TD Economics

The Weekly Bottom Line

January 25, 2008

HIGHLIGHTS

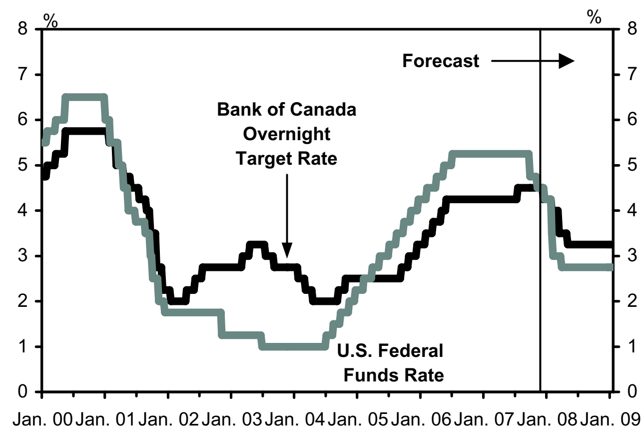
- **Fed stuns with a 75 bps emergency interest rate cut; BoC trims rates by 25 bps**
- **U.S. rate cut curbs stock market plunge**

The recent carnage in equities had the markets crying "uncle" and judging from the Federal Reserve's surprising 75bps interest rate cut earlier in the week, their pleas were heard.

In a dramatic and surprising move that reflected serious concerns about a deteriorating U.S. economy, the Federal Reserve slashed its key interest rate by three-quarters of a percentage point to 3.50% on Tuesday – a week before its January 30th meeting date. At a scheduled meeting the same day, the Bank of Canada also cut rates, but by a more measured 25bps. For the U.S. central bank this marked the biggest reduction in the federal funds rate since October 1984 and is the first such cut between meetings since September 17th, 2001**.** The action followed a plunge in financial markets around the world, as foreign investors expressed alarm that tightening credit in the U.S. could stifle economic growth worldwide. The Fed's decision was, thus, an attempt to address mounting signs of economic trauma and to try to restore calm to investors sentiment. The cut certainly pepped up global stock markets. With triple-digit index gains on Thursday, North American stock markets appear set for more advances at the end of this roller-coaster week. The Dow Jones industrial average closed up108.44 points yesterday, while, in Canada, the S&P/TSX composite index gained 249.87 points after dropping more than 600 points on Monday.

Recent TD Economics Research
January 25, 2008 - Canadian Consumer Price Index
January 24, 2008 - Bank of Canada's MPR Update
January 24, 2008 - Global Economic Decoupling: Is The Cookie Jar Still Out Of Reach?
January 22, 2008 - BoC Interest Rate Announcement
January 22, 2008 - Canadian Retail Sales

BANK OF CANADA RATE AND FED FUNDS RATE



Actual data to Jan. 25, 2008; Forecast by TD Economics as at Jan. 2008; Source: Bank of Canada, U.S. Federal Reserve Board

U.S. economy on the ropes

U.S. economic conditions have deteriorated rapidly in recent weeks. Existing home sales in the U.S. fell dramatically in December (-2.2% m/m), capping the biggest yearly slump (-12.8%) on record in more than a generation. 2007 also recorded the first ever annual decline (-2.8%) in the prices of existing single family homes in at least four decades. With home prices falling steadily and foreclosures likely to climb further amid rising mortgage rate resets, housing shows no sign of bottoming. The seemingly endless descent in the housing market is starting to seep into other sectors and, along with record high energy prices, is weighing on consumer sentiment. Credit conditions continue to tighten due to the massive debt write-downs at financial institutions. This, along with the recent steep slide in global equity markets early in the week, compounded the souring of sentiment. Employment – the last pillar of consumer support – is now giving out, with nonfarm payrolls recording the slowest growth in four years last month, lifting the unemployment rate to a two-year high of 5%. Not surprisingly, the holiday shopping season ended in a Scrooge-like fashion.

