



TD Economics

The Weekly Bottom Line

June 27, 2008

HIGHLIGHTS

- Fed leaves rates at 2.00%
- Statement suggests extended pause, no near-term hike

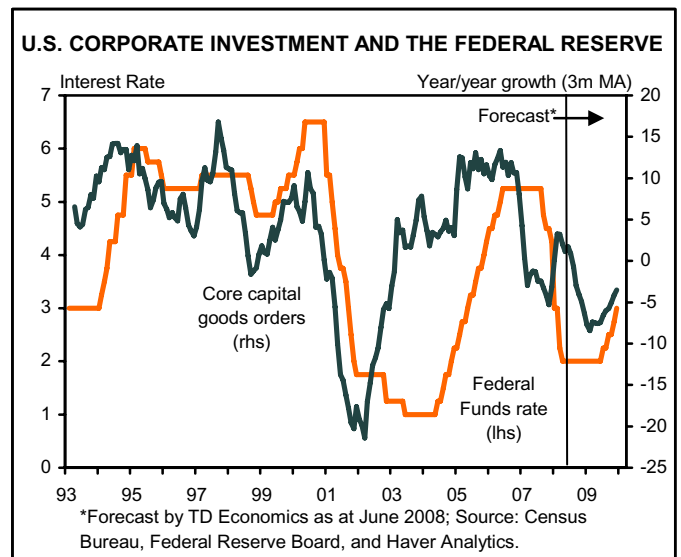
In a week filled with second-tier economic indicators, the importance of words took center stage. In particular, the words of the FOMC's statement that accompanied their decision to leave U.S. rates at 2.00%. While June has been a central bank hawkfest, U.S. and European officials have recently had to back off. Central bankers are not blind automatons and a number of downside risks to economic growth – and yes inflation – remain. In the words this week of Mervin King, Governor of the Bank of England, "It's not sensible to bring inflation back to target in the next six months. That would lead to a deep recession and that would be silly." It remains to be seen whether the markets have a sense of humour.

The Inflation Scare

We do not really care about inflation. Those are the seven words the Federal Reserve can't say – or any other central bank for that matter. The seven words they can and did say, however, was that the "uncertainty about the inflation outlook remains high." U.S. import price inflation for every major category is now running faster than domestic inflation, which has the potential to intensify U.S. inflation. Moreover, oil prices have kept headline inflation stubbornly high.

Recent TD Economics Research

June 27, 2008 - U.S. Personal Income and Spending
 June 26, 2008 - Canada's Housing Boom Comes To An End
 June 25, 2008 - U.S. FOMC Interest Rate Decision
 June 25, 2008 - If a Central Bank's Forecast Falls Short of the Mark, Does It Make a Sound?
 June 25, 2008 - U.S. Durable Goods Orders



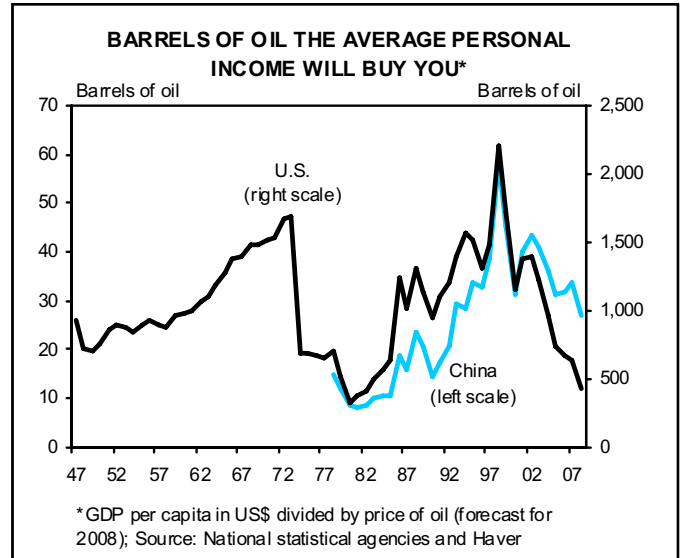
So, while visions of stagflation dance in investors' heads, the Fed this week said that they continue to expect "inflation to moderate later this year and next year." In fact, total inflation for consumer goods in the PCE index was running 3.1% as of May, down from the 3.5% pace it ended 2007 with. The core PCE inflation measure that the Fed likes to look at was at 2.15% y/y as of December 2007 and 2.14% as of May 2008 – nary a smidgen of new inflationary pressures. And, the six month trend in core PCE inflation is now sitting at 1.99%, just inside the 1.5%-2.0% range the Fed is comfortable with. Importantly, the experience in the U.S. over the last decade is that headline inflation converges to the core rate, not the other way around. There is no evidence this dynamic has changed, but the Fed is right to be cautious.

