

TD Economics

The Weekly Bottom Line

February 29, 2008

HIGHLIGHTS

- U.S.-Canada travel: a one-way street?
- U.S. indicators point to continued weakness
- Modest Canadian Federal Budget after October's 'mini budget'

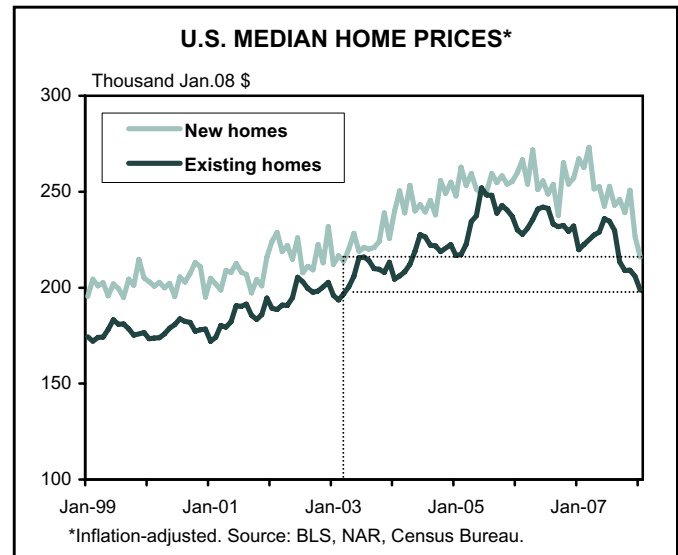
The Canadian fiscal policy centerpiece that is the Federal Budget emphasized prudence in the midst of the current economic slowdown, and offered little after October's significant 'mini-budget' (see our Budget 2008 commentary on our website for details). The only economic data for Canada this week were fourth quarter 2007 current account (CA) figures. Canada's CA balance, which measures the annual difference between national savings and investment and is matched by capital flows, fell into the red for the first time since 1999 with a -\$0.5 billion quarterly print. The yearly CA balance remained positive for 2007 at \$14.2 billion, but reverted back close to 2003 levels after peaking in 2004. The deterioration in the CA was the result of a much weaker goods & services balance. It is well known that the single most important weak area for Canadian growth stems from the U.S. slowdown.

Sore spot

But the sore spot within the balance might surprise, as so much of the emphasis is typically on the weaker goods balance. The goods surplus did soften by \$1.7 billion (-3%) on an annual basis. But this pales in comparison to the ballooning in the services deficit by \$4.3 billion (+28%), mostly due to a much larger travel deficit. A simple story

Recent TD Economics Research

February 29, 2008 - U.S. Personal Income & Spending
February 27, 2008 - U.S. Durable Goods Orders
February 26, 2008 - The 2008 Federal Budget
February 25, 2008 - Industrial Outlook



really, which sees more Canadians visiting the U.S. and much fewer Americans returning the favour. While not yet significant at 0.1% of GDP in the fourth quarter of 2007, the CA deficit does mark a turning point. It is not necessarily symptomatic of any troubling imbalance in Canadian saving, but the CA balance is unlikely to improve in the first half of this year. Although important, a larger drag from the external sector of the economy is not expected to outweigh generalized strength in domestic economic fundamentals.

Generalized weakness

By contrast, the big picture in the U.S. is one of generalized weakness with few pockets of strength, notably exports. Revised estimates of real U.S. GDP growth in the fourth quarter of 2007 were unchanged at 0.6% annualized. This should help quell some of the cries, heard from many corners, that the U.S. was already in a recession at the end of last year. Declining employment and real GDP are both necessary conditions of a recession. As such, only significant final downward revisions to both figures could prove such claims correct.

