TD Bank Financial Group

TD Economics

The Weekly Bottom Line

March 7, 2008

HIGHLIGHTS

- **U.S. weakness takes bite out of Canadian growth**
- **Bank of Canada to cut by another 50 bps in April**

Canada cannot escape the fallout from the U.S. economic slump was the message that rang loudly in the Bank of Canada's decision to pull the trigger on a 50 basis point cut to its overnight rate on Tuesday. In fact, in light of the increasingly "dovish" tone in the communiqué that accompanied the rate move and this week's spate of soft economic data, another rate cut in April appears a very good bet. The only question is: how much? Despite today's unexpectedly robust job report, the risks still are tilted towards another bold half-point reduction by the central bank, taking the overnight rate down to 3.00%.

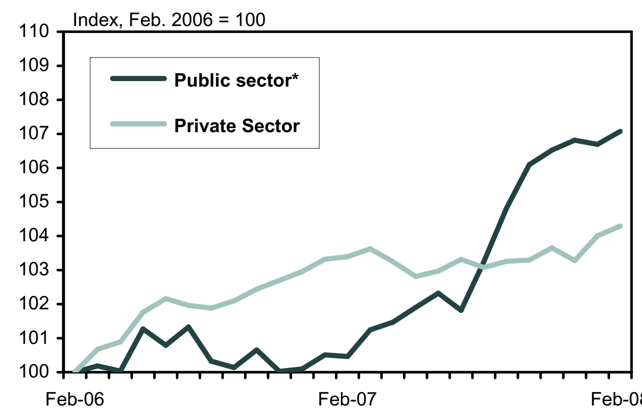
Canadian growth prospects waning

This week's economic news highlighted the growing dent being placed on Canada's growth prospects from softening U.S. demand. A whopping 8.5% drop in exports was the key culprit dragging down Canadian real GDP growth to a six-year low of 0.8% (annualized) in the fourth quarter from 3% in the prior period. Offsetting the export plunge was a surge in domestic spending (+7%), spearheaded by the consumer. So, while the bite of weakening manufacturing exports to the United States is becoming more evident, domestic resilience continues to drive overall expansion – some good news there.

These trends were echoed in this morning's employment numbers – in spades! More than 40,000 net new jobs were created in Canada in February on the heels of an equally impressive gain in January and leaving the jobless rate at a 33-year low of 5.8%. Some 24,000 jobs in the export-heavy manufacturing sector were lost in the month, bringing the total losses since November to 50,000. Yet, service sector job creation powered ahead by 56,000 positions, with increases spread across public and private sectors. On a year-over-year basis, jobs in the public sector have increased at three times the pace (+6.6%) of the overall economy (+2.2%).

The blockbuster employment increase raises the question how much longer the job market can remain "decoupled" from the production side (i.e., GDP). Historical experience in Canada would argue that this divergence won't last very long. As export output and employ-

CANADIAN EMPLOYMENT BY SECTOR



*Includes local, provincial, and federal government, government services & agencies, crown corporations, schools (including universities), and hospitals.
Source: Statistics Canada / Haver Analytics.

Recent TD Economics Research

March 7, 2008 - U.S. Employment Commentary
March 7, 2008 - Canadian Employment Commentary
March 5, 2008 - Global Markets
March 5, 2008 - U.S. ISM Non-Manufacturing Index
March 5, 2008 - What's Behind the Canadian Manufacturing Sector Recession?
March 5, 2008 - U.S. Homeowners Not Getting Much of a Break on Mortgage Rates
March 4, 2008 - BoC Interest Rate Decision
March 3, 2008 - Monetary Policy Monitor
March 3, 2008 - U.S. ISM Manufacturing Index
March 3, 2008 - Canadian Real GDP

ment remain under significant pressure – which as we discuss below is very likely – there will be increasing knock-on effects to construction and services, and employment will ultimately follow suit. Governments will also respond to slower revenue growth by softening the pace of new hiring. In the meantime, the robust job market conditions continue to mitigate the risk of recession in Canada.

