



# TD Economics

## The Weekly Bottom Line

December 7, 2007

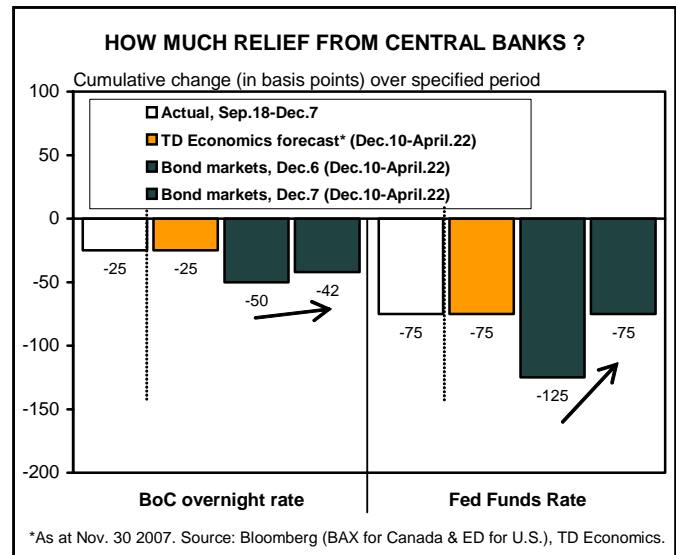
### HIGHLIGHTS

- BoC cuts overnight rate by ¼ percentage point
- Fed expected to ease on December 11th
- Employment surprises in Canada, decent in the U.S.

As we ready ourselves for sluggish economic growth in the months ahead in the U.S. and Canada, central banks on both sides of the border are busy kicking the tires, checking the seatbelts and airbags and, most importantly, adjusting the suspension to help smooth out the ride. In a preemptive move, the Fed funds rate has already been slashed by 75 basis points (bps) since September. On Tuesday, the Bank of Canada (BoC) delivered its first overnight rate cut (-25bps) in over 3 ½ years. The accompanying communiqué explains that “there has been a shift to the downside in the balance of risks around its October projection through 2009”. Indeed, when compared to that projection, the main downside risks – higher Canadian dollar, weaker exports, tighter credit conditions, lower inflation – have actually played out. The latest economic fundamentals remain strong, however, so this was also in part a proactive move on the part of the BoC. Although economic growth in Q1-Q3 has been above potential, a significant slowdown is expected in Q4 and the first half of 2008. Weak net exports and an inventory drawdown from the recent build-up should account for the bulk of this slowdown.

#### Recent TD Economics Research

December 7, 2007 - Canadian Employment  
 December 7, 2007 - U.S. Employment  
 December 6, 2007 - BOE/ECB Interest Rate Decision  
 December 5, 2007 - U.S. ISM Non-Manufacturing Index  
 December 4, 2007 - Housing Market Commentary  
 December 4, 2007 - Bank of Canada Policy Decision  
 December 3, 2007 - Monetary Policy Monitor  
 December 3, 2007 - U.S. ISM Manufacturing Index



### How low will rates go?

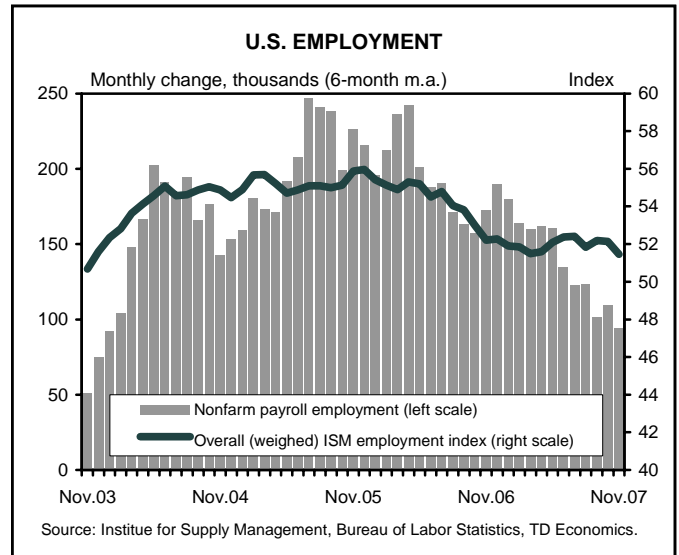
The economic slowdown originates in the U.S. and will be more pronounced there than in Canada. Real GDP annualized growth in Q4 is expected to come in close to flat for the U.S. and only around 1% for Canada. Growth in both countries will likely remain quite sluggish throughout the first half of 2008. The case for a lower Fed funds rate is almost iron-clad.

