



# TD Economics

## The Weekly Bottom Line

February 27, 2009

### HIGHLIGHTS

- U.S. Q4 GDP revised down to 6.2%
- TD Economics to cut growth forecasts

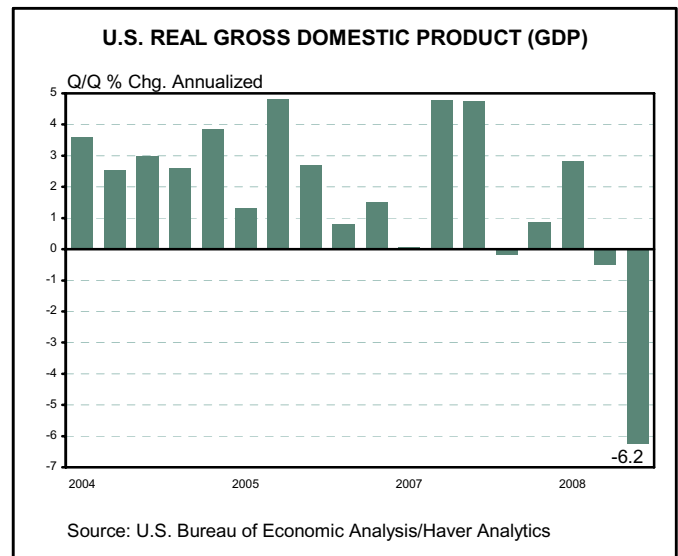
Revisions, revisions, revisions! With all the uncertainty surrounding the economy these days, revisions are becoming more common and more extreme. In the U.S., a staggering downward revision to fourth quarter GDP shocked markets this morning, while the rapid deterioration in both the U.S. and Canadian economies alongside only modest improvements in credit conditions has driven TD Economics to downgrade growth forecasts.

### U.S. economy contracts 6.2% in Q4

U.S. economic growth in the fourth quarter of 2008 was widely expected to come in below -5%. However, the initial report surprised on the upside, indicating that the economy only contracted by 3.8%. Good news? Well, not if you suspected that the forthcoming revisions will adjust that figure down. And indeed, the first revision released this morning indicated that the U.S. economy actually contracted by a whopping 6.2% in the fourth quarter – the biggest contraction in economic activity since 1982. The contribution to economic growth coming from inventories – which prevented the initial real GDP estimate from coming in closer to expectations – saw the largest downward revision, dropping from 1.3 percentage points to a meager 0.1 percentage point. As a result, personal domestic investment weighed more heavily on growth, detracting 3.1

#### Recent TD Economics Research

February 27, 2009 - Monetary Policy Monitor  
 February 26, 2009 - U.S. Durable Goods Orders  
 February 25, 2009 - A Primer on Gasoline Prices  
 February 24, 2009 - Canadian Banks During the Credit Crunch  
 February 23, 2009 - Saskatchewan's Economic and Fiscal Outlook  
 February 23, 2009 - Canadian Retail Sales



percentage points from real GDP, compared to the initial estimate of -1.8 percentage points. Consumer spending was revised down, now shaving 3.0 percentage points off GDP versus an initial estimate of -2.5 percentage points, marking the worst performance in nearly three decades. Government spending and net exports were also revised lower, falling by 0.1 and 0.6 percentage points, respectively. While there is still another revision to come in March, most of the data is in, so this morning's figure portrays an accurate picture of the state of the U.S. economy.

While we now know that the U.S. economy did indeed contract by a massive amount, early 2009 data suggests that the first quarter will also be quite grim. Durable goods orders sank like a stone in January, indicating that capital expenditure by businesses in the U.S. has continued to shrink. This suggests that business confidence is still extremely low. Looking to consumers, sentiment is no better. In fact, it is at an all-time low as indicated by the Conference Board's consumer confidence index, which slipped from 37.4 to a record low of 25.0 in February. Moreover, the report showed that consumers are feeling pretty uneasy about both the present environment as well as their expectations for the future. And given the impor-

tance of the consumer for the overall economy, consumer confidence is something that will have to be restored in order for a recovery to take place.

