TD Bank Financial Group

TD Economics

The Weekly Bottom Line

May 23, 2008

HIGHLIGHTS

- **FOMC minutes detail Fed's concerns on inflation**
- **U.S. housing market continues to flounder**
- **Canadian CPI inflation rises to 1.7% from 1.4% previously**

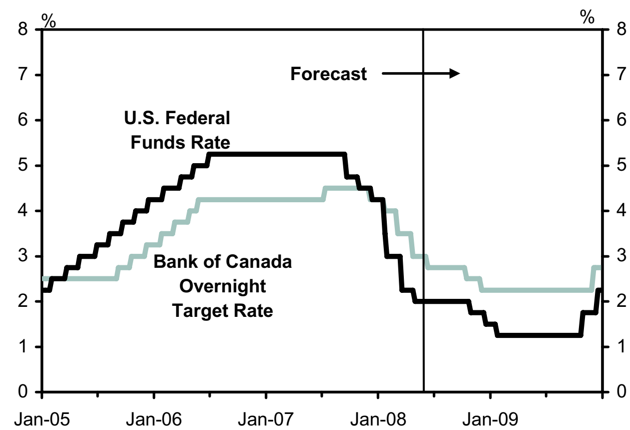
Inflation rose to the forefront this week in both Canada and the United States. Speculation that central banks in both countries may have to limit future easing in order to focus on inflationary pressures caused a sell-off in bond-markets. And after breaking through the 15,000 mark on Tuesday, the S&P TSX index gave back the week's earlier gains on stronger than expected consumer inflation numbers and rising fears the BCE deal may fall through. Similarly, U.S. equity markets gave up last week's gains as oil prices pushed past $135 dollars a barrel and the FOMC minutes showed an increasingly hawkish sounding Fed.

Inflation is the word

It wasn't economic data but the minutes from the Federal Open Market Committee's April 30 interest rate decision that spooked financial markets into retreat this week. The FOMC minutes are a bit like a trip into the minds of participants, delving into the psychology behind their current interest rate decision and setting the tone for future actions of the Bank. The minutes this time were more than explicit in laying out what the Fed would be trying to get across in the interim period between the end of April and the Fed's next meeting in June. Their statement that, "it was unlikely to be appropriate to ease policy in response to information suggesting that the economy was slowing further or even contracting slightly in the near term, unless economic and financial developments indicated a significant weakening of the economic outlook," gave us all the signal we needed to believe the Fed is likely to remain on hold at least in the near term. The Fed topped off their concern for inflation by raising their forecast for headline PCE inflation in 2008 a full percentage point to a range of 3.1% to 3.4% from 2.1% to 2.4% previously. Recognizing the importance of anchoring market inflation expectations, this view necessitated a more neutral stance to monetary policy at least in the near term.

Recent TD Economics Research
May 22, 2008 - Canadian Retail Sales
May 22, 2008 - Predicting The U.S. Recovery: Some Leading Indicators Are Better Than Others
May 21, 2008 - Canadian Consumer Price Index

BANK OF CANADA RATE AND FED FUNDS RATE



Actual data to Apr. 30, 2008; Forecast by TD Economics as at May 2008; Source: Bank of Canada, U.S. Federal Reserve Board