Fed rides to the rescue

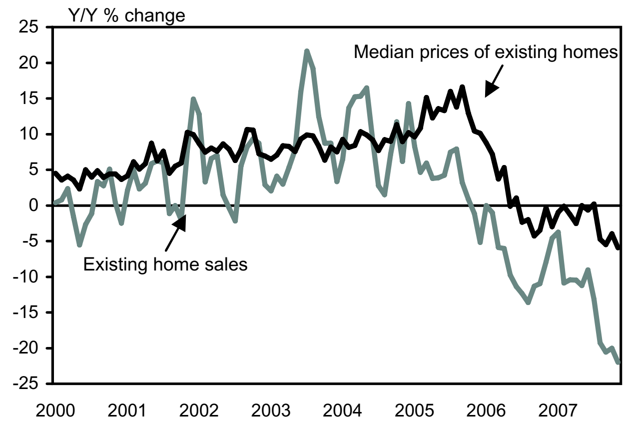
Clearly, the downside risks to U.S. economic growth have increased considerably and the Fed responded with a bold 75bps inter-meeting rate cut on Tuesday.

The Fed's decision, coupled with plans underway to inject fiscal stimulus, shows a strong commitment from the U.S. authorities to try and address the current market distress and associated downside growth risks. We are hoping that the prompt and decisive actions shown by policymakers will help the U.S. avoid an all out recession. Nonetheless, the risks have definitely become acute. Indeed, U.S. real GDP is expected to advance by a mere 1.2% (annualized) in the first half of the year. Clearly, it would not take much for the downside risks to lead to back-to-back contractions in real GDP that would meet the technical definition of a recession. The Fed is well aware of this and will likely take further monetary action to ameliorate the situation. We look for an additional 75 bps in rate cuts from the Fed over the next two meetings (50 bps next week and 25 bps on March 18th), bringing the fed funds rate to 2.75%. The good news is that these hefty Fed rate cuts (175 bps so far and quite possibly 225 bps come Wednesday) should start to revive growth in the second half of 2008. The rate cuts should help lower the extent of upcoming ARM resets and directly lower mortgage costs. Lower mortgage rates, in turn, could help put a floor under home sales and ultimately help with a recovery in consumption.

Weaker times ahead for Canada

In contrast to the Fed's aggressive approach, the Bank of Canada maintained a measured approach to easing this week. The Bank cut its policy rate 25 bps to 4.00% – a move that had been widely expected. However, the deep swoon in global stock markets earlier in the week and the Fed's surprise inter-meeting rate cut, just moments before the Bank's announcement, had pumped expectations of a more aggressive 50 bps cut. Nevertheless, the Bank decided to stick to the script, reflecting their confidence in the Canadian economy's ability to weather the U.S. downturn. The slowdown stateside will, however, have obvious negative ramifications for Canada's exports to the U.S., which account for a sizeable 23% of Canadian GDP. This along with tighter credit conditions at home prompted the Bank of Canada to chop their growth and inflation outlook for 2008 in the MPR update on Thursday. The Bank now expects U.S. growth to average just 1.5% in 2008 (versus 2.1% previously), while the Canadian economy is expected to rise 1.8% this year, well below the 2.3% gain it had previously predicted.

