



TD Economics

The Weekly Bottom Line

June 15, 2007

HIGHLIGHTS

- Stage set for 25bp hike in Canadian target interest rate next month
- Fed move unlikely

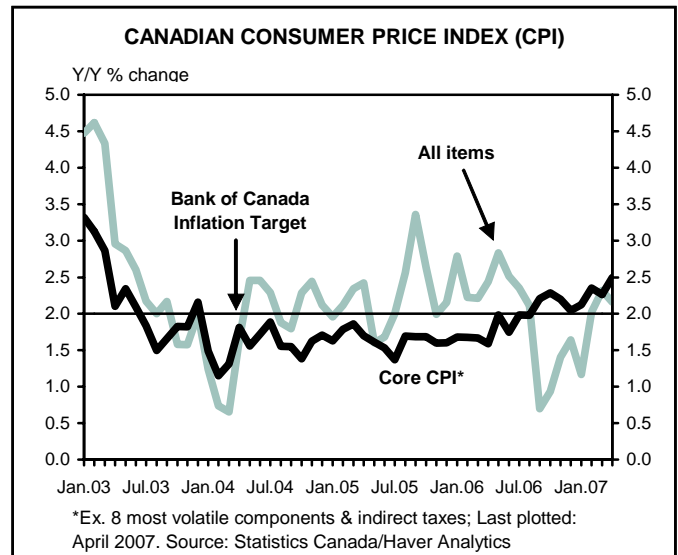
Economists aren't so tech-savvy to think first of iPods when thinking about 'i' words. Safer bets, both at Scrabble and in anticipating what they mean, are the less hip but nonetheless oh so important words like inflation or intervention. Following the Reserve Bank of New Zealand's intervention to help take some steam out of its currency by selling some NZ dollar reserves, this 'i' word prompted some chatter about whether the Bank of Canada (BoC) would view the recent surge in the Canadian dollar as diminishing the need for an interest rate hike. The currency might be on the radar, but it isn't the primary concern of an inflation-targeting central bank like the BoC, and rightly so.

Despite protracted difficulties in the forestry and some manufacturing industries, the Canadian economy as a whole continues to chug along quite nicely. Real GDP growth is running above the BoC's estimate of long-term trend growth of 2.8%. When the economy is in that sense 'overstretched', upward price pressures tend to develop.

Despite Monday's news of better-than-expected 2.8% annualized productivity growth for the first quarter, downward revisions to productivity in the previous two quarters along with a strong 3% gain in unit labor costs will do nothing to alleviate the BoC's concerns over the outlook for inflation. Neither will the April manufacturing

Recent TD Economics Research

June 15, 2007 - U.S. Industrial Production and Capacity Utilization
 June 15, 2007 - U.S. Consumer Price Index
 June 13, 2007 - U.S. Retail Sales
 June 13, 2007 - Canadian Manufacturing Shipments



shipments report which, under a headline 0.6% decline, showed volumes increasing for the third month in a row, bringing the year-over-year change into positive territory.

Tweaking time

In fact quite the contrary has happened, and the stage is now set for a 25 basis points interest rate hike at the BoC's upcoming Fixed-Announcement Date on July 10th. A reputable inflation rate targeting central bank like the BoC cannot, and will not, let core inflation run significantly above target for months on end. From housing to energy, from commodities to wages, demand-pull inflation hasn't let up and doesn't seem likely to do so on its own. New and resale home prices, energy prices, base metals prices, and agricultural commodities prices are all in double-digit territory on a year-over-year basis, and have been for some time.

Hence the need for the BoC to gently tap on the economy's brake by increasing near-term borrowing costs through its target overnight rate. In a speech delivered this week on the monetary policy implications of demographics, BoC Governor Dodge all but confirmed this.

