GDP growth that disappointed expectations but the Bureau of Economic Analysis' revisions of the last three years that painted a much more dour picture of the U.S. economy than previously thought. While U.S. payrolls performed slightly better than consensus with a drop of 51K jobs compared to expectations of -75K, the 0.2 percentage point rise in the unemployment rate to 5.7% erased any optimism that might have been drawn out of the report.

#### You call that a boost?

At first glance the reading on second quarter U.S. GDP growth of 1.9% might have been considered a positive for markets. Amidst skyrocketing energy costs, rapidly falling household wealth and rising unemployment, any number significantly into positive territory might be cause for celebration. But when you consider that it took place alongside the dispersal of \$71 billion in tax rebate checks, which



led to an 11.3% annualized jump in real personal disposable income – the result is less impressive. And while the headline growth number fell just short of market expectations it was really the 1.5% turnout on personal consumption that left the most to be desired. Year-over-year PCE growth remained on a downward trend in spite of the stimulus checks, falling to its slowest pace since 1991.

In an earlier report we wrote that the deceleration in retail sales in June pointed to consumption growth underperforming our original forecast. This was confirmed in the numbers released this week. While it is a bit early to judge the full impact of the fiscal stimulus package as households may have held off spending their checks (pushing some of the impact of the stimulus into the third quarter) this is a risky horse to bet on. It is equally likely that some of the bounce in spending observed in the first quarter was in anticipation of the stimulus checks. Keep in mind that the fiscal stimulus package first started making headlines back in January, giving households adequate time to plan how they were going to spend their windfall. What's more, spending did see a jump in May, the month that the bulk of the stimulus checks went out, before decelerating considerably in June. What we do know is that income growth in

#### Recent TD Economics Research

August 1, 2008 - U.S. Employment Commentary  
 July 31, 2008 - Canadian Real GDP  
 July 31, 2008 - U.S. Real GDP  
 July 30, 2008 - Are the Wheels Falling Off the Ontario Economy?  
 July 30, 2008 - Quarterly Commodity Price Report  
 July 29, 2008 - A Regional Look At U.S. Labour Markets: Don't Mess With Texas!

the third quarter will likely be negative following the temporary bounce from the stimulus and few signs point to a surge in new spending in the third quarter.

### Exports save the day but for how long?

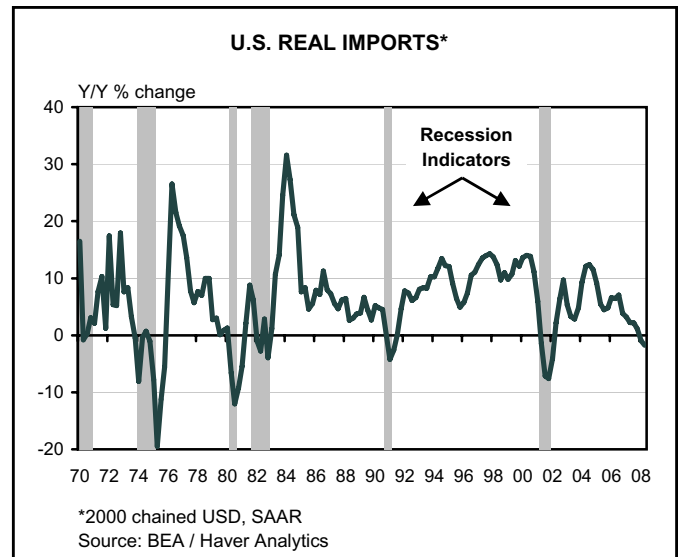
The less-than-stellar contribution from consumer spending was overshadowed by the strong performance of exports. Exports grew by 9.3% and made up over 60% of the total growth in the quarter. With imports falling for the third straight quarter and four out of the last five, net-trade has been a life-line to U.S. economic growth. However, struggling imports are nothing to get excited about. Imports are now down 1.7% from a year ago. Since 1970 this has never taken place outside of a U.S. recession. Moreover, pinning hopes of continued U.S. growth on the export sector is becoming an increasingly shaky proposition. Signs of slowing global growth are popping up everywhere and it is only a matter of time before U.S. exports also feel the pinch.

The one positive note to come out of the GDP report was the \$62 billion drawdown in business inventories, which although it was a negative to second quarter GDP growth is potentially a positive for growth next quarter. Even while we don't expect businesses facing a continued slowdown in sales to be rebuilding inventories, it is the change in the change in inventories that matters for GDP growth and businesses would have to drawdown inventories by even more than \$62 billion in order to subtract from growth. It's not much, but we'll take it.

