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TD Economics

The Weekly Bottom Line

December 19, 2008

Note: The next issue of The Weekly Bottom Line will be published on January 2, 2009.

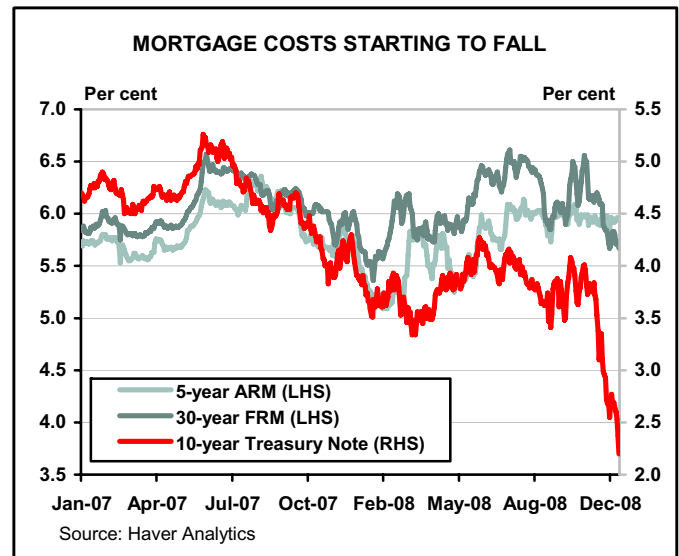
HIGHLIGHTS

- Fed funds rate cut to 0.00-0.25% range
- Details of fiscal spending in U.S. and Canada emerge

The unthinkable continues to become commonplace in the global economy these days. The White House has agreed to extend \$13.4 billion in loans to GM and Chrysler. This has depleted the first \$350bn in TARP funds so Treasury Secretary Paulson has asked Congress for the second half of the \$700bn in funding. All told, it continues to look like the U.S. government is on pace to borrow over two trillion dollars this year. Well, add yet another log to the proverbial fire. The Federal Reserve this week lowered the fed funds rate to virtually zero – it will now trade in a range between 0.00% and 0.25%. This does not mean the Federal Reserve has run out of tools to manage the economy, but it does mean their traditional tool will not help them going forward. They must find innovative, and in many cases untested, ways to get lending flowing through the U.S. economy. This has included the introduction of numerous acronyms as the Fed tries to target the problems

Recent TD Economics Research

December 19, 2008 - Canadian Consumer Price Index
 December 18, 2008 - Canadian Retail Sales
 December 17, 2008 - Despite Opec Restraint, Oil Price Downtrend to Remain Intact
 December 17, 2008 - Canadian Wholesale Sales
 December 16, 2008 - U.S. FOMC Interest Rate Decision
 December 16, 2008 - Rev. Commodity Price Forecast
 December 16, 2008 - Can. Manufacturing Shipments
 December 16, 2008 - U.S. Housing Starts
 December 16, 2008 - U.S. Consumer Price Index



market by market. However, one of the Fed's most important tools remains its words. We discussed in November the likelihood that the Fed would soon turn to bringing down long-term interest rates as the fed funds rate was quickly reaching zero (http://www.td.com/economics/special/rk1108_fed.pdf). The Fed statement this week and Bernanke and other Fed speeches this month has reiterated this, sending Treasury yields and mortgage rates plummeting.