Meanwhile, the outlook for the BoC's overnight rate isn't as clear. In its latest communications, the BoC did not signal if it would cut or pause in January. This isn't for lack of transparency in communicating, but a reflection of the degree of uncertainty with regards to the near-term outcomes. This makes the conduct of monetary more heavily dependent on incoming economic and financial data than usual. As a consequence, the best path for the overnight rate cannot be fully traced out with a high degree of confidence. In this context, it is appropriate that the BoC's stance be non-committal. No mention was made that the current overnight rate was 'deemed appropriate'.

A case can still be made that they will elect to lower rates, but not significantly. The latest employment data

shows nothing of the kind that would justify protracted and significant easing of the overnight rate beyond a further 25 to 50bps. Employment rose by 42,600 in November. While about 2/3 (when excluding self-employed) of net jobs created so far this year have been in the public sector, the private sector joined the party in November. So far this year, the Canadian economy has created close to 400,000 net new jobs, a remarkable performance. Even more astounding is that this is over-and-above the close to 100,000 jobs that have been shed in manufacturing. Regionally, B.C. and Québec have contributed significantly more to this year's employment bonanza than their real GDP weight in the Canadian economy would suggest. This is noteworthy since one would expect the opposite, given of the high concentration of manufacturing in Québec and forestry activity in both those provinces. But it highlights the fact that well-diversified economies can absorb significant job losses. While the national unemployment rate edged up 0.1 percentage points in November to 5.9% due to a large (67,600) influx of people into the labour force, very little if any slack exists in labour markets. Year-over-year wage growth (4.1%) for permanent employees is at its highest level since this data series started being collected ten years ago. So far, along with higher food and energy prices, this has not fed through significantly into inflation expectations or consumer prices. Past experience suggests that it can. It would make the BoC's job all that much more difficult if it did. In any case it limits the extent of interest rate relief the BoC can provide going forward.

As for the U.S., expectations vary as to how far down rates will go – basically depending on whether or not you are factoring in a recession as the most likely scenario. As of Thursday this week, bond markets, in particular Euro-dollar Fed funds futures, were pricing in close to 125bps in interest rate cuts over the next 4 months. Expectations were toned down significantly after the release of nonfarm payroll employment figures for November on Friday and are now pricing in a 75bps reduction between now and April 2008. The U.S. economy created 94,000 net new jobs, in line with expectations. Revisions to previous months, mostly from September, deleted 48,000 jobs from the tally. As a coincident indicator in the middle of Q4, the November employment numbers are not consistent with the view that the U.S. economy is currently about to tilt into recession. Our overall employment ISM index, which weighs the manufacturing and non-manufacturing surveys, has been trending down along with employment growth itself, but remains in slight expansionary territory (above 50). Vulnerable sectors in the current cycle such as construc-



tion, finance, and manufacturing continue to shed jobs, but further job losses are to be expected in these sectors. Gains in other sectors of activity have remained large enough to absorb these losses, preventing the overall job tally from tilting into the red. At the margin, the latest employment data lends further support to our view that the Fed will ease by 25bps rather than a more aggressive 50bps this upcoming Tuesday.

#### A new ARMs deal

Elsewhere in Washington, at a press conference that felt more like an infomercial ("call 1-888-995-HOPE"), President Bush and Treasury Secretary Paulson were busy unveiling a plan to freeze interest rates for up to 5 years on some subprime 'not-so-adjustable' rate mortgages (ARMs) facing resets. The plan applies to subprime ARMs originated between January 2005 and June 2007 and is intended to help forestall foreclosures. Out of 6.6 million homeowners with subprime loans, approximately 1 in 4 (1.7 million) are subprime ARMs facing payment resets between January 2008 and July 2010. 750,000 of these would theoretically qualify for a rate freeze. But a significant number of financial, legal, and administrative impediments mean that only 250,000 would likely qualify in practice. For investors, everything depends on the particulars of what they hold in their book, but for many it is likely that the reduction in potential foreclosures would not offset the foregone interest revenue under a freeze. While clearly beneficial to those households who qualify, it is unlikely the plan will have a significant national impact on the ongoing housing market correction.

