



TD Economics

The Weekly Bottom Line

March 14, 2008

HIGHLIGHTS

- **Weakness in U.S. data seal the deal on additional Fed rate cuts**
- **Central banks increase liquidity injections in efforts to stave off further deterioration in credit markets**

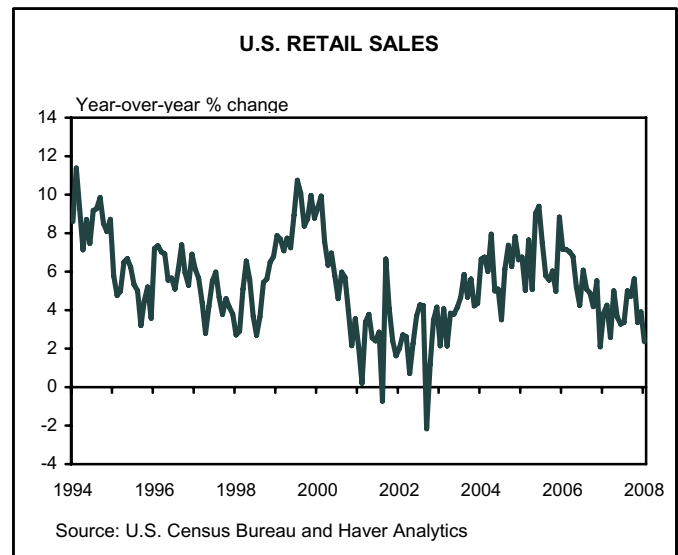
With oil prices pushing past \$110 barrel, a very soft retail spending report and news of the collapse of a major U.S. hedge fund, the timing of Friday's consumer price report could not have been better. While U.S. Treasuries rallied on the expectation that softening inflation seals the deal on at least another 50 basis points in rate cuts when the Fed meets on Tuesday, the response in equity markets was crowded out by yet more bad news from financials - this time with Bear Stearns announcing it was seeking emergency funding to avoid a major cash crunch. In Canada, on the other hand, signs that the domestic economy continues to fire on all cylinders emerged from another strong housing market report. And in a timely speech on financial market turbulence, Bank of Canada governor Mark Carney noted that while better risk management practices have shielded Canadian financial institutions from the worst of recent U.S. outcomes, we are not immune to problems south of the border.

U.S. retail sales show consumer on the brink

If any further proof was needed that U.S. consumers are buckling under the weight of a slowing job market,

Recent TD Economics Research

March 14, 2008 - The 2008 Quebec Budget
 March 14, 2008 - U.S. Consumer Price Index
 March 13, 2008 - U.S. Retail Sales
 March 11, 2008 - Time to Re-think Financial Assistance for Post-secondary Education
 March 11, 2008 - Canadian International Trade
 March 10, 2008 - Canadian Housing Starts



falling home prices and rising energy costs, February's retail sales report may just have provided the smoking gun. Total retail sales fell 0.6% in the month with declining purchases of durable goods from automobiles to home furnishings and electronics and appliances responsible for much of the drop. Perhaps even more telling than the month-to-month decline is that nominal retail sales are now up only 2.6% from a year ago. With CPI inflation still running above 4% this implies that in real terms sales are likely now declining. With the housing market showing few signs of bottoming and continued problems in credit markets, the outlook for consumer spending will remain grim over the next several months. And while the rebate checks, being mailed out in May and June of this year, will provide some support, slackening prospects for income and household net-worth suggest that the windfall will be saved or used for debt reduction rather than towards priming the economy through spending.

Inflation holds steady and not a moment too soon

One concern surrounding aggressive past and future Fed easing has been elevated consumer prices. Given the situation facing consumers, Friday's inflation reading could not have found a better time to surprise on the