The "Other" Risk

The worst may be yet to come - the seven words to describe our U.S. outlook. The Fed acknowledged that downside risks to growth have "diminished somewhat," and GDP growth for the first quarter was revised up this week to 1.0% q/q. In the second half of 2007, housing was the only component of U.S. GDP to contract. Data

on home prices and new and existing sales this week confirm this is likely to continue through 2008; however, a nosedive in consumer confidence highlights the large downside risk for consumer spending. Moreover, there is a sizeable – and, in our opinion, too little discussed – risk that business investment will become increasingly weak as we move forward. Changes in core capital goods orders – a measure for business investment – have been reasonably good at predicting Fed interest rate moves. U.S. core capital goods orders fell 0.8% m/m in May, and while they are still up 2.6% on a year ago basis, the credit crunch has yet to fully make itself felt.

An increasing share of business investment has had to rely on borrowing from the financial sector. At nearly one-third of all capital expenditures right now, this dependence is close to the peaks seen in the previous two energy-induced recessions and the tech bust. Following each of these episodes, the pace of business investment slowed by 20-30 percentage points. From March 2007 to March 2008, the pace of business investment in the U.S. accelerated from 5% to 7%. This will be hard to sustain, as the U.S. financial sector's precarious situation only worsened through June. Over the last couple of weeks, the cost of funding for banks (LIBOR-OIS spreads) has risen by about 15%, the cost of insuring against default in U.S. investment grade corporate debt (CDS spreads) has risen by over 40%, and the Fed is looking to loosen restrictions for private equity groups to invest in banks to help replenish capital. There very well may be global opportunities that corporations could take advantage of if only they had the cash to invest, but he who controls capital, controls the economy.

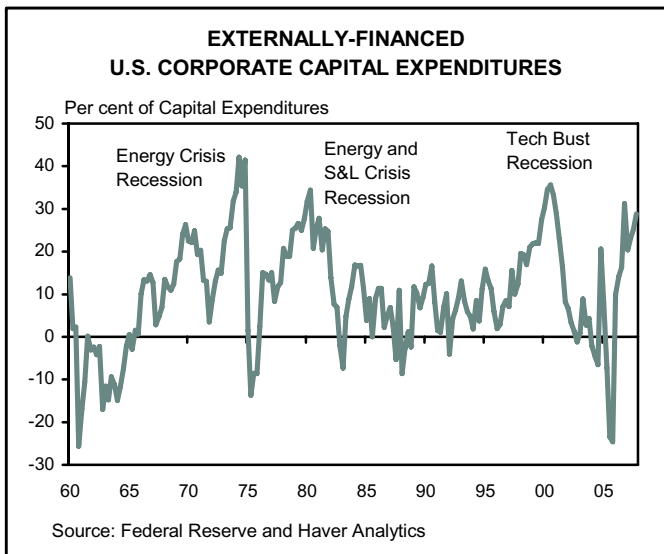


Black Gold

Suffice it to say, oil rose again - the seven words you didn't need me to say. As of midday Friday, WTI crude prices had risen to 974 yuan – that's 142 U.S. dollars for those still tied to antiquated accounting methods. While the impact of the falling U.S. dollar has been well reported, the rapid rise in Chinese incomes is playing a role, as well. As the chart here shows, the average U.S. income will buy 70% less barrels of oil now than it could in 2002, double the decline in Chinese purchasing power. In fact, Chinese purchasing power is where it was in 1994, a far cry from the U.S. where it is near an all-time low. This week, a Chinese firm agreed to a 97% increase in the price of imported iron ore. Others have balked at such a price increase this year, though. It would not be that far off to say China is in a world of its own.

Oil remains behind the inflation scare sweeping the global economy. The Indian central bank provided its second surprise increase in two weeks to both interest rates and the level of reserves banks are forced to keep on hand as falling fuel subsidies drove inflation sharply higher. Meanwhile, ECB President Jean-Claude Trichet signaled a likely quarter-point rate increase next week to help ensure Eurozone inflation expectations stay grounded in the face of rising energy costs. The expectation remains that the ongoing decline in global economic activity will eventually bring oil prices and inflation lower. Until then, we will be forced to mutter a few choice words under our breath.

