



# TD Economics

## The Weekly Bottom Line

July 18, 2008

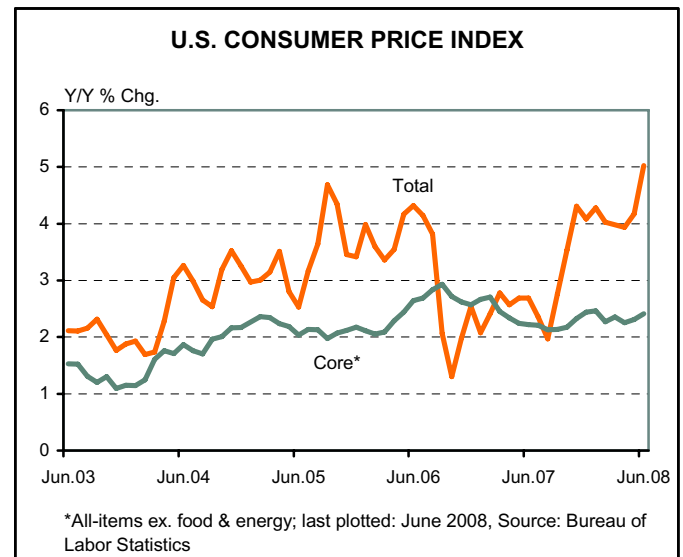
### HIGHLIGHTS

- Inflation firmly on the minds of central bankers
- Oil prices fall close to \$15 dollars on fears of slower global growth

What a week it was. Amid major concerns over the health of government-sponsored agencies, Fannie Mae and Freddie Mac, and the failing of another major mortgage lender, IndyMac, markets were also treated to testimony by Fed Chairman Ben Bernanke, an interest rate decision by the Bank of Canada and some mixed messages from economic data. With all the action out this week, it was nice to have the Bank of Canada to put it all into perspective with its tripartite analysis of the risks facing the Canadian economy – slowing U.S. growth, financial market turmoil and rising energy prices, all of which feature prominently in this week's Bottom Line.

### Inflation eating away at fiscal stimulus

As if any more proof was needed that rising inflation is beginning to have an impact on U.S. consumer spending, a disappointing retail sales report and a surprisingly strong CPI report provided just that. While earlier data from May suggested that consumer spending had received a bounce from the \$45 billion in fiscal stimulus checks sent out that month, the June retail report (which coincided with an infusion of an additional \$25 billion in fiscal stimulus) indi-



cated that much of that bounce faded. Retail sales increased by a tepid 0.1% in June and were revised down to 0.8% from 1.1% in May. For the quarter as a whole, nominal retail sales were up 3.8% on an annual basis due almost entirely to higher food and energy prices. Wednesday's CPI report piled on the bad news – showing headline consumer inflation creeping past the 5.0% mark and the core rate rising to 2.4%. With mounting job losses, falling household wealth and a faster pace of consumer price growth, it is little wonder that households don't feel much like spending. Still, if this is what consumer spending looks like with the fiscal stimulus it's a little scary to think about what it would be without. Whether we meet the technical definition of a recession or not – if it looks like a duck, and quacks like a duck...

### Weak and getting weaker

With the U.S. consumer retrenching it will be up to exports to keep the economy expanding. The trade sector remains the one source of strength to the U.S. economy and continued strong export growth combined with slowing imports should be enough to offset the slower than expected gain in consumer spending in the second quarter.

#### Recent TD Economics Research

July 17, 2008 - Bank of Canada's MPR Update  
 July 17, 2008 - U.S. Housing Starts  
 July 16, 2008 - Canadian Manufacturing Shipments  
 July 16, 2008 - U.S. Consumer Price Index  
 July 16, 2008 - U.S. Households Look To Be Saving Their Stimulus Checks  
 July 15, 2008 - Bank of Canada Interest Rate Decision  
 July 15, 2008 - U.S. Retail Sales  
 July 15, 2008 - Can All The King's Men Put The U.S. Financial System Back Together Again?