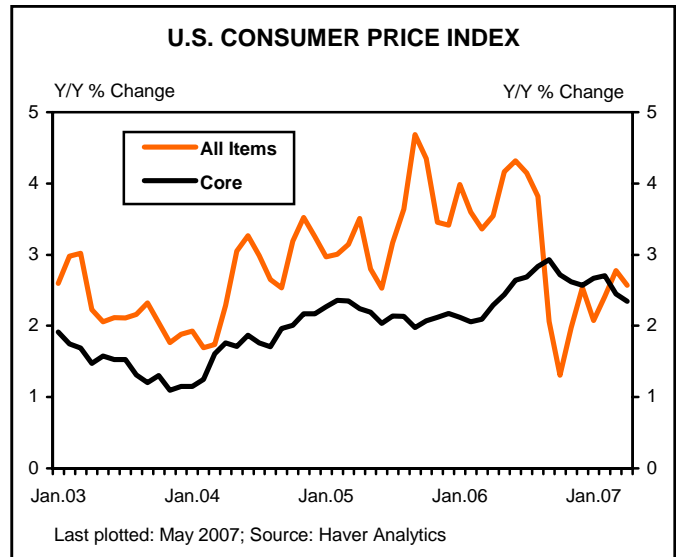
Some lip service was paid to the surging Canadian dollar and the possible substitute role it can play in helping slow down some sectors of the economy as well as price growth, but any BoC attempt to re-align the value of the currency vis-à-vis the U.S. dollar is, to put it lightly, improbable and, in any case, ineffective. The export-oriented industries that are commodity-related are benefiting from enough of a surge in commodity prices to offset the otherwise large drop in their Canadian dollar earnings margins.

Furthermore, the high loonie will not necessarily temper inflation. Lower import prices don't trickle down to lower consumer prices quickly, or completely. They tend to lag changes in the value of the currency, and not match them one for one. Many firms adjust their margins to compensate for losses incurred when the currency's value was much weaker. All told, even the recent 10% climb in the Canadian dollar since March is unlikely to sway the BoC.

Comfortable on the fence

Meanwhile, in the U.S., a much anticipated CPI report for May provided further evidence that core inflation is gradually cooling. Year-over-year core CPI was running at 2.2% in May. More importantly, at 1.6%, the annualized 3-month average is down a full percentage point from that observed in mid-Q1. Although the Federal Reserve doesn't explicitly target the core CPI, it does have an implicit comfort zone of 2.0-2.5%. However, we don't think that Bernanke & Company are itching to pull the trigger either way for some time to come. The fed funds rate is likely to remain unchanged for the remainder of this year.

First, inflation seems to be cooling with no need to tighten policy. Second, the economy, while still growing at a sub-par rate, is doing reasonably well outside of residential construction activity and related sub-prime mortgage market woes. This was highlighted by an advanced retail sales report on Wednesday. Indeed, overall retail sales for May



were up 1.4% and up 1.0% even after excluding auto and gasoline sales. For the most part, American consumers are shrugging off higher gas prices and, in some regions, declining home values. Furthermore, manufacturing and non-manufacturing sector activity indicators like the ISM indices are signalling modest economic expansion going forward.

With this backdrop of a resilient domestic U.S. economy and a fairly strong global growth outlook, markets have finally heeded the call that central banks do what central banks do, which is make sure inflation doesn't get out of hand. As it should be, a tightening bias is on most central bank's menus around the world, and the U.S. isn't immune to that shift. But unlike its international counterparts, most economic risks are still to the downside for the U.S., alongside easing inflationary pressures suggesting rate hikes are not in the pipeline. This upcoming Wednesday, look to our *Quarterly Economic Forecast* for an updated and detailed financial and economic outlook.

