



**Bank
Financial
Group**

TD Economics

The Weekly Bottom Line

August 29, 2008

HIGHLIGHTS

- **One and done – U.S. consumer spending will likely contract in Q3**
- **Canadian real GDP stagnated in Q2, revised down for Q1**

U.S. real GDP growth for Q2 was revised up to 3.3% (from 1.9%) this week. This turned out to be a better performance than the consensus forecast of 2.7%, and the result was naturally taken in positively by markets digging for a cookie in a jar that has been quite empty of late. Something akin to a loose chocolate chip was found on Wednesday upon news that durable goods orders fared well in July. These orders were up 1.3% in that month but were still significantly below (-2.4%) levels from a year-ago. Unfortunately, as we detail below, we are now down to mere crumbs in the cookie jar.

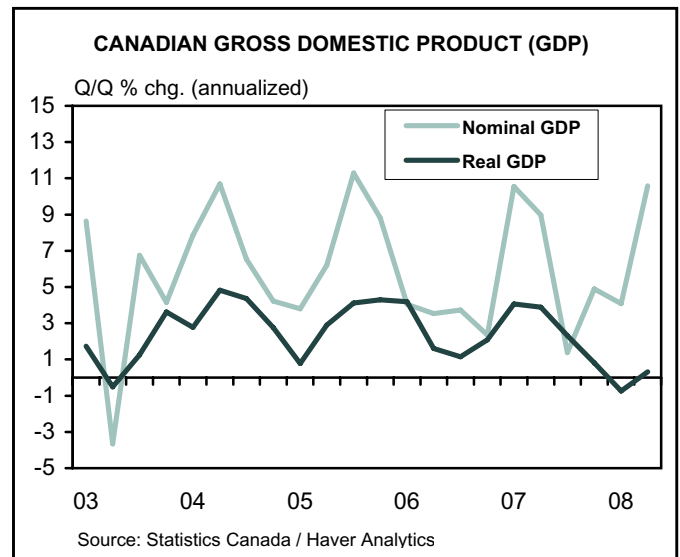
One-and-done

For example, the Conference Board's consumer confidence index was up significantly in August to 56.9 (from 51.9 in July), but is still sitting at recessionary levels. The boost in confidence from basement levels seems to mostly result from lower prices at the pump. Do not be fooled, however – consumers aren't breaking a smile, nor are their wallets getting bulkier, just because gas is now slightly under US\$4/gallon from a national peak near US\$4.10/gallon in July.

The new and existing home sales and inventory data for July, as well as home price indexes for June, only suggest that the pace of the correction is slowing – nothing

Recent TD Economics Research

- August 29, 2008** - Monetary Policy Monitor
- August 29, 2008** - Canadian GDP Commentary
- August 29, 2008** - U.S. Personal Income and Spending Commentary
- August 27, 2008** - U.S. Durable Goods Orders Commentary



cheerier. As such, we have a ways to go before U.S. home prices stabilize and inventories of unsold homes get absorbed back to more typical levels.

Friday morning's release of U.S. personal income and spending figures for July added to bearish sentiment after they indicated that income declined by 0.7% M/M while real personal consumption expenditures (PCE) fell by 0.4% M/M. U.S. consumer spending had been kept afloat in Q2 as a result of the federal fiscal stimulus plan which sent tax rebates of about US\$1,300 per median household. Unfortunately, and such is the nature of short-term fiscal boosts, that was one-and-done deal, and the figures from July suggest that American consumers were finally throwing in the towel at the outset of Q3. Real PCE only grew at a 1.7% pace in Q2, whereas its trend rate of growth over the last 20 years is closer to double that (3.0-3.5%). The report also reminded us that U.S. inflation was still running hot, with the PCE inflation rate at 4.5%, its highest in 17 years. Fortunately, the core PCE inflation measure, while inching up to 2.4% in July, remained better behaved, an indication that pass-through from energy prices to overall prices has been limited so far.