On the housing front, both new and existing home sales were down in January, falling by 10.2% and 5.3%, respectively. As a result, the inventory of unsold new homes rose to 13 months supply, marking another record dating back to 1963. The inventory of unsold existing homes edged up to 9.6 months supply, however it still remains below November's peak of 11 months. While clearly a buyer's market, home sales have yet to reach a bottom. But this is one area worth watching closely, as a stabilization in the housing market will be a key component to restoring confidence in financial markets – and thus could be a sign that an economic recovery is on its way.

### Monetary and fiscal bodies work to calm markets

So with the U.S. economy continuing to deteriorate, all eyes and ears have been focused on any monetary and fiscal stimulus measures that come about. This week, Fed Chairman Bernanke stole the spotlight when he delivered the semi-annual testimony to Congress. He indicated that widespread nationalization of the banking system – which has been a grave concern in financial markets – is not something that the Federal Reserve is in favour of doing. However, he noted that how much more they have to do will depend on the state of each bank, and that the overall outlook is subject to the government's plan to recapitalize the banks actually gaining some traction. Furthermore, he reaffirmed that the Fed is willing to use all tools available to stimulate the economy and restore financial markets to normal. However, he warned that the economy is in a severe contraction and it could take 2-3 years to fully recover.

On the fiscal side, President Obama released his budget outline, which revealed a record deficit of \$1.75 trillion for the fiscal year ending in September. The plan includes higher taxes for couples who earn over \$250,000 per year, an overhaul of the healthcare system, and a paring of some subsidies. Overall, the budget deficit for the current year would equal 12% of GDP, marking the highest debt-to-GDP ratio since the Second World War. And despite Obama's plan to spend \$3.55 trillion in 2010, the President plans to chop the shortfall in half by 2013. While quite ambitious, this proposal is contingent upon everything going according to plan, and a relatively sharp rebound in economic growth of 3.2% in 2010 – two factors that remain very optimistic at this point.

### TD Economics cuts economic growth forecasts

Indeed, with credit market conditions in the U.S. failing to improve as much as hoped, and confidence yet to be restored, TD Economics will be downgrading economic growth forecasts for both 2009 and 2010. Our fully articulated forecast will not be available until mid-March, however the direction of the revisions is quite clear. In general, real GDP in 2009 will likely be revised down from an annual average of -1.6% to -2.9%, while the rebound in 2010 will be more subdued, with growth of only 1.4%, compared to our previous forecast of 3.2%.

Similarly, the knock-on effects from the U.S. economy and a rapid deterioration of economic conditions north of the border also caused us to revise down our Canadian economic growth forecasts. While we won't have official Q4 GDP figures until next Monday, we believe that Canada slipped into a recession in the fourth quarter of 2008. Retail sales data for December was the last key indicator of the fourth quarter to be released, and indeed, it was quite dour. Retail sales plunged 5.4% on the month, marking the largest monthly drop in the series dating back to 1991. What's more, sales were down 6.4% from year ago levels, representing the largest annual decline on record as well. This weakness in retail sales, coupled with the contractions seen in October and November, will likely translate into a 2.5% decline in consumer spending for the fourth quarter as a whole.

Taking into account all data that has been released to date, fourth quarter Canadian real GDP is tracking -4.2% – much worse than the 2.9% contraction that we were initially expecting. So with a weaker hand off for this year, we will be downgrading our 2009 annual real GDP forecast from -1.4% to -2.2%, with the weakest growth expected for the first quarter of 2009. Like in the U.S., we predict that the bounce back in 2010 will also be more muted, with the economy expanding at a 1.4% clip, rather than our initial forecast of 2.8%. Look for details in the *Quarterly Economic Forecast*, which will be available on our website as of March 12<sup>th</sup>.

With real GDP expected to have declined quite rapidly in the fourth quarter – nearly double the Bank of Canada's forecast for a 2.3% contraction – and a further contraction in economic growth expected for the first half of 2009, we expect the Bank of Canada to cut interest rates by 50 basis points at their meeting next week. This would bring the overnight target rate to a record low of 0.50%, where we expect it to remain into 2010.