U.S. EXISTING HOME SALES AND MEDIAN PRICES



Source: NAR/ Haver Analytics

In addition, the Bank took an ax to its inflation forecasts, reflecting the projected emergence of modest excess supply by mid-year, the inflation damping impact of the elevated loonie, and the implementation of the GST cut. Both total and core inflation are expected to fall below 1.5% by mid-year, before returning to 2 % by the end of 2009. Indeed, today's December CPI figures for Canada showed that the core CPI growth rate was already at a 1.5% y/y pace and that the 3-month annualized trend was in fact below zero, at -0.4%. This leaves the core index with a 1.6% pace during Q4, identical to the Bank's estimate from the MPR Update. This decline in inflation should continue in 2008 and will allow the Bank of Canada to push inflation concerns to the back burner as worries over further weakness in the U.S. spilling over into Canada dominate the economic dialogue. The inflation report supports the notion that the Bank has maximum flexibility to respond to growth risks over the coming months, and is one of the key reasons why we see the Bank continuing with its rate cut campaign in the first half of 2008, cutting by an additional 75bps over the next two meetings (50 bps on March 4 and 25 bps on April 22). This will bring the overnight rate to 3.25%. However, there was little in the MPR to hint that they are poised to come close to matching the very aggressive cuts seen from the Fed so far. Unlike our neighbors to the south, Canada's domestic demand platform is fundamentally sound. Indeed, November retail sales out earlier in the week doubled expectations (+0.7%, +1.7% ex-autos), consistent with still-strong consumer spending.

Ritu Sapra, Economist
416-982-6420

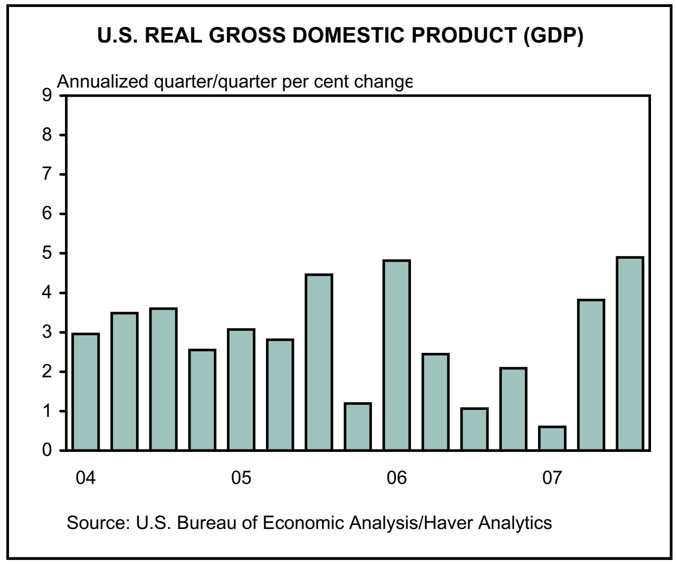
UPCOMING KEY ECONOMIC RELEASES

U.S. Real GDP - Q4/07

Release Date: January 30/08
Q3 Result: 4.9%
TD Forecast: 1.1%
Consensus: 1.2%

U.S. GDP is expected to slow to a pace of 1.1% in the fourth quarter. Consumer spending slowed late in the quarter but was fairly strong through October and November. Consumer spending should keep a pace of about 2.5% for the quarter as a whole. A continued fall in housing starts and existing home sales will be reflected in a further decline in residential construction investment, which will likely lob over 1% off the headline growth number. Business investment is expected to come in fairly strong, held up mainly by non-residential construction investment. The trade balance will provide little support to GDP growth as growth in exports was not sufficient to offset import strength. Inventory investment is also likely to subtract from growth following a significant positive contribution in the third quarter.

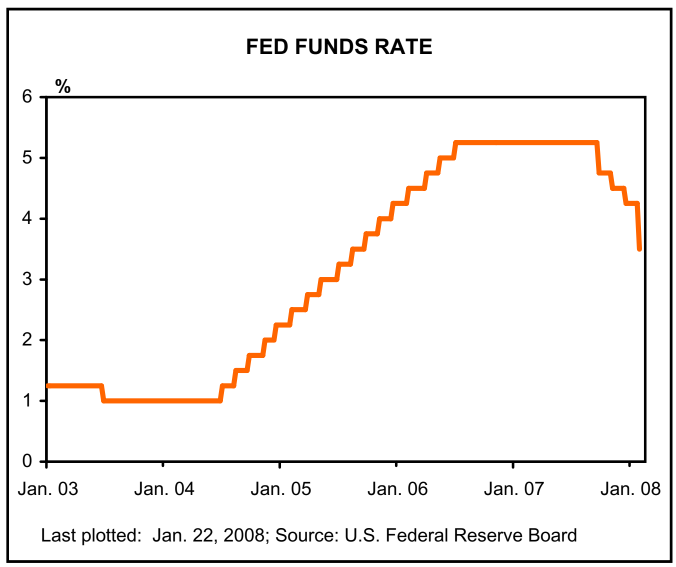
James Marple 416-982-2557



U.S. FOMC Interest Rate Decision

Release Date: January 30/08
Current Rate: 3.50%
TD Forecast: 3.00%
Consensus: 3.00%