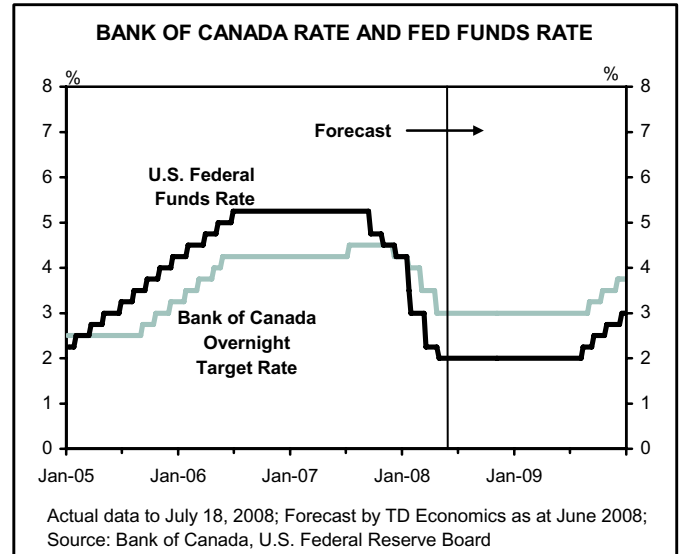
But signs are that this source of growth may also begin to slow. Chinese growth is decelerating and expectations are that second quarter growth in the Euro Zone will also show a sharp drop. Combined, these regions represent over one-fifth of U.S. exports. With the domestic U.S. economy firmly in retreat and downside risks to the external sector increasing – the likelihood of a contraction in overall economic growth in the second half of this year is increasing.

### Bernanke caught between a rock and a hard place

On an action packed Wednesday, Federal Reserve Chairman Benjamin Bernanke gave his testimony to the U.S. Congress on the current state of monetary policy and just to be sure to keep its name in the papers the Fed also released the minutes to their June 24<sup>th</sup> meeting. Bernanke's speech spent considerable time outlining the impact of recent financial turmoil on the U.S. economy and in particular commented on the newest phase of the credit crunch – fears over the viability of GSEs, Fannie Mae and Freddie Mac. These agencies have always been implicitly but until recently never explicitly backed by the Federal government. They own or guarantee half of all U.S. mortgages, making them a vital component to functioning capital markets. Ongoing trouble in financial markets are an unwanted distraction for the Fed who has pulled out all the stops in an effort to keep financial markets functioning, while trying to maintain its credibility as an inflation fighter. While stating that the downside risks to growth remained elevated, Bernanke was careful to stress the upside risks to inflation, a sentiment that was echoed in the FOMC minutes that showed a plurality of members believing current inflationary pressures would likely make the next move in the Fed funds rate a hike. However, economic conditions do appear to have worsened since the end of June and even while the Fed's next move may be to raise interest rates, the considerable strains on the U.S. economy will make it some time before they are able to do so.

### Bank of Canada lays their cards on the table

In Canada all eyes were on the Bank of Canada who in addition to their interest rate decision released an update to their April Monetary Policy Report. While markets were caught off guard last month by the Bank's decision to leave interest rates unchanged (when a cut was largely expected), this month's decision to leave the overnight rate at 3.0% came as no surprise. In their communiqué and MPR, the Bank stated that of the three risks to their inflation outlook – a slowing U.S. economy, ongoing financial market turbulence and rising commodity prices – it was the third that had caught them most off guard. As a result of rising en-



ergy prices the Bank raised their forecast for CPI inflation to a peak above 4.0 % in the first quarter of next year – doubling their previous forecast in April. The Bank also revised their forecast for GDP growth, lowering 2008 growth to 1.0% from 1.4% previously and 2009 growth slightly to 2.3% from 2.4% previously. Overall the Bank maintained its neutral stance, stating that it judges the current risks to the inflation outlook to be roughly balanced and that the economy should begin to show considerable improvement through the first half of 2009. Still, given the ongoing stresses on the U.S. economy and recent signs that the domestic Canadian economy is also slowing we believe the state of economic weakness is likely to be more protracted than what is expected by the Bank. As a result, we continue to expect the Bank of Canada to remain on the sidelines, leaving interest rates unchanged at their current level until the second half of 2009.

### Slowing world demand cause oil prices to pull back

With all the concern shown for energy driven inflation this week, consumers received some relief at the gas pumps as oil pulled back by close to \$15 dollars from U.S. \$145 to U.S. under \$130 per barrel by Thursday. Fears that slowing global growth will seriously cut into energy demand were supported by the weekly inventory report by the Energy Information Administration that showed both a decline in demand for petroleum and a rise in inventories. While oil prices remain extremely volatile and it's too early to call it a trend, evidence of demand destruction is likely to become more pronounced over the summer months. This week's pullback is consistent with our forecast for oil prices to fall back towards the \$100 barrel mark by year end.