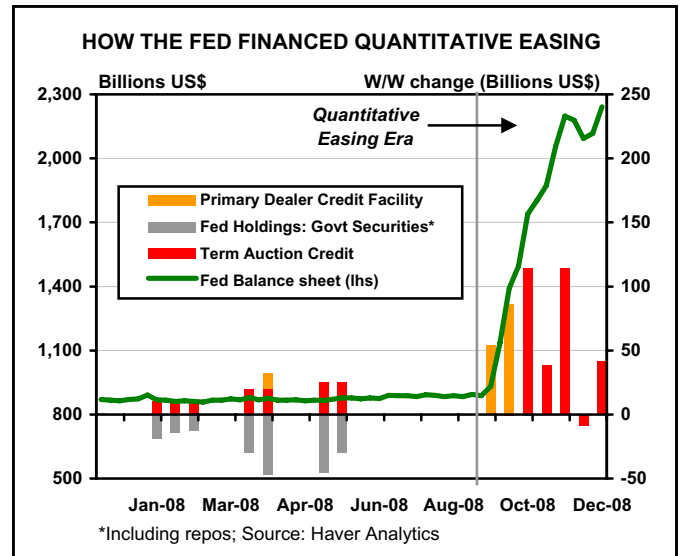
Perhaps inspired by the season, or perhaps disheartened by all the talk of 'the worst since the Great Depression,' we have learned that the Fed plans to go back to the 1930's and take a page out of the playbook of Franklin Delano Roosevelt – the U.S. President who guided the U.S. economy through the Great Depression. In an attempt to make full use of their verbal influence on monetary policy, the Fed intends to create yet another new facility – the FCF or Fireside Chat Facility. Ben Bernanke has been preparing for these more frequent talks to the markets by practicing with schoolchildren. We include below a transcript of his most recent such chat, entitled "Do you fear what I fear?"

Do you fear what I fear?

Good afternoon, boys and girls. I would like to talk to you today about the credit crunch. Now, this is not a new video game that you should expect Santa to bring you this Christmas. In fact, outside of underwear and socks, it's probably the most unwelcome present you can get this holiday season. But as I will explain shortly, the work of the Fed and the work of our neighbor to the far north – Santa not Canada – are very similar. I won't belabor the point of how we got into this mess because quite frankly, it is much more important to determine how we get out.

We typically see some decline in credit in the economy during a recession. With less certainty over the economic horizon, the risks of bankruptcies typically rise due to rising unemployment and sluggish or contracting income growth. In the current context, though, foreclosures in areas such as mortgages were already astronomical, and banks were already under an enormous strain. As a result, what we are seeing is the steepest decline in lending extended by the private financial sector on record. The fear is this has the potential to create an even broader swath of bankruptcies, job losses, and deflationary pressures on the economy.

At the same time, the amount of credit extended by the government and Federal Reserve is at record levels and likely to rise further. It is the job of the government to step in during exceptional times to provide stimulus and stability. Our neighbors to the north (near north) in Canada have done a better job of maintaining fiscal surpluses during these past strong economic times, but even they will likely need to run deficits in the coming years with their

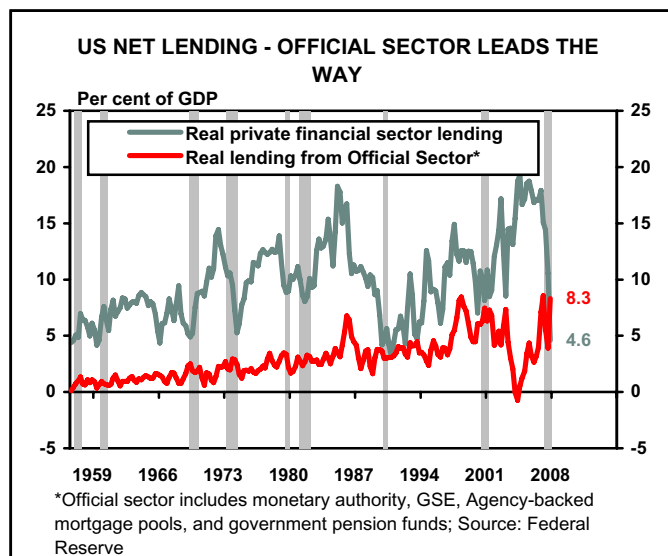


Prime Minister confirming a likely stimulus package of C\$30 billion for this year. But both there and here in the U.S., we must be careful not to spend ourselves into oblivion. Spending on things like infrastructure can provide much needed smoothing in the economy, adding jobs and demand for services now when the private sector is struggling. However, we must also think about the long term. This is likely to be the biggest U.S. government infrastructure plan since we built the interstate highway system. But while there is a tremendous benefit to the first interstate highway, building a second or a third provides much less return in the future. We must be careful to ensure the projects undertaken now will provide returns well into the future.

