TD Bank Financial Group

TD Economics

The Weekly Bottom Line

December 21, 2007

Note: The next issue of The Weekly Bottom Line will be published on January 4, 2008.

HIGHLIGHTS

- **2007 a year to be remembered**
- **Government bond yields tumble, corporate yields jump**
- **USD declines by 9% on a trade-weighted basis**
- **US$ commodity prices climb 25%, led by crude oil, wheat and gold**
- **Most global equity indices on track to eke out small gain**

This time of year is chock-full of prognostications on the year ahead. Last week, we stepped into the fray by providing our updated view on how the increasingly murky economic story will unfold in 2008 (see TD Economics' Quarterly Economic Forecast at www.td.com/economics). In this edition of the Weekly Bottom Line, we take a look back at a year that was – to say the least – memorable. Just as the 1987 stock market crash, the 1998 Russian debt default and 9/11 have gone down in infamy, 2007 will be remembered as the year that the rain of liquidity (much of which was tied to the U.S. sub-prime boom) turned into a drought. The outbreak of the so-called credit crunch this past summer has prompted investors to look at risk through a new lens with enormous implications for the trajectory of prices of bond, equity, commodities and foreign exchange.

The year of the credit crunch

We'll begin with developments in debt markets. It was only six months ago that inflation remained the watchword and a number of central banks around the world (including the Bank of Canada, the ECB, the BOJ and the BOE) were moving to mitigate the risk of overheating by raising interest rates. While the U.S. Fed had held interest rates unchanged at 5.25% throughout the first half of the year, it maintained a bias towards tightening.

When credit markets seized up in mid-August, however, central banks put inflation risks onto the backburner so they could deal with the more pressing challenge of

2007 YEAR IN REVIEW

	29-Dec 2006	19-Dec 2007	2007 High	2007 Low
Debt Markets				
U.S. Gov't (%)				
Fed Funds Target	5.25	4.25	5.25	4.25
2-Year	4.82	3.19	5.10	2.99
10-Year	4.71	4.14	5.23	3.83
Cdn Gov't (%)				
BOC Overnight	4.25	4.25	4.50	4.25
2-Year	4.02	3.76	4.72	3.48
10-Year	4.08	3.98	4.73	3.87
Corporate (%)				
3-mo LIBOR (US$)	5.36	4.91	5.73	4.87
U.S. BBB(1-15+yrs)	5.96	6.29	6.46	5.72
Canada 10-Yr BBB	5.20	5.91	6.06	5.13
FX Markets				
US$ Trade Weighted	81.4	74.4	82.8	71.1
US$/Euro	1.32	1.43	1.49	1.29
Yen/US$	119	113	124	108
US$/C$	0.86	0.99	1.09	0.84
Commodity Markets				
TDCI US$ *	217.5	272.6	278.5	213.7
TDCI C$	251.9	276.2	295.9	244.2
Crude Oil (WTI US$)	61	91	99	50
Gold (US$/ounce)	635	800	841	608

* 18-Item TD Commodity Price Index
Source: Haver Analytics

Recent TD Economics Research

December 21, 2007 - Canadian GDP commentary
December 21, 2007 - Canadian Retail Sales commentary
December 18, 2007 - Canadian CPI commentary

growing liquidity shortages in the inter-bank market. Measures were taken to inject cash into the banking system through repurchase agreements (i.e., repos), and more recently, by extending the financing beyond the traditional overnight period as well as permitting a broader-than-normal set of securities as collateral. The U.S. central bank slashed its Fed Funds and discount rates by 100 and 150 bps, respectively, over the remainder of the year. The Bank of Canada followed suit with one quarter-point cut in December, while other central banks have opted to put their tightening campaigns on hold as they monitored the situation.