### Revisions = Recession?

Any thoughts of "hey things aren't so bad after all" were soundly squashed by the BEA's revisions to GDP estimates. Each of the last three quarters were revised down resulting in a new first quarter GDP estimate that was 0.5% lower than originally published. The biggest revision (-0.7% annualized) to the final quarter of last year brought the quarterly growth rate into negative territory. While we have been critical of placing too much emphasis on the sign in front of growth numbers close to 0.0% the psychological impact of an actual decline in GDP was enough to cause markets to shudder and to bring back talk that the U.S. had already entered into recession. While we'll have to wait likely until next year before a formal announcement is made, as we've said before, if it walks like a duck and quacks like duck...

The real concern though was the downward revisions to consumer spending on services. Up until now, analysts were either touting the stabilizing impact of services spend-



ing – as it contains a number of non-discretionary items – or were becoming increasingly puzzled by the continued outperformance of the series through the perfect storm affecting household incomes and finances. However, this strength now looks to be a fiction, which upon receiving better data has all but been erased (remember there are three kinds of lies). Not only was services spending revised down by an average of 0.9% in the last four quarters, but it also looks to have become more volatile, bringing into question just how stabilizing an impact it actually is.

### Three out of four ain't good

As if we needed any further evidence that the slowdown in the United States is continuing to weigh on economic growth in Canada, May's GDP by industry reading went ahead and provided it anyway. Economic activity contracted by 0.1% (-1.3% annualized) in the month, led by a fall in oil and gas extraction. While manufacturing production eked out a small gain in the month it remains the biggest laggard on a trend basis - down 5.5% from a year ago. The services side of the equation has so far been keeping growth in positive territory but it too was flat in the month and is showing clear signs of decelerating. All told, the Canadian economy is well into excess supply territory and looks to be walking a fine line between expansion and contraction. We continue to expect a modest positive number on GDP growth for the second quarter, which will avoid the recession title. But recession or not, annual growth is expected to come in around 1% for 2008, the slowest pace since 1992 - and hardly something to crow about.

*James Marple, Economist 416-982-2557*

## UPCOMING KEY ECONOMIC RELEASES

### U.S. Personal Income and Spending - June

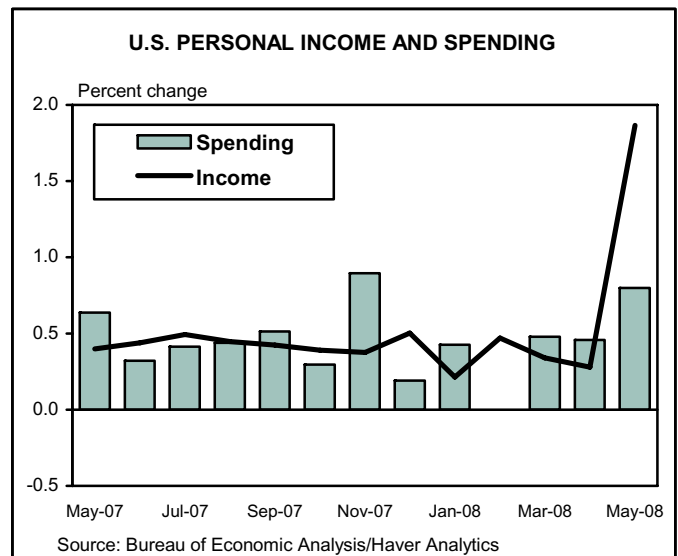
**Release Date:** August 4/08

**May Result:** income +1.9% M/M, spending +0.8% M/M; core PCE deflator +0.1% M/M, +2.1% Y/Y

**TD Forecast:** income +0.1% M/M; spending +0.3% M/M; core PCE deflator +0.3% M/M, 2.3% Y/Y

**Consensus:** income -0.2% M/M; spending 0.5% M/M; core PCE deflator 0.2% M/M, 2.2% Y/Y

After the lofty rebate cheques driven advance seen in U.S. personal income and spending in May, we expect both indicators to fall back to more sustainable levels in June. However, we think that in June there will be a last gasp boost to income from the remainder of the stimulus cheques. With the support of the fiscal stimulus package largely in the rear-view mirror, the road ahead for U.S. consumers is likely to remain difficult, as they contend with the headwinds of a deteriorating labour market, high energy prices, wealth reduction from the prolonged correction in the housing market, and tighter credit conditions. As a result personal income and spending are likely to be subdued as U.S. consumers continue to grapple with the difficult economic environment. In terms of inflation, core



PCE prices are expected to increase at a rather robust pace of 0.3% M/M, raising the annual core PCE inflation rate to 2.3% Y/Y, which will be its fastest pace of annual growth in over a year.