You'll shoot supply out, kid

Now, I am sad to say that nowhere on Earth has been spared from the influence of the credit crunch, not even the North Pole. Typically, Santa would have his elves buy up the parts they needed to build toys from all over the world – mostly China of course. But this year, even Santa's impeccable triple-H credit rating (Ho-Ho-Ho) was not enough to secure the borrowing he needed to meet his production demands. Fortunately, with Santa's magical powers, a little tweak of the nose and all the intermediate parts he needed magically appeared. Now, my nose does not have magical powers, but the Federal Reserve is endowed with magical powers, nonetheless. We call these powers the printing press.

See, typically, when we want to inject cash into the banking system, we would also sell some of our government securities. So earlier this year, each time we ex-



tended loans to financial institutions in the form of PDCF and TAF (Primary Dealer Credit Facility and Term Auction Facility) credits, we also sold government bonds (in effect removing the same amount of cash from elsewhere in the economy). Our balance sheet and the cash in the economy stayed unchanged, but the benefit was we injected liquidity into the specific areas that needed it. Since mid-September though, we quietly stopped this neutralizing. As a result, our balance sheet grew and grew (cue children ooing and ahing). Had we not done this, we

simply would not have had enough firepower to deliver all the “gifts” to the economy that are needed to get credit markets moving again. The magic is that we can continue to do this for as long as it takes and as much as it takes until the credit markets flinch and lending starts flowing again. The fact the money is not being lent out means it is not inflationary, but the potential is there. And once the supply of lending gets moving again, we will begin pulling this liquidity – very slowly – back out. But this is one game of chicken we are resolved not to lose.

Richard Kelly, Senior Economist
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UPCOMING KEY ECONOMIC RELEASES

Canadian Real GDP - October

Release Date: December 24/08

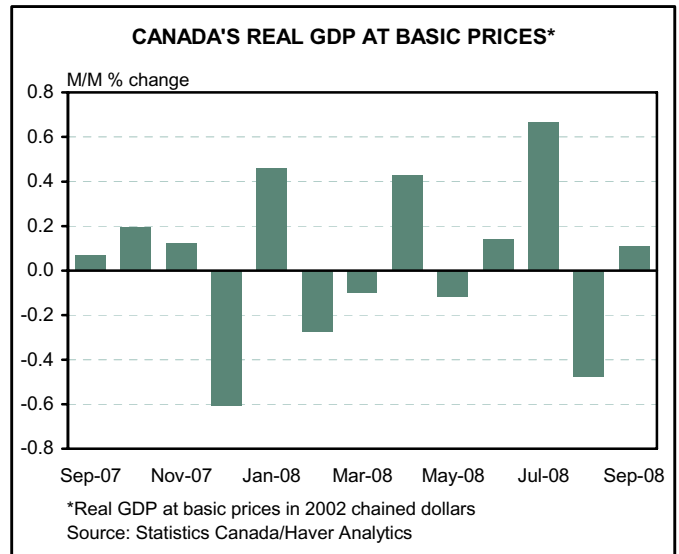
September Result: 0.1% M/M

TD Forecast: -0.3% M/M

Consensus: -0.2% M/M

After a rather sluggish performance in the first three quarters of 2008, the Canadian economy appears to have slipped into a recession in Q4, and for October we expect economic activity to decline by 0.3% M/M, following the meager 0.1% M/M gain the prior month. Much of the weakness in activity can be traced to the continuing slump in commodity prices, though consumer spending has also been ebbing (due to the continued destruction of household wealth). In the months ahead, with retailing, wholesaling and manufacturing sector activity all expected to weaken further and the U.S. economic recession continuing unabated, Canadian GDP growth should remain in or near negative territory as the economic recession intensifies.