But the U.S. economy did start the year on a weak

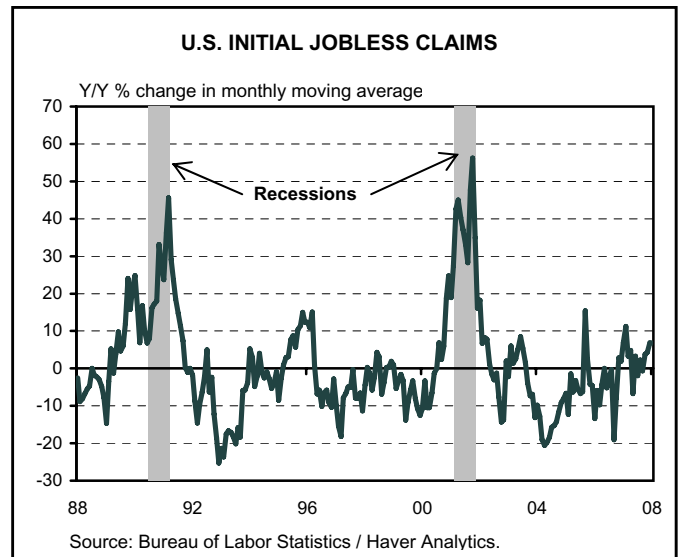
footing. New and existing home market data for January confirmed ongoing weakness in sales, translating into further price declines. New home sales are at their lowest level in 13 years. The relative supply-demand imbalance, as measured by months' supply it would take to liquidate the stock of new homes at the current pace of sales, is at its highest in 26 years. Existing single-family home sales were at their lowest in 10 years. The inflation-adjusted median price of homes, new or existing, has turned back the clock to 2003 levels (see accompanying chart). It would be overly optimistic to anticipate a stabilization of the home market, let alone a rebound, any time soon.

Other economic data out of the U.S. were also weak. Capital goods orders plummeted in January, falling by 5.3% on the month, although this comes on the heels of December's strong 4% gain. On the labour market front, the latest initial jobless claims report saw a significant jump from the week prior. However, the President's day holiday during the reporting week makes the data difficult to interpret, as holidays can throw seasonally-adjusted measures off. March initial and continuing jobless claims should be more telling. However, our leading-indicator signal for initial jobless claims is not yet near flashing a recessionary red light (see accompanying chart).

The outlook for U.S. growth remains weak. The Fed's forecast range is now 1.3-2.0%, in line with TD Economics' forecast of 1.6%. January figures for personal spending show a fairly flat profile with a 3-month annualized trend growth at a mere 1.4%. Given the housing and credit market woes, it comes as no surprise that a consumer confidence index for January was at its lowest level in almost 8 years. Consumers are and have been resilient, but they're not blind.

Lower rates in both countries

Chairman Bernanke's language heard in his testimonies to U.S. House and Senate committees was mostly focused on economic weakness. Inflationary concerns were duly noted but not brought to the forefront. The Fed is still hoping that slower economic activity will eventually translate into weaker inflation. It had better hope this happens soon. Declining home prices have so far failed to translate into weaker inflation. The U.S. dollar declined further this week, partly in anticipation of lower rates. This puts further pressure on import prices and overall inflation. In particular, oil prices keep hitting new record highs, above \$US102/bbl on Thursday. Very little slack has opened in the labour market. All of which puts the Fed in a bind. Its



preferred inflation gauge, the core PCE index, showed little sign of easing in January at 2.2% year-over-year, unchanged from December. A few more months at these or higher levels and further increases in market expectations for inflation could turn the tables and have the Fed re-focus on its price stability mandate. No one ever said that maintaining price stability and the expectation thereof was going to be easy, as the current episode is highlighting. We think the Fed's quandary will limit the extent of further easing to 50 basis points in the near-term.

In Canada, partly because of an elevated Canadian dollar, a strikingly weaker inflation backdrop makes the Bank of Canada's job much easier than its U.S. counterpart. It has signaled its intention to lower its overnight interest rate at its Tuesday meeting. The debate hinges upon the extent of easing. As of Friday morning, futures markets were almost fully pricing in a 50 basis points cut, which is also the TD Economics call for the March 4th meeting. For one, the economic data has not proved any better than expected since incoming Governor Carney took the reigns at the end of January. Second, core inflation was running significantly below the 2% target at 1.4% in January, and is expected to remain below 2% until late 2009. On track with the BoC's forecast and ours, the Canadian economy's excess demand should be eliminated by mid-year. We expect the BoC to hold its overnight rate steady at 3.25% after easing by a cumulative 75 basis points in March & April.