*Millan Mulraine 416-308-2911*

### U.S. FOMC Interest Rate Decision

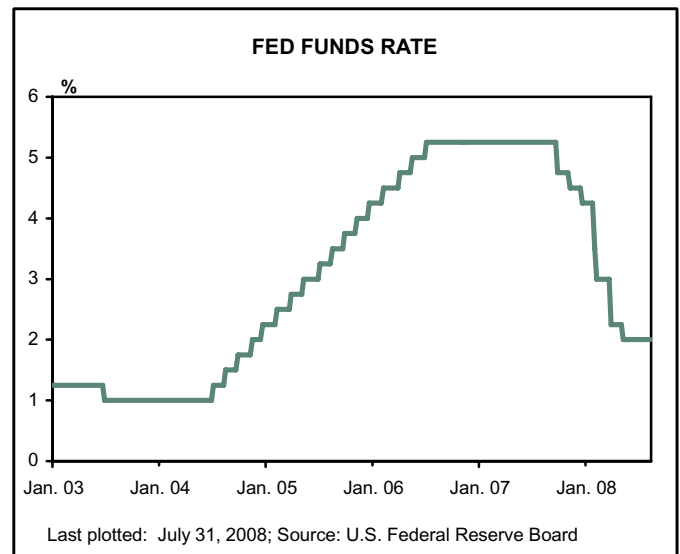
**Release Date:** August 5/08

**Current Rate:** 2.00%

**TD Forecast:** 2.00%

**Consensus:** 2.00%

We expect the Fed to keep the fed funds rate unchanged at 2% when the FOMC meets on August 5. The language of the accompanying statement will likely be less hawkish than in the last communiqué, as the Fed attempts to temper the growing market expectations for higher rates by the end of the year. The Bank's economic assessment is expected to change little, since the recent economic data have continued to be weaker and credit conditions remain tight. Similarly, we are unlikely to see any profound shifts in the language on inflation, even with the retreat in crude oil prices (and to a lesser extent fuel prices at the pump) in the past month. In term of dissent, recent remarks by Philadelphia Fed President Plosser suggest that he is likely to join Dallas Fed President Fisher in advocating for a tighter monetary policy stance, thereby increasing the risks of a joint dissent. Looking ahead, we believe that the tension



between curtailing the elevated level of consumer price inflation and resuscitating the ailing U.S. economy will likely force the Fed to remain on hold in the near to medium term.

*Millan Mulraine 416-308-2911*

## Canadian Employment - July

**Release Date:** August 8/08

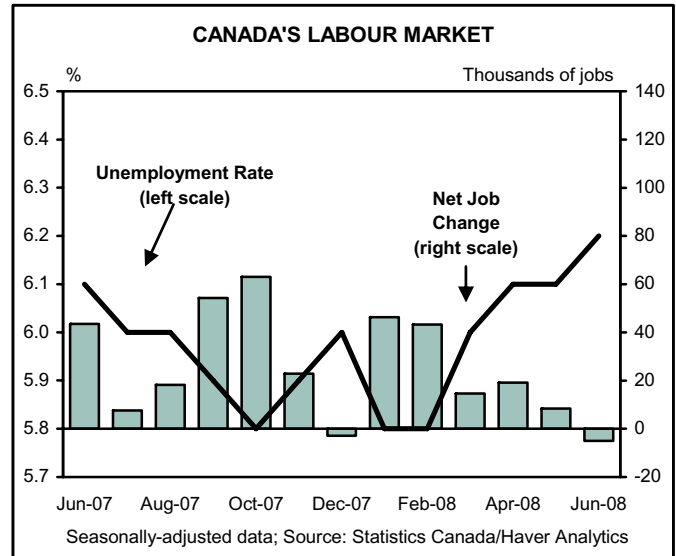
**June Result:** -5.0K; unemployment rate 6.2%

**TD Forecast:** +10K; unemployment rate 6.2%

**Consensus:** +5K; unemployment rate 6.2%

After a surprising drop in the number of people employed in June, we expect the Canadian labour market to rebound modestly in July and add 10K jobs to the employment ranks. The unemployment rate is likely to remain unchanged at 6.2%. On the whole, despite the expected turnaround in the Canadian labour market in July, the sluggish pace of Canadian economic activity will continue to limit the extent of any employment gains going forward. Indeed, we believe that the new normal for job growth in Canadian in the coming months will likely remain in the 0-20K range per month, which is well below the long-term norm of over 20K.

