TD Bank Financial Group

# TD Economics

## The Weekly Bottom Line

July 4, 2008

**HIGHLIGHTS**

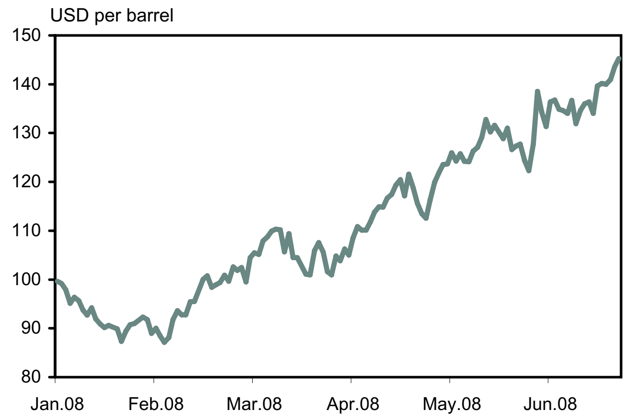
- **Oil prices hit record US$145 per barrel**
- **Canadian GDP rises by 0.4% in April**
- **U.S. economy showing more signs of weakness**

As the festivities begin in the U.S. for the Independence Day holiday, this year's celebration may be a little more subdued than usual. With oil prices inching closer to the US$150 per barrel mark and gasoline prices over US$4 per gallon, many Americans will likely spend the long weekend closer to home.

While oil prices above US$130 per barrel have become the norm over the last month, a string of new records were set this week, with prices hitting US$145 per barrel yesterday. As a result, prices are up more than 50% since the US$95 per barrel level recorded at the start of 2008. The run-up in prices over the past six months has been driven largely by the market's focus on various supply-side issues, including slowing growth in non-OPEC supply, rising production costs and supply disruptions resulting from geopolitical unrest in Nigeria, Venezuela, Iran and Iraq.

But with prices at astronomical levels, it is only a matter of time before global oil demand responds in kind. OECD countries have already shown evidence of falling demand. In North America, there has been a marked shift away from large, gas guzzling vehicles to the smaller more fuel efficient autos. In addition, demand for gasoline in the U.S. has fallen by 1.4% Y/Y as of May, suggesting that Americans are also driving less. This week, U.S. light vehicle sales figures for June were released, indicating that sales were at their lowest level since 1991. Furthermore, a number of non-OECD countries have hiked retail fuel prices in recent months, which should lead to some tapering off in the rate of consumption growth in these regions. As we move into the summer months with oil and gasoline prices still at elevated levels, the demand side of the equation is likely to become more of a focus in the markets, and ultimately lead to a pull back in prices.

**CRUDE OIL PRICES***




*West Texas Intermediate; Last plotted: July 3, 2008
Source: Wall Street Journal/Haver Analytics

| Recent TD Economics Research |
|---|
| July 3, 2008 - U.S. ISM Non-Manufacturing Index |
| July 3, 2008 - ECB Interest Rate Decision |
| July 3, 2008 - U.S. Employment Commentary |
| July 2, 2008 - Canadian Consumers To Gear Down Their Spending |
| June 30, 2008 - Canadian Real GDP Commentary |

### Soaring oil prices a headwind for Central Canada

But what is the impact of these high oil prices on Canada? Given that we are a significant producer of oil, high prices do prove to be beneficial for some parts of the economy – namely Alberta, Saskatchewan and Newfoundland and Labrador. However, the manufacturing oriented provinces of Ontario and Quebec (which together represent about 60% of Canadian real GDP) are feeling the brunt of these high oil prices. Indeed, the first quarter real GDP estimate for Ontario was released on Thursday and the picture was not pretty. Ontario's economy contracted by an annualized 1.4%, which was weaker than Quebec's estimated Q1 turnout of -0.8%. Both estimates were below the 0.3% contraction for Canada as a whole, implying that the rest of the country grew by 1.1%.

