



TD Economics

The Weekly Bottom Line

March 31, 2006

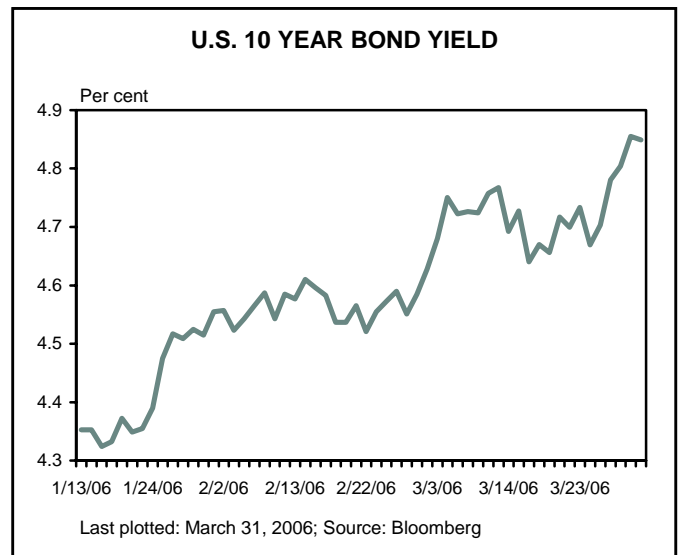
HIGHLIGHTS

- U.S. Treasury market suffers a setback
- Commodity prices remain on a tear, driving S&P TSX to a record
- Lacklustre Canadian GDP result stronger under the surface

It was a relatively quiet week on the U.S. data front. Yet, this didn't stop the U.S. Treasury market from taking a spill, with the 10-year yield surging by almost 20 basis points since last Friday, to 4.85 per cent. The Greenspan "conundrum" related to the ultra-low 4 per cent yield on U.S. 10-year bonds that was the focus a year ago appears to be a distant memory now. Canadian 10-year yields also backed up this week, but only by about half that magnitude. As a result, the U.S.-Canada spread gapped out to almost 60 basis points – its widest level in at least three decades.

U.S. bond investors hit sell

A confluence of factors led U.S. bond investors to flee to the exits this week. First, the FOMC communiqué on Tuesday left little to be desired. Following a widely expected quarter-point hike in the fed funds rate – to 4.75 per cent – the Fed essentially reiterated the same information that was contained in the January communiqué, thereby leaving the door wide open to the possibility of yet another rate hike at its next confab on May 10th. This disap-



pointed some investors who had hoped that the new Chairman, Ben Bernanke, was poised to send a clear signal that the end in the tightening cycle was imminent.

The bigger blow to Treasuries this week was delivered on Thursday. Normally, the final revision to U.S. quarterly GDP fails to catch the markets attention, because by the time it is rolled out, investors have already set their sights on more forward looking data for the current quarter. This was certainly not the case this time around. While the GDP turnaround remained at 1.7 per cent, fixed-income markets were caught off guard by the upward revision to the core PCE deflator – the Fed's favourite price measure – from an annual rate of 1.9 per cent to 2.1 per cent. This is still a relatively benign rate of increase, but places inflation at the upper end of the Fed's implicit comfort zone.

Meanwhile, a jump in world commodity prices only added fuel to the jitters. This week, the TD Commodity Price Index (TDCI) in U.S. dollar terms moved up by 2.1 per cent – reaching its highest level in two months – on the back of strong gains in prices for crude oil, gold, silver and base metals. Crude oil received a lift from con-

Recent TD Economics Research

March 31, 2006 - Canadian Real GDP at Basic Prices
 March 31, 2006 - U.S. Personal Income and Spending
 March 29, 2006 - Will There Again Be A Revenue Windfall For The Federal Budget?
 March 29, 2006 - British Columbia's Golden Decade
 March 28, 2006 - The 2006 New Brunswick Budget
 March 28, 2006 - U.S. FOMC Decision