*Dina Cover, Economist 416-982-2555*

## UPCOMING KEY ECONOMIC RELEASES

### Canadian Real GDP - Q4/08

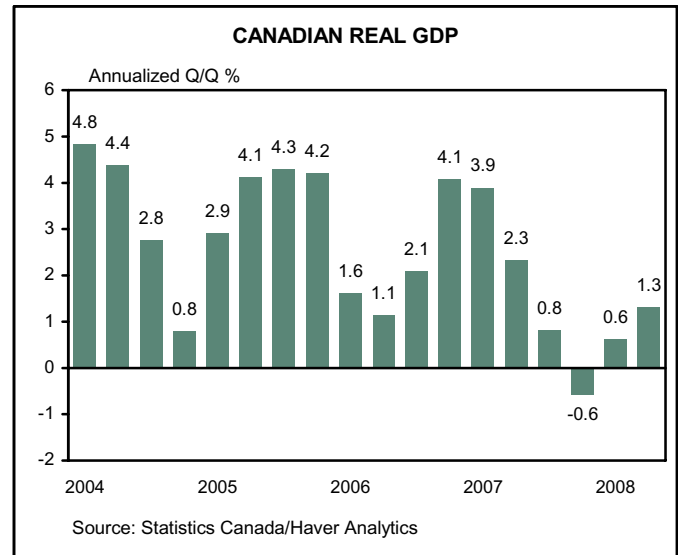
**Release Date:** March 2/09

**Q3 Result:** 1.3% Q/Q ann.

**TD Forecast:** -4.2% Q/Q

**Consensus:** -3.5% Q/Q

This Q4 GDP report is expected to officially confirm the widely held view that the Canadian economy has entered its first recession since the early 1990s, and it should be the first of a few consecutive negative GDP prints. Indeed, with the key backdrops for Canadian economic activity remaining very weak, there appears to be every indication that this economic malaise will last well into the second half of this year. For Q4, we expect Canadian GDP to plunge a staggering 4.2% Q/Q ann., which will be the greatest pace of economic contraction since the last recession. In nominal terms, the drop is expected to an even greater 14.0% Q/Q. The weakness in Q4 economic activity is likely to be broadly based, with both domestic consumption expenditure and external trade providing significant drag on the domestic economy. Business investment



should also be weak, though inventory accumulation may perhaps provide some upward support during the quarter. Government expenditure is expected to add favourably to output.

*Millan Mulraine 416-308-2911*

### U.S. Personal Income & Spending - January

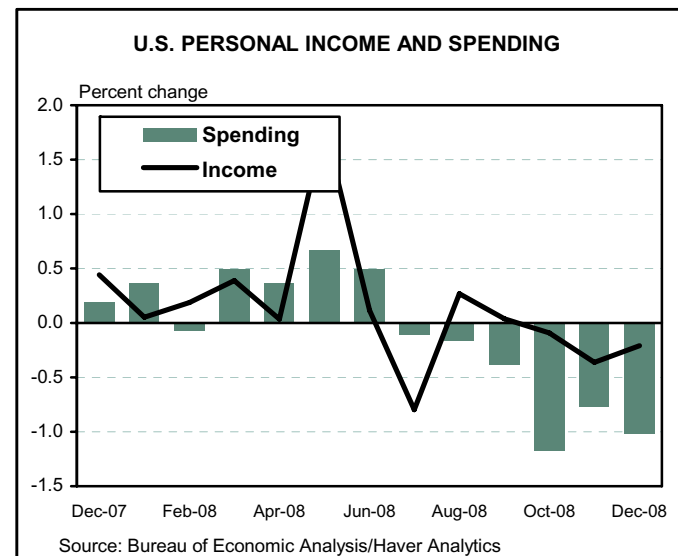
**Release Date:** March 2/09

**December Result:** income -0.2% M/M, spending -1.0% M/M; core PCE deflator 0.0% M/M, 1.7% Y/Y

**TD Forecast:** income -0.2% M/M; spending 0.3% M/M; core PCE deflator 0.2% M/M, 1.6% Y/Y

**Consensus:** income -0.2% M/M; spending 0.4% M/M; core PCE deflator 0.1% M/M, 1.6% Y/Y

The ongoing U.S. economic recession is continuing to take a heavy toll on U.S. consumers, as mounting job losses and growing economic uncertainty conspire to erode confidence and inject anxiety among households. Neither has the ongoing housing market correction and financial sector turmoil been helpful to their cause. As such, we expect personal income and spending to remain soft. During the month, our call is for personal income to fall for a fourth consecutive month, with a further 0.2% M/M drop. Spending, however, is expected to rise slightly, with a modest 0.3% M/M following the dramatic 1% M/M plunge in December. The snap-back in spending, however, should not be considered as a harbinger of a recovery in personal spending, but instead is the result of base-effects. The core PCE deflator is expected to rise by its largest margin



since September, climbing by 0.2% M/M. Despite the increase on the month, the annual pace of core PCE inflation is expected to ease to 1.6% Y/Y, from 1.7% Y/Y. In the months ahead, we expect personal income and spending to remain soft, though the impending stimulus cheques should add some life to both indicators.