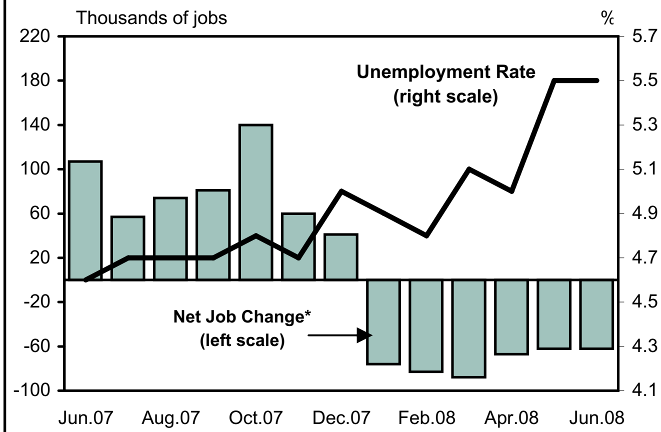
Monday's release of real Canadian GDP for April showed that the national economy began the second quarter on a better note, growing at a 0.4% clip. What's more, the bounce back was fuelled in part by a pick-up in manufacturing activity, which bodes well for a somewhat better second quarter performance in Central Canada. In particular, the impact of a strike in the auto parts industry that crimped assemblies production in the first quarter has since eased, as new supplies were sourced (the strike ended at the end of May). Still, apart from this rebound, autos and manufacturing have a bumpy road ahead. Even with April's positive growth, the level of GDP is not back to January levels. For the year as a whole, TD Economics forecasts Canadian real GDP growth to average a modest 1%.

**High oil prices raise downside risks to global growth**

Elsewhere in the global economy, the oil price shock has raised the downside risks to growth. TD Economics is forecasting global real GDP growth to average 3.8% this year – the slowest pace in six years. One of the challenges is that high energy prices are boosting inflation and preventing central banks from cutting interest rates. In fact, many regions have seen a tightening in monetary policy in recent months, the latest being the European Central Bank which increased interest rates by 25 basis points yesterday. While we expect the ECB to remain on hold now for at least the rest of the year, a further surge in oil prices could put another rate hike on tap in the coming months.

In the U.S., the balance of evidence emanating from recent reports, including reports issued this week, indicate that the probability of a mild recession remains high – even if the economy manages to eke out a slight gain in real GDP in the second quarter. That said, the ISM manufacturing index surprised on the upside this week. The index unexpectedly rose above the 50-threshold – to 50.2 – for the first time since January, indicating that the manufacturing sector was essentially flat on the month. However, the gains in the overall index were driven largely by the inventory sub-index, which jumped above 50 for the first time since April of 2006. So despite the increase in manufacturing activity in June, this rise in inventories could lead to some payback in the form of lower production in coming months, pushing the index back below the 50 mark.

Other data out of the U.S. this week were not much better. The ISM non-manufacturing index plunged from 51.7 in May to 48.2 in June, indicating a contraction activity outside of manufacturing in the final month of the quarter. The culprits behind the weak performance were substantial drops in the employment and new orders sub-indices. Another major concern was the prices paid index,



Seasonally-adjusted data; * Change in non-farm payrolls
Source: U.S. Deptartment of Labor/Haver Analytics

which shot up from 77.0 to 84.5 in June – the highest level since the survey began in 1997. This surge in prices paid stemmed largely from rising energy costs, suggesting non-manufacturers are also being hit by sky-high oil prices.

**U.S. job market remains weak**

The biggest telltale sign of all is in the job market. The National Bureau of Economic Research (NBER) – who renders the decision of whether or not the U.S. experiences a recession – tends to put more weight on the employment sector in its assessment. And while hardly falling off a cliff, employment is clearly on a downward trend. Following five months of job cuts, a total of 62,000 jobs were lost in June. Along with yesterday's report came downward revisions for those last five months, averaging 29,000 jobs per month. Following these recent revisions, June's figure may also be revised downward. The report also showed that companies are scaling back on hours worked, suggesting that they are trying to cut production costs while avoiding further job losses. June's drop brings the total number of job cuts to 438,000 since January. Meanwhile, the unemployment rate remained unchanged at 5.5% in June, despite expectations that some of May's massive half-point increase in the rate would not stick.