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U.S. Personal Income and Spending - November

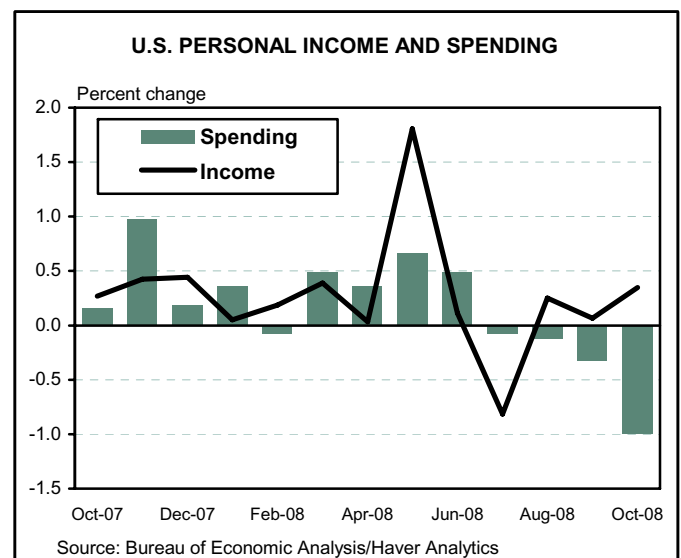
Release Date: December 24/08

October Result: income 0.3% M/M, spending -1.0% M/M;
core PCE deflator 0.0% M/M, 2.1% Y/Y

TD Forecast: income 0.0% M/M; spending -0.7% M/M;
core PCE deflator 0.0% M/M, 2.1% Y/Y

Consensus: income 0.0% M/M; spending -0.7% M/M;
core PCE deflator 0.1% M/M, 2.0% Y/Y

The fate of U.S. consumers has worsened dramatically over the past few months as they navigate against the headwinds of rapidly deteriorating labour market conditions, plunging equity and home prices, and continued economic weakness. The story for November is expected to be the same. During the month, our call is for personal income to remain flat, as the loss of half-million jobs is offset by wage growth. Personal expenditures are expected to fall for the fifth consecutive month, with another sizeable 0.7% M/M drop. Indeed, despite the massive discount that retailers have offered, it appears that consumers are not biting, and the risks to this call are to the downside. On the inflation front, the core PCE deflator is expected to remain flat on the month, bringing the annual rate of core consumer inflation to 2.1% Y/Y. In the months



ahead, as the U.S. economic recession intensifies, we expect to see further moderation in both personal income and spending, with personal consumption expenditures remaining a drag on economic activity.

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U.S. Durable Goods Orders – November

Release Date: December 24/08

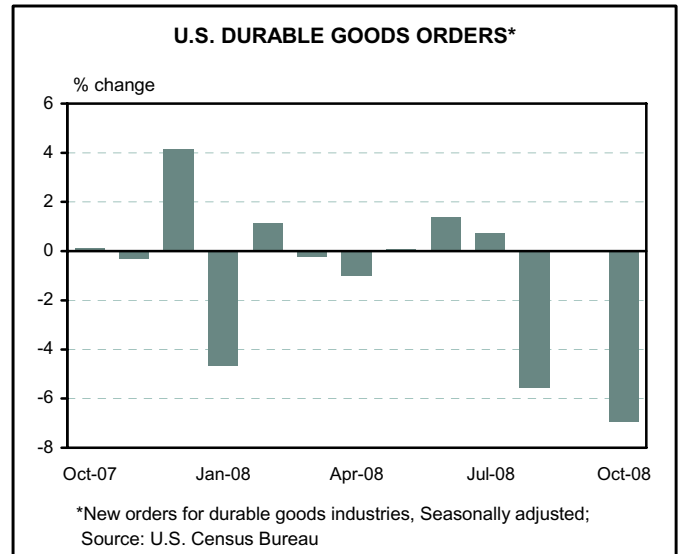
October Result: total -6.9% M/M;
ex-transportation -5.4% M/M

TD Forecast: total -3.5% M/M;
ex-transportation -3.0% M/M

Consensus: total -3.0% M/M;
ex-transportation -3.0% M/M

The dramatic retrenchment in U.S. capital expenditures is like to have continued in November with durable goods orders expected to fall by a massive 3.5% M/M, following the huge 6.9% M/M decline in October. Most of the declines should come from further drops in transportation equipment orders, on account of the enormous drop in aircraft orders and slumping motor vehicle sales. Excluding transportation, new durable good orders should fall by a more modest 3.0% M/M. In the months ahead, we expect to see further reductions in new orders as the prolonged U.S. economic forces business to cut back on capital expenditures in the face of sluggish demand for their products.