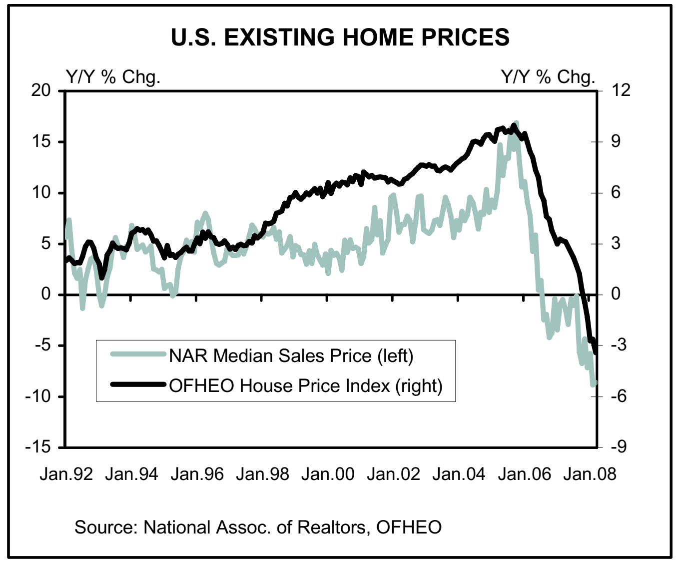
When the Fed speaks we listen

Given the clear indication from the Fed that they are in no mood to cut interest rates at their next few meetings, we have made revisions to our Federal Reserve forecast. It's not that we believe further rate cuts won't still be necessary, in fact, as time goes on and the impact of the fiscal stimulus wears off we believe the U.S. economy will remain in a state of significant weakness. Moreover, as consumer spending returns to pre-stimulus levels the risk of a negative quarter of economic growth at the end of 2008 and into 2009 remains particularly acute. In addition, the slack built up in the economy will limit the upside risks to inflation and allow the Fed to once again focus on securing future economic growth. Even more than our forecast for 2008, which is broadly in line with the Fed's new revised forecasts, we remain much more pessimistic about the prospects for the U.S. economy in 2009. As such, we continue to expect an additional 75 basis points in interest rate cuts, but anticipate that these will come later on in the year with quarter point cuts beginning at the October meeting and ending with the January meeting. The underlying weakness in the U.S. economy will by then have firmly entrenched itself in consumer spending and business investment, making further monetary stimulus essential to moving the U.S. back towards potential by the end of the 2009.

U.S. housing market recovery not coming any time soon

The continued tailspin in the U.S. housing market was confirmed this week by further declines in both home prices and existing home sales. Two measures of home prices were released this week and both were soundly negative. The total OFHEO home price index fell 0.2% in the first quarter and on a year-over-year basis fell to its lowest point in its 33 year history. This index includes prices calculated from refinancing appraisals and has up until this point never slipped into negative territory. The relatively younger purchase-only index, which goes back to 1991 and matches up best with other home price measures, fell 6.7% in the first quarter and also reached its lowest point on record on a year ago basis at -3.1%. The OFHEO index's under-representation of non-conforming loans has made it the most upwardly biased of the home price indicators and its descent into negative territory shows the extent of home price declines in the conforming mortgage market. The existing home price measure which measures the price of homes currently being sold is also firmly in negative territory, falling by 8.0% from April of last year.

In many ways what we are seeing now is an exact reversal of the situation when prices were being driven up – lower prices make new homebuyers more likely to put off purchasing a home for hope of a better deal and lenders less likely to lend for fear of worsening equity. At some point pent-up demand for housing and increasing affordability will turn the tide for housing demand but today's data on existing home sales show we're not there yet. Even when home sales begin to pick up it will take time for inventories of unsold homes to be worked off and prices to stabilize. All told, we expect prices to continue to fall and existing home prices to reach a level between 15%-20% below their peak in 2006.



Canadian CPI shows disinflation trends may be near a close

In Canada it wasn't comments by the central bank that set off inflation alarms but rather the inflation data itself. After months of disinflation, April's Consumer Price Index seemed to suggest that the days of riding the rising Canadian dollar to lower prices on retail products may be near a close. In fact, the overall rate of consumer price inflation picked up significantly in the month, reaching 1.7% from 1.4% in March. The main source of the increase was higher gasoline prices, which were up 11.6% from twelve months ago, compared to 7.9% in March. Previously, deflation in other segments of the index, particularly motor vehicles had been enough to offset higher energy costs, but these trends began to decelerate in April. Moreover, inflation in food prices, which had all but been neutralized by the rising Canadian dollar, tripled in April from 0.4% to 1.2%. While it is only one month of data and not necessarily a signal of a new trend, the increased inflation risk weighs on our forecast for the Bank of Canada. While the Bank has signaled one more rate cut at their meeting on June 10th, the higher inflation results are likely to make this a smaller sized 25 basis point cut. Following this action, we expect the Bank to follow the lead of the Fed and remain on hold for the next two meetings before resuming their easing stance in the fourth quarter with two more quarter point cuts and the floor on interest rates at 2.25%.

James Marple, Economist
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UPCOMING KEY ECONOMIC RELEASES

Canada Current Account Balance – Q1/08

Release Date: May 29/08
Q4 Result: -$0.5B
TD Forecast: $2.3B
Consensus: $2.9

We're expecting to see the Canadian current account balance move back into positive territory in Q1, due to a big rebound in the balance of goods. After falling by about $1B from Q3 to Q4, the (non-annualized) international merchandise trade balance surged by close to $4B in Q1, which was more than enough to move the current account balance from deficit to surplus. However, we do expect to see a further deterioration in the services balance in Q1, and particularly in the travel deficit, since with the Canadian dollar at around parity for the last several months, it's never been cheaper to take the kids to Disney World for March Break. Therefore we don't expect the current account balance to climb quite as high as what the goods balance would suggest, but we do still expect it to improve to $2.3B in the first quarter of 2008.

