TD Bank Financial Group

TD Economics

The Weekly Bottom Line

November 14, 2008

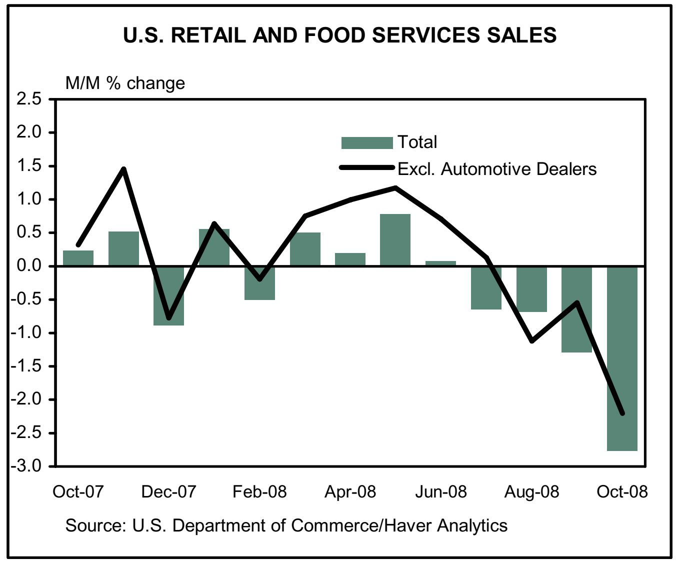
HIGHLIGHTS

- **U.S. data point to even deeper economic slump**
- **Canadian manufacturers inch ahead in September but headwinds getting stronger**
- **U.S. Treasury re-focuses TARP, while Canada's government goes on a mortgage buying spree**

In another week of plunging equity markets and sour economic news, attention turned to the actions of governments to contain the impact of the credit crunch and economic fallout. In the United States, the Treasury announced substantial changes to its Troubled Asset Relief Program (TARP), abandoning its original plan to purchase mortgage-backed securities from financial institutions. Meanwhile in Canada, the federal government did quite the opposite, upping its plan to buy pools of insured mortgages from Canadian banks. This weekend, attention turns to the leaders of the G20 as they meet in Washington to explore ways of dealing with the crisis.

So much for a shallow U.S. recession

Any thoughts that the recession in the United States will be mild were exorcised by the economic data out this week. For the last several quarters the one sector supporting U.S. growth has been the export sector. Back when the U.S. housing sector was the key source of U.S. weakness, export strength was enough to completely offset the drag. That support was pulled out in dramatic fashion in September. Real export volumes fell by a whopping 7.8%, the steepest one month drop in the history of the series going back to 1994. The fall was widespread with every major sector posting decline. It is of little comfort that imports also fell dramatically in September as this simply augers for a much weaker domestic economy – evidence of which was more than provided by the October retail sales report and the astonishing rise in U.S. jobless claims for the first week of November.



Sadly, to say that U.S. consumers have capitulated would be an understatement. It's not just that U.S. retail sales fell by an abysmal 2.8% in October, but in what has become the new norm, the previous two months were also revised downward. On a year-over-year basis we're now talking about the worst decline in retail sales since 1968. Records are being challenged by the week. It must be recognized that retail sales are in nominal terms and a big contributor to the drop was the fall in gasoline prices. As a result of declining gas prices, the fall in sales values at

Recent TD Economics Research
November 14, 2008 - Canadian Manufacturing Shipments
November 14, 2008 - U.S. Retail Sales
November 14, 2008 - Quarterly Commodity Price Report
November 13, 2008 - Canadian International Trade
November 13, 2008 - Can Equities Recover?
November 12, 2008 - Global Markets
November 10, 2008 - Chinese Fiscal Stimulus Can't Buy Happiness
November 10, 2008 - Canadian Housing Starts

gasoline stations was responsible for over half of the total decline in retail sales in October. Still, even without gas stations, sales fell 1.5%, the largest in a five month string of declines.

Not only does recent data point to a likely downward revision to the BEA's advanced estimate for third quarter GDP growth, which they initially put at -0.3%, but given the weak handoff, the risks to a substantially deeper decline in the fourth quarter have risen dramatically. What a way to kick-off the holiday season.

Canada's last hurrah

Economic data north of the border was more upbeat than what we saw in the U.S. While the trade surplus shrank in September, given the dramatic fall in commodity prices, this was not too surprising. Netting out price changes, export volumes actually improved in the month by 0.8%, the first such improvement in three months. In addition, the bigger contribution to the trade surplus' narrowing was not the weakness in exports but the strength in imports, suggesting some resurgence in domestic demand in September.