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U.S. ISM Manufacturing Report - December

Release Date: January 2/09

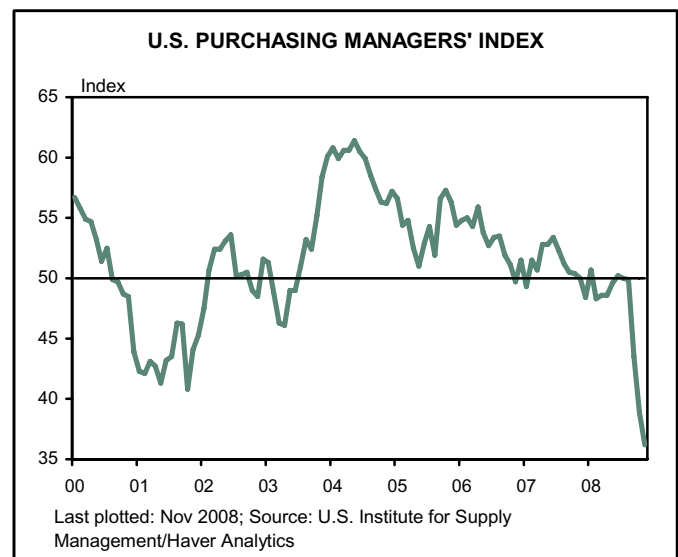
November Result: 36.2

TD Forecast: 35.0

Consensus: 35.2

After five consecutive monthly drops, the U.S. ISM manufacturing index has hovered around basement levels, and there is little to suggest that the fortunes of U.S. manufacturers have turned around. In fact, some indications are that things have worsened, and we expect the ISM to fall to 35.0 in December, which will be its lowest print since 1980. Indeed, given the intensifying U.S. and global recessions, and the adverse impact of the strong U.S. dollar, we expect the struggles of the U.S. manufacturing sector to continue well into 2009, with further job losses and reduction in production activity. In other words, in the coming months the headline ISM index and most of its sub-components should remain a world away from the 50-threshold.

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RECENT KEY ECONOMIC INDICATORS