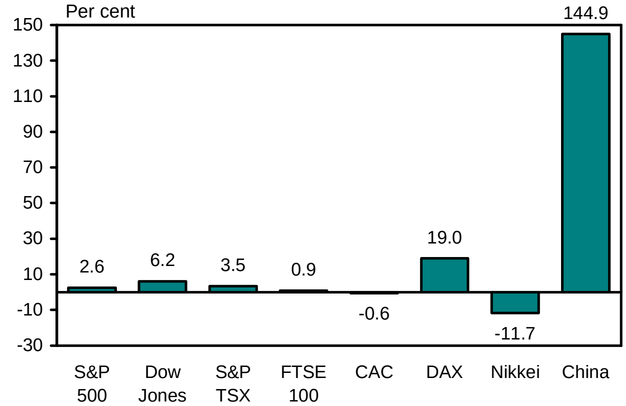
The central banks' moves have provided some support, but risk aversion remains acute as investors brace for more announced losses by banks and companies on holdings of asset backed securities and CDOs. Investors continue to take shelter in U.S. Treasuries. As shown in the accompanying table on page 1, the U.S. government yield curve was inverted at the end of last year, albeit only mildly in the 2-10 year range as yields hovered just under 5%. By the end of 2007, yields across the curve stood some 60-200 bps lower, with the 2-10 year part of the curve steepening dramatically. At the corporate level, there was a hefty widening in spreads over governments, as markets priced in more risk. Indeed, yields on BBB-rated bonds actually rose in absolute terms during the year.

Benefiting less from flight to safety flows, Canadian government bond yields were considerably more stable than their U.S. counterparts. Three-month treasury bills and 2-year bonds ended the year about 25 bps lower, compared to a mere 10 bps drop at the 10-year point along the curve. Similar to the U.S., yields on investment-grade BBB long-term bonds rose over the past 12 months.

U.S. dollar loses 9%

While much of the fireworks were in debt markets this year, foreign-exchange investors were also taken on a wild ride. In the autumn, selling pressure on the greenback stemming from concerns about the U.S. economy and massive current account deficit was exacerbated by Fed interest-rate cuts. But, while the U.S. dollar has managed to pull off its lows since November, it still declined by 9% on a trade-weighted basis during the year as a whole. The star performer was the loonie, which gained 14%, followed by the euro (+8%). Although the yen remained one of the few currencies weakening against the U.S. dollar in the first half of 2007, it more than made up those losses in the second half, as weakening credit-market conditions put a damper on the carry trade.

PER CENT CHANGE IN EQUITY MARKETS DEC 2006/DEC 2007*



*Actual dates used: Dec 19, 2007 and Dec 29, 2006.
Source: Haver Analytics

Commodity rally continues

One key catalyst for the Canadian dollar's run to as high as about US$1.10 this year was the unexpectedly strong performance of commodity prices, which in turn benefited from another blockbuster year of 5%+ world real GDP growth. Even though the U.S. economy slowed this year as expected – to an annual average rate of 2.4% from 3.3% in 2006, other regions came in on the strong side, including China (+11%), India (+9%), Asian NICs and Central and South America (+5-6%) as well as Europe (+3%). And despite a soaring loonie and the U.S. slowdown, the Canadian economy advanced at a solid estimated 2.5% clip. In other words, while there was plenty of evidence of global financial contagion from the U.S. sub-prime crisis, economic contagion was relatively limited.

Overall, the 18-item TD Commodity Price Index (in US dollars) rose by 25% from the end of last year, underpinned by spectacular increases in crude oil and precious metals prices. Still, the big surprise of the year was the fact that agricultural prices, which had been left out of the rally in prior years, finally joined the bandwagon. Indeed, average crop and livestock prices surged by about 50%. Among the major commodity groupings, only non-precious metals and mineral prices lost ground (-9%), hurt by rising fears about the U.S. economy and its potential impact on global commodity demand. Keep in mind that commodity price gains in Canadian dollar terms were muted by the strength of the currency.

Most global equity markets eke out slight gain

The hefty rally in global equity markets during the first half of 2007 has fizzled since the credit crunch. Still, the path over the last few months has been a volatile one, with hopes of interest rate cuts in a tug of war with growing profit warnings, notably in the U.S. and European financial sectors. For the year as a whole, apart from China and Germany, which remain well in the black, most major stock markets are poised to eke out only modest gains (see chart). In addition to Fed rate relief, U.S. equity market performances have also been supported by the weak U.S. dollar, which has buffeted the repatriated earnings of U.S. foreign subsidiaries. In Canada, two-thirds of the major equity groups have registered gains, led by information technology (+38%), materials (+17%) and industrials (+9%). On the other side, health (-28%), consumer staples (-9%) and financial stocks (-4%) have lost ground, while energy has been roughly flat compared to its level at the end of 2006.

Have an enjoyable holiday!

After such an exciting year, we all deserve a break. Have a terrific holiday season.