Despite these unwelcome indicators, the U.S. could pull out some slight growth in the second quarter, helped by the stimulus provided to household spending by government tax rebate cheques. However, as we spell out in our June *Quarterly Economic Forecast*, this will provide only a short-term artificial boost. By the fourth quarter, we see a real possibility that U.S. activity will shrink outright once this impact lifts.

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# UPCOMING KEY ECONOMIC RELEASES

## Canadian Housing Starts - June

**Release Date**: July 9/08
**May Result:** 221K
**TD Forecast:** 215K
**Consensus:** 218K

The Canadian housing market appears to be gradually softening, with home prices now only inching upwards and market metrics suggesting that the long-enjoyed seller's market is now a thing of the past. However, the pace of any future decline should be sluggish due to a recent upturn in residential building permits and modestly favourable weather, with June housing starts set to fall only slightly, to 215K from 221K in May. Perhaps the most compelling near-term argument for a decline in housing activity is that the sector is getting such bad press both abroad and now at home that builders cannot be blamed if they ease up on the gas pedal.

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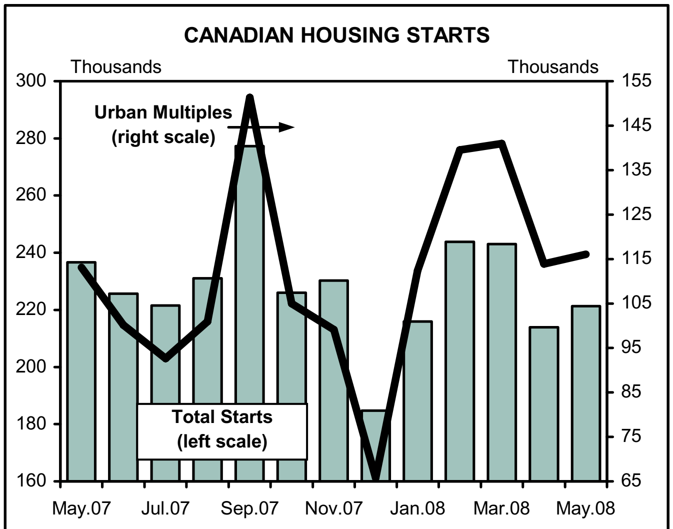

Source: CMHC/Haver Analytics

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## Canadian Employment - June

**Release Date**: July 11/08
**May Result:** 8.4K; unemployment rate 6.1%
**TD Forecast:** 15K; unemployment rate 6.1%
**Consensus**: 10K; unemployment rate 6.1%

After posting its smallest monthly gain since December last year, the Canadian economy should add a modest 15K jobs to the employment ranks in June, with the unemployment rate likely remaining steady at 6.1%. The most recent Ivey employment index points to general labour market softness for June, and the sluggish pace of the Canadian economy will also limit the magnitude of any gains. But with fairly robust domestic demand, we expect the Canadian economy to continue creating a smattering of jobs in the near-term, albeit at a much slower pace than has been the case in the recent past due to export and manufacturing woes. The new normal for Canadian job growth at this point in the economic cycle is likely in the 0-20K range per month, well below the long-term sustainable norm of 20K+.