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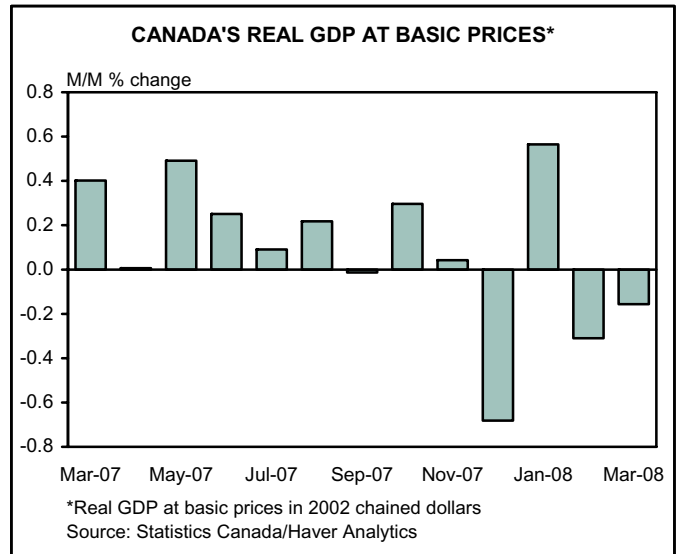
UPCOMING KEY ECONOMIC RELEASES

Canadian Real GDP - April

Release Date: June 30/08
March Result: -0.2% M/M
TD Forecast: +0.3% M/M
Consensus: +0.2% M/M

After posting two consecutive monthly declines in February and March, Canadian economic activity should bounce-back in April, with a fairly reasonable 0.3% M/M gain. The main drivers behind this turnaround in economic activity in April are the rather robust pace of retail and wholesale activity during the month, and the expansion in manufacturing shipments. The rebound in production in April will likely put the Canadian economy back on track for a positive print on GDP growth in Q2, following the contraction in domestic output in Q1 – which was the first quarterly decline in GDP since Q2 2003. However, with the U.S. economy continuing to struggle, we are unlikely to see any sustained upswing in Canadian economic activity in the near term. Note that if there is a risk to this forecast, it is likely to be to the upside.

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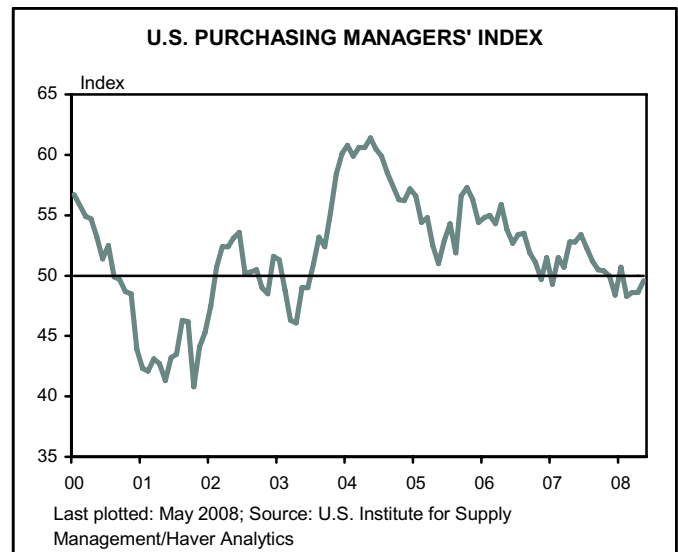


U.S. ISM Manufacturing Report - June

Release Date: July 1/08
May Result: 49.6
TD Forecast: 48.0
Consensus: 49.0

The U.S. manufacturing sector continues to struggle under the weight of sluggish domestic demand and high input costs. And despite the important offset that the export sector continues to provide to these factors, we expect the deterioration in the U.S. manufacturing sector to continue in June. In particular, with the regional Fed manufacturing indices all pointing down during the month, the ISM will likely remain below the 50-threshold for the fifth consecutive month, with a 48.0 print (slightly down from 49.6 in May).