Pascal Gauthier, Economist
416-944-5730

UPCOMING KEY ECONOMIC RELEASES

Canadian Consumer Price Index - May

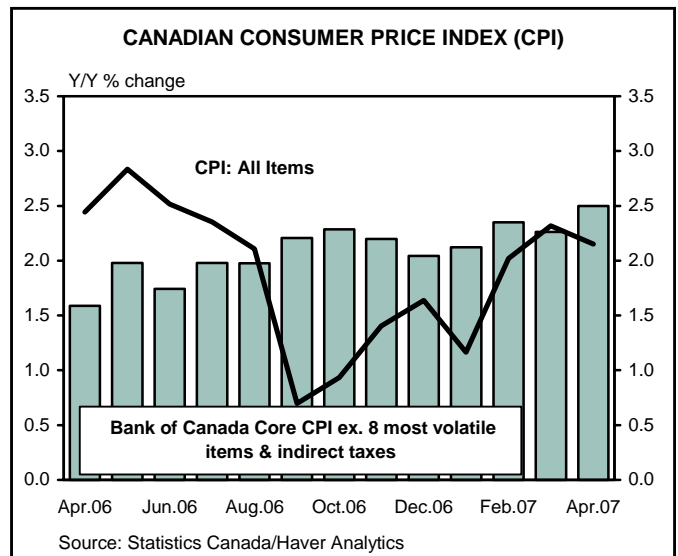
Release Date: June 19/07

TD Forecast: all-items +0.7%; core +0.4%

Consensus: all-items +0.4%; core +0.3%

We expect core CPI to increase by 0.4% in May, and all-items CPI by 0.7%. Although these numbers may look large, there are seasonal factors at play, and once seasonally-adjusted, core CPI is expected to show a more moderate 0.2% gain and all-items CPI a 0.6% gain. The all-items figure is going to be supported by yet another big increase in gasoline prices, as well as smaller increases in the prices of fuel oil and natural gas, pushing the year-over-year measure up to 2.4%. Core CPI is actually going to fall on a year-over-year basis – we’re forecasting a drop to 2.3% - but this does not mean that Canada’s inflation worries are over, since this is only due to base effects. In June, we expect to see core CPI jump back up again to around 2.6%, keeping the Bank of Canada on their toes.

Jacqui Douglas 416-982-7784



Canadian Retail Trade - April

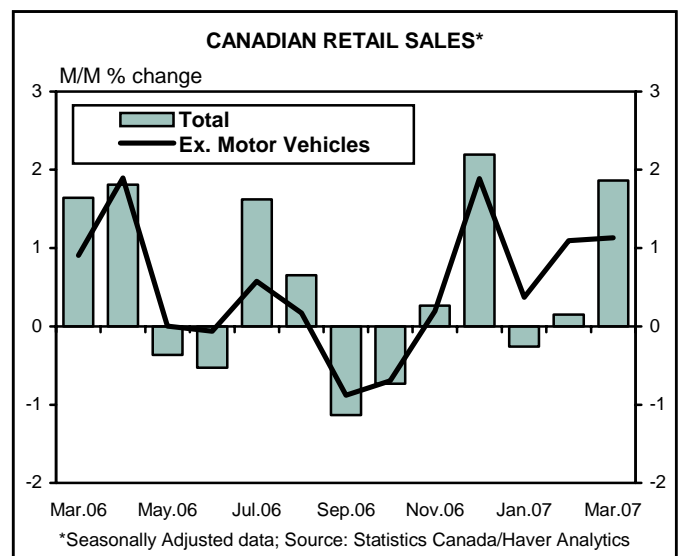
Release Date: June 21/07

TD Forecast: total +2.0%; ex-autos +0.5%

Consensus: total +1.1%; ex-autos +0.5%

We expect total retail sales to record a whopping 2.0% increase in April, which is even more impressive on the back of March’s 1.9% gain. The surge in retail sales is due primarily the increase in the sales of new motor vehicles, which gained 6.9% in April. Ex-autos sales are expected to record a more subdued 0.5% gain. With the surprising strength in Canada’s housing sector that we’ve seen so far this spring, we expect much of the strength in sales excluding autos to come from housing-related sectors like furniture stores, home electronics and appliance stores, and building and garden materials. But with higher gasoline prices and higher interest rates, consumer spending is likely to slow in the second half of the year.

Jacqui Douglas 416-982-7784



RECENT KEY ECONOMIC INDICATORS

June 11- 15, 2007

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
June 11	New Housing Price Index	Apr.	% Chg.	0.8	0.3	
June 11	Capacity Utilization	Q1-07	Per cent	83.0	82.4	R▼
June 12	Labour Productivity	Q1-07	Q/Q % change	0.7	0.2	R▼
June 13	Manufacturing Shipments	Apr.	% change	-0.6	3.0	R▲
June 15	New Motor Vehicle Sales	Apr.	% change	6.9	0.4	R▲
United States						
June 13	Retail Sales	May	% change	1.4	-0.1	R▲
June 13	Retail Sales ex. autos	May	% change	1.3	0.1	R▲
June 13	Business Inventories	Apr.	% change	0.4	0.0	R▲
June 14	Producer Price Index (PPI)	May	% change	0.9	0.7	
June 14	PPI excl. food and energy	May	% change	0.2	0.0	
June 14	Weekly Initial Jobless Claims	9-Jun	Thousands	311	311	R▲
June 15	Consumer Price Index (CPI)	May	% change	0.7	0.4	
June 15	CPI - excl. food and energy	May	% change	0.1	0.2	
June 15	Empire Manufacturing Survey	June	Index	25.8	8.0	
June 15	Current Account Balance	Q1-07	US\$, blns	-192.6	-187.9	R▲
June 15	Industrial Production	May	% change	0.0	0.4	R▼
June 15	Capacity Utilization	May	Per cent	81.3	81.5	R▼
June 15	University of Michigan Consumer Confidence	June	Index	83.7	88.3	