*James Marple, Economist 416-982-2557*

## UPCOMING KEY ECONOMIC RELEASES

### Canadian Retail Sales - May

**Release Date:** July 22/08

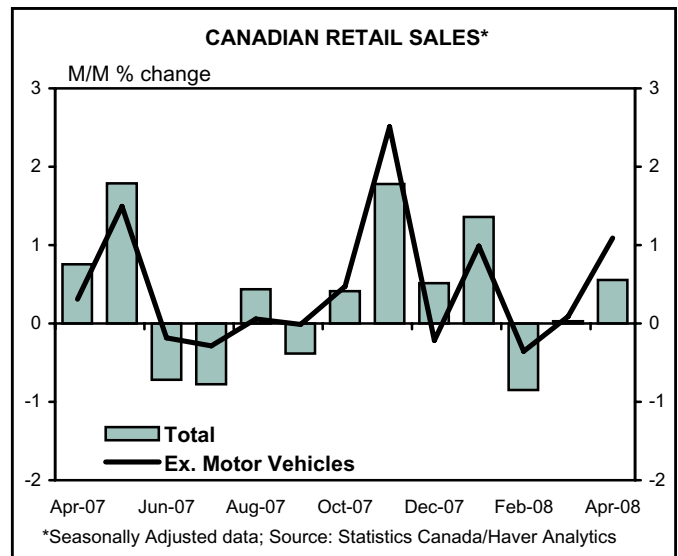
**April Result:** total +0.6% M/M; ex-autos +1.1% M/M

**TD Forecast:** total +0.9% M/M; ex-autos +1.0% M/M

**Consensus:** total +0.7% M/M; ex-autos +0.8% M/M

With economic activity in Canada appearing to be on a rebound, retail sales should post another fair-sized monthly gain in May, with a 0.9% M/M advance in the value of total sales. Excluding autos, sales are expected to rise by a somewhat more robust 1.0% M/M, slightly down from the 1.1% M/M print in April. Both figures, however, will likely be boosted by strong gasoline sales, given that gas prices have risen by a very strong 8.8% M/M in May. And with the rise in retailing activity coming mostly from higher prices, real retail sales will likely post a soft gain.

*Millan Mulraine 416-308-2911*



### Canadian Consumer Price Index - June

**Release Date:** July 23/08

**May Result:** core 0.3% M/M, 1.5% Y/Y;

all-items 1.0% M/M, 2.2% Y/Y

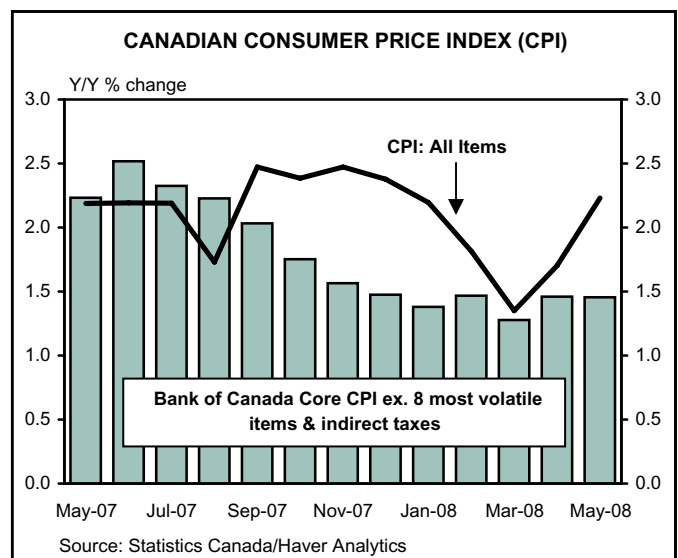
**TD Forecast:** core 0.0% M/M, 1.5% Y/Y;

all-items 0.3% M/M, 2.7% Y/Y

**Consensus:** core 0.1% M/M, 1.6% Y/Y;

all-items 0.5% M/M, 2.9% Y/Y

After declining for four consecutive months between December and March, Canadian consumer price inflation has reversed course in recently on account of the surge in energy and food prices. And we expect the acceleration in the headline inflation rate to continue for the third straight month in June, rising by 0.3% M/M, with the seasonally adjusted index advancing at a strong 0.7% M/M pace, bringing the annual rate of consumer price from 2.2% Y/Y in May to 2.7% Y/Y – which will be the highest print on headline consumer inflation since January 2006. Despite the surge in the headline index, the core inflation measure is expected to remain unchanged at 1.5% Y/Y



for the third straight month. On a monthly basis, core inflation is expected to remain unchanged, with the seasonally adjusted index rising by only 0.2% M/M. If there is a risk to this view, it is to the upside.