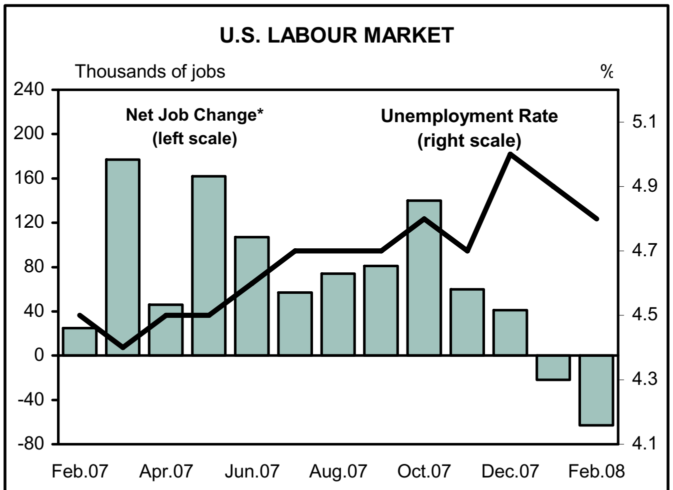
U.S. problems continue

With the U.S. problems leaving an increasing footprint on the Canadian landscape, this week's U.S. indicators did not provide much comfort. After being served up earlier this week with news that housing foreclosures jumped to a new high in the fourth quarter, investors received word that households are facing a rapidly-eroding employment picture. Non-farm payrolls dropped by 63,000 positions in February, chalking up the second straight monthly loss. Other indicators weren't much more heartwarming. The ISM survey of manufacturing activity slipped below 50 – the growth-contraction threshold – for the second time in the three months. On a brighter note, the export sub-index remained well above 50, indicating that a weak U.S. dollar continues to provide a boost to economic growth. The ISM non-manufacturing index rose from its depressed level of 44.6 in December, but at 49.3, remained slightly below 50.

It is the export sector – along with the stimulus from the Bush plan and Fed rate cuts – that will continue to provide key offsets to the headwinds brewing on other fronts going forward. At the same time, however, commodity prices, and notably crude oil (which rose to a new record of U$105 on Thursday) continue to rise on the back of U.S. dollar weakness. And with these elevated prices representing a tax on many U.S. consumers and businesses as well as raising inflation fears, some of the growth benefits of the currency-related weakness be increasingly eroded. In addition, the Fed will have less room to lower interest rates than otherwise would be case. Lastly, as we discuss in special report this week entitled *U.S. Homeowners Not Getting Much of a Break on Mortgage Rates*, the power of central banks to boost growth by rate cuts is lessened significantly when credit markets are in distress. Despite 225 basis points in Fed rate cuts, U.S. mortgage rates have barely budged.

Bank of Canada likely to go 50 again

Putting it all together, while the brisk job growth will not be lost on the Bank of Canada, we still feel that another



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

aggressive half-point rate cut will be in the offing at the central bank's next fixed announcement date in April. By then, it will remain clear that the U.S. problems are not getting better, that the slowdown in Canada continues to broaden to the services side, and that Canada's overall economy will be hard pressed to record growth in the first quarter. Soft core inflation trends also provide credence to our call. Lastly – and importantly – we assume that the March reading on employment will better reflect the softening underlying momentum in the Canadian economy.

TD Economics releases Global Markets

This week, TD Economic released its latest installment of *Global Markets*, which presents quarterly forecasts for North American bond yields and international currencies. Despite the string of soft U.S. news, we still feel that too much pessimism has been priced into U.S. government debt markets, with yields likely to head moderately higher from current ultra-low levels and for the overall curve to flatten over the remaining three quarters. Canadian yields are also forecast to rise, albeit to a much lesser extent. Another key takeaway is that the US greenback will eventually find a bottom, likely by mid-year, although low U.S. rates will limit the extent of the bounce. In contrast, the Canadian dollar is likely to gravitate towards 95 US cents by year end.