*Millan Mulraine 416-308-2911*

## U.S. ISM Manufacturing Report - February

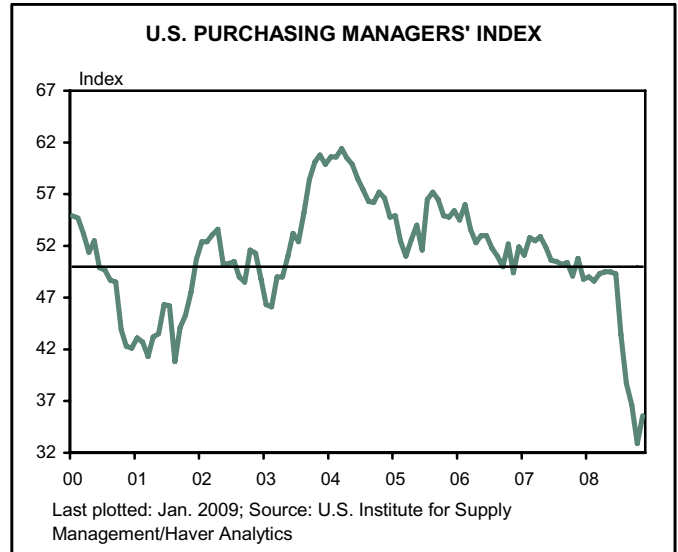
**Release Date:** March 2/09

**January Result:** 35.6

**TD Forecast:** 33.0

**Consensus:** 33.9

U.S. manufacturing sector activity has been clobbered to the ground by the ongoing economic recession that has engulfed the globe. Add to this the strengthening U.S. dollar (which has gained as much as 15% since last May) and it becomes quite clear that there is hardly any hope for a meaningful recovery in the sector anytime soon. Indeed, with the gamut of regional manufacturing surveys all pointing downwards, we expect the ISM manufacturing index to give back most of the surprising gains made in January, falling back to 33.0 in February, with the decline in activity being broadly-based at the sectoral level. In the months ahead, with domestic and foreign consumer demand likely to weaken even further, we believe that the headline ISM index and most of its sub-components will



remain well south of the 50-threshold, suggesting further contraction in the U.S. manufacturing sector.