*Pascal Gauthier, Economist 416-944-5730*

## UPCOMING KEY ECONOMIC RELEASES

### Canadian Housing Starts - November

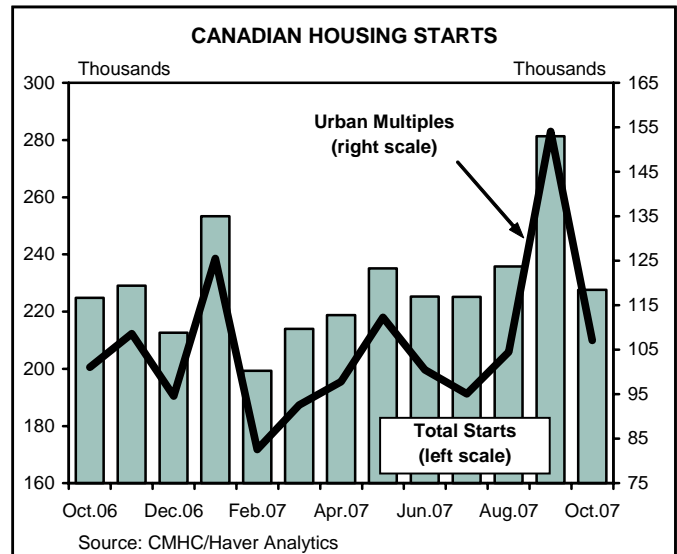
**Release Date:** December 10/07

**TD Forecast:** 225K

**Consensus:** 218.8K

We're expecting to see housing starts remain fairly strong in November, with 225K dwellings started, down only slightly from the 227.6K in the previous month. Mortgage rates moved a little lower in November, which should help at the margin to increase housing demand. Plus residential building permits have remained extremely robust for the last few months, indicating that there are still a lot of plans for new building in the pipeline. However, we do still expect housing starts to cool heading into the new year, returning to a level closer to what demographic trends would suggest.

*Jacqui Douglas 416-982-7784*



### U.S. FOMC Rate Decision

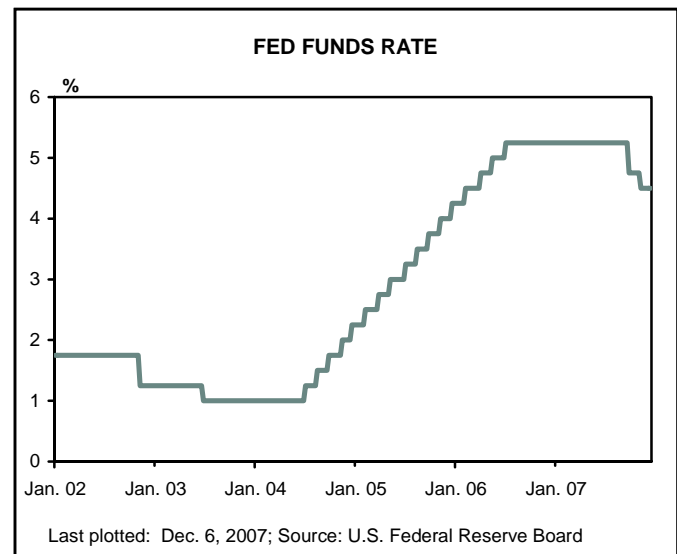
**Release Date:** December 11/07

**TD Forecast:** 4.25%

**Consensus:** 4.25%

Conditions have changed sufficiently since the October 31 FOMC decision to underpin our expectation for a 25bps rate cut this Tuesday. This will bring the federal funds rate to 4.25%. There is good reason for the Fed to continue to deliver insurance cuts and there have been increasingly clear signs from Fed officials that this is what they intend to do. Credit markets remain quite fragile and there has been little resolution to how far or deep the problem goes. This remains one of the key problems for the U.S. as most economic indicators remain consistent with a late cycle slowdown. Not only will the decision itself be important, but what the FOMC says in its communiqué will also be watched closely by the market. There could still be some discussion of price pressures, but ultimately downside growth risks remain most pressing at present.