So it not even the case that U.S. consumers went on a

spending spree this summer, even after factoring in the boost given by tax rebates checks. This should not come as a surprise, given how stretched U.S. wallets have been of late, on both the inflow (income) and the outflow (prices) sides. Americans were facing much higher prices at the pump this summer. Only about 30 cents to each dollar of tax rebate money has been spent. Many households seemingly elected to pay down some of their high credit card debt and other loans, while many others had to absorb increasing mortgage payments. We expect consumer expenditures to contract in Q3 and only grow modestly for the year as a whole, which leaves the U.S. economy without its main pillar of economic growth. While this is a welcome rebalancing which should increase savings, following a massive spending spree in the last few years, the adjustment figures to be painful.

In fact, the better-than-expected growth in the U.S. economy in Q2 was mostly due to soaring exports, which climbed by 13.2% and thereby contributed more than half (1.7 percentage points) to the headline real GDP growth of 3.3%. Even more telling, since real imports declined by a significant 7.6% in Q2, the net trade component contributed almost all (3.1 percentage points) of total real GDP growth. As European and Asian economies are already showing signs of slowing in entering the second half of this year – with many like Canada, Japan, the U.K. and the Eurozone on the edge of a technical recession – U.S. export growth is also expected to moderate in the coming quarters. The bottom line is that while real GDP growth over the last four quarters suggests the U.S. (2.2%) economy fared better than Canada's (0.6%), we would argue that this by itself is not an accurate reflection of the breath and depth of each country's difficulties.

Canada's real GDP standing still

Admittedly, the Canadian economy is hurting. Economic growth (real GDP) did not surprise in Q2 and came in just slightly positive at 0.3%. Furthermore, Q1 growth was revised down to -0.8% (from -0.3%). When stripping out inflation and looking solely at volumes, overall economic activity in Canada has been stuck in a rut since late last year, and we do not expect it to rebound before late next year. After see-sawing since last fall, the level of monthly real GDP by industry hasn't grown in almost nine months. Average annual real GDP growth for this year is likely to come in below even our cautious forecast of 1.0%. Although we won't have the two largest provinces' Q2 estimates for another while, Ontario and Québec real GDP likely contracted for a second consecutive quarter, mostly

a reflection of declining exports to the U.S.

Hence, by itself, the real GDP data suggests that Canada just barely avoided the technical definition of a recession, while the U.S. economy is humming along just fine. Too narrow a focus on real GDP, along with a rearview mirror look, could lead to that erroneous conclusion. Other important indicators of economic health, such as employment, wage & income growth, corporate earnings, housing markets, financial market and credit conditions, as well as consumer balance sheets all point to Canada scoring higher than the U.S., both in recent quarters and, most importantly, in the quarters ahead.

This can also be seen when looking at nominal GDP growth, which recorded a blistering 10.6% (annualized) pace in Q2, which ranks among the best quarterly jumps over the last 20 years. Why the discrepancy? In a nutshell: commodity prices. Therefore, even as the volume of economic activity is moving mostly sideways, prices have supported solid gains in earnings, which should help limit the downside to public finances and help ensure that fiscal surplus or balanced positions are not compromised.

As for monetary policy, the Q2 GDP report is unlikely to sway the Bank of Canada (BoC) into a near-term change of stance away from its currently neutral mode. BoC Deputy Governor Longworth had already indicated on Tuesday that the BoC expected real GDP growth in Q2 to come up short of their July forecast of 0.8%. In our view, while marginally increasing the odds of interest rate cuts in October or later, this slight margin of disappointment on GDP still leaves them with an assessment that the upside and downside risks to both economic growth and inflation remain in balance. Commodity prices have retreated since July, but the Canadian dollar has followed on the way down. Considering both developments together yields a wash in terms of growth and inflation outlook. Further disruptions in financial markets, a deeper weakening in housing markets and/or labour markets could, however, all serve as triggers for a change of view towards a more accommodative stance between now and October. In the near-term, we expect the BoC to stand pat and leave the overnight interest rate unchanged at 3.00% at its upcoming meeting on Tuesday Sept. 3rd. Our attention will be focused on the BoC's communiqué which accompanies their decision, as well as on Friday's employment reports for both the U.S. and Canada, which we expect will continue to highlight downside risks in both economies – see following pages for comment and forecast of each.