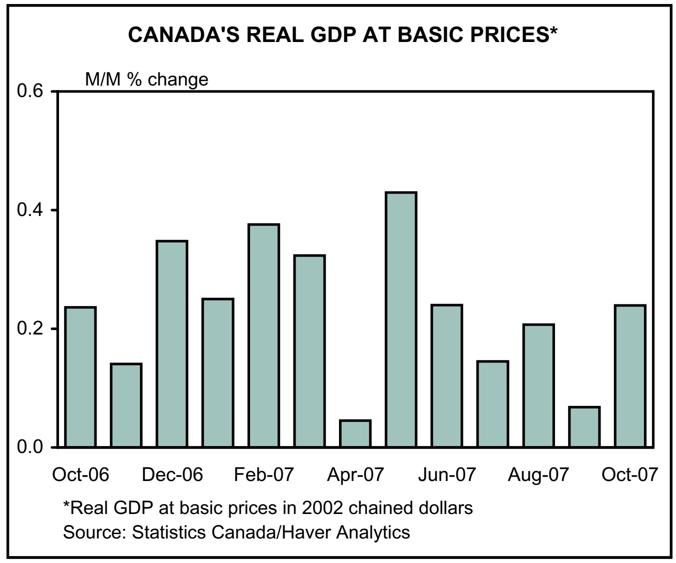
There is a profoundly different environment heading into this FOMC decision, than compared to the last. Economic conditions are undeniably weak, and the wrinkles in the financial markets have been slow to iron out. Since last meeting, the economic data has almost categorically disappointed expectations adding to downside risks to the outlook. Against this backdrop, the recent wild gyrations in global equity markets were potentially destabilizing and were the likely catalyst for the Fed to deliver its first intermeeting cut since 9/11 worth 75bps. The fed funds rate is now 3.5% and the Fed has signaled there is more stimulus in the pipeline. The market is heavily discounting a solid spate of further rate cuts, amid ongoing worry that the U.S. economy is either teetering on or has already entered a recession. In our view, there is no doubt the U.S. economy will be weak for the first half of 2008, but it could manage to sidestep a recession. As such, we ultimately look for fewer rate cuts than the market over the course of the year, but retain a view for a 50bps rate cut to add to the existing spate of rate cuts.



Charmaine Buskas 416 982 3297

Canadian Real GDP - November

Release Date: January 31/08
October Result: +0.2%
TD Forecast: +0.2%
Consensus: 0.1%