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UPCOMING KEY ECONOMIC RELEASES

Canadian Housing Starts - February

Release Date: March 10/08
January Result: 222.7K
TD Forecast: 202K
Consensus: 210K

We're expecting to see housing starts moderate in February to 202K, from 223K in January. Mother Nature was working against the construction sector in February, as huge snowstorms impacted central Canada and the temperatures were a little colder than usual. Furthermore, residential building permits have softened a bit over the prior three months, and tighter credit conditions may have impeded both mortgage demand for consumers and financing for builders. Housing starts should continue to be softer through 2008 than the blistering 228K pace that we saw through 2007.

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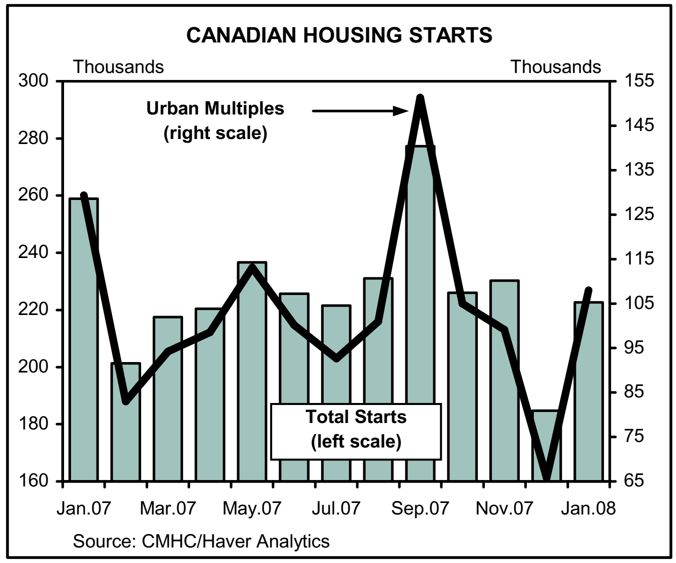
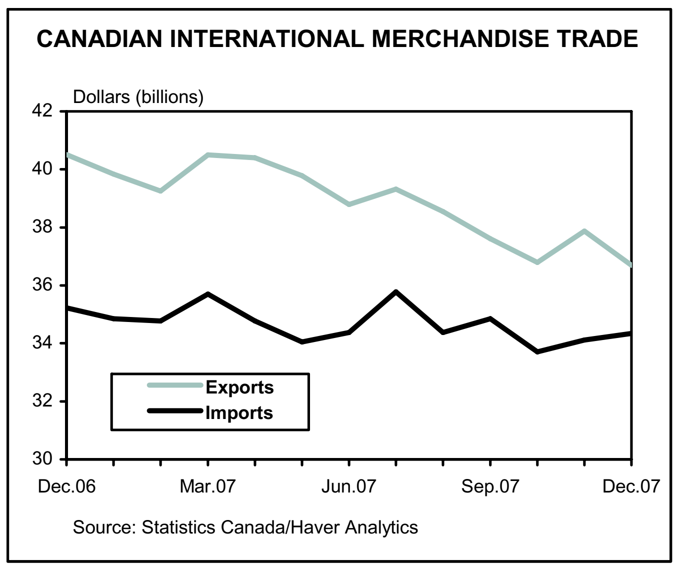


Canadian International Trade - January

Release Date: March 11/08
December Result: $2.4B
TD Forecast: $2.6B
Consensus: $2.3B

We're expecting to see an increase in Canada's trade surplus in January to $2.6B, after it fell to its lowest level since 1998 in December. However, the improvement won't be a story of strength so much as a story of price effects and an underperformance in imports. We're expecting to see nominal exports increase by 1.6% in January, a partial rebound from the 3.1% fall in December. However, this increase will largely be due to price effects, as the Bank of Canada's commodity price index was up 4% during the month and the industrial product price index was up 0.9%. So in real terms, exports will likely fare much worse. We're expecting to see imports post another monthly increase with a 1.0% gain in January. Imports are somewhat more exposed to the auto industry than exports, so the 3.1% decline in U.S. motor vehicle assembly will have a slightly worse effect on imports. Imports are also less exposed to energy products, so they won't benefit nearly as much from the increase in commodity prices. So although the trade surplus might look better on the surface in January, the details will likely paint a gloomier picture.



