



TD Economics

The Weekly Bottom Line

August 15, 2008

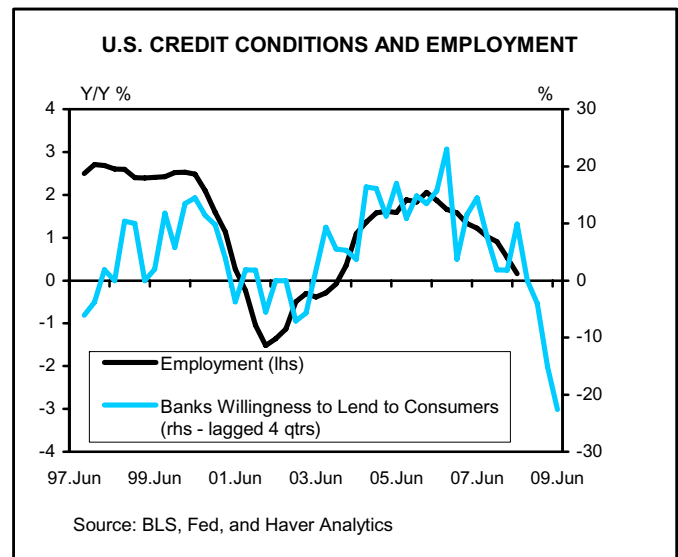
HIGHLIGHTS

- U.S. retail sales lower and inflation higher
- Canadian housing and trade data weak

Global economic sentiment continued to sour this week. The Japanese economy contracted by a 2.4% annualized pace in the second quarter, while the Eurozone economy contracted by 0.8%. The expectation for both economies over the next twelve months is fairly weak. As a result, the pace of real Canadian export growth slowed in June, with better results to the U.S. than other destinations, while housing data for July came in very poor. Meanwhile, the U.S. fiscal stimulus appears to have fizzled, with retail spending in July recording its first monthly contraction since February, and on a year-ago basis, real spending has fallen 2.9%. The Federal Reserve reported credit conditions tightened further in the second quarter. And, adding insult to injury, consumer prices continued to move skyward, with headline inflation unexpectedly jumping from 5.0% to 5.6% and core prices nudging up from 2.4% to 2.5%. The ongoing decline in oil prices should ease some of these pressures, and inflation expectations have recently been trending lower, but it is still worrying that every U.S. inflation sub-index, except for medical expenses, accelerated in July.

Recent TD Economics Research

August 15, 2008 - Canadian Manufacturing Shipments
 August 14, 2008 - U.S. Consumer Price Index
 August 13, 2008 - A Look at U.S. Home Prices from 2002 to Now – The Correction Isn't Over
 August 13, 2008 - Bank of England Inflation Report
 August 13, 2008 - U.S. Retail Sales
 August 12, 2008 - Canadian International Trade
 August 12, 2008 - The Chinese Economy: Domesticating a Dragon
 August 11, 2008 - Canadian Housing Starts



Passing the buck

US import prices have shot up to a 22% annual pace, driven by the weak dollar and elevated food and energy costs. Producer price increases have been sizeable, as well, increasing the pressures on business's margins. This pipeline inflation need not translate into higher consumer prices though. In fact, firms can adjust three ways. In addition to raising their sales prices – directly increasing consumer inflation – they can also lower wages or reduce employment. All options will improve the bottom line. And firms have been selectively using all three. Real wages have fallen 3.1% over the last year while 412 thousand jobs have been cut. As the chart here shows, the two do tend to change in tandem. If the U.S. experiences higher job losses, as the 525 thousand losses we expect in the second half of this year, this implies firms will need to pass along less increases in prices.

