TD Bank Financial Group

TD Economics

The Weekly Bottom Line

January 4, 2008

HIGHLIGHTS

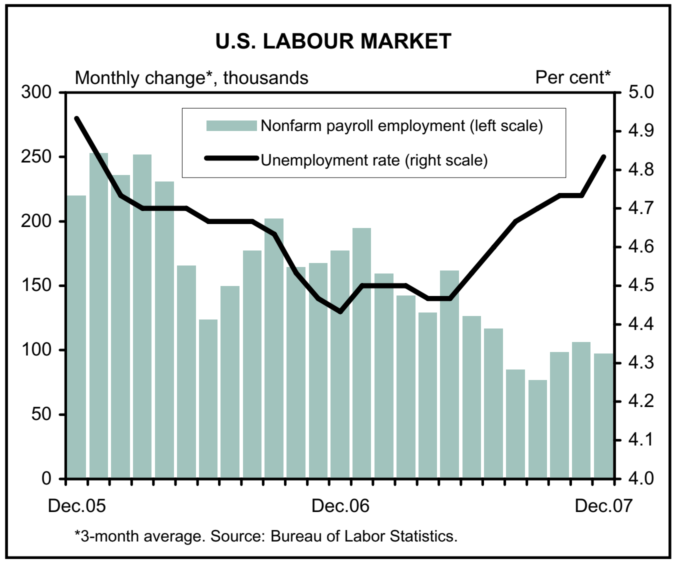
- **U.S. employment slows significantly in December; unemployment rate jumps 0.3 ppts to 5%**
- **ISM indexes confirm slowdown in overall activity**

There was no data out of Canada this week, so our focus was squarely on the U.S. economy. Most of the news there confirmed that the impacts from a retrenching housing market and credit problems are broadening. After stronger than expected growth in the second and third quarter of 2007, annualized growth in U.S. real GDP is estimated to have been les than 1% in Q4. This week's reports help validate our view that the first half of 2008 will not be much better in the world's largest economy.

More of the same in housing

Early in the week we did get more positive news from the U.S. housing market that existing home sales didn't drop further, as anticipated, but rather increased by 0.4% in November. However, upon digging into the details of that report in the context of other housing statistics, it becomes quite clear that the housing market correction has a long way to go. Just last week we learned that new home sales plunged by a further 9% in November, down almost 35% from a year prior. On a year-over-year basis, existing home sales are still down 20%. And this is truly a national story which is not based on a few large or isolated markets. Before calling a bottom to the housing market correction, we'd need to see resale home prices stabilize. Most measures of home prices currently show declines of 3-5% on a year-over-year basis. Furthermore, the momentum is negative, so steeper corrections are to be expected. Before prices can stabilize, housing starts will first have to contract further, and the outsized inventory of existing homes for sale must decline through a combination of listings stabilizing and an eventual pickup in sales. In an environment where credit conditions have tightened and increased foreclosures are adding to unsold inventories, we can't expect the housing market to turn around overnight. But home prices will turn around, eventually, as affordability improves and credit conditions normalize.

Recent TD Economics Research
January 4, 2008 - U.S. Employment commentary
January 4, 2008 - U.S. Non ISM commentary
January 2, 2008 - U.S. ISM commentary