Canadian manufacturing shipments also surprised to the upside, improving by 0.1% in nominal terms and a more impressive 0.7% in real terms. Real manufacturing shipments rounded out the third quarter on a positive note, increasing by 1.7% annualized after declining the previous four quarters. With September's data for trade and manufacturing shipments, there is some upside to our forecast for third quarter GDP growth. However, given the data that has come out of the U.S. in the last few weeks this strength is not likely to hold up through the last quarter of the year.

A TARP by any other name

Perhaps the biggest news to come out this week was Treasury Secretary Henry Paulson's announcement on the focus of the $700 billion financial-market bailout package. Originally, the plan had been to use the cash to purchase "illiquid mortgage-related assets" from U.S. banks. Turns out that finding the appropriate price for these assets was not such an easy task and in any case would not be the quick solution to the financial crisis that the Treasury had originally hoped.

The Treasury wasted little time reworking their plan. Within weeks of getting approval for the first $350 installment from Congress, the Treasury decided to go the European route and use the funds to inject capital directly into U.S. banks. Their first outlay of $250 billion was spent on preferred shares in federally regulated banks and thrifts and just last week an additional $40 billion was put into insurer AIG. These efforts along with the guarantee of bank debt and commercial paper have been successful in unfreezing credit markets. The LIBOR-OIS spread has fallen 200 basis-points from its peak in September but is still high relative to its level just months earlier. (For more on financial market conditions please refer to our Daily Indicators of Financial Stress, available on the TD Economics website).

Going forward, the Treasury has a three-pronged strategy aimed at further alleviating the credit crunch. They will continue to make further capital injections in financial institutions, hoping to leverage their impact by attracting matching private capital. Secondly, they hope to spread the reach of the program to non-bank financial institutions that offer such products as car loans, student loans and credit cards to consumers. Finally, they will continue efforts to stem foreclosures by working towards modifications of existing mortgage loans. These efforts should help to improve conditions in financial markets necessary for an eventual economic recovery but they are unlikely to be enough to forestall what is increasingly looking to be a relatively deep U.S. recession. With the effective Fed funds rate sitting very close to its zero bound, the need for additional fiscal stimulus in order to reverse the negative feedback loop taking place in the U.S. economy has become increasingly important.

Everyone into the pool

In contrast to the reversal in the U.S. Treasury's decision to purchase mortgage-backed assets, the Canadian government is adding liquidity to the Canadian financial by the value of MBS purchases to a total of $75 billion. The difference in approaches speaks to the wide chasm between the systems of mortgage finance in the two countries. Whereas finding an appropriate price for a security backed by a subprime mortgage in the U.S. looks to have baffled both Wall Street and the U.S. Treasury, the purchase of government insured mortgage pools in Canada has gone on without a hitch. The long-term funding made available to Canada's financial institutions has helped to bring down credit spreads. Nonetheless, with an economy as dependent on world trade as Canada's is, the actions of policy makers beyond our borders to get their economies running are just as important as any success made by policy makers at home.

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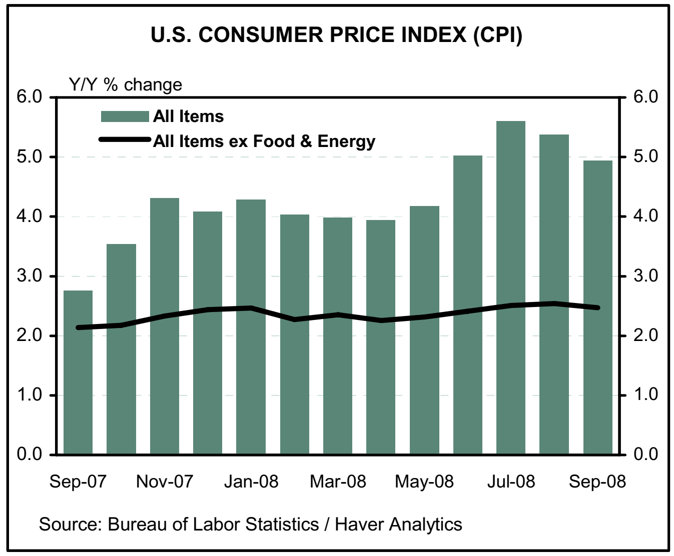
UPCOMING KEY ECONOMIC RELEASES

U.S. Consumer Price Index - October

Release Date: November 19/08
September Result: core 0.1% M/M, 2.5% Y/Y;
all-items 0.0% M/M, 4.9% Y/Y
TD Forecast: core 0.1% M/M, 2.4% Y/Y;
all-items -0.5% M/M, 4.1% Y/Y
Consensus: core 0.2% M/M, 2.4% Y/Y;
all-items -0.8% M/M, 4.1% Y/Y

The downward march for U.S. consumer price inflation should continue for the third straight month in October on account of the dramatic retreat in commodity prices and the growing domestic excess capacity. In fact, with energy prices declining by double-digits in October and the economy appearing to have entered a consumer-led recession, we expect headline inflation to post it biggest monthly drop in two years, with a 0.5% M/M decline. This will bring the headline rate of inflation to 4.1% Y/Y, down from 4.9% Y/Y in September. Core consumer prices, however, should rise by 0.1% M/M, with core inflation declining for the first time since April, falling to 2.4% Y/Y. In the months ahead, we expect to see further moderation in U.S. consumer prices as the growing economic slack and softer commodity prices continue to exert more downward pressure on consumer prices.