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## U.S. Durable Goods Orders – June

**Release Date:** July 25/08

**May Result:** total 0.0% M/M;  
ex-transportation -0.9% M/M

**TD Forecast:** total -1.5% M/M;  
ex-transportation -0.6% M/M

**Consensus: total** -0.3% M/M;  
ex-transportation -0.2% M/M

U.S. business activity has been fairly weak for some time, as firms navigate against the headwinds of a slowing domestic economy and higher input costs. And, despite the important offset coming from the export sector

(due to the weak dollar), we expect activity to remain subdued in the coming months. Moreover, with a deteriorating labour market and sluggish consumer demand, businesses are likely to remain reluctant to increase investment spending, further depressing new orders. To this end, we expect durable goods orders to post a further 1.5% M/M decline in June, following the flat reading in May. However, with aircraft orders falling during the month, orders excluding transportation are likely to fall by a more modest 0.6% M/M.

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## RECENT KEY ECONOMIC INDICATORS

### July 14-July 18, 2008

Date	Economic Indicators	Data for	Units	Current	Prior	
<b>Canada</b>						
July 15	New Motor Vehicle Sales	May	% change	1.1	-2.4	R ▲
July 15	<i>Bank of Canada interest rate announcement</i>	15-Jul	Overnight rate	3.00	3.00	
July 16	Manufacturing Shipments	May	% change	2.7	2.1	R ▲
July 17	International Securities Transactions	May	\$. blns	10.7	9.8	R ▲
July 18	Leading Indicators	Jun.	% change	0.0	0.2	
July 18	Wholesale Sales	May	% change	1.6	1.5	R ▲
<b>United States</b>						
July 15	Producer Price Index	Jun.	% change	1.8	1.4	
July 15	Producer Price Index excl. food and energy	Jun.	% change	0.2	0.2	
July 15	Retail Sales	Jun.	% change	0.1	0.8	R ▼
July 15	Retail Sales ex. Autos	Jun.	% change	0.8	1.2	
July 15	Empire Manufacturing	Jul.	% change	-4.9	-8.7	
July 15	Business Inventories	May	% change	0.3	0.5	
July 16	MBA Mortgage Applications	11-Jul	% change	1.7	7.5	
July 16	Consumer Price Index (CPI)	Jun.	% change	1.1	0.6	
July 16	CPI - excl. food and energy	Jun.	% change	0.3	0.2	
July 16	Industrial Production	Jun.	% change	0.5	-0.2	
July 16	Capacity Utilization	Jun.	Per cent	79.9	79.6	R ▲
July 17	Housing Starts	Jun.	Thousands	1,066.0	977.0	R ▲
July 17	Weekly Initial Jobless Claims	12-Jul	Thousands	366.0	348.0	R ▲
July 17	Building Permits	Jun.	Thousands	1,091.0	978.0	R ▲
July 17	Philadelphia Fed Index	Jul.	Index	-16.3	-17.1	

Source: Bloomberg, TD Economics

## UPCOMING NORTH AMERICAN ECONOMIC CALENDAR

### July 21-July 25, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
<b>Canada</b>					
July 22	Retail Sales	May	% change	0.7	0.6
July 22	Retail Sales excl. autos	May	% change	0.8	1.1
July 23	Consumer Price Index (CPI)	Jun.	Y/Y % chg.	2.9	2.2
July 23	CPI - excl. 8 most volatile items	Jun.	Y/Y % chg.	1.6	1.5
July 23	<i>Fed Governor Mishkin speaks at the Bank of Canada's Economic Conference</i>				
July 23	<i>Fed Vice Chairman Kohn speaks in panel discussion on communication and transparency at BoC conference.</i>				
<b>United States</b>					
July 21	Leading Indicators	Jun.	% change	-0.1	0.1
July 22	<i>Treasury Secretary Paulson speaks on the economy and financial markets at New York Public Library.</i>				
July 22	<i>Philadelphia Fed President Plosser speaks on the U.S. economy in King of Prussia, Pennsylvania.</i>				
July 22	Richmond Fed Index	Jul.	Index	-10.0	-12.0
July 23	MBA Mortgage Applications	18-Jul	% change	--	1.7
July 23	Fed's Beige book released				
July 24	Weekly Initial Jobless Claims	19-Jul	Thousands	--	366.0
July 24	Existing Home Sales	Jun.	US\$, mlns	5.0	5.0
July 24	<i>New York Fed President Geithner and SEC Chairman Cox testify before House Committee.</i>				
July 25	Durable Goods Orders	Jun.	% change	-0.3	0.0
July 25	New Home Sales	Jun.	Thousands	505.5	512.0