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UPCOMING KEY ECONOMIC RELEASES

U.S. ISM Manufacturing Report - August

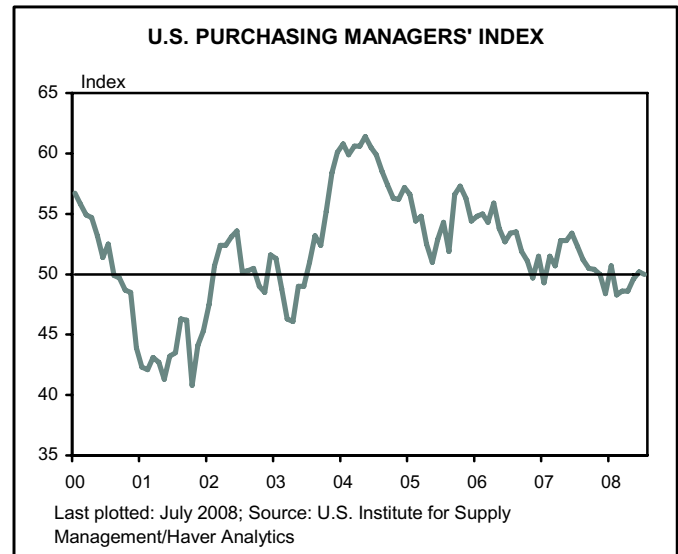
Release Date: September 1/08

July Result: 50.0

TD Forecast: 50.0

Consensus: 49.6

The resurgence in U.S. exports (due in no small part to the weak dollar) in the first half of this year has meant that manufacturing sector activity has surprised to the upside more often than not. But this is likely to change later in the year. Indeed, the recent strengthening of the U.S. dollar and weakness in the economic fortune of U.S. trading partners (particularly Europe) will likely mean that the support from the export sector may come to an unceremonious end soon, adversely affecting the extent of manufacturing sector activity in the U.S. In the meantime, however, we expect the ISM manufacturing index to remain unchanged at 50 in August. Indeed, while durable goods



orders remain very strong, most regional manufacturing sector indices continue to point to a mixed performance in the sector.

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U.S. Nonfarm Payrolls - August

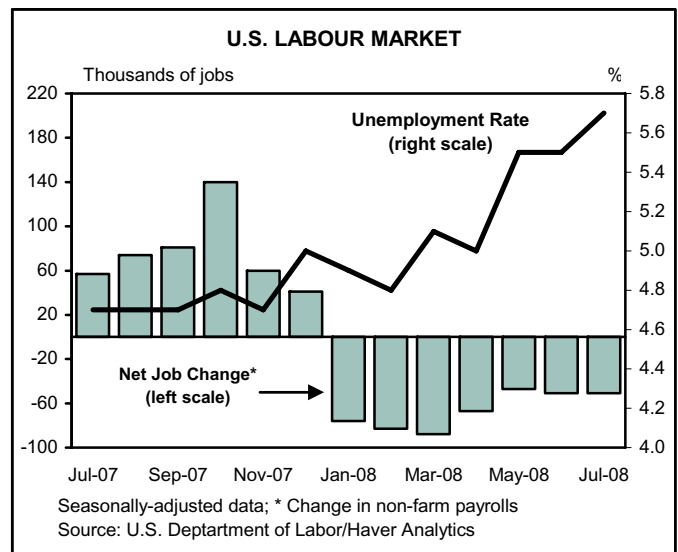
Release Date: September 5/08

July Result: -51K; unemployment rate 5.7%

TD Forecast: -50K; unemployment rate 5.7%

Consensus: -71K; unemployment rate 5.7%

The U.S. economy has lost jobs each month this year, with a total of 463K positions being eliminated from the nonfarm payrolls. And with signs of continued weakness in the U.S. labour market, demonstrated by the weak regional Fed employment indicators and to a lesser extent the elevated level of continuing jobless claims, there is little to suggest that this trend will be reversed any time soon. For August, we expect to see a further 50K jobs being eliminated from the nonfarm payrolls, with the unemployment rate remaining unchanged at 5.7%. Looking ahead, the U.S. labour market is expected to remain weak, with a nontrivial risk of the pace of deterioration accelerating in the coming months as the economy softens.