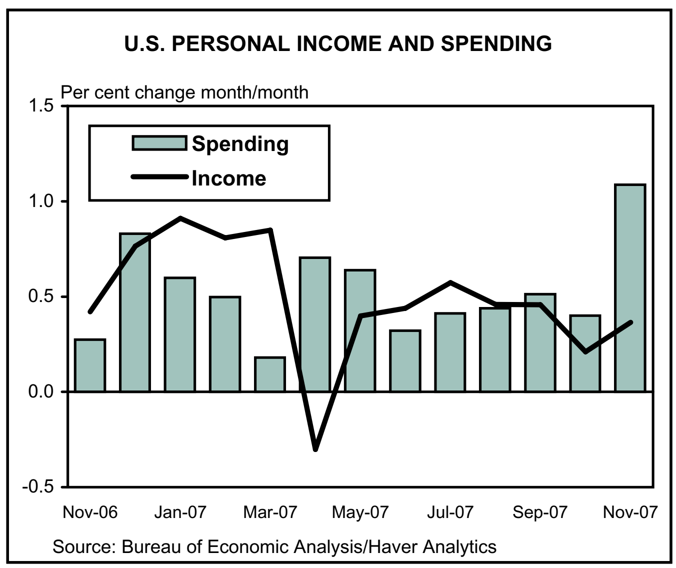


We're expecting to see that Canadian GDP grew by a moderate 0.2% in November. While no sector recorded phenomenal gains during the months, no sector recorded big losses either. Real manufacturing shipments, retail sales, and wholesale sales had modest gains of 0.1%, 0.2%, and 0.3%, respectively. Meanwhile, exports were rather strong during the month, with real exports advancing by 2.9%, and every single sub sector advancing. The construction sector should also show strength, since both housing starts and building permits were both very strong through the autumn months. However, we'll likely see weakness in the accommodation and food sector, since tourism has been rather weak with the appreciation of the Canadian dollar.

Jacqui Douglas 416-982-7784

U.S. Personal Income and Spending - December

Release Date: January 31/08
November Result: income +0.4%; spending +1.1%; core PCE deflator +0.2% M/M, 2.2% Y/Y
TD Forecast: income +0.3%; spending 0.0%; core PCE deflator +0.2% M/M, 2.2% Y/Y
Consensus: income +0.4%; spending 0.1%; core PCE deflator +0.2% M/M, 2.2% Y/Y



We're expecting to see both income and spending slow in November, but particularly spending. With retail sales having fallen by 0.4% during the month, and real personal disposable income having declined for the previous two months, we're expecting to see spending come in flat in December. On the income side we expect to see a better result with a 0.3% gain. Although payrolls growth was weak in December at only 18K, hours worked (+1.2%) and hourly wages (+0.4%) were both still pretty strong, which should support income growth. For the core PCE deflator, we're expecting to see a 0.2% M/M increase, leaving the Y/Y measure unchanged at 2.2%.

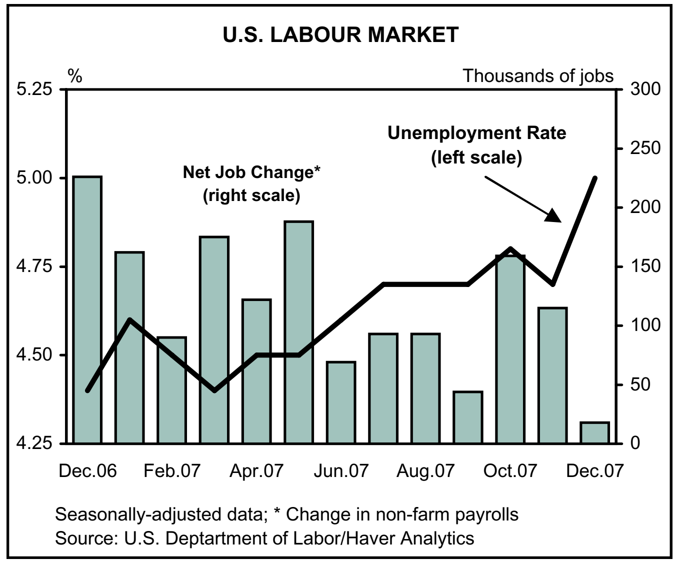
Jacqui Douglas 416-982-7784

U.S. Nonfarm Payrolls - January

Release Date: February 1/08
December Result: +18K; unemployment rate 5.0%
TD Forecast: 70K; unemployment rate 5.0%
Consensus: Consensus: 55K; unemployment rate 5.0%

We're forecasting a decent 70K gain in U.S. payrolls for the month of January. Whereas in December the labour market really appeared to be struggling, conditions are actually looking a little more favourable right now. Both initial and continuing jobless claims have turned back around, and each measure is about 100K below a level that would be consistent with outright job losses in the U.S. Furthermore, the Michigan confidence measure actually increased in January, from 75.5 to 80.5. While decent job growth in the U.S. may not be sustainable for much longer, we don't expect to see the capitulation occur in January.