*Charmaine Buskas 416 982 3297*



## Canadian International Trade - October

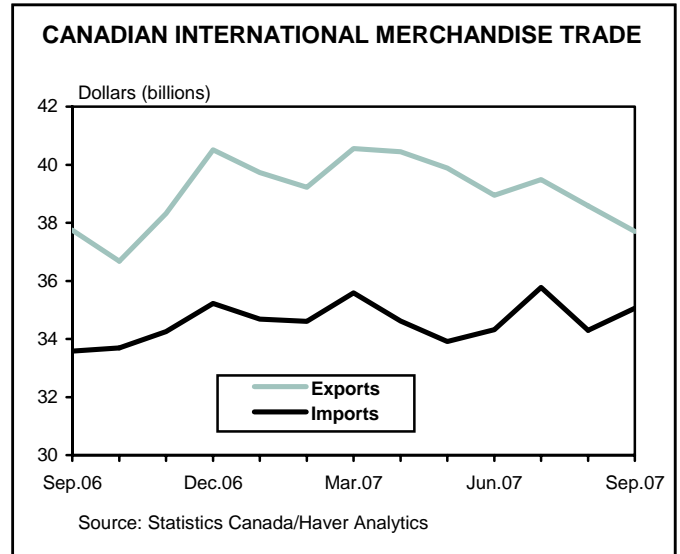
**Release Date:** December 12/07

**TD Forecast:** \$3.7B

**Consensus:** \$2.2B

We're expecting to see the Canadian trade surplus rebound forcefully to \$3.7B in October from September's drop to \$2.6B. And the main reason behind this rebound is that we don't think the surplus was really quite that low in September, since the national accounts data for Q3 suggest that an upward revision is in the pipeline. Assuming that we're starting at a higher base –perhaps about \$3.5B in September – we expect to see a small improvement in the trade balance in October. Exports are likely to come in flat, since the upward pressure from higher commodity prices will likely be wiped out by the price effects from the appreciation of the Canadian dollar (which was up about 5% in October), and a weaker manufacturing sector. Imports are likely to fall a bit in nominal terms, due largely to price effects from the currency, but will probably be quite a bit stronger in real terms, creating a bigger drag on GDP than the headline numbers would indicate.

*Jacqui Douglas 416-982-7784*



## Canadian Manufacturing Shipments - October

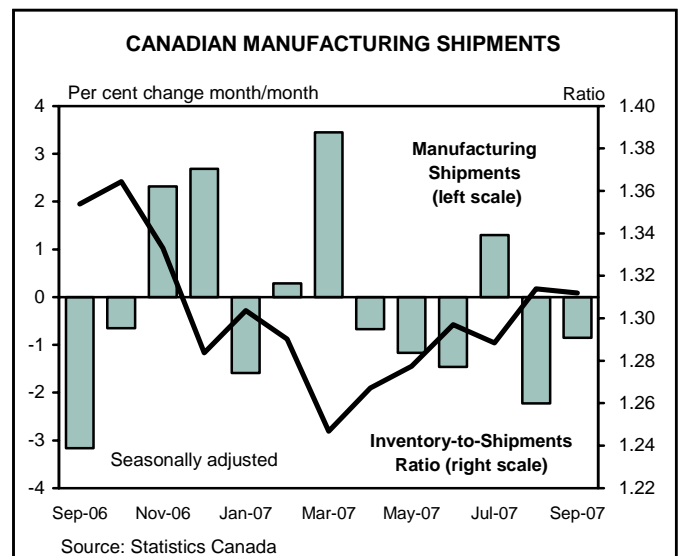
**Release Date:** December 13/07

**TD Forecast:** -0.8%

**Consensus:** -1.5%

We're expecting to see another deterioration in manufacturing shipments in October, with a 0.8% decline. The last two months of new orders for manufactured products have been extremely weak, falling by 2.5% in September and 5.4% in August, which does not bode well for future shipments. Plus, the U.S. manufacturing sector, which is closely linked to Canada's, has been relatively soft lately. Furthermore, the industrial product price index fell by 1.1% in October, and falling prices will depress the nominal value of shipments. However, the good news is that real shipments should be stronger.