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Bank of Canada Rate Decision

Release Date: September 3/08

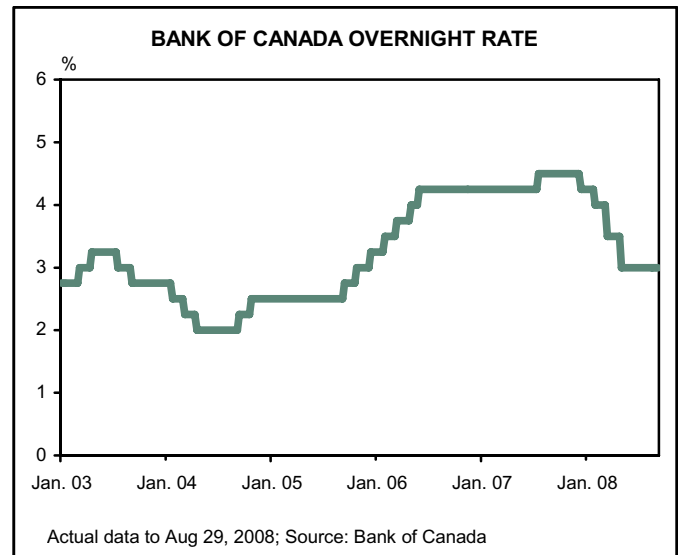
Current Rate: 3.00%

TD Forecast: 3.00%

Consensus: 3.00%

The Bank of Canada is expected to keep rates on hold at 3%. Admittedly, there are arguments that extend in both directions. First, the economy is unambiguously weak. Second, the slowdown in economic activity has started to sow the seeds of some moderation in price pressures. Core CPI still remains below the Bank's 2% operational target, and was up 1.5% Y/Y in July. Other price metrics have also eased in recent months. But there is still some risk associated with headline price pressures associated with movement in commodities and the loonie, and on that front, the Bank will want some time to assess such risks. The U.S. economy has surprised to the upside, household credit growth is strong, and alternative inflation measures are high. Considering that the Bank has generally retained a neutral bias in the last statement and subsequent rhetoric, it is unlikely that they will make any change to the overnight rate.

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Canadian Employment - August

Release Date: September 5/08

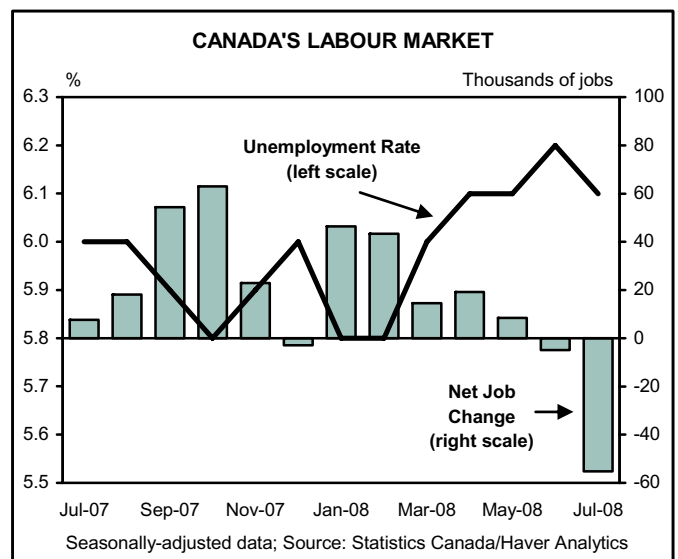
July Result: -55.2K; unemployment rate 6.1%