*Millan Mulraine 416-308-2911*

## Bank of Canada Interest Rate Decision

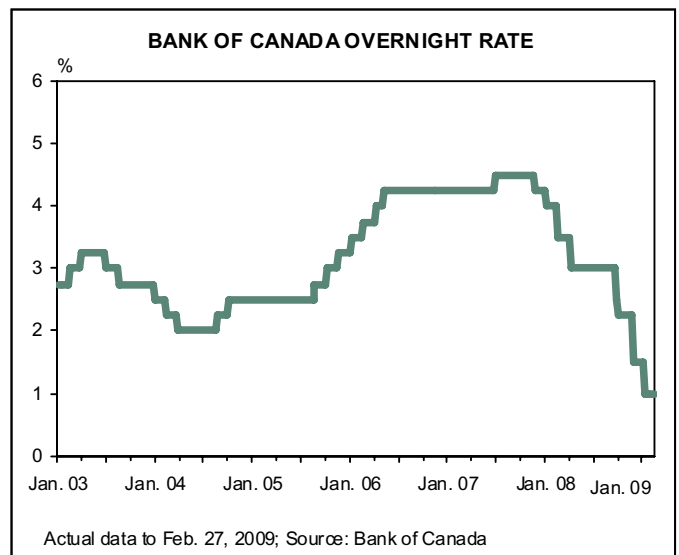
**Release Date:** March 3/09

**Current Rate:** 1.00%

**TD Forecast:** 0.50%

**Consensus:** 0.50%

Heading into the March 3<sup>rd</sup> FAD, the economic data has confirmed the rather rapid deterioration in the Canadian economy, complete with evaporating price pressures. There has been a steady stream of disappointing data that confirms the economy quickly unravelled in the fourth quarter as not only the domestic drivers of growth contracted, but so too did the external drivers succumb to the recession in the U.S. The last piece of the puzzle will be Monday's official Q4 GDP data, which is expected to post a 4.2% Q/Q ann. decline. Moreover, improvement in the credit market has been slow and the Bank of Canada continues its stewardship of that process. So in light of these factors, the case for one final 50bps rate cut by the Bank of Canada to leave the overnight rate at a historical low of 0.50% this Tuesday seems like a logical outcome. We also think this will mark the end of the easing cycle. The markets will put a lot of emphasis on the statement, which in recent months had become increasingly transparent. The



Bank might rejig its statement about the "extent (to which) further monetary stimulus will be required." The bigger question is whether the statement will hint at measures of unorthodox monetary policy and at present we are inclined to think not.

*Charmaine Buskas 416-982 3297*

## U.S. Nonfarm Payrolls - February

**Release Date:** March 6/09

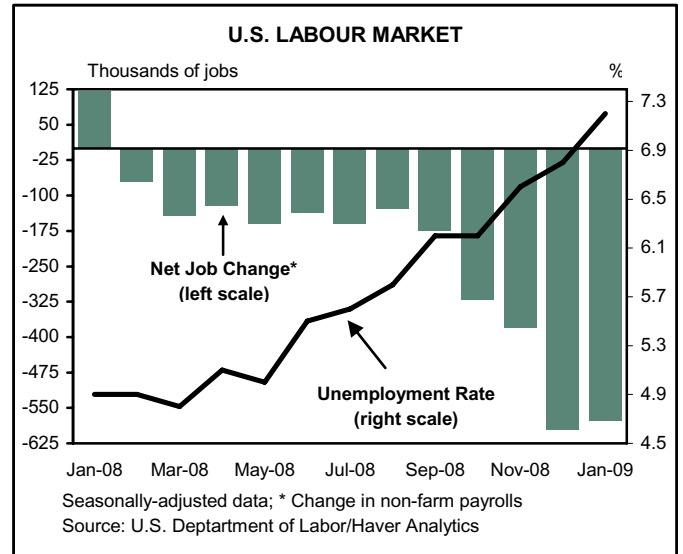
**January Result:** -598K; unemployment rate 7.6%

**TD Forecast:** -700K; unemployment rate 7.9%

**Consensus:** -640K; unemployment rate 7.9%

Things have undoubtedly fallen apart in the U.S. labour market, as the ongoing economic and financial crises wreak havoc on the ranks of the employed like a tornado. In fact, since the onset of the recession some 3.6 million people have lost their jobs, and there is little to suggest that this trend will reverse anytime soon. In February, we expect the number of jobs being lost to accelerate, with an additional 700K positions being made redundant. If this is the case, it will be the largest number of monthly job losses in the U.S. since the demilitarization following World War 2. The unemployment rate should rise even further, climbing to 7.9%. The job losses are expected to be fairly broadly-based, with both the goods and services producing sectors shedding jobs. In the months ahead, we expect the level of job losses to remain brisk, as the ongoing economic recession gathers traction.

*Millan Mulraine 416-308-2911*



## RECENT KEY ECONOMIC INDICATORS

February 23 - February 27, 2009

Release Date	Economic Indicators	Data for Period	Units	Current	Prior	
<b>Canada</b>						
Feb. 23	Retail Sales	Dec.	M/M % chg.	-5.4	-2.4	
Feb. 23	Retail Sales Less Autos	Dec.	M/M % chg.	-3.2	-2.3	
Feb. 27	Current Account Balance (SA)	Q4	\$C, blns	-7.5	3.2	R▼
Feb. 27	Industrial Product Price	Jan.	M/M % chg.	-0.1	-2.1	
Feb. 27	Raw Materials Price Index	Jan.	M/M % chg.	1.4	--	
<b>United States</b>						
Feb. 24	ABC Consumer Confidence	22 Feb.	Index	-48	-49	
Feb. 25	MBA Mortgage Applications	20 Feb.	% change	-15.1	45.7	
Feb. 25	Existing Home Sales	Jan.	M/M % chg.	-5.3	4.4	R▼
Feb. 27	GDP (prelim)	Q4	Annual rate	-6.2	-3.8	
Feb. 27	Personal Consumption	Q4	Q/Q % chg.	-4.3	-3.5	
Feb. 27	GDP Price Index	Q4	Q/Q % chg.	0.5	-0.1	
Feb. 27	Core PCE Price Index	Q4	Q/Q % chg.	0.8	0.6	
Feb. 27	Chicago Purchasing Managers	Feb.	Index	34.2	33.3	
Feb. 27	University of Michigan Confidence	Feb.	Index	56	56.2	