Jacqui Douglas 416-982-7784

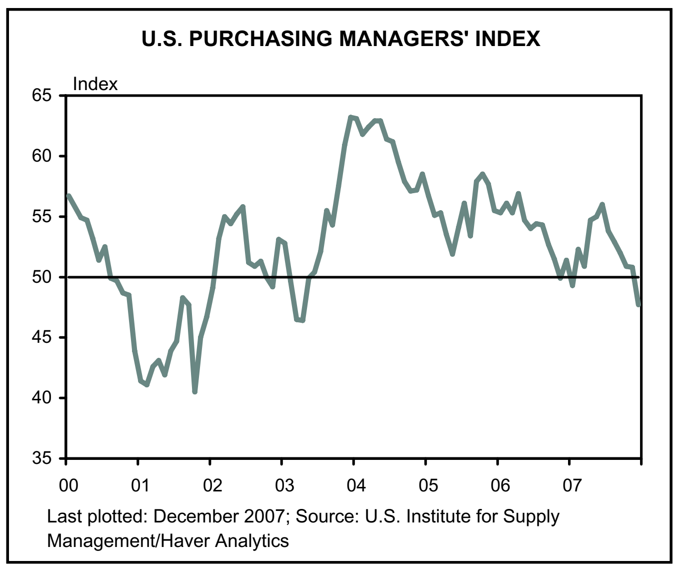


U.S. ISM Manufacturing Report - January

Release Date: February 1/08
December Result: 47.7
TD Forecast: 45.7
Consensus: 47.3

We're forecasting a big drop in the ISM manufacturing index for January, from 47.7 to 45.7. Every single Fed manufacturing survey that's been released to date showed some degree of decline in January, with the Philly Fed leading the way, plunging from -1.6 to -20.9. This is concerning since the Philly Fed index has a stronger correlation with the ISM than any of the Fed's other regional surveys. Looking at the data for the past several years, every time the Philly Fed index has had a monthly drop of 15 points or more, the ISM index has fallen by about 2 points in the same month, which leads us to our forecast of a 2-point drop to 45.7.

Jacqui Douglas 416-982-7784



RECENT KEY ECONOMIC INDICATORS
January 21-25, 2008

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
Jan. 21	Wholesale Sales	Nov.	% change	0.3	0.4	R▼
Jan. 22	Retail Sales	Nov.	% change	0.7	0.3	R▲
Jan. 22	Retail Sales - excl. autos	Nov.	% change	1.7	0.1	R▲
Jan. 22	*Bank of Canada interest rate announcement*		*Overnight rate*	*4.00*	*4.25*	
Jan. 23	Leading Indicators	Dec.	% change	-0.1	0.0	
Jan. 25	Consumer Price Index (CPI)	Dec.	Y/Y % chg.	2.4	2.5	
Jan. 25	CPI - excl. 8 most volatile items	Dec.	Y/Y % chg.	1.5	1.6	
United States						
Jan. 22	*FOMC Rate Decision -inter meeting rate cut*	*Jan. 22*	*Overnight Rate*	*3.50*	*4.25*	
Jan. 22	Richmond Fed Index	Jan.	Index	-8.0	-4.0	
Jan. 24	Weekly Initial Jobless Claims	19-Jan	Thousands	301	302	R▲
Jan. 24	Existing Home Sales	Dec.	Millions	4.89	5.00	