TD Forecast: +10K; unemployment rate 6.2%

Consensus: +10K; unemployment rate 6.2%

The surprising 55K drop in the Canadian employment ranks in July has ostensibly exposed the soft underbelly of the Canadian labour market. Yet, we are not convinced that this sizeable drop will be the beginning of a prolonged deterioration in the labour market, but instead see it as perhaps the expected offset to the anomalous strength in job creation in the first half of the year. Nevertheless, with the economy softening, we believe that the period of oversized monthly job gains is behind us, and any increase in employment will be modest – at best. To this end, we expect to see a reasonable bounce back of 10K jobs added to the Canadian economy in August, on account of the recent strength in manufacturing sector activity and the encouraging labour force intentions of Canadian firms. The unemployment rate is expected to edge up modestly to 6.2% on labour force growth after the sharp drop in July.

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UPCOMING NORTH AMERICAN ECONOMIC CALENDAR
September 1 - September 5, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Sep 3	Bank of Canada Rate	3-Sep	%	3.0	3.0
Sep 5	Unemployment Rate	Aug	%	6.2	6.1
Sep 5	Net Change in Employment	Aug	Thousands	10.0	-55.2
Sep 5	IVEY Purchasing Managers Index	Aug	Index	62.0	65.5
United States					
Sep 1	<i>Fed Governor Kroszner Speaks in Buenos Aires on the Financial System</i>				
Sep 1	<i>Fed Governor Hoenig Speaks in Argentina on Financial Turmoil</i>				
Sep 2	ISM Manufacturing	Aug.	Index	49.5	50.0
Sep 2	Construction Spending	Jul.	M/M % chg.	-0.5	-0.4
Sep 2	ABC Consumer Confidence	31-Aug	Index	-49.0	-50.0
Sep 3	Total Vehicle Sales	Aug.	Millions	13.0	12.5
Sep 3	MBA Mortgage Applications	29-Aug	% change	--	0.5
Sep 3	Factory Orders	Jul.	% change	0.9	1.7
Sep 3	Boston Fed Governor Rosengren Speaks in Manchester, New Hampshire				
Sep 3	<i>Fed Releases Beige Book Economic Report</i>				
Sep 4	ADP Employment Change	Aug.	Thousands	-20.0	9.0
Sep 4	Non-Farm Productivity	Q2	% change	3.0	2.2
Sep 4	Unit Labour Costs	Q2	% change	0.6	1.3
Sep 4	Initial Jobless Claims	30-Aug	Thousands	423.0	425.0
Sep 4	Continuing Claims	23-Aug	Thousands	3400.0	3423.0
Sep 4	ISM Non-Manufacturing Composite Index	Aug.	Index	49.5	49.5
Sep 4	<i>Fed Governor Fisher Speaks in Houston on U.S. Economic Challenges</i>				
Sep 4	<i>Fed Governor Yellen Speaks in Salt Lake City on U.S. Economy</i>				
Sep 5	Change in Nonfarm Payrolls	Aug	Thousands	-35.0	-51.0
Sep 5	Unemployment rate	Aug	%	5.7	5.7
Sep 5	Change in Manufacturing Payrolls	Aug	Thousands	-35.0	-35.0
Sep 5	Average Hourly Earnings	Aug	Y/Y % chg.	3.4	3.4
Sep 5	Mortgage Delinquencies	Q2	% change	--	6.4
Sep 5	<i>Fed Governor Yellen Speaks in Los Angeles on U.S. Economy</i>				