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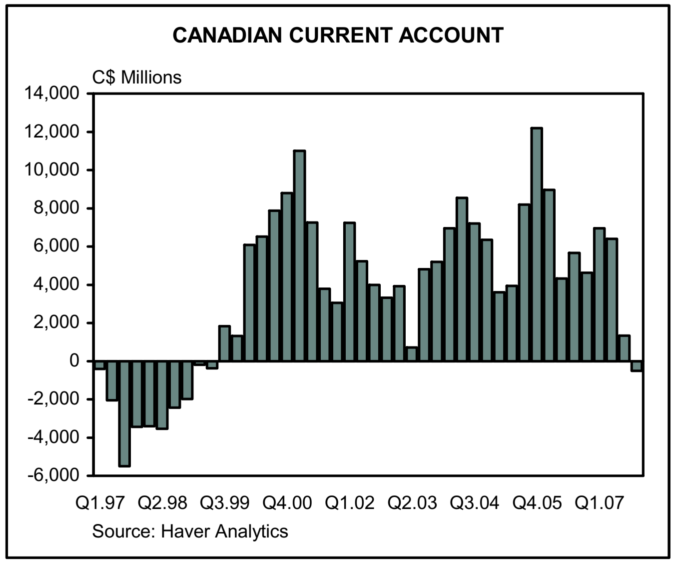

Canadian Real GDP - Q1-08

Release Date: May 30/08
Q4 Result: 0.8%
TD Forecast: 0.2%
Consensus: 0.5%

We're expecting to see that Canadian economic growth slowed even further in Q1 2008 to only a 0.2% annualized rate, after posting a lacklustre 0.8% growth rate in Q4 2007. And this will likely be another quarter featuring strong consumer spending and domestic demand, since real retail sales grew at a healthy 5.0% annualized rate, and the surge in housing starts should boost residential construction activity. However, the strength there will not be enough to counteract the numerous sources of weakness in Q1, including business investment, inventory accumulation, and non-residential construction. And with March GDP likely to come in flat, there won't be a whole lot of momentum heading into Q2 either, meaning that we'll likely get a third quarter of weak economic growth.

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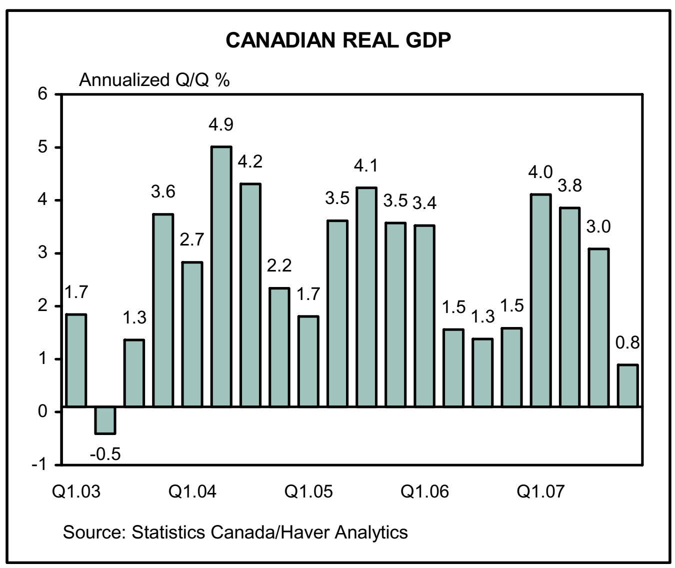
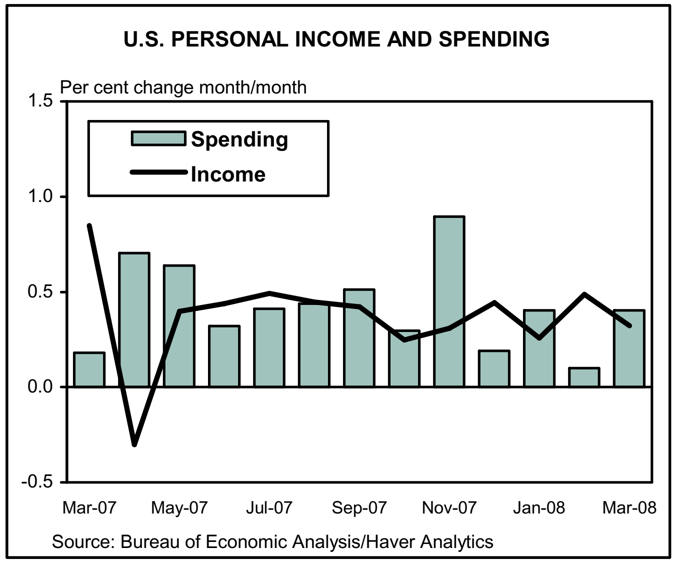