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U.S. Retail Sales - February

Release Date: March 13/08
January Result: total +0.3%; ex-autos +0.3%
TD Forecast: total +0.1%; ex-autos 0.0%
Consensus: total +0.2%; ex-autos +0.2%

We're expecting to see pretty soft retail sales in February, with total sales up only 0.1% during the month and ex-autos sales coming in flat. However, the results excluding gasoline sales should be a little bit stronger, since the 0.5% decline in gasoline prices will put downward pressure on the value of sales. Looking at the upside, we saw same store sales post a modest 0.5% increase in February, and the numbers of cars and trucks sold edged up 0.3%. The ISM non-manufacturing index also improved in February, but from a very low level in January, and is still below the all-important 50 mark. However, with employment having declined in both January and February, we think that U.S. consumers likely tightened up the purse strings in February, as consumer confidence sank and Americans adopted a more cautious attitude toward spending.

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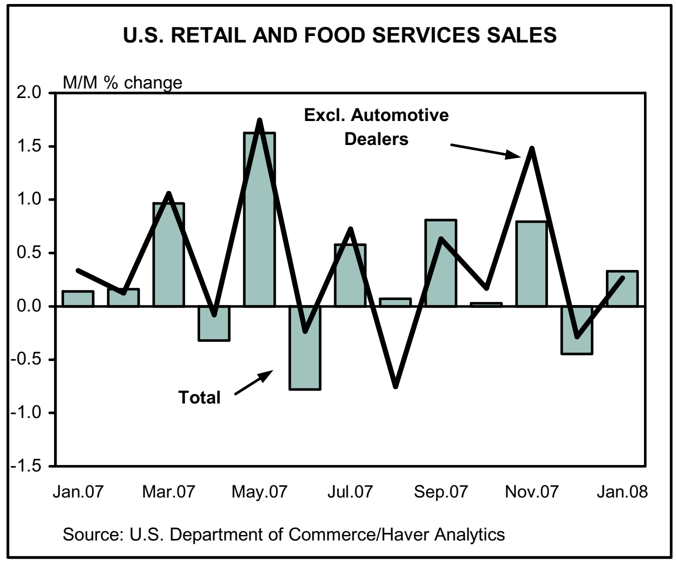

U.S. Consumer Price Index - February

Release Date: March 14/08
January Result: core +0.3% M/M, 2.5% Y/Y; all-items +0.4% M/M, 4.3% Y/Y
TD Forecast: core +0.2% M/M, 2.5% Y/Y; all-items +0.3% M/M, 4.4% Y/Y
Consensus: core +0.2% M/M, 2.4% Y/Y; all-items +0.3% M/M, 4.2% Y/Y

We're expecting to see another month of elevated U.S. inflation rates, with a 0.2% M/M gain in core CPI and a 0.3% gain in all-items CPI. The inflation trends seem to be pretty persistent in the U.S., and price pressures in core finished consumer goods remain elevated in the PPI data. For all-items CPI, the slight 0.5% moderation in gasoline prices will help to keep a lid on the monthly increases, although we expect to see a decent gain in food prices, as the food inflation story remains important. The Y/Y rate in all-items CPI will likely move up a notch to 4.4%, while the Y/Y rate of core inflation should remain unchanged at 2.5%.

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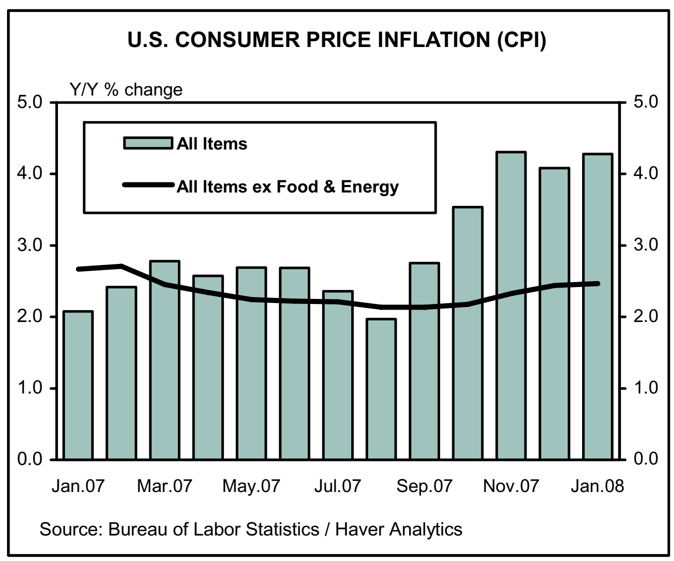