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR

June 18- 22, 2007

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
June 18	International Securities Transactions	Apr.	\$C, blns	3.0	4.7
June 19	Consumer Price Index (CPI)	May	Y/Y % chg.	2.2	2.2
June 19	CPI - excl. 8 most volatile items	May	Y/Y % chg.	2.3	2.5
June 20	Wholesale Sales	Apr.	% change	0.5	1.9
June 20	Leading Indicators	May	% change	0.5	0.4
June 21	Retail Sales	Apr.	% change	1.1	1.9
June 21	Retail Sales - excl. autos	Apr.	% change	0.5	1.1
United States					
June 19	Housing Starts	May	Thousands	1,480.0	1,528.0
June 19	Building Permits	May	Thousands	1,480.0	1,429.0
June 21	Weekly Initial Jobless Claims	16-Jun	Thousands	310.0	311.0
June 21	Leading Indicators	May	% change	0.2	-0.5
June 21	Philadelphia Fed Index	June	Index	6.8	4.2

Source: Bloomberg, TD Economics

G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
June 18	8:30 19:00	Canada U.S.	International Securities Transactions <i>Boston Fed President Minehan gives opening remarks at the bank's research conference in Chatham, MA</i>	Apr.	\$C, blns	3.0	4.7
June 19	5:00 5:00 5:00 7:00 7:00 8:15 8:30 8:30 8:30 19:50 21:30	EU-12 Germany Germany Canada Canada U.S. U.S. U.S. U.S. Japan AU	ZEW Survey - Economic Sentiment ZEW Survey - Economic Sentiment ZEW Survey - Current Situation Consumer Price Index (CPI) CPI - excl. 8 most volatile items <i>Boston Fed President Minehan gives introductory remarks at the bank's economic conference in Chatham, MA</i> <i>Former Fed Chairman Volcker speaks on 'Corruption in the Financial World' in Georgetown, KY</i> Housing Starts Building Permits Bank of Japan Monetary Policy meeting minutes for May released New Motor Vehicle Sales	June June June May May May May May	Index Index Index Y/Y % chg. Y/Y % chg. Thousands Thousands % change	26.0 29.0 88.0 2.2 2.3 1,480 1,480 n/a	22.3 24.0 88.0 2.2 2.5 1,528 1,429 -1.1
June 20	4:30 8:30 8:30 10:00 11:30 19:50	U.K. Canada Canada U.S. U.S. U.S. Japan	Bank of England minutes released Wholesale Sales Leading Indicators <i>Treasury Secretary Paulson testifies at the House Financial Services Committee in Washington, D.C.</i> <i>Fed Presidents Yellen and Geithner speak at Conference on Asian Financial Sectors in San Francisco, CA</i> <i>Dallas Fed President Fisher speaks on Regional Economy in Abilene, TX</i> Trade Balance	 Apr. May May	 % change % change ¥, blns	 0.5 0.5 470.4	 1.9 0.4 922.8
June 21	2:45 4:00 8:30 8:30 8:30 9:00 9:00 10:00 12:00 13:30	France EU-12 U.S. Canada Canada Canada U.S. U.S. U.S. Canada	Consumer Spending Purchasing Managers Index (Man.) Weekly Initial Jobless Claims Retail Sales Retail Sales - excl. autos <i>Bank of Canada releases Financial System Review</i> <i>Federal Reserve's Consumer Advisory Council holds meeting on home lending in Washington, D.C.</i> Leading Indicators Philadelphia Fed Index <i>Bank of Canada Deputy Governor Macklem speaks on International Monetary System in Winnipeg, MB</i>	May June 16-Jun Apr. Apr. May June	% change Index Thousands % change % change % change Index	0.5 54.9 310.0 1.1 0.5 0.2 6.8	-0.3 55.0 311.0 1.9 1.1 -0.5 4.2
June 22	4:00 4:00 4:00 8:45	Germany Germany Germany U.S.	Ifo Business Climate Survey Ifo Survey - Current Assessment Ifo Survey - Business Expectations <i>Cleveland Fed President Pianalto gives remarks at the 2007 community development summit in Cleveland, OH</i>	June June June	Index Index Index	108.4 112.2 104.7	108.6 112.5 104.8

* Eastern Standard Time; Sources: Bloomberg, TD Economics

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