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UPCOMING KEY ECONOMIC RELEASES

Canadian Real GDP - Q4-07

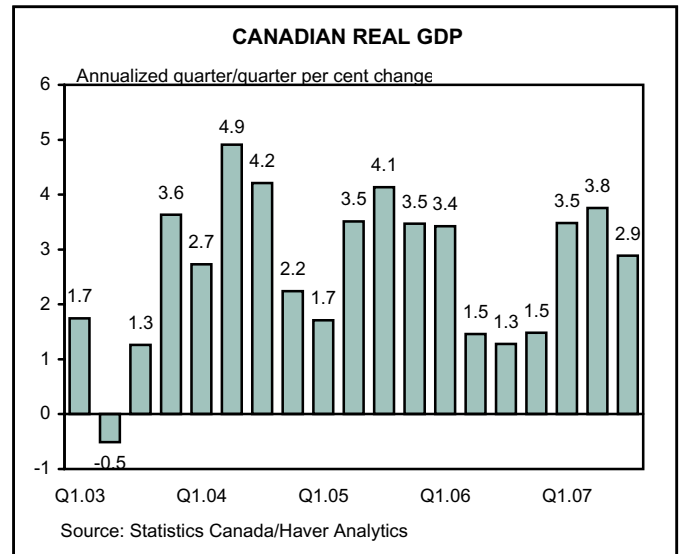
Release Date: March 3/08

Q3 Result: 2.9%

TD Forecast: 1.0%

Consensus: 1.0%

We're expecting to see Canadian GDP growth slow markedly in the last quarter of 2007, to only 1.0% at an annualized pace. And, the risks to our forecast lie squarely to the downside. While consumer spending should rebound to some extent in Q4 and investment in machinery and equipment should post another big gain, that's not going to be enough to make up for the weakness we saw in several other sectors. Since the pace of housing starts slowed significantly from Q3 to Q4 and Statistics Canada reported a mere 0.4% increase in non-residential construction, we'll see much less growth from both residential and non-residential structures than over the last few quarters. International trade will also likely be a big drag on growth, with real exports of goods having declined by 6.3% and real imports increasing by 6.6%. The monthly GDP figures are



also pointing to a weak Q4 result, with December GDP likely to decline by 0.5%, which is consistent with only about a 0.8% pace of GDP growth in the fourth quarter of the year.

Jacqui Douglas 416-982-7784

U.S. ISM Manufacturing Report - February

Release Date: March 3/08

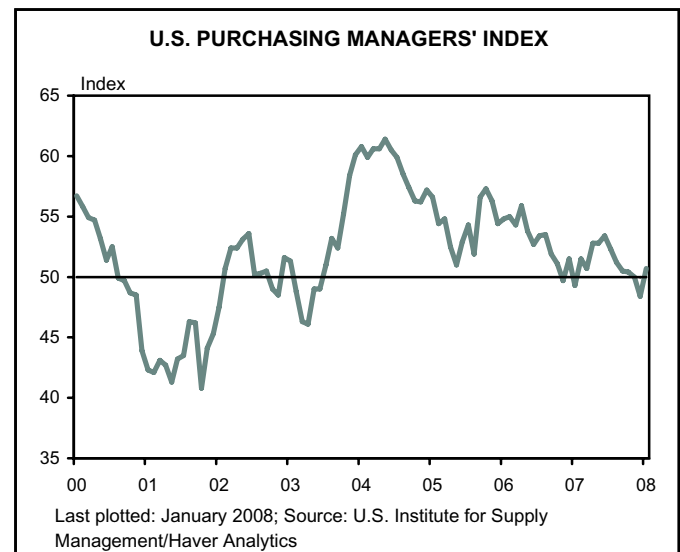
January Result: 50.7

TD Forecast: 46.0

Consensus: 48.5

We're expecting to see the ISM manufacturing index drop rather significantly, from 50.7 in January to only 46.0 in February. Every single major regional manufacturing indicator is well into negative territory, with particularly troubling drops in the Empire Fed (from +9.03 to -11.72) and the Chicago PMI (51.5 to 44.5) in February. Furthermore, the ISM manufacturing index was unrealistically strong in January, given the declines in all of the regional manufacturing indices and the huge degree of weakness in the ISM non-manufacturing index, so there could be some serious payback in February.