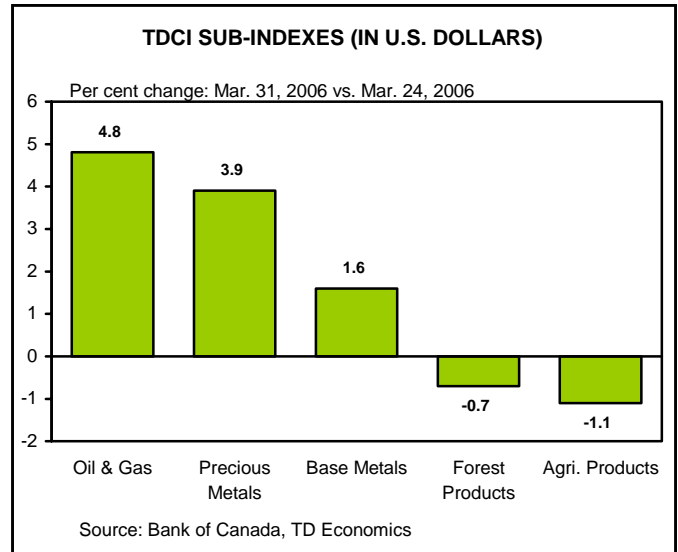
cerns about increasing tensions with Iran, as the United Nations Security Council gave the country 30 days to comply with International Atomic Energy Agency requirements. In addition to receiving support from heightened inflation fears, precious metal prices were further towed along by expectations that the launch of exchange-traded funds (ETFs) would continue to stir up investor interest. By week's end, gold prices had touched a new 25-year high of more than US\$575 per ounce.

While acknowledging the upside risks to prices, we don't believe that the inflation genie is set to pop out of the bottle. Globalization has capped inflationary pressures up until now, and this too is unlikely to change on temporary spikes in prices. What's more, we believe energy prices will be in retreat by the fall, as evidence of a U.S. economic slowdown emerges (see *TD Quarterly Economic Forecast*, March 2006). Friday morning data on personal income and expenditures also brought some reassuring news. In particular, the year-over-year increase in the core PCE measure has since eased to 1.8 per cent in both January and February. Our base-case scenario calls for both U.S. core PCE to remain stable, and for core CPI to hold at just over 2 per cent in the coming quarters. Accordingly, we are of the view that the Fed is more likely to hike rates just one more time in May – capping the tightening cycle at 5.00 per cent, with 10-year yields to drift back down to around 4.50 per cent by mid-year.

Commodity rally drives Canadian markets

In Canada, the story was commodities, commodities, commodities, which helped to drive the S&P TSX to a new record level of 12,207 – and the Canadian dollar to a 1-month high of 86.5 U.S. cents – on Thursday. Some of the air came out of the rally on Friday following a weaker-than-expected report on Gross Domestic Product (GDP) for January. Still, the pull-back in both equity markets and the loonie, to 85.8 U.S. cents and 12,100, respectively, was likely more to do with profit taking than any discernible shift in sentiment.

Indeed, the details underlying the lackluster 0.2 per cent turnout in Canadian real GDP in January point to an economy that continues to possess solid momentum. For one, output was curtailed by a substantial decline in utili-



ties output – which in turn reflected unseasonably warm weather – and temporary shutdowns in crude oil facilities and mining sites. And, secondly, January's outcome comes on the heels of an above-par 0.4 per cent gain in December. All in all, we still expect the economy to grow at more than 3 per cent in the first quarter of 2006. With this backdrop, we are looking for the Bank of Canada to raise its benchmark rate to 4.00 per cent on April 25th.

Paralleling the actions of the Fed, that is probably going to be the last move by Canada's central bank. Although the near-term outlook for service sector activity remains strong, the high Canadian dollar is expected to further dampen output in the manufacturing sector. Further, we expect commodity prices to head lower in the months ahead, as markets become increasingly concerned about a looming mid-cycle slowdown in the U.S. economy. This is likely to curtail some of the recent enthusiasm in Canada's resource sector. As such, real GDP growth is expected to slow to below 3 per cent in the second quarter, taking pressure off both inflation and the Bank of Canada to raise rates further.