*Jacqui Douglas 416-982-7784*



## U.S. Retail Sales - November

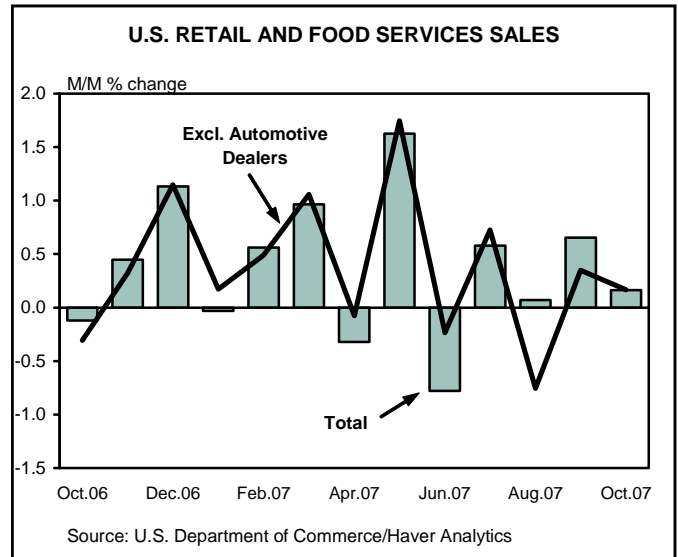
**Release Date:** December 13/07

**TD Forecast:** total +0.7%; ex-autos +0.5%

**Consensus:** total +0.6%; ex-autos +0.6%

We're expecting to see a strong headline number for U.S. November retail sales, with total sales growing by 0.7% and ex-autos sales gaining 0.5%. However, the sales figures are likely going to be much weaker below the surface, since most of the gain in the value of sales will come from the 10% increase in gasoline prices during the month. Ex-autos, ex-gasoline sales are likely to come in close to flat, as consumer spending softens in the final quarter of the year. However, with the U.S. labour market still eking out increases every month, and wage growth still pretty strong, we don't foresee an outright collapse in consumer spending either, and expect retail spending to continue to post modest gains for the next couple of quarters.

*Jacqui Douglas 416-982-7784*



## U.S. Consumer Price Index - November

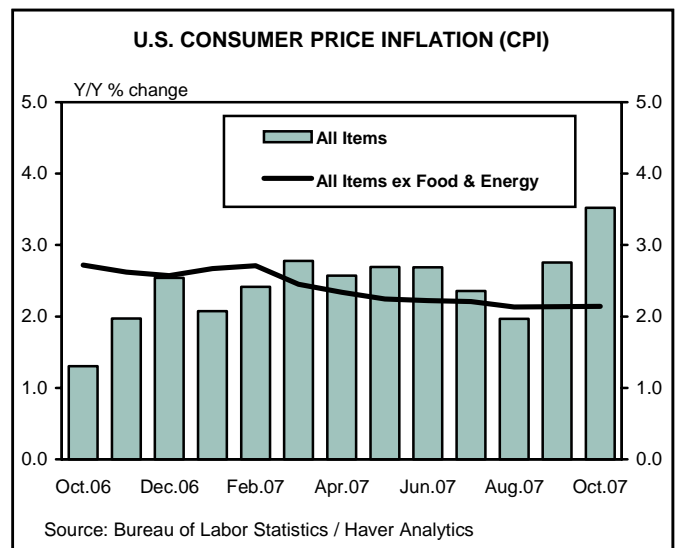
**Release Date:** December 14/07

**TD Forecast:** core +0.2% M/M, 2.2% Y/Y; all-items 0.6% M/M, 4.1% Y/Y

**Consensus:** core +0.2% M/M, 2.3% Y/Y; all-items 0.6% M/M, 4.1% Y/Y

We're expecting to see a big jump in all-items CPI in November to 4.1% Y/Y, largely on the back of a spike in energy prices. We know that crude oil prices surged in November, which drove gasoline and fuel oil prices upwards. Natural gas prices also climbed, moving upwards by 5.0% during the month. However, we still expect core CPI to remain reasonably well-contained, with an average 0.2% M/M gain, leaving the Y/Y rate unchanged at 2.2%.