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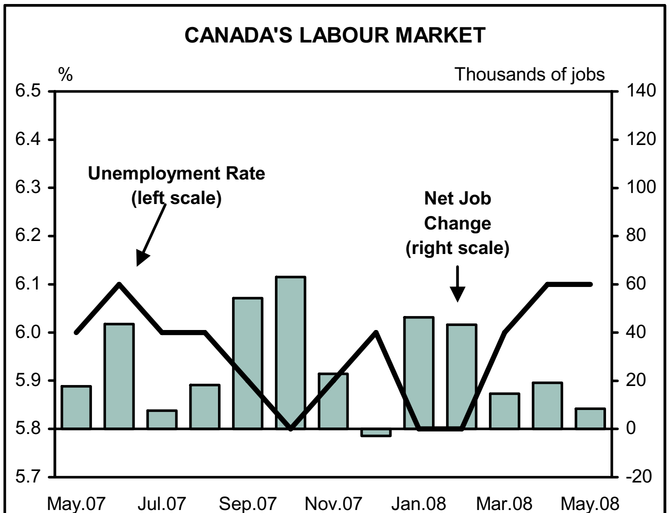

Seasonally-adjusted data; Source: Statistics Canada/Haver Analytics

## Canadian International Trade - May

**Release Date**: July 11/08
**April Result:** $5.1B
**TD Forecast:** $5.6B
**Consensus:** $5.2B

The Canadian international merchandise trade balance is expected to improve in May to show a fairly robust $5.6B surplus (up from $5.1B in April). The modest improvement should come from the projected 1.7% M/M increase in merchandise exports during the month, offsetting the 0.5% M/M gain in imports. Much of the gain in export is on account of the strong 10.9% M/M boost in energy prices in May, while exports of other commodities should also make meaningful contributions, given the 8.3% M/M gain in overall commodity prices. However, with price effects being the main driver of this improvement, the volume of exports will likely fall, due mostly to the weakness in Canadian manufacturing. On the other hand, nominal imports will likely be very tepid, as a result of the weakness in the value of the Canadian dollar (which was down 1.4% M/M) in May.

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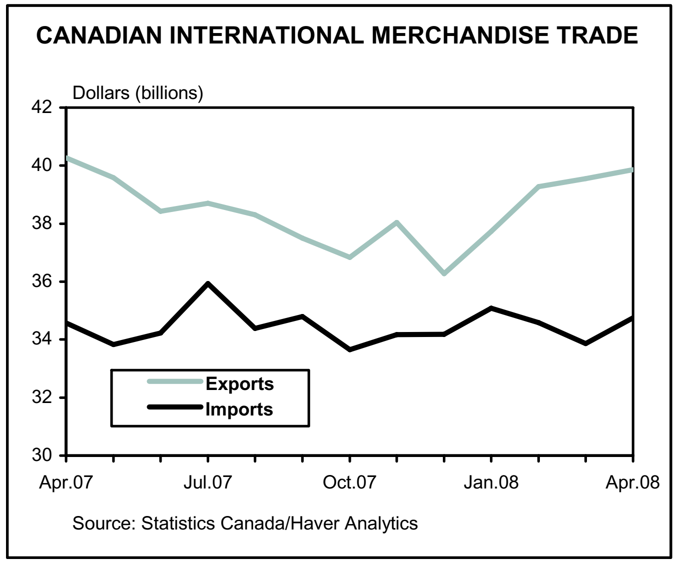

## RECENT KEY ECONOMIC INDICATORS
## June 30-July 4, 2008

| Date | Economic Indicators | Data for | Units | Current | Prior | |
|---|---|---|---|---|---|---|
| **Canada** | | | | | | |
| June 30 | Real GDP at Basic Prices | Apr. | % Chg. | 0.4 | -0.2 | |
| July 4 | Ivey Purchasing Managers Index | Jun. | Index | 69.6 | 62.5 | |
| **United States** | | | | | | |
| June 30 | Chicago Purchasing Managers Index | Jun. | Index | 49.6 | 49.1 | |
| July 1 | Domestic Vehicle Sales | Jun. | Millions | 9.9 | 10.5 | |
| July 1 | Total Vehicle Sales | Jun. | Millions | 13.6 | 14.3 | |
| July 1 | ISM Manufacturing | Jun. | Index | 50.2 | 49.6 | |
| July 1 | Construction Spending | May | % Chg. | -0.4 | -0.1 | R▲ |
| July 2 | MBA Mortgage Applications | 27-Jun | % Chg. | 3.6 | -9.3 | |
| July 2 | ADP Employment Change | Jun. | Thousands | -79.0 | 25.0 | R▼ |
| July 2 | Factory Orders | May | % Chg. | 0.6 | 1.3 | R▲ |
| July 3 | Change in Non-farm Payrolls | Jun. | Thousands | -62.0 | -62.0 | R▼ |
| July 3 | Unemployment Rate | Jun. | Per cent | 5.5 | 5.5 | |
| July 3 | Average Hourly Earnings | Jun. | % Chg. | 0.3 | 0.3 | |
| July 3 | Weekly Initial Jobless Claims | 28-Jun | Thousands | 404.0 | 388.0 | R▲ |
| July 3 | ISM Non-manufacturing Composite | Jun. | Index | 48.2 | 51.7 | |