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Bank of Canada Rate Decision

Release Date: March 4/08

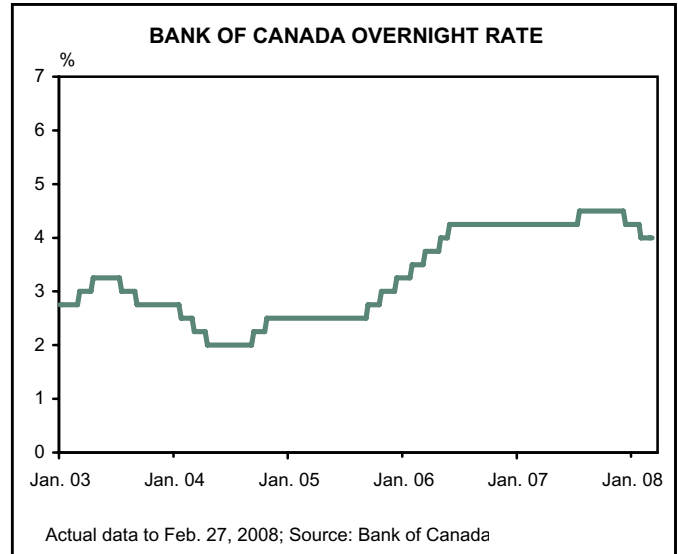
Current Rate: 4.00%

TD Forecast: 3.50%

Consensus: 3.75%

We're expecting to see the Bank of Canada cut rates for the third consecutive time on March 4, but this time by a larger 50bps. The Bank of Canada has already indicated that they plan to cut interest rates again, with the January 22 statement stating that "further monetary stimulus is likely to be required in the near term." Since monetary policy acts with a lag, and the downside risks stemming from a weakening U.S. economy necessitate further monetary accommodation in Canada, we think that the Bank of Canada would be better off delivering rate cuts sooner rather than later.

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Canadian Employment - February

Release Date: March 7/08

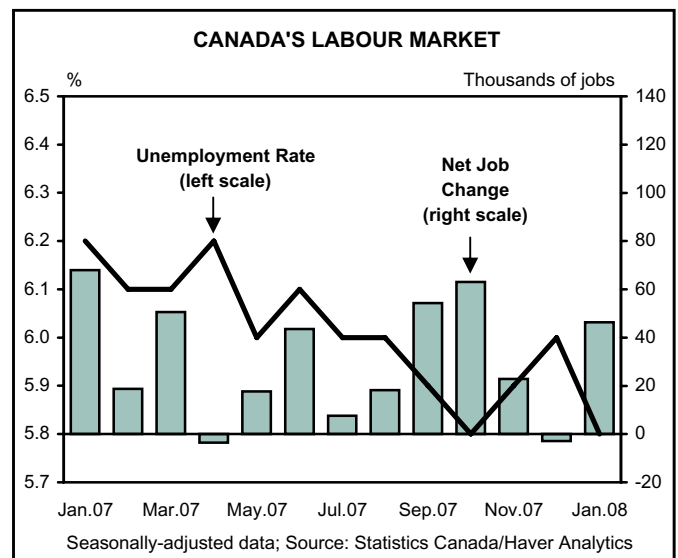
January Result: 46.4K; unemployment rate 5.8%

TD Forecast: 10K; unemployment rate 5.8%

Consensus: 5K; unemployment rate 5.9%

We're expecting to see the pace of Canadian employment growth slow in February, after what we think was its last hurrah in January. For one, the composition of growth in January was simply unsustainable. Nearly all the job growth came from the goods sector, with a particularly surprising 17.5K increase in manufacturing employment, where we're expecting to see some payback in February. However, with the participation rate expected to edge down a bit, the unemployment rate will likely remain unchanged at its record-low level of 5.8%. Canadian economic growth will likely be extremely soft in the first quarter of 2008, taking some of the shine off the unbelievably strong labour market.