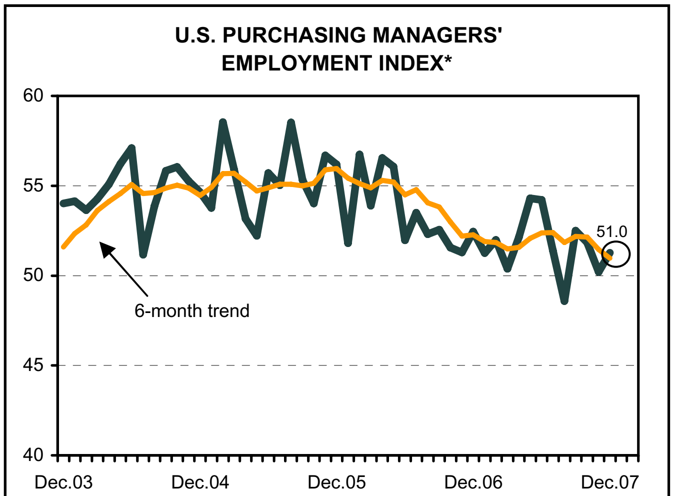
Running out of steam

The drag exerted by the decline in housing market activity isn't the wildcard for the economy's outlook. It's been ongoing for more than a year now and will continue well into this year. More important is the extent to which the housing strains spread to the rest of the economy. It has been remarkable that given the unprecedented scale of the ongoing housing correction, combined with the tightening of credit conditions, we had yet to see much slowdown in the overall economy. But our baseline forecast for 2008 builds in a significant slowdown in the most important component of U.S. GDP, consumer expenditures. The positive wealth effect from increasing home prices and the direct consumption boost out of home equity withdrawals are behind us. U.S. equity returns were also less than stellar in 2007, as stocks went on a roller coaster ride. But at least wealth on that front is increasing. Even a strongly home-biased index stock portfolio containing 80% U.S. and 20% non-U.S. equity would have increased by roughly 5.5% in U.S. dollar terms since January 2007. American consumers aren't being handed cash hand-over-fist anymore, and are left to finance consumption of out of real current income flows (a revolutionary concept if any!). Oil prices breaching the $100/bbl mark this week also reminds us that sustained elevated oil prices will leave less disposable income towards other consumption.

Today's employment numbers for December confirm a weakening picture for household income prospects. The 18,000 nonfarm payroll jobs created overall in December was only positive on the count of public sector employment. The private sector shed jobs during that month, to the tune of 13,000. That decline was also broad-based. As expected, construction (-49,000) and manufacturing (-31,000) continue to bleed. Revisions only helped to increase the previous 2 months by 10,000 net jobs and leave the 3-month monthly average job creation at 97,000. The unemployment rate spiked 0.3 percentage points to reach 5.0%, the highest since November 2005. Even as 2007 ends up being the weakest for overall job creation since 2004 at 1.8 millions jobs, our forecast for 2008 is that the economy will struggle to create about a third as much in 2008. All of which means the unemployment rate is also expected to increase gradually and stay above 5½% for the second half of this year.

As if any was needed, we got further confirmation of a slowing economy from the ISM purchasing managers' manufacturing index for December. That business activity index took a 3.1 percentage point tumble down to 47.7. Of significance, it dropped below the 50 threshold which signals that this sector was contracting. Each of the sub-indexes (employment, new orders, and production) now also lies below that threshold.

The non-manufacturing ISM index fared better, slipping only 0.2 percentage points to 53.9 in December. Improvements in the non-manufacturing new orders and employment indices helped offset market sentiment from the negatives of the manufacturing ISM and payroll reports. Our overall (manufacturing and non-manufacturing) weighted ISM employment index improved by 1.1 percentage points to 51.3 in December. But it has been trending down over the last two years and could see further downside. The bulk of the service economy, which is in turn the bulk of the entire economy, along with the help of export-oriented manufacturing activity should still do well enough, output and employment wise, to help the U.S. economy muddle though this rough patch.



*Weighted measure of manufacturing and non-manufacturing ISM employment indices. Source: U.S. ISM, TD Economics.

In sum then, we enter the New Year with U.S. data that indicate the U.S. economy is on shaky ground. This solidifies the case for a Fed funds rate cut at the next FOMC meeting at the end of January. We still believe they will elect to cut the rate by 25 basis points rather than a hasty 50 basis points, for a variety of reasons. First, because of their own monetary policy actions: the delayed positive impact of significant cuts last year (-125 basis points since September) will start to be felt in 2008. Second, they've also built in a significant slowdown in their forecast, so unless the numbers sour much more than anticipated, further monetary stimulus would be unwarranted. Last, but certainly not least for a central bank, wage growth remains strong, and the key inflationary measures of core CPI and core PCE have edged up recently. Pass-through from record-high oil prices and a continued weak U.S. dollar to headline inflation cannot be dismissed either. Between a rock and a hard place is not a most comfortable place to be.