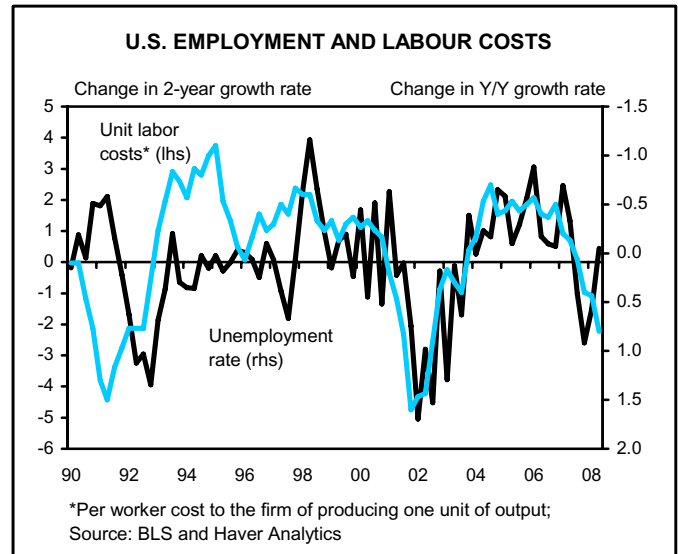
This is our base case U.S. forecast and the most likely scenario given the tightening in credit and weakening consumer spending power is likely to help moderate inflation. But, if the modest pace of job losses that we've seen in the U.S. were to continue, averaging just 65k per month, then the U.S. would likely see inflation higher than we

currently forecast, as businesses try to make ends meet, and the Fed would be hard pressed not to raise interest rates before the middle of 2009 as we currently forecast. On the other hand, given the ongoing twin financial/commodity shocks, we could see even greater job losses, even larger wage declines, and even further retrenchment in spending and growth – resulting in lower inflation but unlikely an easing in monetary policy. The base case scenario balances both of these risks, but the risks are real.

Death of the dollar has been greatly exaggerated

Putting aside the forecast risks, the latest news of higher inflation in the US has markets pricing in a higher risk interest rates could march higher. This has three effects, all negative for oil prices. Higher interest rates mean even less U.S. consumer demand. Strike one for oil. Higher expectations for interest rate increases from the Fed tend to mean a stronger U.S. dollar, which markets have used as shorthand for shorting oil. Strike two. Lastly, the fact that the U.S. dollar has appreciated by about 5-10% against most emerging market and major currencies in the last month means oil prices elsewhere have either fallen less or not at all – especially after you account for falling subsidies in many emerging markets. Strike three. As a result, oil prices – with many other commodities – haven't just come off the boil, they've spilled all over the floor.

There were a couple quotes this week that the oil markets' story this year has been the weaker than expected demand in OECD countries. Really? The economy was going to chug right along with the price of oil doubling in 2007 and then increasing by another 50% in the first six months of 2008? It doesn't take an economist to find the flaw in that logic, but we did, given our forecast throughout this oil spike for prices to near \$100 per barrel by the end of 2008. The real oil market story this year has been the market's willingness to throw common sense to the wind. Of course OECD demand would wane. What did support oil for so long was the fact oil price declines were associated with ongoing U.S. dollar declines, which moderated the impact for every other nation and allowed emerging markets to continue their solid expansions. It should be no surprise - especially given our perfect hindsight – that oil markets finally peaked just as the US fiscal stimulus was waning, emerging market subsidies were receding, and economic growth across the advanced world was flailing. The concern now is that the largest destruction of economic demand from high oil prices tends to only be felt 3-4 quarters later, which means the lingering effects will still be sizeable into the first half of next year and will only be



partially offset through the relief from lower prices. The shadow of oil still lingers large.

Hazy, crazy days of summer

For Canada, on the other hand, lower oil prices tend to be good for consumers due to slower inflation and increasing purchasing power, but are still a net negative for economic growth as a whole. With the rapid drop in oil prices – that we expect is not over – driving the prospects for Canadian economic growth and inflation lower, there is a nascent risk that the Bank of Canada may shift back into a dovish stance. We don't think we are there yet, but the economic data this week did very little to dispel this notion. Housing starts in June unexpectedly fell 14%. We expect some upward correction in July given the volatility of this series and the fact that the economic fundamentals suggest the pace of starts should be closer to 200k, not the current 186k, to be more representative of the underlying demand and supply in the major markets. Existing home prices in Canada are now showing declines over last year, but they too seem to have overshot the fundamentals. The national 3.6% decline in existing home prices is also being driven by the sizeable 8% decline in Calgary and 5% decline in Edmonton. Excluding these two markets, the year-to-date prices have grown by 2%, much closer to what we think is consistent with the current state of the economy. Canadian manufacturing shipments provided a ray of hope for Canadian GDP in June, but the trend there is still lower as export demand weakens. Looking through the volatility, it seems clear the Canadian economy is struggling to expand through the summer months.