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U.S. Nonfarm Payrolls - June

Release Date: July 3/08

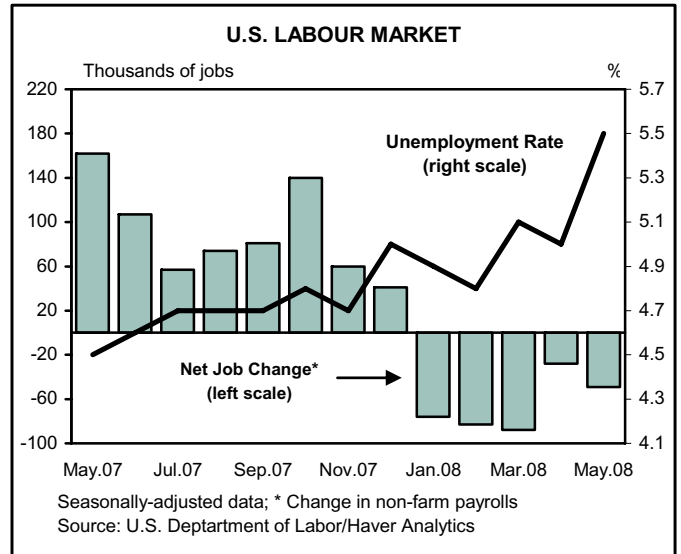
May Result: -49K; unemployment rate 5.5%

TD Forecast: -75K; unemployment rate 5.4%

Consensus: -50K; unemployment rate 5.4%

With a slowing economy and rock-bottom consumer confidence, the U.S. labour market continues to be weak as businesses conserve on their use of labour in response to the sluggish consumer demand for their products. However, despite the 324K jobs that have been lost since the economy started shedding jobs in January, the extent of job losses has been relatively mild compared to previous cycles. This is likely to change in the near term. We expect U.S. non-farm payrolls to decline for the sixth straight month, and for the deterioration to accelerate in June with a more profound -75K, compared to the -49K in May. And all indications are that the demise in the U.S. labour market will continue into the coming months. We expect to see the unemployment rate fallback modestly in June to 5.4%, following the surprising spike to 5.5% in May.

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RECENT KEY ECONOMIC INDICATORS

June 23-June 27, 2008

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
June 27	Industrial Product Price Index	May	% Chg.	0.6	1.6	R▲
June 27	Raw Materials Price Index	May	% Chg.	3.1	5.0	R▼
United States						
June 24	S&P/CS Composite-20	Apr.	Y/Y % chg.	-15.3	-14.3	R▼
June 24	Consumer Confidence	Jun.	Index	50.4	58.1	R▲
June 24	Richmond Fed Index	Jun.	Index	-12.0	-3.0	
June 25	MBA Mortgage Applications	20-Jun	% Chg.	-9.3	-8.7	R▼
June 25	Durable Goods Orders	May	% Chg.	0.0	-1.0	R▼
June 25	New Home Sales	May	Thousands	512.0	525.0	R▼
June 25	FOMC Rate Decision	25-Jun	Overnight Rate	2.00	2.00	
June 26	Weekly Initial Jobless Claims	21-Jun	Thousands	384.0	384.0	R▲
June 26	Existing Home Sales	May	US\$, mlns	4.99	4.89	
June 27	Personal Income	May	% Chg.	1.9	0.3	R▲
June 27	Personal Spending	May	% Chg.	0.8	0.4	R▲
June 27	PCE Deflator	May	Y/Y % chg.	3.1	3.2	
June 27	PCE Core	May	Y/Y % chg.	2.1	2.1	

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR

June 30-July 4, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
June 30	Real GDP at Basic Prices	Apr.	% Chg.	0.3	-0.2
July 1	<i>Canada Day - Market and Public holiday</i>				
July 4	Ivey Purchasing Managers Index	Jun.	Index	62.0	62.5
United States					
June 30	Chicago Purchasing Managers Index	Jun.	Index	48.4	49.1
July 1	Domestic Vehicle Sales	Jun.	Millions	10.3	10.5
July 1	Total Vehicle Sales	Jun.	Millions	14.2	14.3
July 1	ISM Manufacturing	Jun.	Index	49.0	49.6
July 1	Construction Spending	May	% Chg.	-0.6	-0.4
July 1	<i>Atlanta Fed President Lockhart speaks on the economic slowdown, market fallout and path to recovery at Georgetown University.</i>				
July 2	MBA Mortgage Applications	27-Jun	% Chg.	--	-9.3
July 2	ADP Employment Change	Jun.	Thousands	-20.0	40.0
July 2	Factory Orders	May	% Chg.	0.5	1.1
July 2	<i>Fed Governor Mishkin speaks on "The Global Financial Disruption and World Economy" at conference in Israel.</i>				
July 3	Change in Non-farm Payrolls	Jun.	Thousands	-55.0	-49.0
July 3	Unemployment Rate	Jun.	Per cent	5.4	5.5
July 3	Average Hourly Earnings	Jun.	% Chg.	0.3	0.3
July 3	Weekly Initial Jobless Claims	28-Jun	Thousands	--	384.0
July 3	ISM Non-manufacturing Composite	Jun.	Index	51.5	51.7
July 4	<i>Independence Day - Market and Public holiday</i>				