Pascal Gauthier, Economist 416-944-5730

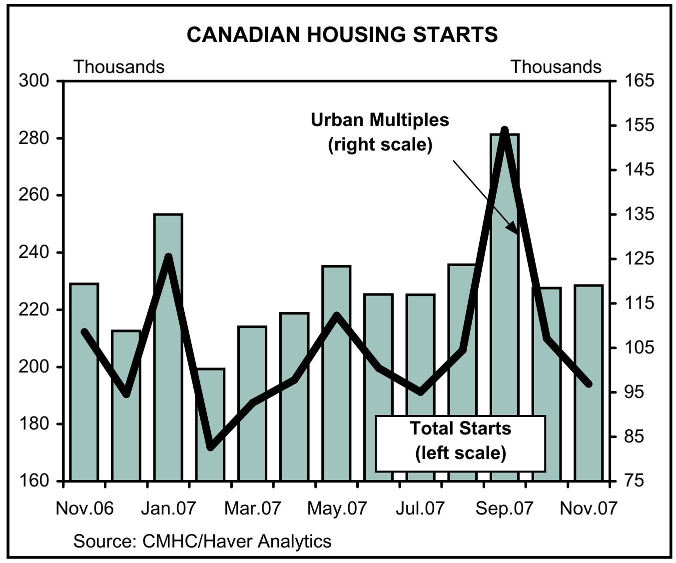
UPCOMING KEY ECONOMIC RELEASES

Canadian Housing Starts - December

Release Date**: January 9/08**

TD Forecast: 230K

Consensus: 223K



We're expecting housing starts to finish the year on a strong note, with 230K starts in the month of December. This would leave total starts for 2007 at 231K (recall that the monthly numbers are already annualized), which would be the second-highest level on record, just behind the 232.7K starts recorded in 2004. Turning to the details of the data, we'll likely see a small drop in single-unit starts, which recorded an outsized 13.1% M/M gain in November. On the other hand, we'll likely see a pick-up in the always-volatile multi-unit starts, which fell in both October and November after the huge 47.5% M/M pop in September. Overall, housing starts should remain at a healthy level in December before slowing gradually through 2008.

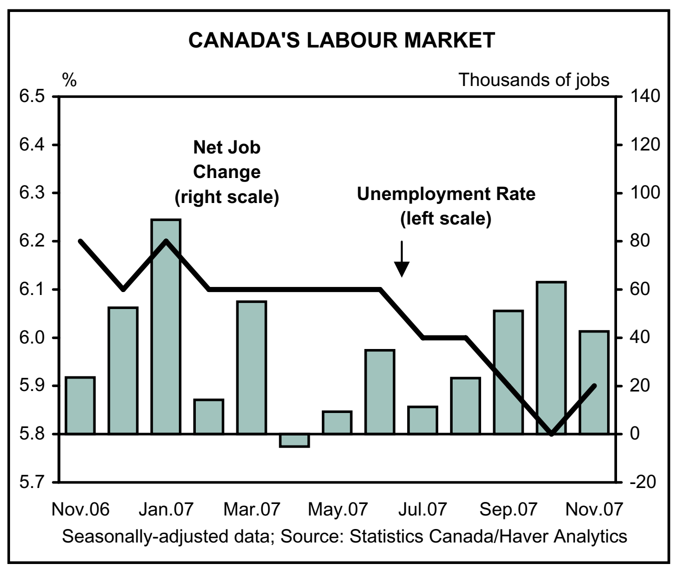
Jacqui Douglas 416-982-7784

Canadian Employment - December

Release Date**: January 11/08**

TD Forecast: 25K

Consensus: 15K



We're expecting to see another strong month of employment growth in Canada, with 25K net new positions added in December. It appears as if the private-paid sector came back to life in the fall, adding jobs every month since September, including a whopping 48.9K positions in November. Plus, labour force growth, which is often a good indicator of future job growth, has been very strong over the last couple of months, increasing by a huge 67.6K in November. Putting it all together, the unemployment rate will likely drop back down to its record-low level of 5.8% in December, after the huge increase in the labour force drove it up a notch in the prior month.