Richard Kelly, Senior Economist 416-982-2559

UPCOMING KEY ECONOMIC RELEASES

U.S. Housing Starts - July

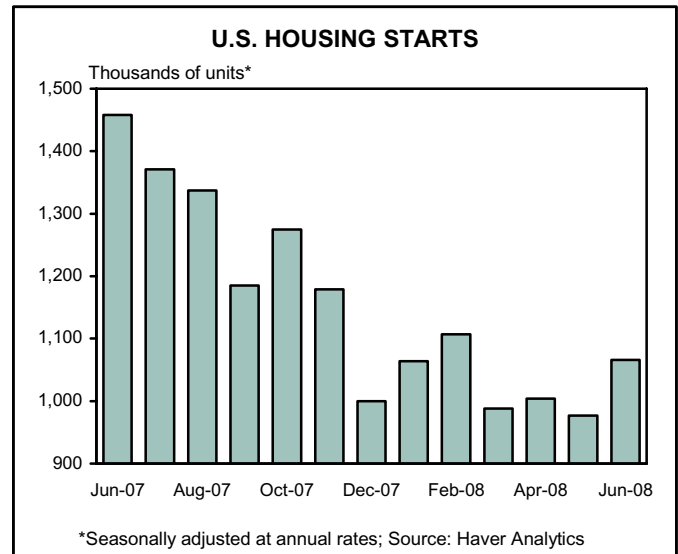
Release Date: August 19/08

June Result: 1066K

TD Forecast: 980K

Consensus: 960K

The unexpected surge in U.S. residential building activity in June (driven by the changes to the New York building codes, and affecting permits issued after July 1) should begin to unwind this month, though we highlight the risk that starts could remain unnaturally high as previously approved permits are implemented. More generally, with the malaise in the overall U.S. housing market continuing unabated, deteriorating labour market conditions and a sluggish economy, there is little signs of an imminent turnaround for the sector. We expect housing starts to fall back to 980K in July. Moreover, with the inventory of unsold new and existing homes remaining at elevated levels, home builders are likely to continue retrenching



their building activity in the coming months, further depressing starts in the second half of the year.

Millan Mulraine 416-308-2911

Canadian Wholesale Sales - June

Release Date: August 19/08

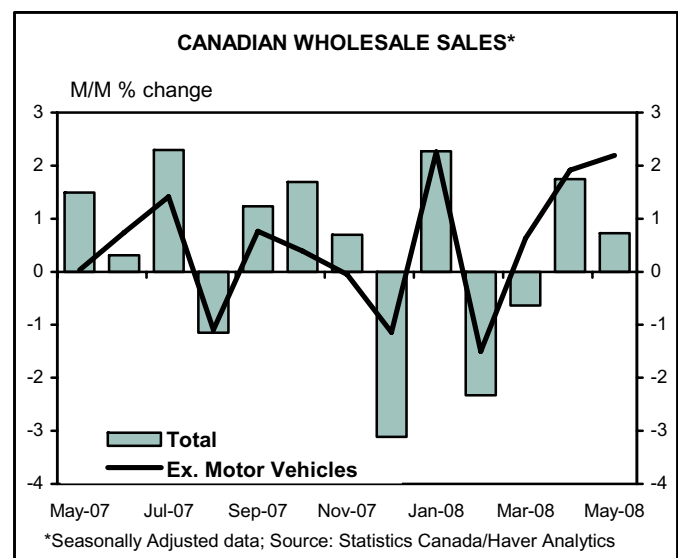
May Result: total +1.6% M/M

TD Forecast: total +1.5% M/M

Consensus: total +0.5% M/M

After a disappointing first quarter, Canadian wholesale sales rebounded with a vengeance in the first two months of the second quarter, with even real sales posting sizeable gains. We expect the momentum to be sustained for at least one more month, with sales posting a further 1.5% M/M increase in June, following the robust 1.6% advance in May, on account of the revival in Canadian manufacturing sector activity – which has been driven in large part by the astonishing surge in auto-related sector activity during the month. Looking further ahead, however, we expect activity in the sector to moderate as the impact of the slowing U.S. and Canadian economies takes hold.