Source: Bloomberg, TD Economics

**UPCOMING NORTH AMERICAN ECONOMIC CALENDAR**  
**March 2 - March 6, 2009**

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
<b>Canada</b>					
Mar. 2	GDP	Feb.	M/M % chg.	-0.6	-0.7
Mar. 2	GDP	Q4	Q/Q % chg.	-3.5	1.3
Mar. 3	<i>Bank of Canada Rate Decision</i>			0.50	1.00
Mar. 5	Building Permits	Jan.	M/M % chg.	-3.5	-3.9
Mar. 5	Ivey Purchasing Managers Index	Feb.	Index	37.0	36.1
<b>United States</b>					
Mar. 2	Personal Income	Jan.	% change	-0.2	0.2
Mar. 2	Personal Spending	Jan.	% change	0.4	-1.0
Mar. 2	Personal Consumption Expenditure Deflator	Jan.	Y/Y % chg.	0.5	0.6
Mar. 2	Personal Consumption Expenditure Core	Jan.	Y/Y % chg.	1.6	1.7
Mar. 2	ISM Manufacturing	Feb.	Index	33.9	35.6
Mar. 2	<i>Fed Governor Rosengren speaks to bankers in Washington</i>				
Mar. 2	<i>Richmond Fed President Lacker speaks to economists in Virginia</i>				
Mar. 3	<i>Atlanta Fed President Lockhart speaks on economy at Tampa</i>				
Mar. 3	Pending Home Sales	Jan.	M/M % chg.	-3.0	6.3
Mar. 3	ABC Consumer Confidence	1 Mar.	Index	-47	-48
Mar. 4	MBA Mortgage Applications	27 Feb.	% change	--	-15.1
Mar. 4	ADP Employment Change	Feb.	Thousands	-610	-522
Mar. 4	<i>Dallas Fed President Fisher speaks in Texas</i>				
Mar. 4	ISM Non-Manufacturing Composite	Feb.	Index	41.0	42.9
Mar. 4	<i>Atlanta Fed President Lockhart speaks on economic outlook in Miami</i>				
Mar. 4	<i>Fed's Beige Book Economic Report Released</i>				
Mar. 5	Non-farm Productivity	Q4	Q/Q % chg.	1.6	3.2
Mar. 5	Unit Labor Costs	Q4	Q/Q % chg.	3.4	1.8
Mar. 5	Initial Jobless Claims	28 Feb.	Thousands	640	667
Mar. 5	Continuing Claims	21 Feb.	Thousands	5,150	5112
Mar. 5	Factory Orders	Jan.	M/M % chg.	-2.4	-3.9
Mar. 5	<i>Treasury Secretary Geithner testifies on budget</i>				
Mar. 5	<i>Atlanta Fed President Lockhart speaks on economy</i>				
Mar. 6	Change in Non-farm Payrolls	Feb.	Thousands	-640	-598
Mar. 6	Unemployment Rate	Feb.	Percent	7.9	7.6
Mar. 6	Change in Manufacturing Payrolls	Feb.	Thousands	-185	-207
Mar. 6	Average Hourly Earnings	Feb.	Y/Y % chg.	--	3.9
Mar. 6	Consumer Credit	Jan.	US\$, blns	-4.0	-6.6