*Millan Mulraine 416-308-2911*



## RECENT KEY ECONOMIC INDICATORS

### July 28 - August 1, 2008

Date	Economic Indicators	Data for	Units	Current	Prior	
<b>Canada</b>						
July 30	Industrial Product Price	Jul	M/M % chg.	1.0	0.9	R▲
July 30	Raw Materials Price Index	Jun	M/M % chg.	3.0	3.1	
July 31	Gross Domestic Product	May	M/M % chg.	0.2	0.4	
<b>United States</b>						
July 28	<i>Fed Governor Mishkin Speaks on Communication in Washington</i>					
July 29	S&P/Case Shiller Home Price Index	May	Index	168.5	170.0	R▲
July 29	Consumer Confidence	Jul.	Index	50.0	51.0	R▼
July 29	<i>Treasury Under Secretary McCormick Speaks at Peterson Institute</i>					
July 30	MBA Mortgage Applications	Jul.	% change	-14.1	-6.2	
July 31	Employment Cost Index	Q2	%	0.7	0.7	
July 31	Gross Domestic Product (annualized)	Q2	Q/Q % chg.	2.0	0.9	R▼
July 31	Personal Consumption	Q2	Q/Q % chg.	1.4	0.9	R▼
July 31	Initial Jobless Claims (Jul 26)	Jul.	Thousands	390.0	404.0	R▼
July 31	Chicago Purchasing Manager Index	Jul.	Index	49.0	49.6	
August 1	Change in Nonfarm Payrolls	Jul.	Thousands	-75.0	-62.0	
August 1	Unemployment Rate	Jul.	%	5.6	5.5	
August 1	ISM Manufacturing Index	Jul.	Index	49.2	50.2	
August 1	Total Vehicle Sales	Jul.	Millions	13.7	13.6	

Source: Bloomberg, TD Economics

## UPCOMING NORTH AMERICAN ECONOMIC CALENDAR

### August 4 - August 8, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
<b>Canada</b>					
Aug 6	IVEY Purchasing Managers Index	Jul.	Index	65.0	69.6
Aug 7	Building Permits	Jun.	M/M % chg.	-0.1	1.1
Aug 8	Unemployment Rate	Jul.	%	6.2	6.2
Aug 8	Net Change in Employment	Jul.	Thousands	10.0	-5.0
<b>United States</b>					
Aug 4	Personal Income	Jun.	% change	-0.2	1.9
Aug 4	Personal Spending	Jun.	% change	0.5	0.8
Aug 4	Personal Consumption Expenditure (Core)	Jun.	M/M % chg.	0.2	0.1
Aug 4	Factory Orders	Jun.	% change	0.7	0.6
Aug 5	<i>Fed's Open Market Committee Meets on Interest Rates, Economy</i>				
Aug 5	ISM Non-Manufacturing Composite	Jul.	Index	48.0	48.2
Aug 5	<i>Federal Reserve Open Market Committee Meeting</i>				
Aug 5	FOMC Rate Decision	5-Aug	%	2.0	2.0
Aug 6	MBA Mortgage Applications	Aug.	% change	---	-14.1
Aug 7	Initial Jobless Claims	Jul.	Thousands	415.0	448.0
Aug 7	Continuing Claims	26-Jul	Thousands	---	3282.0
Aug 7	Pending Home Sales	Jun.	M/M % chg.	-1.0	-4.7
Aug 7	Consumer Credit	Jun.	USD, blns	6.4	7.8
Aug 8	Nonfarm Productivity	Q2	% change	2.7	2.6
Aug 8	Unit Labor Costs	Q2	% change	1.2	2.2
Aug 8	Wholesale Inventories	Jun.	% change	0.6	0.8