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Canadian Retail Sales - June

Release Date: August 20/08

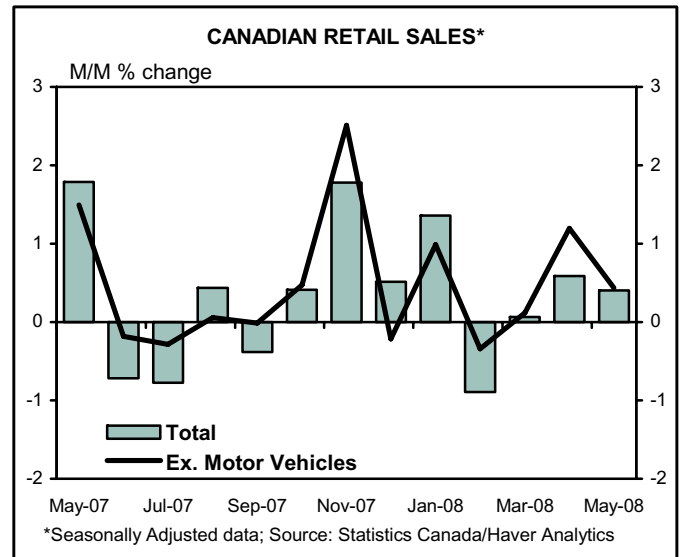
May Result: total +0.4% M/M; ex-autos +0.4% M/M

TD Forecast: total +0.7% M/M; ex-autos +1.0% M/M

Consensus: total +0.4% M/M; ex-autos +0.4% M/M

Canadian retail sales are expected to post their biggest gain since January with a strong +0.7% M/M advance in June, on the heels of the 0.4% M/M rise in May. Much of the strength in sales will likely come from gasoline sales, given that gas prices rose by a very strong 5.8% M/M during the month. The dramatic turnaround in weather conditions in June, following the unseasonably cold May, is also likely to be an important factor. Notwithstanding the jump in the headline number, with consumers continuing to shy away from automobile purchases, sales excluding autos are expected to advance at a more robust 1.0% M/M clip. In real terms, sales are likely to be less strong and most of the gains will likely come from price effects.

Millan Mulraine 416-308-2911



Canadian Consumer Price Index - July

Release Date: August 21/08

June Result: core 0.1% M/M, 1.5% Y/Y;

all-items 0.7% M/M, 3.1% Y/Y

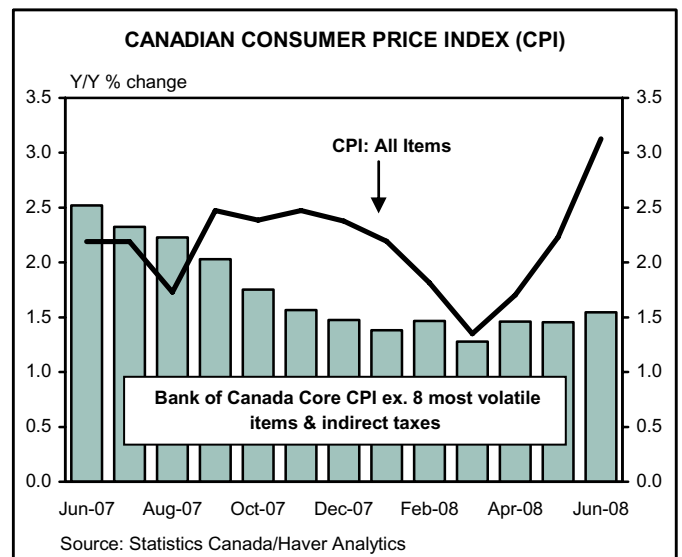
TD Forecast: core 0.1% M/M, 1.5% Y/Y;

all-items 0.2% M/M, 3.2% Y/Y

Consensus: core 0.2% M/M, 1.6% Y/Y;

all-items 0.4% M/M, 3.4% Y/Y

As global commodity prices moved skywards in the first half of the year, Canadian headline consumer price inflation when along for the ride, accelerating from a modest 1.4% Y/Y in March to a rather toasty 3.1% Y/Y in June. However, with the ascent in crude oil prices (and other commodities) appearing to have come to an end, we expect consumer inflation to begin moderating, before falling later in the year. Indeed, with gasoline prices rising by their smallest margin in many months (increasing by less than 1% M/M following four consecutive monthly gains of 4% M/M plus increases), we expect to see consumer prices rise by a more modest 0.2% M/M. The seasonally adjusted index is also expected to increase by 0.2% M/M. Annual headline inflation should rise to 3.2% Y/Y.