Source: Bloomberg, TD Economics

## UPCOMING NORTH AMERICAN ECONOMIC CALENDAR
## July 7-July 11, 2008

| Release Date | Economic Indicators | Data for Period | Units | Consensus Forecast | Prior |
|---|---|---|---|---|---|
| **Canada** | | | | | |
| July 7 | Building Permits | May | % Chg. | -5.8 | 14.5 |
| July 7 | *Bank of Canada Business Outlook Survey released* | | | | |
| July 9 | Housing Starts | Jun. | Thousands | 218.0 | 221.3 |
| July 11 | Unemployment Rate | Jun. | Per cent | 6.1 | 6.1 |
| July 11 | Net Change in Employment | Jun. | thousands | 10.0 | 8.4 |
| July 11 | International Merchandise Trade Balance | May | C$, blns | 5.2 | 5.1 |
| July 11 | New Housing Price Index | May | % Chg. | 0.1 | 0.0 |
| **United States** | | | | | |
| July 7 | *San Francisco Fed President Yellen speaks on the U.S. economic outlook at the UCSD Economics Roundtable.* | | | | |
| July 8 | *Fed Chairman Bernanke speaks at the Federal Deposit Insurance Corp.'s Forum on Mortgage Lending.* | | | | |
| July 8 | Wholesale Inventories | May | % Chg. | 0.7 | 1.3 |
| July 8 | *Richmond Fed President Lacker speaks on economic outlook to the National Economists Club in Washington.* | | | | |
| July 9 | MBA Mortgage Applications | 4-Jul | % Chg. | -- | 3.6 |
| July 10 | Weekly Initial Jobless Claims | 5-Jul | Thousands | 395.0 | 404.0 |
| July 10 | *Fed Chairman Bernanke and Treasury Secretary Paulson testify before the House Financial Services Committee.* | | | | |
| July 10 | *San Francisco Fed President Yellen speaks at a community leaders luncheon in Portland.* | | | | |
| July 11 | Trade Balance | May | US$, blns | -62.5 | -60.9 |
| July 11 | Import Price Index | Jun. | % Chg. | 2.0 | 2.3 |
| July 11 | U. Michigan Consumer Confidence (prelim.) | Jul. | Index | 55.5 | 56.4 |