Source: Bloomberg, TD Economics

## G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period	
Aug 4	4:30	U.K.	Purchasing Managers Index (construction)	Jul.	Index	---	38.8	
	5:00	EU-12	Purchasers' Price Index	Jun.	M/M % chg.	0.9	1.2	
	8:30	U.S.	Personal Income	Jun.	% change	-0.2	1.9	
	9:30	U.S.	Personal Spending	Jun.	% change	0.5	0.8	
	10:30	U.S.	Personal Consumption Expenditure (Core)	Jun.	M/M % chg.	0.2	0.1	
	10:00	U.S.	Factory Orders	Jun.	% change	0.7	0.6	
Aug 5	3:50	France	Purchasing Managers Index (services)	Jul.	Index	47.0	47.0	
	3:55	Germany	Purchasing Managers Index (services)	Jul.	Index	53.3	53.3	
	4:00	EU-12	Purchasing Managers Index (services)	Jul.	Index	48.3	48.3	
	4:00	EU-12	Purchasing Managers Index (composite)	Jul.	Index	---	47.8	
	4:00	U.K.	Industrial Production	Jun.	M/M % chg.	0.2	-0.8	
	4:30	U.K.	Purchasing Managers Index (services)	Jun.	Index	46.8	47.1	
	4:30	U.K.	Manufacturing Production	Jun.	M/M % chg.	0.2	-0.5	
	5:00	EU-12	Retail Sales	Jul.	M/M % chg.	-0.6	1.2	
	9:00	U.S.	<i>Fed's Open Market Committee Meets on Interest Rates, Economy</i>					
	10:00	U.S.	ISM Non-Manufacturing Composite	Jul.	Index	48.0	48.2	
	14:15	U.S.	<i>Federal Reserve Open Market Committee Meeting</i>					
	14:15	U.S.	FOMC Rate Decision	5-Aug	%	2.00	2.00	
	19:01	U.K.	NIESR Gross Domestic Product Estimate	Jul.	% change	---	0.2	
19:01	U.K.	Nationwide Consumer Confidence	Jul.	Index	---	61.0		
Aug 6	6:00	Germany	Factory Orders	Jun.	M/M % chg.	0.3	-0.9	
	7:00	U.S.	MBA Mortgage Applications	Aug.	% change	---	-14.1	
	10:00	Canada	IVEY Purchasing Managers Index	Jul.	Index	65.0	69.6	
	18:45	N.Z.	Unemployment Rate	Q2	%	3.8	3.6	
	21:30	AU	Unemployment Rate	Jul.	%	---	4.2	
Aug 7	---	Germany	Wholesale Price Index	Jul.	Y/Y % chg.	---	8.9	
	2:00	Germany	Trade Balance	Jun.	Eur, blns	16.0	14.4	
	2:00	Germany	Current Account	Jun.	Eur, blns	---	7.5	
	2:00	Germany	Imports	Jun.	M/M % chg.	---	0.5	
	2:00	Germany	Exports	Jun.	M/M % chg.	---	-3.4	
	2:45	France	Trade Balance	Jun.	Eur, blns	-4.5	-4.7	
	6:00	Germany	Industrial Production	Jun.	Y/Y % chg.	1.9	0.8	
	7:00	U.K.	BOE Rate Announcement	7-Aug	%	5.00	5.00	
	7:45	EU-12	ECB Rate Announcement	7-Aug	%	4.25	2.25	
	8:30	Canada	Building Permits	Jun.	M/M % chg.	-0.1	1.1	
	8:30	U.S.	Initial Jobless Claims	Jul.	Thousands	415.0	448.0	
	8:30	U.S.	Continuing Claims	26-Jul	Thousands	---	3,282.0	
	10:00	U.S.	Pending Home Sales	Jun.	M/M % chg.	-1.0	-4.7	
15:00	U.S.	Consumer Credit	Jun.	USD, blns	6.4	7.8		
Aug 8	0:30	Japan	Bankruptcies	Jul.	Y/Y % chg.	---	11.7	
	7:00	Canada	Unemployment Rate	Jul.	%	6.2	6.2	
	7:00	Canada	Net Change in Employment	Jul.	Thousands	10.0	-5.0	
	8:30	U.S.	Nonfarm Productivity	Q2	% change	2.7	2.6	
	8:30	U.S.	Unit Labor Costs	Q2	% change	1.2	2.2	
	10:00	U.S.	Wholesale Inventories	Jun.	% change	0.6	0.8	

\* Eastern Standard Time; Sources: Bloomberg, TD Economics

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