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR
January 28 - February 1, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Jan. 29	Business Conditions Orders	Jan.	Index	5.0	-3.0
Jan. 30	*Bank of Canada Senior Deputy Governor Jenkins and Deputy Governor Murray give a speech on "The Impact of the Appreciating Value of the Canadian Dollar on the Canadian Economy" to the Standing Committee on Industry, Science and Technology in House of Commons, Ottawa ON*				
Jan. 31	Real GDP at Basic Prices	Nov.	% change	0.1	0.2
Feb. 1	Industrial Product Price Index	Dec.	% change	0.5	0.6
Feb. 1	Raw Materials Price Index	Dec.	% change	1.0	3.4
United States					
Jan. 28	New Home Sales	Dec.	Thousands	645	647
Jan. 29	Durable Goods Orders	Dec.	% change	1.8	-0.1
Jan. 29	S&P/CS Composite-20	Nov.	Index	-7.1	-6.1
Jan. 29	Consumer Confidence	Jan.	Index	87.0	88.6
Jan. 29	*U.S. Federal Reserve Open Market committee meets*				
Jan. 30	ADP Employment Change	Jan.	Thousands	40.0	40.0
Jan. 30	Real Gross Domestic Product (advance)	Q4-07	Ann. % chg.	1.2	4.9
Jan. 30	Personal Consumption (advance)	Q4-07	Ann. % chg.	2.8	2.8
Jan. 30	*Former Fed Chairman Greenspan speaks at an investment forum in Moscow*				
Jan. 30	*FOMC Rate Decision*	*Jan. 30*	*Overnight Rate*	*3.00*	*3.50*
Jan. 31	Personal Income	Dec.	% chg.	0.4	0.4
Jan. 31	Personal Spending	Dec.	% chg.	0.1	1.1
Jan. 31	PCE Deflator	Dec.	Y/Y % chg.	3.5	3.6
Jan. 31	PCE Core	Dec.	Y/Y % chg.	2.2	2.2
Jan. 31	Weekly Initial Jobless Claims	26-Jan	Thousands	320	301
Jan. 31	Employment Cost Index	Q4-07	Q/Q % chg.	0.8	0.8
Jan. 31	Chicago Purchasing Managers Index	Jan.	Index	53.0	56.4
Feb. 1	Change in Non-farm Payrolls	Jan.	Thousands	55.0	18.0
Feb. 1	Unemployment Rate	Jan.	Per cent	5.0	5.0
Feb. 1	Average Hourly Earnings	Jan.	% change	0.3	0.4
Feb. 1	ISM Index (manufacturing)	Jan.	Index	47.3	47.7
Feb. 1	Construction Spending	Dec.	% change	-0.5	0.1
Feb. 1	Total Vehicle Sales	Jan.	Millions	16.0	16.3
Feb. 1	Domestic Vehicle Sales	Jan.	Millions	12.3	12.5