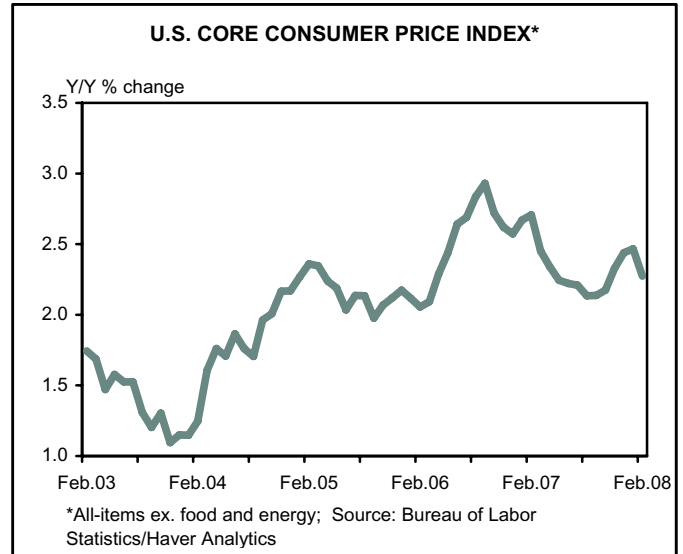
downside. While consensus had been calling for a 0.2% increase in the headline reading and 0.3% in core inflation, both headline and core remained steady in the month. Though the reading was unambiguously positive, the U.S. is not out of the inflation woods yet. Inflation expectations have risen significantly in the last several months with the market-based measure (based on the spread between inflation protected and nominal Treasury securities) showing 2.8% on a year-over-year basis, its highest reading since 2004.

Net-trade improves in Canada, deteriorates in the U.S.

This week also featured international trade reports for January for both Canada and the U.S. In Canada, the report was modestly positive as exports rebounded by 3.6% after falling 3.8% in December. Unfortunately, price effects were responsible for much of the gains and in real terms exports showed a negligible 0.3% gain, while imports fell 0.4%. Real exports of automotive products continued to plummet in the month, falling 14.7% - the largest decline in over a decade. With the U.S. consumer's spending on durable goods stalling, automotive exports are unlikely to see much improvement in the near future. Exports in the U.S., on the other hand, continued to leverage the weak U.S. dollar to reasonably strong gains in January. However, as imports were also up and are significantly larger than exports, the net result was a deterioration in the trade balance. Nonetheless, net trade is likely to be the one source of strength to the U.S. economy over the next several quarters. But, given that it represents a small piece of the overall U.S. economy net export growth is unlikely to be able to fully offset the considerable weakness in domestic demand.

Central banks try again to keep liquidity train rolling

With problems in financial markets percolating and continuing to threaten outcomes in the real economy, the Federal Reserve (in coordination with a number of central banks, including the Bank of Canada) made another attempt to counter mounting liquidity problems by announcing a further expansion in its term lending facilities. The Fed announcement made available \$200 billion in 28-day Treasury Bills in exchange for a widened list of collateral including agency-backed mortgage securities. Prior to the announcement short term lending markets looked to be freezing up and spreads between Treasuries and inter-bank lending rates had risen several basis points on the heightened level of risk aversion. The Fed's action should help to shore up short term lending markets and will also take pres-



sure off dealers holding mortgage securities backed by government sponsored enterprises. Recently investors have pushed up yields on agency-backed securities, which given the complete drying up of the subprime mortgage market, remain one of the last sources of mortgage credit available. As the Fed has recognized, if conditions in housing markets are ever to improve these sources of funding must remain available. Though these moves generated an immediate rise in equities and sell-off in fixed income, developments later in the week served to largely unwind these gains.

Carney emphasizes the importance of effective risk management

Bank of Canada governor, Mark Carney also had liquidity on his mind this week and in a speech in Toronto commented extensively on recent market turbulence. Along with a discussion of the main causes of the current credit crunch - mispricing of risk, inadequate transparency and misaligned incentives - he spent a significant amount of time discussing the official sector's role in cleaning up the mess, most specifically by ensuring adequate liquidity exists in financial markets. In his comments, the governor emphasized the need for adequate liquidity management but also reiterated the central bank's commitment to broaden the ability of the central bank to support market liquidity. On the broader subject of monetary policy, contagion from the U.S. will likely continue to call for more monetary stimulus and we continue to expect an additional 50 basis points in easing at each of the next two Bank of Canada fixed announcement meetings.