Source: Bloomberg, TD Economics

RECENT KEY ECONOMIC INDICATORS
August 25 - August 29, 2008

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
Aug 28	Current Account	Q2	\$C, blns	6.8	4.5	R▼
Aug 29	Industrial Product Prices	Jul.	M/M % chg.	0.4	1.6	R▲
Aug 29	Raw Materials Price Index	Jul.	M/M % chg.	1.4	4.3	R▼
Aug 29	Gross Domestic Product (annualized)	Q2	Q/Q % chg.	0.3	-0.8	R▼
United States						
Aug 25	Existing Home Sales	Jul.	Millions	5.0	4.9	R▼
Aug 26	S&P/CaseShiller Home Price Index	Jun.	Index	167.7	168.5	
Aug 26	Consumer Confidence	Aug.	Index	56.9	51.9	
Aug 26	New Home Sales	Jul.	Thousands	515.0	503.0	R▼
Aug 26	House Price Index	Jun.	M/M % chg.	0.0	-0.4	R▼
Aug 26	Richmond Fed. Manufacturing Index	Aug.	Index	-16.0	-16.0	
Aug 26	<i>Minutes of Aug. 5 FOMC Meeting</i>					
Aug 26	ABC Consumer Confidence	24-Aug	Index	-50.0	-49.0	
Aug 27	MBA Mortgage Applications	Aug 22	% change	0.5	-1.5	
Aug 27	Durable Goods Orders	Jul.	% change	1.3	1.3	R▲
Aug 27	Durable Goods Orders (Ex. Transportation)	Jul.	% change	0.7	2.4	R▲
Aug 27	<i>Atlanta Fed Governor Lockhart to Speak on Inflation at Georgia State</i>					
Aug 28	Gross Domestic Product (annualized)	Q2	Q/Q % chg.	3.3	1.9	
Aug 28	Personal Consumption	Q2	% change	1.7	1.5	
Aug 28	Initial Jobless Claims	23-Aug	Thousands	425.0	435.0	R▲
Aug 28	Continuing Claims	16-Aug	Thousands	3423.0	3359.0	R▼
Aug 29	Personal Income	Jul.	% change	-0.7	0.1	
Aug 29	Personal Spending	Jul.	% change	0.2	0.6	
Aug 29	Personal Consumption Expenditure Deflator	Jul.	Y/Y % chg.	4.5	4.0	R▼
Aug 29	Core Personal Consumption Expenditure	Jul.	Y/Y % chg.	2.4	2.3	
Aug 29	Chicago Purchasing Managers Index	Aug.	Index	57.9	50.8	
Aug 29	U of Michigan Confidence Index	Aug.	Index	63.0	61.7	