U.S. Personal Income and Spending - April

Release Date: May 30/08
March Result: income +0.3%, spending +0.4%;
core PCE deflator +0.2% M/M, 2.1% Y/Y
TD Forecast: income +0.2%; spending +0.2%;
core PCE deflator +0.1% M/M, 2.1% Y/Y
Consensus: income +0.2%; spending +0.2%;
core PCE deflator +0.1% M/M, 2.1% Y/Y



We're expecting to see a slowdown in both income and spending in April compared to what we saw in March. For income, we expect to see a smaller 0.2% increase, based on the 0.9% fall in hours worked, and the smallest monthly increase in average hourly earnings since May 2006. We're also expecting to see a 0.2% increase in spending, since the slowdown in income means that consumers have less money to spend, and since we saw CPI slow on a M/M basis in April, so the value of goods will not have grown so fast. For the core PCE deflator, we're expecting to see another moderate 0.1% monthly increase, in line with the tame 0.1% increase that we saw in core CPI in April. This should leave the Y/Y rate unchanged at 2.1%, since without some super-soft, near flat, monthly numbers for the core PCE deflator, due to base effects we probably won't see a substantial decline in the year-over-year rate until the middle of the summer.

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RECENT KEY ECONOMIC INDICATORS
May 19-May 23, 2008

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
May 20	International Securities Transactions	Mar.	$C, blns	5.3	3.7	R▼
May 20	Wholesale Sales	Mar.	% change	0.6	-2.1	R▼
May 21	Consumer Price Index (CPI)	Apr.	Y/Y % chg.	1.7	1.4	
May 21	Bank of Canada CPI Core	Apr.	Y/Y % chg.	1.5	1.3	
May 21	Leading Indicators	Apr.	% change	0.1	0.0	
May 22	Retail Sales	Mar.	% change	0.1	-0.80	R▼
May 22	Retail Sales excl. autos	Mar.	% change	0.0	-0.4	R▼
United States						
May 19	Leading Indicators	Apr.	% change	0.1	0.1	
May 20	Producer Price Index	Apr.	% change	0.2	1.1	
May 20	Producer Price Index excl. food and energy	Apr.	% change	0.4	0.2	
May 21	MBA Mortgage Applications	16-May	% change	-7.8	2.9	
May 22	Weekly Initial Jobless Claims	17-May	thousands	365.0	374	R▲
May 23	Existing Home Sales	Apr.	US$, mlns	4.89	4.9	

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR
May 26-May 30, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
May 29	Current Account (BOP)	Q1-08	$C, blns	2.9	-0.5
May 30	Industrial Product Price Index	Apr.	% change	1.2	1.7
May 30	Raw Materials Price Index	Apr.	% change	--	6.6
May 30	Gross Domestic Product (advance)	Q1-08	Q/Q % chg.	0.5	0.8
United States					
May 25	Treasury Secretary Paulson delivers commencement address at Hamilton College.				
May 25	Treasury Assistant Secretary Lowery speaks on financial markets at Foreign Correspondents Club of Tokyo.				
May 27	S&P/CS Composite-20	Mar.	Y/Y % chg.	-14.1	-12.7
May 27	Consumer Confidence	May	Index	61.0	62.3
May 27	Richmond Fed Index	May	Index	--	0.0
May 27	New Home Sales	Apr.	Thousands	520.0	526.0
May 27	San Francisco Fed President Yellen speaks on economic outlook and policy at 36th FPA NorCal Conference.				
May 28	MBA Mortgage Applications	23-May	% change	--	-7.8
May 28	Durable Goods Orders	Apr.	% change	-1.1	-0.3
May 28	Dallas Fed President Fisher speaks on inflation and debt at the Commonwealth Club of California.				
May 29	Weekly Initial Jobless Claims	24-May	thousands	--	365.0
May 29	Gross Domestic Product (GDP) (prelim.)	Q1-08	Q/Q % change	0.9	0.6
May 29	Personal Consumption (prelim)	Q1-08	Ann. % chg.	--	1.0
May 29	New York Fed President Geithner delivers opening remarks at NY Fed's "Role of Money Markets" conference.				
May 29	Fed Vice Chairman Kohn speaks at NY Fed's "Role of Money Markets" conference.				
May 30	Personal Income	Apr.	% change	0.2	0.3
May 30	PCE Deflator	Apr.	Y/Y % chg.	--	3.2
May 30	PCE Core	Apr.	Y/Y % chg.	2.1	2.1
May 30	Chicago Purchasing Managers Index	May	Index	48.5	48.3