RECENT KEY ECONOMIC INDICATORS
March 3-7, 2008

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
Mar. 3	Real GDP at Basic Prices	Dec.	% change	-0.7	0.1	
Mar. 3	Gross Domestic Product (advance)	Q4-07	Q/Q % chg.	0.8	3.0	R▲
Mar. 4	*Bank of Canada interest rate announcement*		*Overnight rate*	*3.50*	*4.00*	
Mar. 6	Building Permits	Jan.	% change	-2.9	-0.1	R▼
Mar. 6	Ivey Purchasing Managers Index	Feb.	Index	62.0	56.2	
Mar. 7	Unemployment Rate	Feb.	Per cent	5.8	5.8	
Mar. 7	Net Change in Employment	Feb.	Thousands	43.3	46.4	
United States						
Mar. 3	ISM Index (manufacturing)	Feb.	Index	48.3	50.7	
Mar. 3	Construction Spending	Jan.	% change	-1.7	-1.3	R▼
Mar. 3	Total Vehicle Sales	Feb.	Millions	15.4	15.2	
Mar. 3	Domestic Vehicle Sales	Feb.	Millions	11.7	11.7	
Mar. 5	ADP Employment Change	Feb.	Thousands	-23	119	R▼
Mar. 5	Factory Orders	Jan.	% change	-2.5	2.0	R▼
Mar. 6	Weekly Initial Jobless Claims	1-Mar	Thousands	351	375	R▲
Mar. 7	Change in Non-farm Payrolls	Feb.	Thousands	-63	-22	R▼
Mar. 7	Unemployment Rate	Feb.	Per cent	4.8	4.9	
Mar. 7	Average Hourly Earnings	Feb.	% change	0.3	0.3	R▲

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR
March 10-14, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Mar. 10	Housing Starts	Feb.	Thousands	210.0	222.7
Mar. 11	International Merchandise Trade Balance	Jan.	C$, blns	2.3	2.4
Mar. 11	New Housing Price Index	Jan.	% Chg.	0.3	0.1
Mar. 12	*Bank of Canada Senior Deputy Governor Jenkins and Deputy Governor Murray give speech on "Issues Dealing with Interprovincial Barriers to Trade" to the Senate Committee on Banking, Trade & Commerce in Ottawa, ON*				
Mar. 13	Capacity Utilization Rate	Q4-07	Per cent	82.1	82.7
Mar. 13	*Bank of Canada Governor Carney gives speech on "Addressing Financial Market Turbulence" to the Toronto Board of Trade in Toronto, ON*				
Mar. 14	Labour Productivity	Q4-07	Q/Q % change	-0.2	0.2
United States					
Mar. 10	Wholesale Inventories	Jan.	% Chg.	0.5	1.1
Mar. 11	Trade Balance	Jan.	US$, blns	-59.5	-58.8
Mar. 13	Retail Sales	Feb.	% change	0.2	0.3
Mar. 13	Retail Sales ex. autos	Feb.	% change	0.2	0.3
Mar. 13	Weekly Initial Jobless Claims	8-Mar	Thousands	355	351
Mar. 13	Business Inventories	Jan.	% change	0.4	0.6
Mar. 14	Consumer Price Index (CPI)	Feb.	% change	0.3	-0.4
Mar. 14	CPI - excl. food and energy	Feb.	% change	0.2	0.4
Mar. 14	U. Michigan Consumer Confidence (prelim.)	Mar.	Index	70.4	70.8