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UPCOMING KEY ECONOMIC RELEASES

Canadian Employment - March

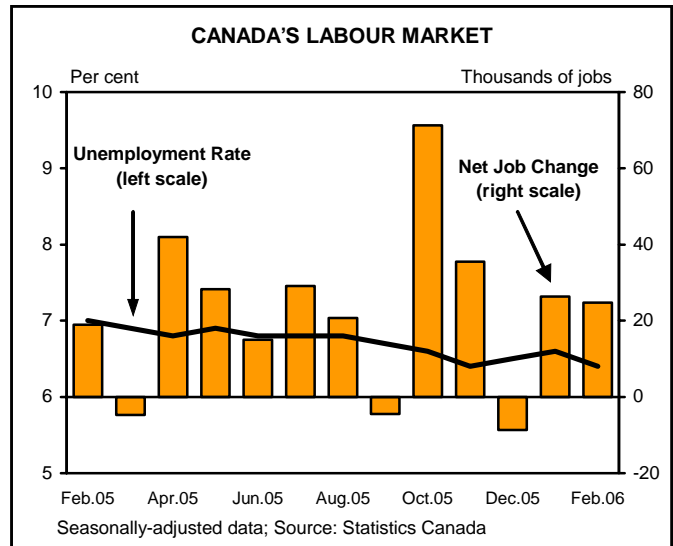
Release Date: April 7/06

TD Forecast: +15.0K

Consensus: +22.6K

Although the Canadian labour market is healthy by any measure you'd care to examine, we are dubious that the Canadian economy can sustain a fifth big job gain in just six months. As a result, we are looking for a moderate increase of 15,000 workers in March – a decent but uninspiring outcome. The manufacturing sector may experience softness after a large gain in February, as could retail and wholesale trade, which added 25,100 jobs between the two of them last month. In general, look for the service sector to outperform the goods sector. By contrast, Canada's unemployment rate is likely to remain unchanged at a rock bottom 6.4%, pointing to the fact that the current labour market is as strong as Canada has seen in several decades.

Eric Lascelles 416-982-8979



U.S. Nonfarm Payrolls - March

Release Date: April 7/06

TD Forecast: +190K

Consensus: +190K

The U.S. economy should generate another month of solid job gains in March, although perhaps not quite as impressive as the 243,000 new jobs created in February. All told, we anticipate the creation of 190,000 jobs, which should keep the U.S. unemployment rate unchanged at a low 4.8%. Driving this outlook, two regional economic surveys combine to suggest that job growth continued at a robust pace during the month. Meanwhile, jobless claims remained modest, although a little higher than the previous month, hence our slightly less exuberant outlook relative to February. Regardless, the U.S. job market remains quite healthy.

Eric Lascelles 416-982-8979



RECENT KEY ECONOMIC INDICATORS

March 27-31, 2006

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
Mar. 30	Industrial Product Price Index	Feb.	% change	-0.4	0.6	R▲
Mar. 30	Raw Materials Price Index	Feb.	% change	-3.2	4.9	R▼
Mar. 31	Real GDP at Basic Prices	Jan.	% change	0.4	0.4	
United States						
Mar. 28	Consumer Confidence	Mar.	Index	107.2	102.7	R▲
Mar. 28	Richmond Fed Index	Mar.	Index	21.0	0.0	
Mar. 28	<i>FOMC Rate Decision</i>		<i>Overnight rate</i>	4.75	4.50	
Mar. 30	Weekly Initial Jobless Claims	Mar. 25	Thousands	302	312	R▲
Mar. 31	Personal Income	Feb.	% change	0.3	0.7	
Mar. 31	Personal Spending	Feb.	% change	0.1	0.8	R▼
Mar. 31	PCE Deflator	Feb.	Y/Y % chg.	2.9	3.1	
Mar. 31	PCE Core	Feb.	Y/Y % chg.	1.8	1.8	
Mar. 31	Chicago Purchasing Managers Index	Mar.	Index	60.4	54.9	
Mar. 31	Factory Orders	Feb.	% change	0.2	-3.9	R▲