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UPCOMING KEY ECONOMIC RELEASES

Canadian Manufacturing Shipments - January

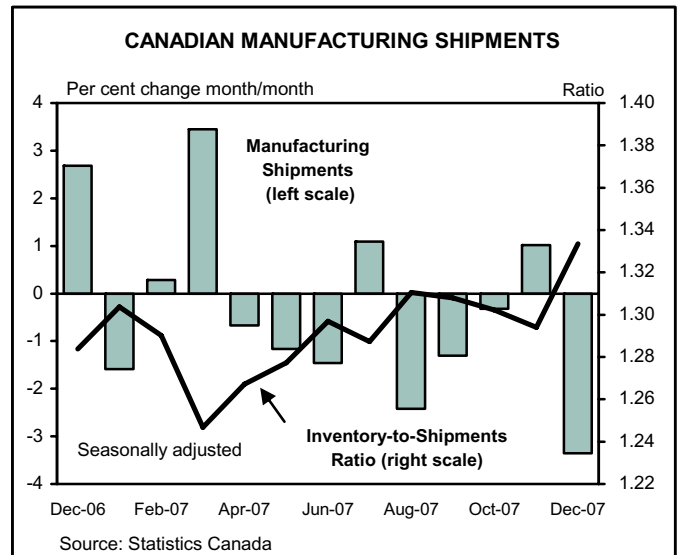
Release Date: March 17/08

December Result: -3.4%

TD Forecast: +0.2%

Consensus: 0.0%

We're expecting to see Canadian manufacturing shipments eke out a 0.2% monthly gain in January, after dropping by 3.4% in December. Unfortunately, it doesn't look like the manufacturing sector has improved much in the new year with the ISM manufacturing index wobbling around 50 from September 2007 onwards, and new orders of U.S. durable goods having fallen by 5.1% in January. Furthermore, the Canadian export data for the same month just add to the dour outlook for the manufacturing sector, with exports of machinery and equipment down 1.3%, and exports of automotive products down 9.9% following the 10.1% drop in December. However, the 10.7% increase in industrial goods and materials exports will help to keep manufacturing shipments from completely falling apart. But, with industrial prices up 0.9% in January, the



real manufacturing shipments figure will likely be softer than that headline number, and will likely post its third consecutive monthly drop.

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Canadian Consumer Price Index - February

Release Date: March 18/08

January Result: core +0.1% M/M, 1.4% Y/Y;

all-items -0.2% M/M, 2.2% Y/Y

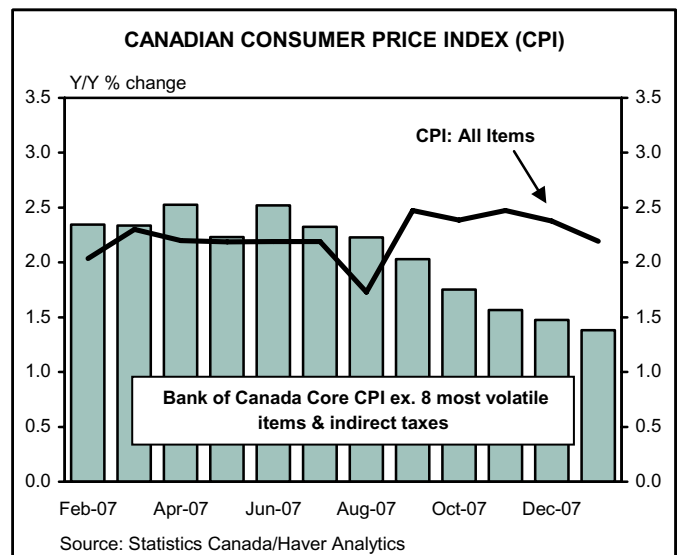
TD Forecast: core +0.4% M/M, 1.3% Y/Y;

all-items +0.4% M/M, 1.8% Y/Y

Consensus: core +0.3% M/M, 1.2% Y/Y;

all-items +0.3% M/M, 1.8% Y/Y

We're expecting to see Canadian inflation continue to soften in February, with core CPI falling to 1.3% Y/Y and all-items CPI to 1.8% Y/Y, which would be the first time that all-items CPI is below 2% since August 2007. While the monthly gains in both core CPI and all-items CPI look strong on the surface, the strength is coming largely from seasonal factors, which tend to add 0.2-0.3 percentage points to the monthly numbers. So on a seasonally-adjusted basis, both core and all-items CPI are expected to post more moderate 0.1% monthly gains. And as far as the component break-down goes, we'll likely continue to see upward pressure from both food prices and mortgage



interest costs. With the Canadian dollar no longer appreciating and holding steady near parity, we will no longer be immune to the food inflation that has affected the rest of the world.