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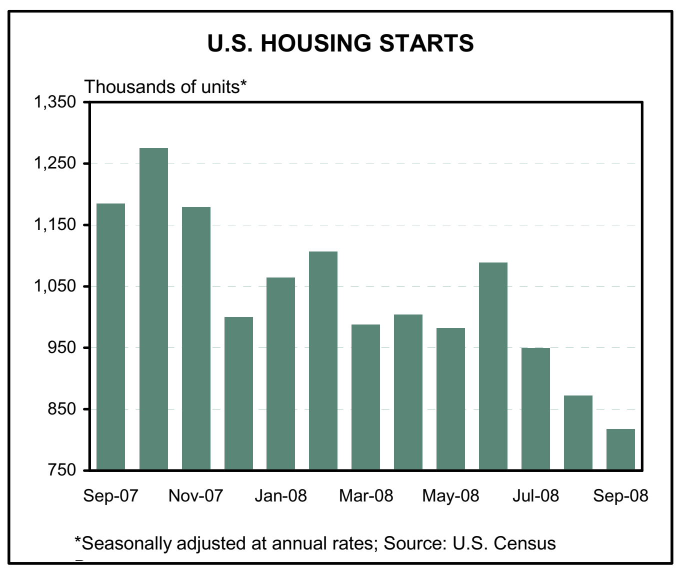
U.S. Housing Starts - October

Release Date: November 19/08
September Result: 817K
TD Forecast: 800K
Consensus: 780K

The U.S. housing market remains in freefall, as the combination of a weak domestic economy, tighter lending condition, elevated stock of unsold homes and deteriorating labour market fundamentals all conspire to prolong the duration of the housing correction. Indeed, with home sales continuing to languish and credit availability drying up, there is little to suggest that the fortune for U.S. home builders will change materially any time soon. With this in mind, we expect new residential construction to fall to 800K in October, following the dramatic plunge to 817K in September. During the month, we should see a recovery of sorts in the construction of single-family units (following the whopping 12.0% M/M drop last month), though this will likely be offset by a decline in the volatile multi-units component. Looking ahead, housing starts should continue trending lower, before perhaps reaching bottom some time next year.



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Canadian Wholesale Sales - September

Release Date: November 20/08
August Result: total -1.5% M/M
TD Forecast: total 0.3% M/M
Consensus: total -0.8% M/M

After a surprisingly strong performance in the early part of this year, Canadian wholesale trade activity appears to have hit a bit of a soft patch. And the prospects for a return of the recent buoyancy in the wholesale sector in the near term remain limited, given the sluggish domestic economy and growing economic anxiety among Canadian households. Nevertheless, wholesale trade should post a modest gain in September, with a 0.3% M/M advance in activity, following the dramatic 1.5% M/M decline in August. Some weakness is expected to come from the automotive sector, which has continued to be battered by slumping U.S. demand, but sales in other trade groups should more than compensate for this drag. In the coming months, as the Canadian economy grinds to a halt, we expect wholesale sales to weaken further.

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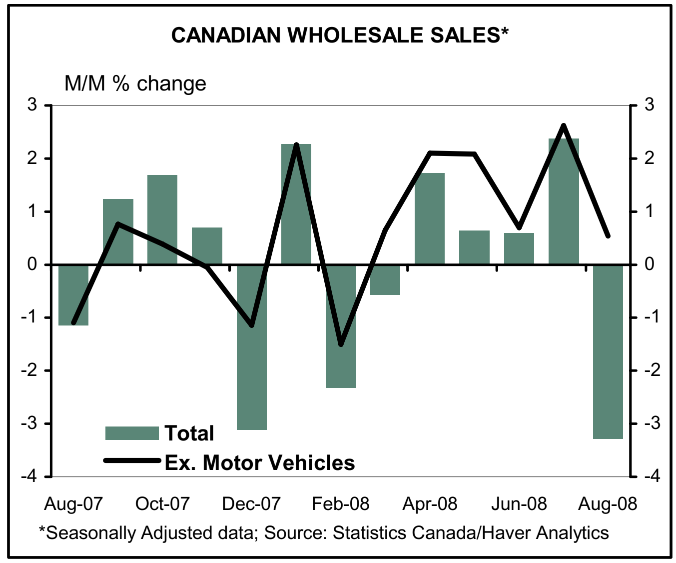
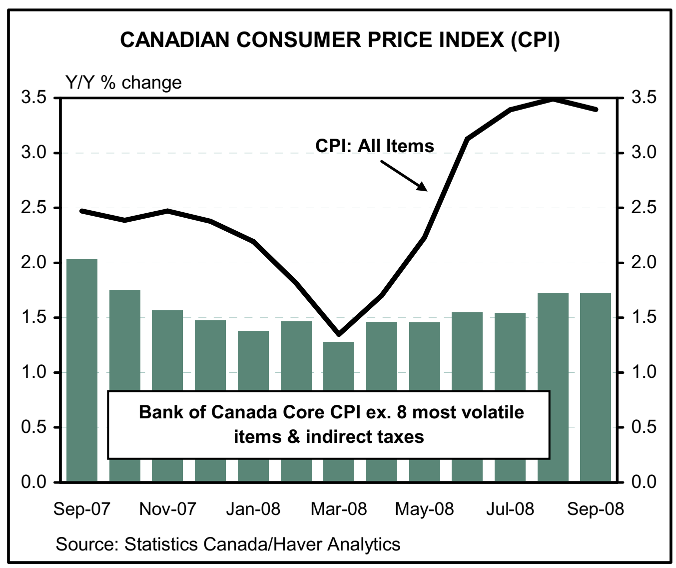