December 15 - December 19, 2008

| Release Date | Economic Indicators | Data for Period | Units | Current | Prior | |
|----------------------|--------------------------------------------------------------------------------------------------|-----------------|------------|---------|--------|----|
| Canada | | | | | | |
| Dec. 16 | Manufacturing Shipments | Oct. | M/M % chg. | -0.5 | -0.3 | R▼ |
| Dec. 17 | Wholesale Sales | Oct. | % change | -1.8 | 1.5 | R▲ |
| Dec. 17 | <i>Bank of Canada Governor Carney to speak on women in capital markets in Toronto.</i> | | | | | |
| Dec. 18 | International Securities Transactions | Oct. | \$C, blns | 2.85 | -0.27 | |
| Dec. 18 | Leading Indicators | Nov. | M/M % chg. | -0.7 | -0.5 | R▼ |
| Dec. 18 | Retail Sales | Oct. | M/M % chg. | -0.9 | 0.9 | R▼ |
| Dec. 18 | Retail Sales (Ex. Autos) | Oct. | M/M % chg. | -1.1 | 0.5 | R▼ |
| Dec. 19 | Consumer Price Index (CPI) | Nov. | Y/Y % chg. | 2.0 | 2.6 | |
| Dec. 19 | Bank of Canada Core CPI | Nov. | Y/Y % chg. | 2.4 | 1.7 | |
| United States | | | | | | |
| Dec. 15 | Empire Manufacturing Index | Dec. | Index | -25.8 | -25.4 | |
| Dec. 15 | Industrial Production | Nov. | Y/Y % chg. | 286 | 143 | R▼ |
| Dec. 15 | Capacity Utilization Rate | Nov. | % | 75.4 | 76.0 | R▼ |
| Dec. 16 | Consumer Price Index (CPI) | Nov. | % change | 1.1 | 3.7 | |
| Dec. 16 | CPI - excl. food and energy | Nov. | % change | 2.0 | 2.2 | |
| Dec. 16 | Housing Starts | Nov. | Thousands | 625.0 | 771.0 | R▼ |
| Dec. 16 | Building Permits | Nov. | Thousands | 616.0 | 730.0 | R▲ |
| Dec. 16 | FOMC Rate Decision | 16-Dec | % | 0.25 | 1.00 | |
| Dec. 17 | Current Account Balance | Q3-08 | US\$, blns | -174 | -181 | R▲ |
| Dec. 18 | Initial Jobless Claims | 13-Dec | Thousands | 554.0 | 575.0 | R▲ |
| Dec. 18 | Continuing Claims | 6-Dec | Thousands | 4384.0 | 4431.0 | R▲ |
| Dec. 18 | Philadelphia Fed Index | Dec. | Index | -32.9 | -39.3 | |
| Dec. 18 | Leading Indicators | Nov. | % change | -0.4 | -0.8 | |
| Dec. 18 | <i>Fed Governor Fisher speaks on historical perspective on current economic crisis in Dallas</i> | | | | | |

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR

December 22 - December 26, 2008

| Release Date | Economic Indicators | Data for Period | Units | Consensus Forecast | Prior |
|----------------------|-------------------------------------------|-----------------|------------|--------------------|--------|
| Canada | | | | | |
| Dec. 24 | Gross Domestic Product | Oct | M/M % chg. | -0.3 | 0.1 |
| United States | | | | | |
| Dec. 23 | Gross Domestic Product (annualized) | Q3 | Q/Q % chg. | -0.5 | -0.5 |
| Dec. 23 | Personal Consumption | Q3 | Q/Q % chg. | -3.7 | -3.7 |
| Dec. 23 | Core Personal Consumption Expenditure | Q3 | Q/Q % chg. | 2.6 | 2.6 |
| Dec. 23 | U. of Michigan Confidence Index | Dec. | Index | 58.6 | 59.1 |
| Dec. 23 | New Home Sales | Nov. | Thousands | 415.0 | 433.0 |
| Dec. 23 | Existing Home Sales | Nov. | Thousands | 4.9 | 5.0 |
| Dec. 23 | House Price Index | Oct. | M/M % chg. | -1.4 | -1.3 |
| Dec. 23 | Richmond Fed. Manufacturing Index | Dec. | Index | -40.0 | -38.0 |
| Dec. 23 | ABC Consumer Confidence | 21-Dec | Index | -- | -51.0 |
| Dec. 24 | Personal Income | Nov. | % change | 0.0 | 0.3 |
| Dec. 24 | PCE Deflator | Nov. | Y/Y % chg. | 1.5 | 3.2 |
| Dec. 24 | Durable Goods Orders | Nov. | % change | -3.0 | -6.9 |
| Dec. 24 | Durable Goods Orders (ex. Transportation) | Nov. | % change | -3.0 | -5.4 |
| Dec. 24 | Initial Jobless Claims | 20-Dec | Thousands | 550.0 | 554.0 |
| Dec. 24 | Continuing Claims | 13-Dec | Thousands | 4425.0 | 4384.0 |