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 6 | 19:50 | Japan | Official Reserve Assets | Jun. | ¥, blns | -- | 997.0 |
| July 7 | 4:30 | UK | Industrial Production | May | % Chg. | -0.1 | 0.2 |
| | 4:30 | UK | Manufacturing Production | May | % Chg. | -0.1 | 0.1 |
| | 6:00 | Germany | Industrial Production | May | % Chg. | 0.2 | -0.8 |
| | 8:30 | Canada | Building Permits | May | % Chg. | -5.8 | 14.5 |
| | *10:30* | *Canada* | *Bank of Canada Business Outlook Survey released* | | | | |
| | *11:00* | *U.S.* | *San Francisco Fed President Yellen speaks on the U.S. economic outlook at the UCSD Economics Roundtable.* | | | | |
| | 19:50 | Japan | Money Supply (M2+CD) | Jun. | Y/Y % chg. | 2.0 | 2.0 |
| July 8 | 0:30 | Japan | Bankruptcies | Jun. | Y/Y % chg. | -- | -1.5 |
| | *8:30* | *U.S.* | *Fed Chairman Bernanke speaks at the Federal Deposit Insurance Corp.'s Forum on Mortgage Lending.* | | | | |
| | 10:00 | U.S. | Wholesale Inventories | May | % Chg. | 0.7 | 1.3 |
| | *12:30* | *U.S.* | *Richmond Fed President Lacker speaks on economic outlook to the National Economists Club in Washington.* | | | | |
| | 19:50 | Japan | Machine Orders | May | Y/Y % chg. | -3.7 | 0.5 |
| July 9 | 2:00 | Germany | Trade Balance | May | Eur, blns | 18.0 | 18.7 |
| | 2:00 | Germany | Current Account Balance | May | Eur, blns | 12.5 | 14.5 |
| | 2:00 | Japan | Machine Tool Orders (prelim.) | Jun. | Y/Y % chg. | -- | 1.4 |
| | 2:45 | France | Trade Balance | May | Eur$, blns | -4.0 | -3.7 |
| | 4:30 | UK | Merchandise Trade Balance | May | £, mlns | -7,400.0 | -7,594.0 |
| | 4:30 | UK | Merchandise Trade Balance - excl. EU | May | £, mlns | -4,100.0 | -4,185.0 |
| | 7:00 | U.S. | MBA Mortgage Applications | 4-Jul | % Chg. | -- | 3.6 |
| | 8:15 | Canada | Housing Starts | Jun. | Thousands | 218.0 | 221.3 |
| | 19:50 | Japan | Current Account Total | May | ¥, blns | 1,934.80 | 1,380.90 |
| | 19:50 | Japan | Trade Balance | May | ¥, blns | 500.00 | 634.70 |
| | 21:00 | AU | Consumer inflation expectations released | Jul. | Per cent | -- | 5.9 |
| | 21:30 | AU | Unemployment Rate | Jun. | Per cent | 4.3 | 4.3 |
| | 21:30 | AU | Net Change in Employment | Jun. | Thousands | 10.0 | -19.7 |
| July 10 | 2:45 | France | Industrial Production | May | % Chg. | -0.6 | 1.4 |
| | 2:45 | France | Manufacturing Production | May | % Chg. | -0.5 | 1.7 |
| | *4:00* | *EU* | *ECB publishes July monthly report.* | | | | |
| | *7:00* | *UK* | *Bank of England Announces Rates* | *10-Jul* | *Per cent* | *5.00* | *5.00* |
| | 8:30 | U.S. | Weekly Initial Jobless Claims | 5-Jul | Thousands | 395.0 | 404.0 |
| | *10:00* | *U.S.* | *Fed Chairman Bernanke and Treasury Secretary Paulson testify before House Financial Services Committee.* | | | | |
| | *15:30* | *U.S.* | *San Francisco Fed President Yellen speaks at a community leaders luncheon in Portland.* | | | | |
| July 11 | 7:00 | Canada | Unemployment Rate | Jun. | Per cent | 6.1 | 6.1 |
| | 7:00 | Canada | Net Change in Employment | Jun. | thousands | 10.0 | 8.4 |
| | 8:30 | Canada | International Merchandise Trade Balance | May | C$, blns | 5.2 | 5.1 |
| | 8:30 | Canada | New Housing Price Index | May | % Chg. | 0.1 | 0.0 |
| | 8:30 | U.S. | Trade Balance | May | US$, blns | -62.5 | -60.9 |
| | 8:30 | U.S. | Import Price Index | Jun. | % Chg. | 2.0 | 2.3 |
| | 10:00 | U.S. | U. Michigan Consumer Confidence (prelim.) | Jul. | Index | 55.5 | 56.4 |

* Eastern Standard Time; Sources: Bloomberg, TD Economics