Jacqui Douglas 416-982-7784



U. S. Non-Farm Payrolls - February

Release Date: March 7/08

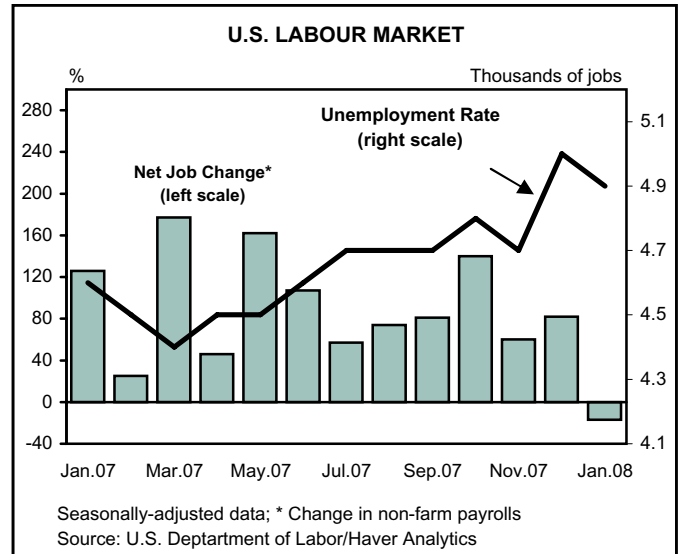
January Result: -17K; unemployment rate 4.9%

TD Forecast: -20K; unemployment rate 5.0%

Consensus: 30K; unemployment rate 5.0%

We're expecting to see U.S. nonfarm payrolls decline in February by 20K, following the 17K fall in January. Over the last month, virtually every single indicator of employment has weakened. The 4-week moving average of initial jobless claims rose, and is now just a hair off the levels where it was in 1990 and 2001 when payrolls turned negative. And the 4-week moving average for continuing claims has moved well past the levels that signaled job losses in the past. Furthermore, the employment sub-index of the Chicago PMI, which correlates pretty well with overall payrolls, plummeted in February from 47.0 to only 33.5. This level is generally consistent with payrolls declines of over 100K, and adds some further downside risk to our payrolls forecast.

Jacqui Douglas 416-982-7784



RECENT KEY ECONOMIC INDICATORS
February 25-29, 2008

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
Feb. 29	Current Account (BOP)	Q4-07	\$C, blns	-0.5	1.3	R▲
Feb. 29	Industrial Product Price Index	Jan.	% change	0.9	1.1	
Feb. 29	Raw Materials Price Index	Jan.	% change	3.4	0.4	R▲
United States						
Feb. 25	Existing Home Sales	Jan.	Millions	4.89	4.91	R▲
Feb. 26	Producer Price Index (PPI)	Jan.	% change	1.0	-0.3	R▼
Feb. 26	PPI excl. food and energy	Jan.	% change	0.4	0.2	
Feb. 26	S&P/CS Composite-20	Dec.	Index	-9.1	-7.7	
Feb. 26	Consumer Confidence	Feb.	Index	75.0	87.3	R▼
Feb. 26	Richmond Fed Index	Feb.	Index	-5.0	-8.0	
Feb. 27	Durable Goods Orders	Jan.	% change	-5.3	4.4	R▼
Feb. 27	New Home Sales	Jan.	Thousands	588	605	R▲
Feb. 28	Personal Consumption (prelim)	Q4-07	Ann. % chg.	1.9	2.0	
Feb. 28	Weekly Initial Jobless Claims	23-Feb	Thousands	373	354	R▲
Feb. 29	Personal Income	Jan.	% chg.	0.3	0.5	
Feb. 29	Personal Spending	Jan.	% chg.	0.4	0.3	R▲
Feb. 29	PCE Deflator	Jan.	Y/Y % chg.	3.7	3.6	R▲
Feb. 29	PCE Core	Jan.	Y/Y % chg.	2.2	2.2	
Feb. 29	Chicago Purchasing Managers Index	Feb.	Index	44.5	51.5	