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U.S. FOMC Interest Rate Decision

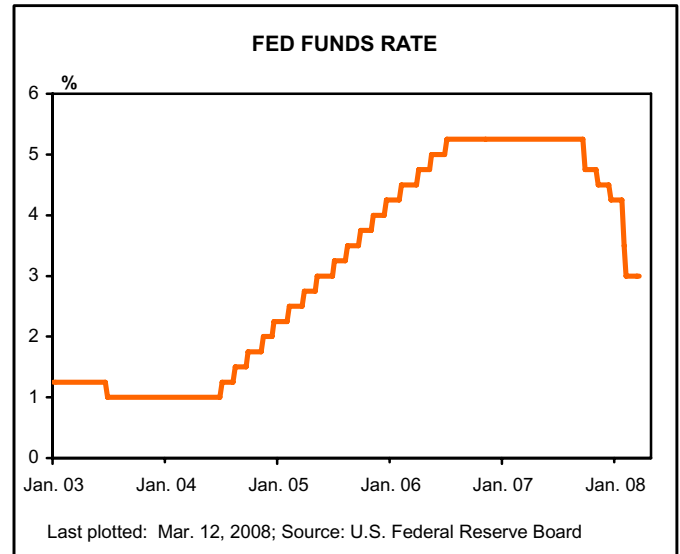
Release Date: March 18/08

Current Rate: 3.00%

TD Forecast: 2.50%

Consensus: 2.50%

Signs of economic deterioration in the U.S. continue to gather traction. Since the FOMC last met, there has been a spate of weak data on the manufacturing sector which has added to the existing weak profile of the housing market. Consumers are becoming increasingly pessimistic as the economy loses ground, oil prices are now well over \$100/bbl and it seems that consumers have not received much relief from the recent rate cuts. Aside from high frequency data, the more anecdotal evidence contained in the last Beige Book from the Fed has detailed a rather uniformly dour outlook for the economy. With few exceptions, economic activity has moderated measurably across the twelve Fed districts. Moreover, there seems to be another wave of credit concerns which has propelled the Fed into action once again. Since the last meeting, the Fed has twice pulled out its toolbox and helped to provide liquidity to the market through bolstered Term Auction Fa-



ILITIES (TAF) and the new Term Securities Lending Facility (TSLF) which allows the Fed to loan up to \$200 billion of Treasury securities to primary dealers. In short, the combination of ongoing macro economic slowing and lingering credit concerns underpins our view for another 50bps rate cut by the Fed.

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RECENT KEY ECONOMIC INDICATORS

March 10-14, 2008

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
Mar. 10	Housing Starts	Feb.	Thousands	256.9	222.7	
Mar. 11	International Merchandise Trade Balance	Jan.	C\$, blns	3.3	2.3	R▼
Mar. 11	New Housing Price Index	Jan.	% Chg.	0.6	0.1	
Mar. 13	Capacity Utilization Rate	Q4-07	Per cent	81.8	83.4	R▲
Mar. 14	Labour Productivity	Q4-07	Q/Q % change	-0.8	0.1	R▼
United States						
Mar. 10	Wholesale Inventories	Jan.	% Chg.	0.8	1.1	
Mar. 11	Trade Balance	Jan.	US\$, blns	-58.2	-57.9	R▲
Mar. 13	Retail Sales	Feb.	% change	-0.6	0.4	R▲
Mar. 13	Retail Sales ex. autos	Feb.	% change	-0.2	0.5	R▲
Mar. 13	Weekly Initial Jobless Claims	8-Mar	Thousands	353	353	R▲
Mar. 13	Business Inventories	Jan.	% change	0.8	0.7	R▲
Mar. 14	Consumer Price Index (CPI)	Feb.	% change	0.0	0.4	
Mar. 14	CPI - excl. food and energy	Feb.	% change	0.0	0.3	
Mar. 14	U. Michigan Consumer Confidence (prelim.)	Mar.	Index	70.5	70.8	