Source: Bloomberg, TD Economics

G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period		
Sep 1	--	AU	Inventories	Q2	% change	0.6	0.9		
	1:00	Japan	Vehicle Sales	Aug.	Y/Y % chg.	--	5.4		
	2:00	Germany	Retail Sales	Aug.	Y/Y % chg.	-2.2	-3.9		
	3:50	France	Purchasing Managers Index (Manufacturing)	Aug.	Index	45.1	45.1		
	3:55	Germany	Purchasing Managers Index (Manufacturing)	Aug.	Index	49.9	49.9		
	4:00	EU-12	Purchasing Managers Index (Manufacturing)	Aug.	Index	47.5	47.5		
	4:30	U.K.	M4 Money Supply	Jul.	Y/Y % chg.	--	11.2		
	4:30	U.K.	Mortgage Approvals	Jul.	Thousands	35.0	36.0		
	4:30	U.K.	Purchasing Managers Index (Manufacturing)	Aug.	Index	44.0	44.3		
	9:30	U.S.	<i>Fed Governor Kroszner Speaks in Buenos Aires on the Financial System</i>						
	14:45	U.S.	<i>Fed Governor Hoenig Speaks in Argentina on Financial Turmoil</i>						
Sep 2	4:30	U.K.	Purchasing Managers Index (Construction)	Aug.	Index	36.0	36.7		
	5:00	EU-12	Euro-Zone Producer Price index	Jul.	Y/Y % chg.	9.1	8.0		
	10:00	U.S.	ISM Manufacturing	Aug.	Index	49.5	50.0		
	10:00	U.S.	Construction Spending	Jul.	M/M % chg.	-0.5	-0.4		
	17:00	U.S.	ABC Consumer Confidence	31-Aug	Index	-49.0	-50.0		
	19:01	U.K.	Nationwide Consumer Confidence	Aug.	Index	49.0	51.0		
	21:30	AU	Gross Domestic Product	Q2	Y/Y % chg.	2.9	3.6		
Sep 3	3:50	France	Purchasing Managers Index (Services)	Aug.	Index	48.5	48.5		
	3:55	Germany	Purchasing Managers Index (Services)	Aug.	Index	50.6	50.6		
	4:00	EU-12	Purchasing Managers Index (Services)	Aug.	Index	48.2	48.2		
	4:00	EU-12	Purchasing Managers Index (Composite)	Aug.	Index	48.0	48.0		
	4:30	U.K.	Purchasing Managers Index (Services)	Aug.	Index	47.0	47.4		
	5:00	EU-12	Euro-Zone Gross Domestic Product	Q2	Y/Y % chg.	1.5	1.5		
	5:00	EU-12	Euro-Zone Retail Sales	Jul.	Y/Y % chg.	-2.1	-3.1		
	--	U.S.	Total Vehicle Sales	Aug.	Millions	13.0	12.5		
	7:00	U.S.	MBA Mortgage Applications	29-Aug	% change	--	0.5		
	9:00	Canada	Bank of Canada Rate	3-Sep	%	3.00	3.00		
	10:00	U.S.	Factory Orders	Jul.	% change	0.9	1.7		
	12:30	U.S.	<i>Boston Fed Governor Rosengren Speaks in Manchester, New Hampshire</i>						
	14:00	U.S.	<i>Fed Releases Beige Book Economic Report</i>						
21:30	AU	Trade Balance	Jul.	\$AU, blns	50.0	411.0			
Sep 4	6:00	Germany	Factory Orders	Jul.	Y/Y % chg.	-2.2	-6.1		
	7:00	U.K.	Bank of England Announces Rates	4-Sep	%	5.00	5.00		
	7:45	EU-12	European Central Bank Announces Rates	4-Sep	%	4.25	4.25		
	8:15	U.S.	ADP Employment Change	Aug.	Thousands	-20.0	9.0		
	8:30	U.S.	Non-Farm Productivity	Q2	% change	3.0	2.2		
	8:30	U.S.	Unit Labour Costs	Q2	% change	0.6	1.3		
	8:30	U.S.	Initial Jobless Claims	30-Aug	Thousands	423.0	425.0		
	8:30	U.S.	Continuing Claims	23-Aug	Thousands	3,400.0	3,423.0		
	10:00	U.S.	ISM Non-Manufacturing Composite Index	Aug.	Index	49.5	49.5		
	13:40	U.S.	<i>Fed Governor Fisher Speaks in Houston on U.S. Economic Challenges</i>						
	14:30	U.S.	<i>Fed Governor Yellen Speaks in Salt Lake City on U.S. Economy</i>						
Sep 5	6:00	Germany	Industrial Production	Jul.	Y/Y % chg.	0.8	1.7		
	7:00	Canada	Unemployment Rate	Aug	%	6.2	6.1		
	7:00	Canada	Net Change in Employment	Aug	Thousands	10.0	-55.2		
	8:30	U.S.	Change in Nonfarm Payrolls	Aug	Thousands	-35.0	-51.0		
	8:30	U.S.	Unemployment rate	Aug	%	5.7	5.7		
	8:30	U.S.	Change in Manufacturing Payrolls	Aug	Thousands	-35.0	-35.0		
	8:30	U.S.	Average Hourly Earnings	Aug	Y/Y % chg.	3.4	3.4		
	10:00	Canada	IVEY Purchasing Managers Index	Aug	Index	62.0	65.5		
	10:00	U.S.	Mortgage Delinquencies	Q2	% change	--	6.35		
15:55	U.S.	<i>Fed Governor Yellen Speaks in Los Angeles on U.S. Economy</i>							

* Eastern Standard Time; Sources: Bloomberg, TD Economics

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