Core inflation is expected to remain unchanged at a tepid 1.5% Y/Y for the fourth straight month. On a monthly basis, we expect core consumer prices to rise by 0.1% M/M, with the seasonally adjusted index posting a 0.2% M/M gain.

Millan Mulraine 416-308-2911

RECENT KEY ECONOMIC INDICATORS
August 11 - August 15, 2008

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
Aug 11	Housnig Starts	Jul.	Thousands	186.5	215.9	R▼
Aug 12	New Housing Price index	Jun.	M/M % chg.	0.1	0.0	
Aug 12	International Merchandise Trade	Jun.	\$C, blns	5.8	5.2	R▼
Aug 15	New Motor Vehicle Sales	Jun.	M/M % chg.	-1.0	0.8	R▼
Aug 15	Manufacturing Shpiments	Jun.	M/M % chg.	2.1	2.2	R▼
United States						
Aug 12	Trade Balance	Jun.	US\$, blns	56.8	-59.2	R▼
Aug 13	MBA Mortgage Applications	8-Aug	% change	-1.5	2.8	
Aug 13	Import Price Index	Jul.	Y/Y % chg.	21.6	21.1	R▲
Aug 13	Advance Retail Sales	Jul.	% change	-0.1	0.3	R▲
Aug 13	Business Inventories	Jun.	% change	0.7	0.4	R▲
Aug 14	Consumer Price Index	Jul.	Y/Y % chg.	5.6	5.0	
Aug 14	Initial Jobless Claims	9-Aug	Thousands	450.0	460.0	R▲
Aug 14	Continuing Claims	2-Aug	Thousands	3417.0	3303.0	R▼
Aug 14	<i>Fed's Stern Speaks in Three Forks, Montana on Financial Shock</i>					
Aug 15	Empire Manufacturing Index	Aug.	Index	2.8	-4.9	
Aug 15	TICS Flows	Jun.	US\$, blns	51.1	12.3	R▲
Aug 15	Industrial Production	Jul.	% change	0.2	0.4	R▼
Aug 15	Univ. of Michigan Confidence Index	Aug.	Index	61.7	61.2	
Aug 15	<i>Chicago Fed's Evans to Speak on Economic Outlook in Illinois</i>					

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR
August 18 - August 22, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior	
Canada						
Aug 20	Leading Indicators	Jul.	M/M % chg.	0.1	0.0	
Aug 20	Retail Sales	Jun.	M/M % chg.	0.5	0.4	
Aug 20	Retail Sales (Ex. Autos)	Jun.	M/M % chg.	0.6	0.4	
Aug 21	Consumer Price Index	Jul.	Y/Y % chg.	3.4	3.1	
Aug 21	Consumer Price Index (Core)	Jul.	Y/Y % chg.	1.6	1.5	
United States						
Aug 19	Producer Price Index	Jul.	Y/Y % chg.	9.3	9.2	
Aug 19	Producer Price Index (Ex. Food & Energy)	Jul.	Y/Y % chg.	3.2	3.0	
Aug 19	Housing Starts	Jul.	Thousands	960.0	1066.0	
Aug 19	Building Permits	Jul.	Thousands	970.0	1091.0	
Aug 19	<i>Fed Governor Fisher Speaks in Aspen on U.S. Economy</i>					
Aug 19	ABC Consumer Confidence	17-Aug	Index	--	-50.0	
Aug 20	MBA Mortgage Applications	15-Aug	% change	--	-1.5	
Aug 21	Initial Jobless Claims	16-Aug	Thousands	450.0	150.0	
Aug 21	Continuing Claims	9-Aug	Thousands	--	3417.0	
Aug 21	Philadelphia Fed Index	Aug.	% change	-15.0	-16.3	
Aug 21	Leading Indicators	Jul.	% change	-0.2	-0.1	
Aug 22	<i>Fed Governor Bernanke Speaks on Financial Stability at Jackson Hole</i>					