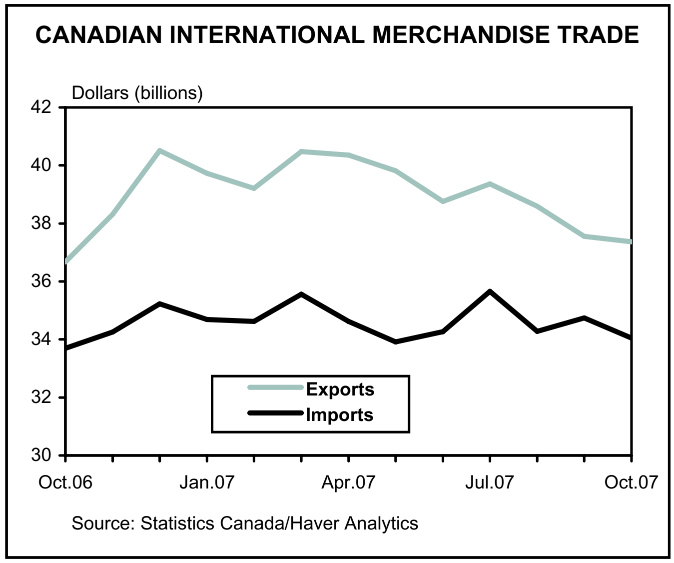
Jacqui Douglas 416-982-7784

Canadian International Trade - November

Release Date: January 11/08
TD Forecast: $3.8B
Consensus: $3.1B

We're expecting the trade surplus to improve in November to $3.8B, from $3.3B in December. However, the increase in the surplus is mostly going to come from price effects, and not from a real improvement in international trade conditions. Exports are likely to increase by about 1.8% on the back of a big increase in commodity prices. The Bank of Canada's commodity price index was up 3.4% in USD terms in November, although the increase wouldn't have been quite so strong in Canadian dollar terms, with the 0.8% appreciation in the C$ during the month. Industrial goods prices were also up by 0.6%, which will boost the prices of our manufactured exports. Imports are also expected to increase, but only by about 0.5%, as the dramatic appreciation of the Canadian dollar depresses import prices. In real terms, exports are likely to be weaker than the headline numbers suggest, and imports somewhat stronger, so the impact on GDP will not be as positive as the nominal trade balance suggests.

Jacqui Douglas 416-982-7784



RECENT KEY ECONOMIC INDICATORS
December 31, 2007 - January 4, 2008

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
Jan. 4	Industrial Product Price Index	Nov.	% change	0.6	-1.2	R▼
Jan. 4	Raw Materials Price Index	Nov.	% change	3.4	0.7	R▲
Jan. 4	Ivey Purchasing Managers Index	Dec.	Index	45.9	58.7	
United States						
Dec. 31	Existing Home Sales	Nov.	Millions	5.00	4.98	R▲
Jan. 2	ISM Index (manufacturing)	Dec.	Index	47.7	50.8	
Jan. 2	Construction Spending	Nov.	% change	0.1	-0.4	R▲
Jan. 3	ADP Employment Change	Dec.	Thousands	40	173	R▼
Jan. 3	Weekly Initial Jobless Claims	29-Dec	Thousands	336	357	R▲
Jan. 3	Total Vehicle Sales	Dec.	Millions	16.3	16.2	
Jan. 3	Domestic Vehicle Sales	Dec.	Millions	12.5	12.4	
Jan. 3	Factory Orders	Dec.	% change	1.5	0.7	R▲
Jan. 4	Change in Non-farm Payrolls	Dec.	Thousands	18.0	115.0	R▲
Jan. 4	Unemployment Rate	Dec.	Per cent	5.0	4.7	
Jan. 4	Average Hourly Earnings	Dec.	% change	0.4	0.4	R▼
Jan. 4	ISM Non-Manufacturing	Dec.	Index	53.9	54.1	

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR
January 7-11, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Jan. 8	*Bank of Canada Deputy Governor Kennedy gives speech on "Transparency: The more, the better?" to the Association of Quebec Women in Finance in Montreal, QC*				
Jan. 9	Housing Starts	Dec.	Thousands	223.0	227.9
Jan. 10	New Housing Price Index	Nov.	% Chg.	0.3	0.1
Jan. 10	Building Permits	Nov.	% change	-2.0	6.8
Jan. 11	Unemployment Rate	Dec.	Per cent	5.9	5.9
Jan. 11	Net Change in Employment	Dec.	Thousands	15.0	42.6
Jan. 11	International Merchandise Trade Balance	Nov.	C$, blns	3.1	3.3
United States					
Jan. 7	*Atlanta Fed President Lockhart speaks on the U.S. economic outlook in Atlanta, GA*				
Jan. 8	*Philadelphia Fed President Plosser speaks on the economic outlook in Gladwyne, PA*				
Jan. 8	*Boston Fed President Rosengren speaks at an economic conference in Harftord, CT*				
Jan. 9	*St. Louis Fed President Poole speaks on the U.S. economy in St. Louis, MO*				
Jan. 10	Weekly Initial Jobless Claims	5-Jan	Thousands	340	336
Jan. 10	Wholesale Inventories	Nov.	% Chg.	0.4	0.0
Jan. 10	*Fed Chairman Bernanke speaks on the economic outlook in Washington, DC*				
Jan. 10	*Kanas City Fed President Hoenig speaks on the the U.S. economic outlook in Kansas City, KS*				
Jan. 11	Trade Balance	Nov.	US$, blns	-59.4	-57.8
Jan. 11	*Fed President Mishkin speaks on financial markets, risk and policy in New York City, NY*				
Jan. 11	*Boston Fed President Rosengren speaks at an outlook conference in South Burlington, VT*				