Source: Bloomberg, TD Economics

G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
May 25	*10:30*	*U.S.*	*Treasury Secretary Paulson delivers commencement address at Hamilton College.*				
	18:45	NZ	Trade Balance	Apr.	NZ$, mlns	-150.0	-50.0
	23:00	*U.S.*	*Treasury Assistant Secretary Lowery speaks on financial markets at Foreign Correspondents Club of Tokyo.*				
May 26	19:50	Japan	Corporate Service Price Index	Apr.	Y/Y % chg.	0.6	0.4
May 27	2:45	France	Business Confidence Indicator	May	Index	105.0	106.0
	2:45	France	Production Outlook Indicator	May	Index	-10.0	-9.0
	9:00	U.S.	S&P/CS Composite-20	Mar.	Y/Y % chg.	-14.1	-12.7
	10:00	U.S.	Consumer Confidence	May	Index	61.0	62.3
	10:00	U.S.	Richmond Fed Index	May	Index	--	0.0
	10:00	U.S.	New Home Sales	Apr.	Thousands	520.0	526.0
	11:50	*U.S.*	*San Francisco Fed President Yellen speaks on economic outlook and policy at 36th FPA NorCal Conference.*				
May 28	--	Germany	Consumer Price Index (CPI) (prelim.)	May	Y/Y % change	2.8	2.4
	2:45	France	Consumer Confidence Index	May	Index	-37.0	-37.0
	4:00	EU	Current Account Balance	Mar.	Eur, blns	--	4.3
	7:00	U.S.	MBA Mortgage Applications	23-May	% change	--	-7.8
	8:30	U.S.	Durable Goods Orders	Apr.	% change	-1.1	-0.3
	19:50	Japan	Large Retailers' Sales	Apr.	% change	-1.2	0.2
	19:50	Japan	Retail Trade	Apr.	% change	0.0	0.4
	21:00	*U.S.*	*Dallas Fed President Fisher speaks on inflation and debt at the Commonwealth Club of California.*				
May 29	3:55	Germany	Unemployment Rate	May	Per cent	7.8	7.9
	3:55	Germany	Unemployment Change	May	Thousands	-20.0	-7.0
	4:00	EU-12	M3 Money Supply Growth	Apr.	Y/Y % chg.	10.3	10.3
	6:00	*UK*	*UK CBI May Distributive Trades Report*				
	8:30	U.S.	Weekly Initial Jobless Claims	24-May	thousands	--	365.0
	8:30	Canada	Current Account (BOP)	Q1-08	$C, blns	2.9	-0.5
	8:30	U.S.	Gross Domestic Product (GDP) (prelim.)	Q1-08	Q/Q % change	0.9	0.6
	8:30	U.S.	Personal Consumption (prelim)	Q1-08	Ann. % chg.	--	1.0
	9:00	*U.S.*	*New York Fed President Geithner delivers opening remarks at NY Fed's "Role of Money Markets" conference.*				
	18:15	*U.S.*	*Fed Vice Chairman Kohn speaks at NY Fed's "Role of Money Markets" conference.*				
	19:30	Japan	Jobless Rate	Apr.	Per cent	3.9	3.8
	19:30	Japan	Workers' Household Spending	Apr.	Y/Y % chg.	-0.7	-1.6
	19:30	Japan	Tokyo CPI excl. perishables	May	Y/Y % chg.	0.9	0.7
	19:50	Japan	Industrial Production (prelim.)	Apr.	% change	-0.5	-3.4
May 30	0:00	Japan	Vehicle Production	Apr.	Y/Y % chg.	--	2.3
	1:00	Japan	Housing Starts	Apr.	Y/Y % chg.	-11.8	-15.6
	2:00	Germany	Retail Sales	Apr.	% change	0.5	-1.9
	5:00	EU	Unemployment Rate	Apr.	Per cent	7.1	7.1
	8:30	U.S.	Personal Income	Apr.	% change	0.2	0.3
	8:30	Canada	Industrial Product Price Index	Apr.	% change	1.2	1.7
	8:30	Canada	Raw Materials Price Index	Apr.	% change	--	6.6
	8:30	U.S.	Personal Spending	Apr.	% change	0.2	0.4
	8:30	U.S.	PCE Deflator	Apr.	Y/Y % chg.	--	3.2
	8:30	Canada	Gross Domestic Product (advance)	Q1-08	Q/Q % chg.	0.5	0.8
	8:30	U.S.	PCE Core	Apr.	Y/Y % chg.	2.1	2.1
	9:45	U.S.	Chicago Purchasing Managers Index	May	Index	48.5	48.3

* Eastern Standard Time; Sources: Bloomberg, TD Economics