Source: Bloomberg, TD Economics

## G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period		
Mar. 2	0:00	Japan	Vehicle Sales	Feb.	Y/Y % chg.	--	-27.9		
	4:00	E.C.	Purchasing Managers Index Manufacturing	Feb.	Index	33.6	33.6		
	4:30	U.K.	M4 Money Supply	Feb.	Y/Y % chg.	--	17.5		
	5:00	E.C.	Euro-zone CPI	Feb.	Y/Y % chg.	1.0	1.1		
	8:30	Canada	GDP	Feb.	M/M % chg.	-0.6	-0.7		
	8:30	Canada	GDP	Q4	Q/Q % chg.	-3.5	1.3		
	8:30	U.S.	Personal Income	Jan.	% change	-0.2	0.2		
	8:30	U.S.	Personal Spending	Jan.	% change	0.4	-1.0		
	8:30	U.S.	Personal Consumption Expenditure Deflator	Jan.	Y/Y % chg.	0.5	0.6		
	8:30	U.S.	Personal Consumption Expenditure Core	Jan.	Y/Y % chg.	1.6	1.7		
	10:00	U.S.	ISM Manufacturing	Feb.	Index	33.9	35.6		
	11:30	U.S.	<i>Fed Governor Rosengren speaks to bankers in Washington</i>						
	12:45	U.S.	<i>Richmond Fed President Lacker speaks to economists in Virginia</i>						
	18:50	Japan	Monetary Base	Feb.	Y/Y % chg.	--	3.9		
	Mar. 3	8:00	U.S.	<i>Atlanta Fed President Lockhart speaks on economy at Tampa</i>					
9:00		Canada	<i>Bank of Canada Rate Decision</i>					0.50	1.00
10:00		U.S.	Pending Home Sales	Jan.	M/M % chg.	-3.0	6.3		
17:00		U.S.	ABC Consumer Confidence	1 Mar.	Index	-47	-48		
19:01		U.K.	Nationwide Consumer Confidence	Feb.	Index	38	40		
Mar. 4	4:00	E.C.	Purchasing Managers Index Services	Feb.	Index	38.9	38.9		
	4:00	E.C.	Purchasing Managers Index Composite	Feb.	Index	36.2	36.2		
	7:00	U.S.	MBA Mortgage Applications	27 Feb.	% change	--	-15.1		
	8:15	U.S.	ADP Employment Change	Feb.	Thousands	-610	-522		
	8:30	U.S.	<i>Dallas Fed President Fisher speaks in Texas</i>						
	10:00	U.S.	ISM Non-Manufacturing Composite	Feb.	Index	41.0	42.9		
	12:00	U.S.	<i>Atlanta Fed President Lockhart speaks on economic outlook in Miami</i>						
14:00	U.S.	<i>Fed's Beige Book Economic Report Released</i>							
Mar. 5	2:50	France	Producer Prices	Feb.	Y/Y % chg.	-0.4	0.0		
	5:00	E.C.	Euro-zone GDP	Q4	Q/Q % chg.	-1.5	-1.5		
	7:00	U.K.	<i>Bank of England Rate Decision</i>					0.50	1.00
	7:45	E.C.	<i>European Central Bank Rate Decision</i>					1.50	2.00
	8:30	Canada	Building Permits	Jan.	M/M % chg.	-3.5	-3.9		
	8:30	U.S.	Non-farm Productivity	Q4	Q/Q % chg.	1.6	3.2		
	8:30	U.S.	Unit Labor Costs	Q4	Q/Q % chg.	3.4	1.8		
	8:30	U.S.	Initial Jobless Claims	28 Feb.	Thousands	640	667		
	8:30	U.S.	Continuing Claims	21 Feb.	Thousands	5150	5112		
	10:00	Canada	Ivey Purchasing Managers Index	Feb.	Index	37.0	36.1		
	10:00	U.S.	Factory Orders	Jan.	M/M % chg.	-3.5	-3.9		
	10:00	U.S.	<i>Treasury Secretary Geithner testifies on budget</i>						
	12:45	U.S.	<i>Atlanta Fed President Lockhart speaks on economy</i>						
Mar. 6	4:30	U.K.	Producer Price Output	Feb.	Y/Y % chg.	3.1	3.5		
	8:30	U.S.	Change in Non-farm Payrolls	Feb.	Thousands	-640	-598		
	8:30	U.S.	Unemployment Rate	Feb.	Percent	7.9	7.6		
	8:30	U.S.	Change in Manufacturing Payrolls	Feb.	Thousands	-185	-207		
	8:30	U.S.	Average Hourly Earnings	Feb.	Y/Y % chg.	--	3.9		
	15:00	U.S.	Consumer Credit	Jan.	US\$, blns	-4	-6.6		

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

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