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 18	00:00	Japan	<i>Bank of Japan Monetary Policy Meeting</i>				
	1:00	Japan	Leading Index CI	Jun.	Index	--	91.2
	1:00	Japan	Coincident Index CI	Jun.	Index	--	101.7
	2:30	France	Bank of France Business Sentiment	Jul.	Index	94.0	95.0
	5:00	EU-12	Trade Balance	Jun.	Eur, blns	1.2	-4.6
	13:00	U.S.	NAHB Housing Market Index	Aug.	Index	16.0	16.0
Aug 19	--	Japan	<i>Bank of Japan Target rate Decision</i>	19-Aug	%	0.5	0.5
	--	Germany	Import Price Index	Jul.	Y/Y % chg.	9.2	8.9
	2:00	Germany	Producer Prices	Jul.	Y/Y % chg.	7.5	6.7
	8:30	U.S.	Producer Price Index	Jul.	Y/Y % chg.	9.3	9.2
	8:30	U.S.	Producer Price Index (Ex. Food & Energy)	Jul.	Y/Y % chg.	3.2	3.0
	8:30	U.S.	Housing Starts	Jul.	Thousands	960.0	1,066.0
	8:30	U.S.	Building Permits	Jul.	Thousands	970.0	1,091.0
	10:00	U.S.	<i>Fed Governor Fisher Speaks in Aspen on U.S. Economy</i>				
	17:00	U.S.	ABC Consumer Confidence	17-Aug	Index	--	-50.0
Aug 20	1:00	Japan	<i>Bank of Japan Monthly Report</i>				
	4:30	U.K.	<i>Bank of England Minutes</i>				
	4:00	U.K.	M4 Money Supply	Jul.	Y/Y % chg.	10.7	11.4
	7:00	U.S.	MBA Mortgage Applications	15-Aug	% change	--	-1.5
	8:30	Canada	Leading Indicators	Jul.	M/M % chg.	0.1	0.0
	8:30	Canada	Retail Sales	Jun.	M/M % chg.	0.5	0.4
	8:30	Canada	Retail Sales (Ex. Autos)	Jun.	M/M % chg.	0.6	0.4
	19:50	Japan	Merchandise Trade Balance	Jul.	¥, blns	235.0	121.9
	21:30	AU	New Motor Vehicle Sales	Jul.	Y/Y % chg.	--	1.4
Aug 21	3:00	France	Purchasing Managers Index (Manufacturing)	Aug.	Index	47.0	47.1
	3:00	France	Purchasing Managers Index (Services)	Aug.	Index	47.5	47.5
	3:30	Germany	Purchasing Managers Index (Manufacturing)	Aug.	Index	50.5	50.9
	3:30	Germany	Purchasing Managers Index (Services)	Aug.	Index	52.1	53.1
	4:00	EU-12	Purchasing Managers Index (Manufacturing)	Aug.	Index	47.0	47.4
	4:00	EU-12	Purchasing Managers Index (Services)	Aug.	Index	48.0	48.3
	4:00	EU-12	Purchasing Managers Index (Composite)	Aug.	Index	47.7	47.8
	4:30	U.K.	Retail Sales	Jul.	Y/Y % chg.	1.8	2.2
	7:00	Canada	Consumer Price Index	Jul.	Y/Y % chg.	3.4	3.1
	7:00	Canada	Consumer Price Index (Core)	Jul.	Y/Y % chg.	1.6	1.5
	8:30	U.S.	Initial Jobless Claims	16-Aug	Thousands	450.0	150.0
	8:30	U.S.	Continuing Claims	9-Aug	Thousands	--	3417.0
	10:00	U.S.	Philadelphia Fed Index	Aug.	% change	-15.0	-16.3
	10:00	U.S.	Leading Indicators	Jul.	% change	-0.2	-0.1
19:50	Japan	<i>Bank of Japan Monetary Policy Meeting Minutes for July</i>					
Aug 22	4:30	U.K.	Gross Domestic Product	Q2	Y/Y % chg.	1.5	1.6
	4:30	U.K.	Exports	Q2	Q/Q % chg.	0.4	0.0
	4:30	U.K.	Imports	Q2	Q/Q % chg.	-0.3	-0.6
	10:00	U.S.	<i>Fed Governor Bernanke Speaks on Financial Stability at Jackson Hole</i>				

* Eastern Standard Time; Sources: Bloomberg, TD Economics

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