*Jacqui Douglas 416-982-7784*



## RECENT KEY ECONOMIC INDICATORS December 3-7, 2007

Date	Economic Indicators	Data for	Units	Current	Prior	
<b>Canada</b>						
Dec. 4	Bank of Canada interest rate announcement		Overnight rate	4.25	4.50	
Dec. 6	Building Permits	Oct.	% change	6.8	-1.1	R ▲
Dec. 6	Ivey Purchasing Managers Index	Nov.	Index	58.7	57.1	
Dec. 7	Unemployment Rate	Nov.	Per cent	5.9	5.8	
Dec. 7	Net Change in Employment	Nov.	Thousands	42.6	63.0	
<b>United States</b>						
Dec. 3	ISM Index (manufacturing)	Nov.	Index	50.8	50.9	
Dec. 3	Total Vehicle Sales	Nov.	Millions	16.2	16.1	
Dec. 3	Domestic Vehicle Sales	Nov.	Millions	12.4	12.2	
Dec. 5	ADP Employment Change	Nov.	Thousands	189	119	R ▲
Dec. 5	ISM Non-Manufacturing	Nov.	Index	54.1	55.8	
Dec. 5	Factory Orders	Oct.	% change	0.5	0.3	R ▲
Dec. 6	Weekly Initial Jobless Claims	1-Dec	Thousands	338	353	R ▲
Dec. 7	Change in Non-farm Payrolls	Nov.	Thousands	94.0	170.0	R ▲
Dec. 7	Unemployment Rate	Nov.	Per cent	4.7	4.7	
Dec. 7	Average Hourly Earnings	Nov.	% change	0.5	0.1	R ▼
Dec. 7	University of Michigan Consumer Confidence	Dec.	Index	74.5	76.1	

Source: Bloomberg, TD Economics

## UPCOMING NORTH AMERICAN ECONOMIC CALENDAR December 10-14, 2007

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
<b>Canada</b>					
Dec. 10	Housing Starts	Nov.	Thousands	218.8	227.6
Dec. 10	<i>Bank of Canada Governor Dodge speaks on "Reflections on Developments in the Canadian Financial System" to the Canadian Club of Toronto and the Empire Club of Canada in Toronto, ON</i>				
Dec. 12	International Merchandise Trade Balance	Oct.	C\$, blns	2.2	2.6
Dec. 13	New Housing Price Index	Oct.	% Chg.	0.3	0.3
Dec. 13	Manufacturing Shipments	Oct.	% change	-1.5	-0.9
Dec. 13	Labour Productivity	Q3-07	Q/Q % change	0.1	0.2
Dec. 14	Capacity Utilization Rate	Q3-07	Per cent	82.4	83.0
<b>United States</b>					
Dec. 11	Wholesale Inventories	Oct.	% Chg.	0.5	0.8
Dec. 11	FOMC Rate Decision		Overnight Rate	4.25	4.50
Dec. 12	Trade Balance	Oct.	US\$, blns	-57.3	-56.5
Dec. 13	Producer Price Index (PPI)	Nov.	% change	1.5	0.1
Dec. 13	PPI excl. food and energy	Nov.	% change	0.2	0.0
Dec. 13	Retail Sales	Nov.	% change	0.6	0.2
Dec. 13	Retail Sales ex. autos	Nov.	% change	0.6	0.2
Dec. 13	Weekly Initial Jobless Claims	8-Dec	Thousands	332	338
Dec. 13	Business Inventories	Oct.	% change	0.3	0.4
Dec. 14	Consumer Price Index (CPI)	Nov.	% change	0.6	0.3
Dec. 14	CPI - excl. food and energy	Nov.	% change	0.2	0.2
Dec. 14	Industrial Production	Nov.	% change	0.1	-0.5
Dec. 14	Capacity Utilization	Nov.	Per cent	81.7	81.7