* Eastern Standard Time; Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR

April 3-7, 2006

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Apr. 4	<i>Bank of Canada Deputy Governor Duguay gives speech on "The Conduct of Monetary Policy: Dealing with Changes in Terms of Trade" to the Okanagan School of Business in Kelowna, BC</i>				
Apr. 6	Building Permits	Feb.	% change	0.2	-19.3
Apr. 6	Ivey Purchasing Managers Index	Mar.	Index	60.8	59.5
Apr. 7	Unemployment Rate	Mar.	Per cent	6.4	6.4
Apr. 7	Net Change in Employment	Mar.	Thousands	22.6	24.7
United States					
Apr. 3	<i>Fed Governor Kroszner speaks at a European conference in Frankfurt, Germany</i>				
Apr. 3	Construction Spending	Feb.	% change	0.5	0.2
Apr. 3	ISM Index (manufacturing)	Mar.	Index	57.5	56.7
Apr. 3	Total Vehicle Sales	Mar.	Millions	16.8	16.6
Apr. 3	Domestic Vehicle Sales	Mar.	Millions	13.40	13.30
Apr. 4	<i>Chicago Fed President Moskow speaks at a European conference in Frankfurt, Germany</i>				
Apr. 4	<i>Dallas Fed President Fisher speaks on free enterprise in Wichita Falls, TX</i>				
Apr. 4	<i>Richmond Fed President Lacker speaks to the economic roundtable of the Ohio Valley in Parkersburg, WV</i>				
Apr. 4	<i>Kansas City Fed President Hoenig speaks about monetary policy in Kansas City</i>				
Apr. 5	<i>Fed Chairman Bernanke announces the results of a financial literacy program in Washington, DC</i>				
Apr. 5	ISM Non-Manufacturing	Mar.	Index	59.0	60.1
Apr. 5	<i>Kansas City Fed President Hoenig speaks about monetary policy in Kansas City</i>				
Apr. 6	<i>Fed Governor Kroszner speaks on banking integration in London, England</i>				
Apr. 6	Weekly Initial Jobless Claims	Apr. 1	Thousands	305	302
Apr. 7	Change in Non-farm Payrolls	Mar.	Thousands	190.0	243.0
Apr. 7	Unemployment Rate	Mar.	Per cent	4.8	4.8
Apr. 7	Average Hourly Earnings	Mar.	% change	0.3	0.3
Apr. 7	Wholesale Inventories	Feb.	% change	0.5	0.1