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. 6	16:45	NZ	Trade Balance	Nov.	NZ, blns	-0.5	-0.7
	19:50	Japan	Monetary Base (YoY)	Dec.	Y/Y % chg.	n/a	1.0
Jan. 7	5:00	EU	Euro-Zone PPI	Nov.	% change	0.8	0.6
	5:00	EU	Unemployment Rate	Nov.	Per cent	7.2	7.2
	5:00	EU	Industrial Confidence Index	Dec.	Index	2.0	3.0
	5:00	EU	Consumer Confidence Index	Dec.	Index	-8.0	-8.0
	5:00	EU	Business Climate Indicator	Dec.	Index	0.90	1.04
	5:00	EU	Economic Confidence Index	Dec.	Index	104.3	104.8
	5:00	EU	Services Confidence Index	Dec.	Index	13.0	14.0
	12:40	*U.S.*	*Atlanta Fed President Lockhart speaks on the U.S. economic outlook in Atlanta, GA*				
Jan. 8	5:00	EU	Retail Trade	Nov.	% change	0.5	-0.7
	6:00	Germany	Factory Orders	Nov.	% change	-1.8	4.0
	8:20	*U.S.*	*Philadelphia Fed President Plosser speaks on the economic outlook in Gladwyne, PA*				
	10:50	*U.S.*	*Boston Fed President Rosengren speaks at an economic conference in Harftord, CT*				
	12:20	*Canada*	*Bank of Canada Deputy Governor Kennedy gives speech on "Transparency: The more, the better?" to the Association of Quebec Women in Finance in Montreal, QC*				
	19:30	AU	Retail Sales	Nov.	% change	0.5	0.2
Jan. 9	2:00	Germany	Retail Sales	Nov.	% change	1.1	-2.3
	2:00	Germany	Trade Balance	Nov.	Eur, blns	17.5	18.7
	2:00	Germany	Current Account Balance	Nov.	Eur, blns	14.3	13.7
	2:45	France	Trade Balance	Nov.	Eur$, blns	-3.5	-3.6
	6:00	Germany	Industrial Production	Nov.	% Chg.	0.4	-0.3
	8:15	Canada	Housing Starts	Dec.	Thousands	223.0	227.9
	9:30	*U.S.*	*St. Louis Fed President Poole speaks on the U.S. economy in St. Louis, MO*				
	19:30	AU	Trade Balance	Nov.	AU, blns	-2.5	-3.0
Jan. 10	1:00	Japan	Leading Economic Index (prelim.)	Nov.	Index	10.0	18.2
	1:00	Japan	Coincident Index (prelim.)	Nov.	Index	33.3	70.0
	2:45	France	Industrial Production	Nov.	% Chg.	-0.6	2.1
	2:45	France	Manufacturing Production	Nov.	% Chg.	-0.4	1.9
	4:30	U.K.	Merchandise Trade Balance - Total	Nov.	£, blns	-7.2	-7.1
	4:30	U.K.	Merchandise Trade Balance - ex. EU	Nov.	£, blns	-4.3	-4.4
	7:00	*U.K.*	*Bank of England rate announcement*		*Base rate*	*5.50*	*5.50*
	7:45	*EU-12*	*European Central Bank rate announcement*		*Refin. rate*	*4.00*	*4.00*
	8:30	Canada	New Housing Price Index	Nov.	% Chg.	0.3	0.1
	8:30	Canada	Building Permits	Nov.	% change	-2.0	6.8
	8:30	U.S.	Weekly Initial Jobless Claims	5-Jan	Thousands	340	336
	10:00	U.S.	Wholesale Inventories	Nov.	% Chg.	0.4	0.0
	13:00	*U.S.*	*Fed Chairman Bernanke speaks on the economic outlook in Washington, DC*				
	13:00	*U.S.*	*Kanas City Fed President Hoenig speaks on the the U.S. economic outlook in Kansas City, KS*				
	18:50	Japan	Money Supply (M2+CD)	Dec.	Y/Y % chg.	2.0	2.0
	18:50	Japan	Broad Liquidity	Dec.	Y/Y % chg.	3.5	3.5
Jan. 11	4:30	U.K.	Industrial Production	Nov.	% Chg.	0.1	0.4
	4:30	U.K.	Manufacturing Production	Nov.	% Chg.	0.1	0.3
	5:00	EU	*OECD January Economic Outlook table released*				
	7:00	Canada	Unemployment Rate	Dec.	Per cent	5.9	5.9
	7:00	Canada	Net Change in Employment	Dec.	Thousands	15.0	42.6
	8:30	Canada	International Merchandise Trade Balance	Nov.	C$, blns	3.1	3.3
	8:30	U.S.	Trade Balance	Nov.	US$, blns	-59.4	-57.8
	12:45	*U.S.*	*Fed President Mishkin speaks on financial markets, risk and policy in New York City, NY*				
	13:00	*U.S.*	*Boston Fed President Rosengren speaks at an outlook conference in South Burlington, VT*				

* Eastern Standard Time; Sources: Bloomberg, TD Economics