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR

March 3-7, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Mar. 3	Real GDP at Basic Prices	Dec.	% change	-0.1	0.1
Mar. 3	Gross Domestic Product (advance)	Q4-07	Q/Q % chg.	1.0	2.9
Mar. 4	<i>Bank of Canada interest rate announcement</i>		<i>Overnight rate</i>	3.75	4.00
Mar. 6	Building Permits	Jan.	% change	1.0	0.4
Mar. 6	Ivey Purchasing Managers Index	Feb.	Index	55.0	56.2
Mar. 7	Unemployment Rate	Feb.	Per cent	5.9	5.8
Mar. 7	Net Change in Employment	Feb.	Thousands	5.0	46.4
United States					
Mar. 3	<i>Philadelphia Fed President Plosser speaks on monetary policy in Arlington, VA</i>				
Mar. 3	ISM Index (manufacturing)	Feb.	Index	48.5	50.7
Mar. 3	Construction Spending	Jan.	% change	-0.7	-1.1
Mar. 3	Total Vehicle Sales	Feb.	Millions	15.5	n/a
Mar. 3	Domestic Vehicle Sales	Feb.	Millions	11.9	n/a
Mar. 3	<i>Fed Governor Kroszner speaks on the economy in Washington, D.C.</i>				
Mar. 4	<i>Fed Chairman Bernanke speaks on mortgage foreclosures in Orlando, FL</i>				
Mar. 4	<i>Fed Governor Mishkin speaks to economists in Arlington, VA</i>				
Mar. 4	<i>Dallas Fed President Fisher speaks on inflation and growth in London, England</i>				
Mar. 5	ADP Employment Change	Feb.	Thousands	15.0	126.0
Mar. 5	Factory Orders	Jan.	% change	-2.5	2.3
Mar. 5	<i>Fed's Beige book released</i>				
Mar. 5	<i>Cleveland Fed President Pianalto speaks on the economy in New York, NY</i>				
Mar. 6	<i>Boston Fed President Rosengren speaks at an economic breakfast in Quincy, MA</i>				
Mar. 6	Weekly Initial Jobless Claims	1-Mar	Thousands	360	373
Mar. 6	<i>New York Fed President Geithner speaks on financial challenges in New York, NY</i>				
Mar. 6	<i>Boston Fed President Rosengren speaks on risk management Chicago, IL</i>				
Mar. 6	<i>St. Louis Fed President Poole speaks at the University of Illinois</i>				
Mar. 7	<i>Kansas City Fed President Hoenig speaks at a finance conference in Rio de Janeiro, Brazil</i>				
Mar. 7	<i>Dallas Fed President Fisher speaks at Banque de France conference in Paris, France</i>				
Mar. 7	<i>San Francisco Fed President Yellen speaks at Banque de France conference in Paris, France</i>				
Mar. 7	Change in Non-farm Payrolls	Feb.	Thousands	30.0	-17.0
Mar. 7	Unemployment Rate	Feb.	Per cent	5.0	4.9
Mar. 7	Average Hourly Earnings	Feb.	% change	0.3	0.2
Mar. 7	<i>Fed Governor Mishkin speaks on central banking in Oslo, Norway</i>				
Mar. 7	<i>Fed Vice Chairman Kohn speaks at Banque de France conference in Paris, France</i>				