Source: Bloomberg, TD Economics

## G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period	
July 21	10:00	U.S.	Leading Indicators	Jun.	% change	-0.1	0.1	
	19:50	Japan	All Industry Activity Index	May	% change	0.4	0.8	
July 22	8:10	U.S.	<i>Treasury Secretary Paulson speaks on the economy and financial markets at New York Public Library.</i>					
	8:30	Canada	Retail Sales	May	% change	0.7	0.6	
	8:30	Canada	Retail Sales excl. autos	May	% change	0.8	1.1	
	8:30	U.S.	<i>Philadelphia Fed President Plosser speaks on the U.S. economy in King of Prussia, Pennsylvania.</i>					
	10:00	U.S.	Richmond Fed Index	Jul.	Index	-10.0	-12.0	
	21:30	AU	Consumer Prices	Q2-08	Q/Q % chg.	1.3	1.3	
July 23	2:45	France	Consumer Spending	Jun.	% change	-0.6	2.0	
	4:30	UK	<i>Bank of England Minutes</i>					
	6:00	U.K.	<i>CBI July Quarterly Industrial trends released</i>					
	7:00	Canada	Consumer Price Index (CPI)	Jun.	Y/Y % chg.	2.9	2.2	
	7:00	Canada	CPI - excl. 8 most volatile items	Jun.	Y/Y % chg.	1.6	1.5	
	7:00	U.S.	MBA Mortgage Applications	18-Jul	% change	--	1.7	
	9:00	Canada	<i>Fed Governor Mishkin speaks at the Bank of Canada's Economic Conference</i>					
	11:15	Canada	<i>Fed Vice Chairman Kohn speaks in panel discussion on communication and transparency at BoC conference.</i>					
	14:00	U.S.	<i>Fed's Beige book released</i>					
	17:00	NZ	RBNZ Cash Target	24-Jul	Cash Rate	8.25	8.25	
	19:50	Japan	Merchandise Trade Balance	Jun.	¥, blns	506.0	362.2	
July 24	2:50	France	Business Confidence Indicator	Jul.	Index	100.0	102.0	
	2:50	France	Production Outlook Indicator	Jul.	Index	-17.0	-15.0	
	3:00	France	Purchasing Managers Index (mfg.) (prelim.)	Jul.	Index	48.8	49.2	
	3:00	France	Purchasing Managers Index (serv.) (prelim.)	Jul.	Index	49.5	50.1	
	3:30	Germany	Purchasing Managers Index (mfg.)	Jul.	Index	52.0	52.6	
	3:30	Germany	Purchasing Managers Index (serv.)	Jul.	Index	51.5	52.1	
	4:00	Germany	IFO - Business Climate	Jul.	Index	100.2	101.3	
	4:00	Germany	IFO - Current Assessment	Jul.	Index	106.5	108.3	
	4:00	Germany	IFO - Expectations	Jul.	Index	93.2	94.7	
	4:00	EU	Purchasing Managers Index (mfg.)	Jul.	Index	48.7	49.2	
	4:00	EU	Purchasing Managers Index (serv.)	Jul.	Index	48.8	49.3	
	4:00	EU	Current Account Balance	May	Eur, blns	--	-9.2	
	4:30	UK	Retail Sales	Jun.	% change	-2.6	3.5	
	8:30	U.S.	Weekly Initial Jobless Claims	19-Jul	Thousands	--	366.0	
	10:00	U.S.	Existing Home Sales	Jun.	US\$, mlns	4.95	4.99	
	10:00	U.S.	<i>New York Fed President Geithner and SEC Chairman Cox testify before House Committee.</i>					
19:30	Japan	Tokyo CPI excl. perishables	Jul.	Y/Y % chg.	1.6	1.3		
19:50	Japan	Corporate Service Price Index	Jun.	Y/Y % chg.	0.6	0.6		
July 25	4:00	EU-12	M3 Money Supply Growth	Jun.	Y/Y % chg.	10.3	10.5	
	4:30	UK	Gross Domestic Product (GDP)	Q2-08	Q/Q % change	0.2	0.3	
	8:30	U.S.	Durable Goods Orders	Jun.	% change	-0.3	0.0	
	10:00	U.S.	New Home Sales	Jun.	Thousands	505.5	512.0	

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

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