Source: Bloomberg, TD Economics

## G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period	
Dec. 9	18:50	Japan	Machine Orders	Oct.	Y/Y % chg.	-2.2	-7.0	
	18:50	Japan	Money Supply (M2+CD)	Nov.	Y/Y % chg.	1.9	1.9	
	18:50	Japan	Broad Liquidity	Nov.	Y/Y % chg.	3.5	3.6	
Dec. 10	2:00	Germany	Trade Balance	Oct.	Eur, blns	16.8	18.1	
	2:00	Germany	Current Account Balance	Oct.	Eur, blns	14.2	15.4	
	2:45	France	Industrial Production	Oct.	% Chg.	0.5	-1.1	
	2:45	France	Manufacturing Production	Oct.	% Chg.	0.6	-1.3	
	8:15	Canada	Housing Starts	Nov.	Thousands	218.8	227.6	
	10:30	U.K.	Leading Economic Index (prelim.)	Oct.	Index	n/a	-0.1	
	10:30	U.K.	Coincident Index (prelim.)	Oct.	Index	n/a	0.1	
	13:05	Canada	<i>Bank of Canada Governor Dodge speaks on "Reflections on Developments in the Canadian Financial System" to the Canadian Club of Toronto and the Empire Club of Canada in Toronto, ON</i>					
Dec. 11	2:00	AU	<i>Reserve Bank Governor Stevens speaks</i>					
	4:30	U.K.	Merchandise Trade Balance - Total	Oct.	£, blns	-7.4	-7.8	
	4:30	U.K.	Merchandise Trade Balance - ex. EU	Oct.	£, blns	-4.4	-4.7	
	5:00	EU	ZEW Survey - Economic Sentiment	Dec.	Index	-35.0	-30.0	
	5:00	Germany	ZEW Survey - Economic Sentiment	Dec.	Index	-34.5	-32.5	
	5:00	Germany	ZEW Survey - Current Situation	Dec.	Index	67.3	70.0	
	10:00	U.S.	Wholesale Inventories	Oct.	% Chg.	0.5	0.8	
	14:15	U.S.	<i>FOMC Rate Decision</i>		<i>Overnight Rate</i>	4.25	4.50	
	19:50	Japan	Current Account Balance	Oct.	¥, blns	2,040.0	2,883.1	
	23:30	Japan	Bankruptcies	Nov.	Y/Y % chg.	n/a	8.1	
Dec. 12	2:45	France	Trade Balance	Oct.	Eur\$, blns	n/a	-2.3	
	5:00	EU	Unemployment Rate	Q3-07	Per cent	n/a	0.5	
	5:00	EU	Industrial Production	Oct.	% change	0.2	-0.7	
	8:30	U.S.	Trade Balance	Oct.	US\$, blns	-57.3	-56.5	
	8:30	Canada	International Merchandise Trade Balance	Oct.	C\$, blns	2.2	2.6	
	16:45	NZ	Retail Sales	Oct.	% change	n/a	1.0	
	21:30	AU	Unemployment Rate	Nov.	Per cent	4.3	4.3	
	21:30	AU	Net Change in Employment	Nov.	Thousands	20.0	12.9	
Dec. 13	2:45	France	Consumer Price Index	Nov.	Y/Y % Chg.	2.2	2.0	
	4:00	EU	<i>European Central Bank publishes Dec. monthly report</i>					
	5:00	EU	Euro-Zone Labour Costs	Q3-07	Ann. % chg.	2.6	2.5	
	8:30	U.S.	Producer Price Index (PPI)	Nov.	% change	1.5	0.1	
	8:30	U.S.	PPI excl. food and energy	Nov.	% change	0.2	0.0	
	8:30	Canada	New Housing Price Index	Oct.	% Chg.	0.3	0.3	
	8:30	Canada	Manufacturing Shipments	Oct.	% change	-1.5	-0.9	
	8:30	Canada	Labour Productivity	Q3-07	Q/Q % change	0.1	0.2	
	8:30	U.S.	Retail Sales	Nov.	% change	0.6	0.2	
	8:30	U.S.	Retail Sales ex. autos	Nov.	% change	0.6	0.2	
	8:30	U.S.	Weekly Initial Jobless Claims	8-Dec	Thousands	332	338	
10:00	U.S.	Business Inventories	Oct.	% change	0.3	0.4		
Dec. 14	5:00	EU-12	Consumer Price Index	Nov.	Y/Y % chg.	3.0	2.6	
	8:30	Canada	Capacity Utilization Rate	Q3-07	Per cent	82.4	83.0	
	8:30	U.S.	Consumer Price Index (CPI)	Nov.	% change	0.6	0.3	
	8:30	U.S.	CPI - excl. food and energy	Nov.	% change	0.2	0.2	
	9:15	U.S.	Industrial Production	Nov.	% change	0.1	-0.5	
	9:15	U.S.	Capacity Utilization	Nov.	Per cent	81.7	81.7	

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

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