Source: Bloomberg, TD Economics

G-7 ECONOMIC RELEASES AND EVENTS

| Date | Time* | Country | Economic Indicator/Event | Data for Period | Units | Consensus Forecast | Last Period |
|---------|--------------------------------------------------------------------------------------|--------------------------------------------------------------|---------------------------------------------------------|-----------------|------------|--------------------|-------------|
| Dec. 22 | 2:00 | Germany | Import Price Index | Nov. | Y/Y % chg. | 0.0 | 2.9 |
| | 2:45 | France | Producer Prices | Nov. | Y/Y % chg. | 2.7 | 4.3 |
| | 16:45 | NZ | Gross Domestic Product | Q3 | Y/Y % chg. | -0.1 | 1.0 |
| Dec. 23 | 4:00 | EU-15 | Current Account (SA) | Nov. | Eur, blns | -- | -10.6 |
| | 4:30 | U.K. | Gross Domestic product | Q3 | Y/Y % chg. | 0.3 | 0.3 |
| | 4:30 | U.K. | Current Account | Q3 | £, blns | -11.9 | -11.0 |
| | 8:30 | U.S. | Gross Domestic Product (annualized) | Q3 | Q/Q % chg. | -0.5 | -0.5 |
| | 8:30 | U.S. | Personal Consumption | Q3 | Q/Q % chg. | -3.7 | -3.7 |
| | 8:30 | U.S. | Core Personal Consumption Expenditure | Q3 | Q/Q % chg. | 2.6 | 2.6 |
| | 10:00 | U.S. | U. of Michigan Confidence Index | Dec. | Index | 58.6 | 59.1 |
| | 10:00 | U.S. | New Home Sales | Nov. | Thousands | 415.0 | 433.0 |
| | 10:00 | U.S. | Existing Home Sales | Nov. | Thousands | 4.93 | 4.98 |
| | 10:00 | U.S. | House Price Index | Oct. | M/M % chg. | -1.4 | -1.3 |
| | 10:00 | U.S. | Richmond Fed. Manufacturing Index | Dec. | Index | -40.0 | -38.0 |
| | 17:50 | U.S. | ABC Consumer Confidence | 21-Dec | Index | -- | -51.0 |
| | 18:50 | Japan | Merchandise Trade Balance | Nov. | ¥, blns | -217.3 | -67.7 |
| | Dec. 24 | Christmas Eve <i>U.S. Bond Markets Close Early</i> | | | | | |
| 7:00 | | U.S. | MBA Mortgage Applications | 19-Dec | % change | -- | 2.9 |
| 8:30 | | Canada | Gross Domestic Product | Oct | M/M % chg. | -0.3 | 0.1 |
| 8:30 | | U.S. | Personal Income | Nov. | % change | 0.0 | 0.3 |
| 8:30 | | U.S. | PCE Deflator | Nov. | Y/Y % chg. | 1.5 | 3.2 |
| 8:30 | | U.S. | Durable Goods Orders | Nov. | % change | -3.0 | -6.9 |
| 8:30 | | U.S. | Durable Goods Orders (ex. Transportation) | Nov. | % change | -3.0 | -5.4 |
| 8:30 | | U.S. | Initial Jobless Claims | 20-Dec | Thousands | 550.0 | 554.0 |
| 8:30 | | U.S. | Continuing Claims | 13-Dec | Thousands | 4,425.0 | 4,384.0 |
| 18:50 | | Japan | <i>BoJ Monetary Policy Meeting Minutes for November</i> | | | | |
| Dec. 25 | Christmas Day <i>Canadian Markets Closed</i> <i>U.S. Markets Closed</i> | | | | | | |
| | 18:30 | Japan | Consumer Price Index | Nov. | Y/Y % chg. | 1.1 | 1.7 |
| | 18:30 | Japan | Consumer Price Index (ex. Food & Energy) | Nov. | Y/Y % chg. | 0.0 | 0.2 |
| | 18:50 | Japan | Industrial Production | Nov. | Y/Y % chg. | -15.0 | -7.1 |
| | 18:50 | Japan | Retail Trade | Nov. | Y/Y % chg. | -1.5 | -0.7 |
| Dec. 26 | Boxing Day Holiday <i>Canadian Markets Closed</i> | | | | | | |

* Eastern Standard Time; Sources: Bloomberg, TD Economics

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