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RECENT KEY ECONOMIC INDICATORS
December 17-21, 2007

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
Dec. 17	New Motor Vehicle Sales	Oct.	% change	-1.4	-2.7	R▼
Dec. 17	International Securities Transactions	Oct.	$C, blns	-24.3	-5.2	
Dec. 18	Consumer Price Index (CPI)	Nov.	Y/Y % chg.	2.5	2.4	
Dec. 18	CPI - excl. 8 most volatile items	Nov.	Y/Y % chg.	1.6	1.8	
Dec. 18	Leading Indicators	Nov.	% change	0.0	0.0	R▼
Dec. 19	Wholesale Sales	Oct.	% change	0.5	1.1	
Dec. 21	Retail Sales	Oct.	% change	0.1	-0.2	
Dec. 21	Retail Sales - excl. autos	Oct.	% change	0.0	0.2	R▲
Dec. 21	Real GDP at Basic Prices	Oct.	% change	0.2	0.1	
United States						
Dec. 17	Current Account Balance	Q3-07	US$, blns	-178.5	-188.9	R▲
Dec. 17	Empire Manufacturing Survey	Dec.	Index	10.3	27.4	
Dec. 18	Housing Starts	Nov.	Thousands	1,187	1,232	R▲
Dec. 18	Building Permits	Nov.	Thousands	1,152	1,170	
Dec. 20	Weekly Initial Jobless Claims	15-Dec	Thousands	346	334	R▲
Dec. 20	Leading Indicators	Nov.	% change	-0.4	-0.5	
Dec. 20	Philadelphia Fed Index	Dec.	Index	-5.7	8.2	
Dec. 21	PCE Deflator	Nov.	Y/Y % chg.	3.6	3.0	R▲
Dec. 21	PCE Core	Nov.	Y/Y % chg.	2.2	2.0	R▲
Dec. 21	Personal Income	Nov.	% chg.	0.4	0.2	
Dec. 21	Personal Spending	Nov.	% chg.	1.1	0.4	R▲

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR
December 24, 2007 - January 4, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Jan. 4	Industrial Product Price Index	Nov.	% change	-0.1	-1.1
Jan. 4	Raw Materials Price Index	Nov.	% change	0.9	0.3
Jan. 4	Ivey Purchasing Managers Index	Dec.	Index	n/a	58.7
United States					
Dec. 26	S&P/CS Composite-20	Oct.	Index	-5.6	-4.9
Dec. 26	Richmond Fed Index	Dec.	Index	0.0	0.0
Dec. 27	Durable Goods Orders	Nov.	% change	2.0	-0.2
Dec. 27	Weekly Initial Jobless Claims	22-Dec	Thousands	340	346
Dec. 27	Consumer Confidence	Dec.	Index	86.4	87.3
Dec. 28	Chicago Purchasing Managers Index	Dec.	Index	52.0	52.9
Dec. 28	New Home Sales	Nov.	Thousands	720	728
Dec. 31	Existing Home Sales	Nov.	Millions	5.0	5.0
Jan. 2	ISM Index (manufacturing)	Dec.	Index	50.4	50.8
Jan. 2	Construction Spending	Nov.	% change	-0.3	-0.8
Jan. 3	ADP Employment Change	Dec.	Thousands	50.0	189.0
Jan. 3	Weekly Initial Jobless Claims	29-Dec	Thousands	n/a	n/a
Jan. 3	Total Vehicle Sales	Dec.	Millions	15.9	16.2
Jan. 3	Domestic Vehicle Sales	Dec.	Millions	12.2	12.4
Jan. 3	Factory Orders	Dec.	% change	1.2	0.5
Jan. 4	Change in Non-farm Payrolls	Dec.	Thousands	70.0	94.0
Jan. 4	Unemployment Rate	Dec.	Per cent	4.8	4.7
Jan. 4	Average Hourly Earnings	Dec.	% change	0.3	0.5
Jan. 4	ISM Non-Manufacturing	Dec.	Index	53.5	54.1
Jan. 4	*Fed Vice Chairman Kohn speaks to economists in New Orleans, LA*				