* Eastern Standard Time; Source: Bloomberg, TD Economics

G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
Apr. 2	19:50	Japan	Tankan Large Manufacturers Index	Q1-06	Index	23.0	21.0
	19:50	Japan	Tankan Non-Manufacturers Index	Q1-06	Index	18.0	17.0
	21:30	AU	Trade Balance	Feb.	AU, mlns	-1,800	-2,690
Apr. 3	---	AU	<i>Reserve Bank April policy setting meeting held</i>				
	0:00	Japan	Vehicle Sales	Mar.	Y/Y % chg.	n/a	-1.2
	4:00	EU-12	Purchasing Managers Index (Man.)	Mar.	Index	55.0	54.5
	7:00	U.S.	<i>Fed Governor Kroszner speaks at a European conference in Frankfurt, Germany</i>				
	10:00	U.S.	Construction Spending	Feb.	% change	0.5	0.2
	10:00	U.S.	ISM Index (manufacturing)	Mar.	Index	57.5	56.7
	---	U.S.	Total Vehicle Sales	Mar.	Millions	16.8	16.6
	---	U.S.	Domestic Vehicle Sales	Mar.	Millions	13.4	13.3
	19:50	Japan	Monetary Base (YoY)	Mar.	Y/Y % chg.	n/a	1.9
Apr. 4	5:00	EU-12	Unemployment Rate	Feb.	Per cent	8.3	8.3
	5:00	EU-12	Euro-Zone PPI	Feb.	% change	0.5	1.2
	6:30	U.S.	<i>Chicago Fed President Moskow speaks at a European conference in Frankfurt, Germany</i>				
	12:00	U.S.	<i>Dallas Fed President Fisher speaks on free enterprise in Wichita Falls, TX</i>				
	12:45	U.S.	<i>Richmond Fed President Lacker speaks to the economic roundtable of the Ohio Valley in Parkersburg, WV</i>				
	20:45	U.S.	<i>Kansas City Fed President Hoenig speaks about monetary policy in Kansas City</i>				
	21:30	Canada	<i>Bank of Canada Deputy Governor Duguay gives speech on "The Conduct of Monetary Policy: Dealing with Changes in Terms of Trade" to the Okanagan School of Business in Kelowna, BC</i>				
	---	U.K.	<i>Bank of England's Monetary Policy committee meets</i>				
Apr. 5	4:00	EU-12	Services Index	Mar.	Index	58.2	58.2
	4:30	U.K.	Industrial Production	Feb.	% change	0.3	0.4
	4:30	U.K.	Manufacturing Production	Feb.	% change	0.2	0.2
	5:00	EU-12	Retail Trade	Feb.	% change	0.0	0.8
	9:30	U.S.	<i>Fed Chairman Bernanke announces the results of a financial literacy program in Washington, DC</i>				
	10:00	U.S.	ISM Non-Manufacturing	Mar.	Index	59.0	60.1
	20:45	U.S.	<i>Kansas City Fed President Hoenig speaks about monetary policy in Kansas City</i>				
	21:30	AU	Unemployment Rate	Mar.	Per cent	5.2	5.2
	21:30	AU	Net Change in Employment	Mar.	Thousands	10.0	25.9
Apr. 6	0:00	Japan	Leading Economic Index (prelim.)	Feb.	Index	n/a	81.8
	0:00	Japan	Coincident Index (prelim.)	Feb.	Index	n/a	95.0
	1:00	Japan	Machine Tool Orders (prelim.)	Mar.	Y/Y % chg.	n/a	5.6
	3:30	U.S.	<i>Fed Governor Kroszner speaks on banking integration in London, England</i>				
	4:00	EU-12	Purchasing Managers Index (Retail)	Mar.	Index	n/a	49.6
	6:00	Germany	Factory Orders (prelim.)	Feb.	% change	0.5	1.4
	7:00	U.K.	<i>Bank of England rate announcement</i>		<i>Base rate</i>	<i>4.50</i>	<i>4.50</i>
	7:45	EU-12	<i>European Central Bank rate announcement</i>		<i>Refin. rate</i>	<i>2.50</i>	<i>2.50</i>
	8:30	Canada	Building Permits	Feb.	% change	0.2	-19.3
	8:30	U.S.	Weekly Initial Jobless Claims	Apr. 1	Thousands	305	302
10:00	Canada	Ivey Purchasing Managers Index	Mar.	Index	60.8	59.5	
Apr. 7	2:00	Germany	Trade Balance	Feb.	Eur, blns	13.0	12.5
	2:00	Germany	Current Account Balance	Feb.	Eur, blns	6.4	5.1
	6:00	EU-12	OECD Leading Indicator	Feb.	Index	n/a	n/a
	6:00	Germany	Industrial Production (prelim.)	Feb.	% change	0.6	-0.1
	7:00	Canada	Unemployment Rate	Mar.	Per cent	6.4	6.4
	7:00	Canada	Net Change in Employment	Mar.	Thousands	22.6	24.7
	8:30	U.S.	Change in Non-farm Payrolls	Mar.	Thousands	190.0	243.0
	8:30	U.S.	Unemployment Rate	Mar.	Per cent	4.8	4.8
	8:30	U.S.	Average Hourly Earnings	Mar.	% change	0.3	0.3
	10:00	U.S.	Wholesale Inventories	Feb.	% change	0.5	0.1

* Eastern Standard Time; Sources: Bloomberg, TD Economics

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