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. 9	19:50	Japan	Machine Orders	Jan.	Y/Y % chg.	-4.5	-3.3
	19:50	Japan	Money Supply (M2+CD)	Feb.	Y/Y % chg.	2.1	2.1
	19:50	Japan	Broad Liquidity	Feb.	Y/Y % chg.	3.5	3.6
Mar. 10	2:00	Germany	Trade Balance	Jan.	Eur, blns	15.5	10.8
	2:00	Germany	Current Account Balance	Jan.	Eur, blns	13.0	15.9
	2:45	France	Industrial Production	Jan.	% Chg.	0.0	0.7
	2:45	France	Manufacturing Production	Jan.	% Chg.	0.2	0.3
	2:45	France	Trade Balance	Jan.	Eur$, blns	-4.0	-4.3
	5:30	U.K.	Industrial Production	Jan.	% Chg.	0.1	-0.1
	5:30	U.K.	Manufacturing Production	Jan.	% Chg.	0.1	-0.2
	8:15	Canada	Housing Starts	Feb.	Thousands	210.0	222.7
	10:00	U.S.	Wholesale Inventories	Jan.	% Chg.	0.5	1.1
Mar. 11	5:00	EU-12	ZEW Survey - Economic Sentiment	Mar.	Index	-42.0	-41.4
	5:00	Germany	ZEW Survey - Economic Sentiment	Mar.	Index	-40.0	-39.5
	5:00	Germany	ZEW Survey - Current Situation	Mar.	Index	30.0	33.7
	8:30	U.S.	Trade Balance	Jan.	US$, blns	-59.5	-58.8
	8:30	Canada	International Merchandise Trade Balance	Jan.	C$, blns	2.3	2.4
	8:30	Canada	New Housing Price Index	Jan.	% Chg.	0.3	0.1
	19:50	Japan	*Bank of Japan Monetary Policy meeting minutes for February released*				
	19:50	Japan	Current Account Balance	Jan.	¥, blns	1,250.0	1,697.2
Mar. 12	2:45	France	Consumer Price Index	Feb.	Y/Y % Chg.	3.0	2.8
	4:30	U.K.	Merchandise Trade Balance - Total	Jan.	£, blns	-7.5	-7.6
	4:30	U.K.	Merchandise Trade Balance - ex. EU	Jan.	£, blns	-4.1	-4.1
	5:00	EU	Industrial Production	Jan.	% change	0.4	-0.2
	16:00	*Canada*	*Bank of Canada Senior Deputy Governor Jenkins and Deputy Governor Murray give speech on "Issues Dealing with Interprovincial Barriers to Trade" to the Senate Committee on Banking, Trade & Commerce in Ottawa, ON*				
	17:45	NZ	Retail Sales	Jan.	% change	n/a	0.1
	20:30	AU	Unemployment Rate	Feb.	Per cent	4.2	4.1
	20:30	AU	Net Change in Employment	Feb.	Thousands	15.0	26.8
Mar. 13	2:45	France	Current Account	Jan.	Eur$, blns	n/a	-2.7
	5:00	*EU*	*European Central Bank publishes the March monthly report*				
	8:30	Canada	Capacity Utilization Rate	Q4-07	Per cent	82.1	82.7
	8:30	U.S.	Retail Sales	Feb.	% change	0.2	0.3
	8:30	U.S.	Retail Sales ex. autos	Feb.	% change	0.2	0.3
	8:30	U.S.	Weekly Initial Jobless Claims	8-Mar	Thousands	355	351
	10:00	U.S.	Business Inventories	Jan.	% change	0.4	0.6
	13:10	*Canada*	*Bank of Canada Governor Carney gives speech on "Addressing Financial Market Turbulence" to the Toronto Board of Trade in Toronto, ON*				
Mar. 14	5:00	EU	Euro-Zone Labour Costs	Q4-07	Ann. % chg.	2.6	2.5
	5:00	EU	Consumer Price Index	Jan.	Y/Y % chg.	3.2	3.2
	8:30	U.S.	Consumer Price Index (CPI)	Feb.	% change	0.3	-0.4
	8:30	U.S.	CPI - excl. food and energy	Feb.	% change	0.2	0.4
	8:30	Canada	Labour Productivity	Q4-07	Q/Q % change	-0.2	0.2
	10:00	U.S.	U. Michigan Consumer Confidence (prelim.)	Mar.	Index	70.4	70.8

* Eastern Standard Time; Sources: Bloomberg, TD Economics