Source: Bloomberg, TD Economics

G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
Jan. 27	18:50	Japan	Corporate Service Price Index	Dec.	Y/Y % chg.	1.4	1.4
Jan. 28	4:00	EU	M3 Money Supply Growth	Dec.	Y/Y % chg.	12.2	12.3
	10:00	U.S.	New Home Sales	Dec.	Thousands	645	647
	19:30	Japan	Jobless Rate	Dec.	Per cent	3.9	3.8
	19:30	Japan	Workers' Household Spending	Dec.	Y/Y % chg.	-0.3	-0.6
	19:50	Japan	Retail Sales	Dec.	% change	-2.0	0.4
Jan. 29	2:45	France	Consumer Confidence Indicator	Jan.	Index	-30.0	-29.0
	4:00	EU	Current Account Balance	Nov.	Eur, blns	n/a	1.3
	8:30	U.S.	Durable Goods Orders	Dec.	% change	1.8	-0.1
	8:30	Canada	Business Conditions Orders	Jan.	Index	5.0	-3.0
	9:00	U.S.	S&P/CS Composite-20	Nov.	Index	-7.1	-6.1
	10:00	U.S.	Consumer Confidence	Jan.	Index	87.0	88.6
	14:15	*U.S.*	*U.S. Federal Reserve Open Market committee meets*				
	19:50	Japan	Industrial Production (prelim.)	Dec.	% change	2.0	-1.6
Jan. 30	4:00	EU	Purchasing Managers Index (Retail)	Jan.	Index	n/a	46.0
	8:15	U.S.	ADP Employment Change	Jan.	Thousands	40.0	40.0
	8:30	U.S.	Real Gross Domestic Product (advance)	Q4-07	Ann. % chg.	1.2	4.9
	8:30	U.S.	Personal Consumption (advance)	Q4-07	Ann. % chg.	2.8	2.8
	12:00	*U.S.*	*Former Fed Chairman Greenspan speaks at an investment forum in Moscow*				
	15:30	*Canada*	*Bank of Canada Senior Deputy Governor Jenkins and Deputy Governor Murray give a speech on "The Impact of the Appreciating Value of the Canadian Dollar on the Canadian Economy" to the Standing Committee on Industry, Science and Technology in House of Commons, Ottawa ON*				
	14:15	*U.S.*	*FOMC Rate Decision*	*Jan. 30*	*Overnight Rate*	*3.00*	*3.50*
	16:45	NZ	Trade Balance	Dec.	NZ, blns	*n/a*	*-646.0*
Jan. 31	--	Germany	Consumer Price Index (prelim.)	Jan.	Y/Y % chg.	2.7	2.8
	3:55	Germany	Unemployment Change	Jan.	Thousands	8.3	8.4
	3:55	Germany	Unemployment Rate	Jan.	Per cent	-43.0	-78.0
	5:00	EU	Consumer Price Index	Jan.	Y/Y % chg.	3.1	3.1
	5:00	EU	Unemployment Rate	Dec.	Per cent	7.1	7.2
	5:00	EU	Industrial Confidence Index	Jan.	Index	2.0	2.0
	5:00	EU	Consumer Confidence Index	Jan.	Index	-10	-9
	5:00	EU	Business Climate Indicator	Jan.	Index	0.86	0.92
	5:00	EU	Economic Confidence Index	Jan.	Index	104.1	104.7
	5:00	EU	Services Confidence Index	Jan.	Index	13.0	14.0
	8:30	U.S.	Personal Income	Dec.	% chg.	0.4	0.4
	8:30	U.S.	Personal Spending	Dec.	% chg.	0.1	1.1
	8:30	Canada	Real GDP at Basic Prices	Nov.	% change	0.1	0.2
	8:30	U.S.	PCE Deflator	Dec.	Y/Y % chg.	3.5	3.6
	8:30	U.S.	PCE Core	Dec.	Y/Y % chg.	2.2	2.2
	8:30	U.S.	Weekly Initial Jobless Claims	26-Jan	Thousands	320	301
	8:30	U.S.	Employment Cost Index	Q4-07	Q/Q % chg.	0.8	0.8
	9:45	U.S.	Chicago Purchasing Managers Index	Jan.	Index	53.0	56.4
Feb. 1	3:50	France	Purchasing Managers Index (Man.)	Jan.	Index	53.5	53.8
	3:55	Germany	Purchasing Managers Index (Man.)	Jan.	Index	53.6	53.6
	4:30	U.K.	Purchasing Managers Index (Man.)	Jan.	Index	52.6	52.6
	8:30	U.S.	Change in Non-farm Payrolls	Jan.	Thousands	55.0	18.0
	8:30	U.S.	Unemployment Rate	Jan.	Per cent	5.0	5.0
	8:30	U.S.	Average Hourly Earnings	Jan.	% change	0.3	0.4
	8:30	Canada	Industrial Product Price Index	Dec.	% change	0.5	0.6
	8:30	Canada	Raw Materials Price Index	Dec.	% change	1.0	3.4
	10:00	U.S.	ISM Index (manufacturing)	Jan.	Index	47.3	47.7
	10:00	U.S.	Construction Spending	Dec.	% change	-0.5	0.1
	---	U.S.	Total Vehicle Sales	Jan.	Millions	16.0	16.3
	---	U.S.	Domestic Vehicle Sales	Jan.	Millions	12.3	12.5

* Eastern Standard Time; Sources: Bloomberg, TD Economics