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. 3	4:00	EU	Purchasing Managers Index (Man.)	Feb.	Index	52.3	52.3
	5:00	EU	Consumer Price Index	Feb.	Y/Y % chg.	3.2	3.2
	8:00	U.S.	<i>Philadelphia Fed President Plosser speaks on monetary policy in Arlington, VA</i>				
	8:30	Canada	Real GDP at Basic Prices	Dec.	% change	-0.1	0.1
	8:30	Canada	Gross Domestic Product (advance)	Q4-07	Q/Q % chg.	1.0	2.9
	10:00	U.S.	ISM Index (manufacturing)	Feb.	Index	48.5	50.7
	10:00	U.S.	Construction Spending	Jan.	% change	-0.7	-1.1
	---	U.S.	Total Vehicle Sales	Feb.	Millions	15.5	n/a
	---	U.S.	Domestic Vehicle Sales	Feb.	Millions	11.9	n/a
	14:00	U.S.	<i>Fed Governor Kroszner speaks on the economy in Washington, D.C.</i>				
	19:30	AU	Retail Sales	Jan.	% change	0.5	0.5
	19:30	AU	Current Account Balance	Q4-07	\$AU, blns	-17.80	-15.90
	22:30	AU	<i>RBA Cash Target</i>	Feb.	Cash Rate	7.25	7.00
Mar. 4	5:00	EU	Euro-Zone PPI	Jan.	% change	0.8	0.1
	2:45	EU	Real Gross Domestic Product (prelim.)	Q4-07	Q/Q % chg.	0.4	0.4
	9:00	Canada	<i>Bank of Canada interest rate announcement</i>		<i>Overnight rate</i>	3.75	4.00
	9:00	U.S.	<i>Fed Chairman Bernanke speaks on mortgage foreclosures in Orlando, FL</i>				
	13:00	U.S.	<i>Fed Governor Mishkin speaks to economists in Arlington, VA</i>				
	13:00	U.S.	<i>Dallas Fed President Fisher speaks on inflation and growth in London, England</i>				
	17:00	AU	<i>Assistant RBA Governor Edey gives speech on the economy</i>				
	19:30	AU	Gross Domestic Product (advance)	Q4-07	Q/Q % chg.	0.8	1.0
	22:00	AU	<i>Assistant RBA Governor Debelle gives speech on the bond market</i>				
Mar. 5	4:00	EU	Services Index	Feb.	Index	52.3	52.3
	5:00	EU	Retail Trade	Jan.	% change	0.3	-0.1
	8:15	U.S.	ADP Employment Change	Feb.	Thousands	15	126
	10:00	U.S.	Factory Orders	Jan.	% change	-2.5	2.3
	14:00	U.S.	<i>Fed's Beige book released</i>				
	15:00	NZ	<i>RBNZ Cash Target</i>	Feb.	Cash Rate	8.25	8.25
	19:30	U.S.	<i>Cleveland Fed President Pianalto speaks on the economy in New York, NY</i>				
	20:30	AU	Trade Balance	Jan.	AU, blns	-25.5	-19.4
23:00	Japan	<i>Bank of Japan Monetary Policy meeting held</i>					
Mar. 6	2:00	Japan	Machine Tool Orders (prelim.)	Feb.	Y/Y % chg.	n/a	0.0
	7:00	U.K.	<i>Bank of England rate announcement</i>		<i>Base rate</i>	5.25	5.25
	7:45	EU	<i>European Central Bank rate announcement</i>		<i>Refin. rate</i>	4.00	4.00
	8:00	U.S.	<i>Boston Fed President Rosengren speaks at an economic breakfast in Quincy, MA</i>				
	8:30	Canada	Building Permits	Jan.	% change	1.0	0.4
	8:30	U.S.	Weekly Initial Jobless Claims	1-Mar	Thousands	360	373
	10:00	Canada	Ivey Purchasing Managers Index	Feb.	Index	55.0	56.2
	---	Japan	<i>Bank of Japan Target Rate</i>		<i>Overnight rate</i>	0.50	0.50
	13:00	U.S.	<i>New York Fed President Geithner speaks on financial challenges in New York, NY</i>				
	19:30	U.S.	<i>Boston Fed President Rosengren speaks on risk management Chicago, IL</i>				
20:00	U.S.	<i>St. Louis Fed President Poole speaks at the University of Illinois</i>					
Mar. 7	0:00	U.S.	<i>Kansas City Fed President Hoenig speaks at a finance conference in Rio de Janeiro, Brazil</i>				
	1:00	Japan	<i>Bank of Japan Monthly report released</i>				
	3:00	U.S.	<i>Dallas Fed President Fisher speaks at Banque de France conference in Paris, France</i>				
	5:00	U.S.	<i>San Francisco Fed President Yellen speaks at Banque de France conference in Paris, France</i>				
	6:00	EU	OECD Leading Indicators	Jan.	Index	n/a	n/a
	7:00	Canada	Unemployment Rate	Feb.	Per cent	5.9	5.8
	7:00	Canada	Net Change in Employment	Feb.	Thousands	5.0	46.4
	8:30	U.S.	Change in Non-farm Payrolls	Feb.	Thousands	30.0	-17.0
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* Eastern Standard Time; Sources: Bloomberg, TD Economics

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