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR

March 17-21, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Mar. 17	Manufacturing Shipments	Jan.	% change	0.0	-3.4
Mar. 17	New Motor Vehicle Sales	Jan.	% change	6.0	4.8
Mar. 18	Consumer Price Index (CPI)	Feb.	Y/Y % chg.	1.8	2.2
Mar. 18	CPI - excl. 8 most volatile items	Feb.	Y/Y % chg.	1.2	1.4
Mar. 19	Wholesale Sales	Jan.	% change	0.5	-2.9
Mar. 20	International Securities Transactions	Jan.	\$C, blns	n/a	1.2
Mar. 20	Leading Indicators	Feb.	% change	0.1	0.2
United States					
Mar. 17	Current Account Balance	Q4-07	US\$, blns	-184.4	-178.5
Mar. 17	Empire Manufacturing Survey	Mar.	Index	-6.3	-11.7
Mar. 17	Industrial Production	Feb.	% change	-0.1	0.1
Mar. 17	Capacity Utilization	Feb.	Per cent	81.3	81.5
Mar. 18	Producer Price Index (PPI)	Feb.	% change	0.4	1.0
Mar. 18	PPI excl. food and energy	Feb.	% change	0.2	0.4
Mar. 18	Housing Starts	Feb.	Thousands	995	1,012
Mar. 18	Building Permits	Feb.	Thousands	1,023	1,061
Mar. 18	<i>FOMC Rate Decision</i>		<i>Overnight Rate</i>	2.50	3.00
Mar. 20	Weekly Initial Jobless Claims	15-Mar	Thousands	357	353
Mar. 20	Philadelphia Fed Index	Mar.	Index	-18.0	-24.0
Mar. 20	Leading Indicators	Feb.	% change	-0.3	-0.1

Source: Bloomberg, TD Economics

G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
Mar. 17	6:00	EU	Unemployment Rate	Q4-07	Per cent	n/a	0.3
	8:30	U.S.	Current Account Balance	Q4-07	US\$, blns	-184.4	-178.5
	8:30	Canada	Manufacturing Shipments	Jan.	% change	0.0	-3.4
	8:30	Canada	New Motor Vehicle Sales	Jan.	% change	6.0	4.8
	8:30	U.S.	Empire Manufacturing Survey	Mar.	Index	-6.3	-11.7
	9:15	U.S.	Industrial Production	Feb.	% change	-0.1	0.1
	9:15	U.S.	Capacity Utilization	Feb.	Per cent	81.3	81.5
	20:30	AU	<i>Reserve Bank of Australia publishes board minutes</i>				
Mar. 18	5:30	U.K.	Consumer Price Index	Feb.	Y/Y % chg.	2.5	2.2
	5:30	U.K.	Retail Price Index excl. Mortgages (RPIX)	Feb.	Y/Y % chg.	3.7	3.4
	7:00	Canada	Consumer Price Index (CPI)	Feb.	Y/Y % chg.	1.8	2.2
	7:00	Canada	CPI - excl. 8 most volatile items	Feb.	Y/Y % chg.	1.2	1.4
	8:30	U.S.	Producer Price Index (PPI)	Feb.	% change	0.4	1.0
	8:30	U.S.	PPI excl. food and energy	Feb.	% change	0.2	0.4
	8:30	U.S.	Housing Starts	Feb.	Thousands	995	1,012
	8:30	U.S.	Building Permits	Feb.	Thousands	1,023	1,061
	14:15	U.S.	<i>FOMC Rate Decision</i>		<i>Overnight Rate</i>	<i>2.50</i>	<i>3.00</i>
Mar. 19	5:30	U.K.	<i>Bank of England minutes released</i>				
	5:00	EU	Trade Balance	Jan.	Eur, blns	-7.0	-4.2
	8:30	Canada	Wholesale Sales	Jan.	% change	0.5	-2.9
Mar. 20	4:00	France	Purchasing Managers Index (Man.)	Mar.	Index	53.4	53.8
	4:30	Germany	Purchasing Managers Index (Man.)	Mar.	Index	54.0	54.3
	5:00	EU-12	Purchasing Managers Index (Man.)	Mar.	Index	52.0	52.3
	4:30	U.K.	Retail Sales	Feb.	% change	-0.2	0.8
	8:30	Canada	International Securities Transactions	Jan.	\$C, blns	n/a	1.2
	8:30	Canada	Leading Indicators	Feb.	% change	0.1	0.2
	8:30	U.S.	Weekly Initial Jobless Claims	15-Mar	Thousands	357	353
	10:00	U.S.	Philadelphia Fed Index	Mar.	Index	-18.0	-24.0
	10:00	U.S.	Leading Indicators	Feb.	% change	-0.3	-0.1
Mar. 21	---	EU, NA	<i>Good Friday - Market and public holiday</i>				
	3:45	France	Consumer Spending	Feb.	% change	0.4	-1.2

* Eastern Standard Time; Sources: Bloomberg, TD Economics

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