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. 24	18:50	Japan	Corporate Service Price Index	Nov.	Y/Y % chg.	1.4	1.4
Dec. 25	18:50	Japan	Bank of Japan Monetary Policy meeting minutes for October 31 released				
	18:50	Japan	Bank of Japan Monetary Policy meeting minutes for November released				
Dec. 26	9:00	U.S.	S&P/CS Composite-20	Oct.	Index	-5.6	-4.9
	10:00	U.S.	Richmond Fed Index	Dec.	Index	0.0	0.0
Dec. 27	1:00	Japan	Housing Starts	Nov.	Y/Y % chg.	-28.5	-35.0
	8:30	U.S.	Durable Goods Orders	Nov.	% change	2.0	-0.2
	8:30	U.S.	Weekly Initial Jobless Claims	22-Dec	Thousands	340	346
	10:00	U.S.	Consumer Confidence	Dec.	Index	86.4	87.3
	19:30	Japan	Jobless Rate	Nov.	Per cent	4.0	4.0
	19:30	Japan	Tokyo CPI excl. perishables	Dec.	Y/Y % chg.	0.3	0.1
	19:30	Japan	Workers' Household Spending	Nov.	Y/Y % chg.	0.4	0.6
	19:50	Japan	Retail Sales	Nov.	% change	-0.7	-1.7
Dec. 28	--	Germany	Consumer Price Index (prelim.)	Dec.	Y/Y % chg.	3.0	3.1
	4:00	EU-12	Purchasing Managers Index (Retail)	Dec.	Index	n/a	45.9
	4:00	Germany	Purchasing Managers Index (Retail)	Dec.	Index	n/a	43.6
	4:00	France	Purchasing Managers Index (Retail)	Dec.	Index	51.0	48.8
	9:45	U.S.	Chicago Purchasing Managers Index	Dec.	Index	52.0	52.9
	10:00	U.S.	New Home Sales	Nov.	Thousands	720	728
Dec. 31	10:00	U.S.	Existing Home Sales	Nov.	Millions	5.00	4.97
Jan. 2	3:50	France	Purchasing Managers Index (Man.)	Dec.	Index	52.2	52.5
	3:55	Germany	Purchasing Managers Index (Man.)	Dec.	Index	53.3	53.7
	4:30	U.K.	Purchasing Managers Index (Man.)	Dec.	Index	53.8	54.4
	10:00	U.S.	ISM Index (manufacturing)	Dec.	Index	50.4	50.8
	10:00	U.S.	Construction Spending	Nov.	% change	-0.3	-0.8
Jan. 3	3:55	Germany	Unemployment Change	Dec.	Thousands	8.5	8.6
	3:55	Germany	Unemployment Rate	Dec.	Per cent	-36.0	-53.0
	4:00	EU-12	M3 Money Supply Growth	Nov.	Y/Y % chg.	12.2	12.3
	8:15	U.S.	ADP Employment Change	Dec.	Thousands	50.0	189.0
	8:30	U.S.	Weekly Initial Jobless Claims	29-Dec	Thousands	n/a	n/a
	---	U.S.	Total Vehicle Sales	Dec.	Millions	15.9	16.2
	---	U.S.	Domestic Vehicle Sales	Dec.	Millions	12.2	12.4
	10:00	U.S.	Factory Orders	Dec.	% change	1.2	0.5
Jan. 4	3:50	France	Services Index	Dec.	Index	58.3	59.2
	3:55	Germany	Services Index	Dec.	Index	52.4	53.1
	4:30	U.K.	Services Index	Dec.	Index	52.0	51.9
	5:00	EU-12	Consumer Price Index	Dec.	Y/Y % chg.	3.1	3.1
	8:30	U.S.	Change in Non-farm Payrolls	Dec.	Thousands	70.0	94.0
	8:30	U.S.	Unemployment Rate	Dec.	Per cent	4.8	4.7
	8:30	U.S.	Average Hourly Earnings	Dec.	% change	0.3	0.5
	8:30	Canada	Industrial Product Price Index	Nov.	% change	-0.1	-1.1
	8:30	Canada	Raw Materials Price Index	Nov.	% change	0.9	0.3
	10:00	U.S.	ISM Non-Manufacturing	Dec.	Index	53.5	54.1
	10:00	Canada	Ivey Purchasing Managers Index	Dec.	Index	n/a	58.7
	11:15	*U.S.*	*Fed Vice Chairman Kohn speaks to economists in New Orleans, LA*				

* Eastern Standard Time; Sources: Bloomberg, TD Economics