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 30	1:00	Japan	Housing Starts	May	Y/Y % chg.	-3.7	-8.7	
	5:00	EU	Euro-Zone CPI (estimate)	Jun.	Y/Y % chg.	3.8	3.6	
	8:30	Canada	Real GDP at Basic Prices	Apr.	% Chg.	0.3	-0.2	
	9:45	U.S.	Chicago Purchasing Managers Index	Jun.	Index	48.4	49.1	
July 1	---	Canada	<i>Canada Day - Market and Public holiday</i>					
	0:00	U.S.	Domestic Vehicle Sales	Jun.	Millions	10.3	10.5	
	0:30	AU	RBA Cash Target	2-Jul	Cash Rate	7.25	7.25	
	1:00	Japan	Vehicle Sales	Jun.	Y/Y % chg.	--	-6.1	
	2:00	Germany	Retail Sales	May	% Chg.	0.5	-0.6	
	3:55	Germany	Unemployment Rate	Jun.	Per cent	7.9	7.9	
	3:55	Germany	Unemployment Change	Jun.	Thousands	-15.0	4.0	
	4:30	UK	Purchasing Managers Index (mfg.)	Jun.	Index	49.8	50.0	
	5:00	EU	Unemployment Rate	May	Per cent	7.1	7.1	
	--	U.S.	Total Vehicle Sales	Jun.	Millions	14.2	14.3	
	10:00	U.S.	ISM Manufacturing	Jun.	Index	49.0	49.6	
	10:00	U.S.	Construction Spending	May	% Chg.	-0.6	-0.4	
	18:00	U.S.	<i>Atlanta Fed President Lockhart speaks on the economic slowdown, market fallout and path to recovery at Georgetown University.</i>					
	19:50	Japan	Monetary Base	Jun.	Y/Y % chg.	--	-0.9	
21:30	AU	Retail Sales	May	% Chg.	0.1	-0.2		
July 2	5:00	EU-12	Euro-Zone PPI	May	% Chg.	--	0.8	
	7:00	U.S.	MBA Mortgage Applications	27-Jun	% Chg.	--	-9.3	
	8:15	U.S.	ADP Employment Change	Jun.	Thousands	-20.0	40.0	
	10:00	U.S.	Factory Orders	May	% Chg.	0.5	1.1	
	11:00	UK	<i>U.S. Treasury Secretary Paulson speaks on markets and the economy in London.</i>					
	12:00	U.S.	<i>Fed Governor Mishkin speaks on "The Global Financial Disruption and World Economy" at conference in Israel.</i>					
	21:30	AU	Trade Balance	May	AU, mlns	-950.0	-957.0	
July 3	4:30	UK	Purchasing Managers Index (serv.)	Jun.	Index	49.5	49.8	
	5:00	EU-12	Euro-Zone Retail Sales	May	% Chg.	--	-0.7	
	7:45	EU	<i>European Central Bank Announces Interest Rates</i>					
	8:30	U.S.	Change in Non-farm Payrolls	Jun.	Thousands	-55.0	-49.0	
	8:30	U.S.	Unemployment Rate	Jun.	Per cent	5.4	5.5	
	8:30	U.S.	Average Hourly Earnings	Jun.	% Chg.	0.3	0.3	
	8:30	U.S.	Weekly Initial Jobless Claims	28-Jun	Thousands	--	384.0	
	10:00	U.S.	ISM Non-manufacturing Composite	Jun.	Index	51.5	51.7	
July 4	---	U.S.	<i>Independence Day - Market and Public holiday</i>					
	1:00	Japan	Leading Economic Index (prelim.)	May	Index	93.0	92.8	
	1:00	Japan	Coincident Index (prelim.)	May	Index	103.4	101.7	
	6:00	Germany	Factory Orders	May	% Chg.	0.6	-1.8	
	10:00	Canada	Ivey Purchasing Managers Index	Jun.	Index	62.0	62.5	

* Eastern Standard Time; Sources: Bloomberg, TD Economics

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