Canadian Consumer Price Index - October

Release Date: November 21/08
September Result: core 0.4% M/M, 1.7% Y/Y;
all-items 0.4% M/M, 3.4% Y/Y
TD Forecast: core 0.0% M/M, 1.9% Y/Y;
all-items -0.4% M/M, 3.3% Y/Y
Consensus: core 0.0% M/M, 1.9% Y/Y;
all-items -0.3% M/M, 3.4% Y/Y

Plunging commodity prices and growing economic slack will continue to be the key themes for lower Canadian consumer price inflation. For October, given that gasoline and natural gas prices have declined by double-digits and wage pressures appear to be abating, we expect consumer prices to ease further with headline CPI falling by a dramatic 0.4% M/M. This will bring the annual rate of consumer price inflation to 3.3% Y/Y. On a seasonally-adjusted basis, all-items CPI is expected to fall by a more modest 0.1% M/M. The Bank of Canada's core consumer index should remain flat on the month (but rise by 0.2% M/M on a seasonally adjusted basis), though the core inflation rate is expected to rise to a one year high of 1.9% Y/Y. In the coming months, with both moderating forces likely to remain well entrenched, we expect Canadian consumer price pressures to ease further.



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RECENT KEY ECONOMIC INDICATORS
November 10 - November 14, 2008

Release Date	Economic Indicators	Data for Period	Units	Current	Prior	
Canada						
Nov. 10	Housing Starts	Oct.	Thousands	211.8	218.6	R▲
Nov. 10	New Housing Price Index	Sept.	M/M % chg.	0.1	0.0	
Nov. 13	International Merchandise Trade	Sept.	$C, blns	4.5	5.6	R▼
Nov. 14	Manufacturing Shipments	Sept.	M/M % chg.	0.1	-3.7	
Nov. 14	New Motor Vehicle Sales	Sept.	M/M % chg.	2.5	-2.2	R▲
United States						
Nov. 11	ABC Consumer Confidence	7-Nov	Index	-50	-48	
Nov. 12	MBA Mortgage Applications	9-Nov	% change	11.9	-20.3	
Nov. 13	Trade Balance	Sept.	US$, blns	-56.5	-59.1	
Nov. 13	Initial Jobless Claims	8-Nov	Thousands	516	484	R▲
Nov. 13	Continuing Claims	1-Nov	Thousands	3897	3832	R▼
Nov. 13	Monthly Budget Statement	Oct.	US$, blns	-237.2	-56.8	
Nov. 14	Import Price Index	Oct.	Y/Y % chg.	6.7	13.6	R▼
Nov. 14	Advance Retail Sales	Oct.	% change	-2.8	-1.3	R▼
Nov. 14	Retail Sales Less Autos	Oct.	% change	-2.2	-0.5	R▲
Nov. 14	U. of Michigan Confidence Index	Nov.	Index	57.9	57.6	
Nov. 14	Business Inventories	Sept.	% change	-0.2	0.2	R▼

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR
November 17 - November 21, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Nov. 19	International Securities Transactions	Sept.	$C, blns	-1.0	-0.7
Nov. 19	Leading Indicators	Oct.	M/M % chg.	-0.2	-0.2
Nov. 20	Wholesale Sales	Sept.	M/M % chg.	-0.8	-1.5
Nov. 20	*BoC Governer Mark Carney speaks at the Canada-UK Chamber of Commerce on building continuous markets.*				
Nov. 21	Consumer Price Index (CPI)	Oct.	Y/Y % chg.	3.4	3.4
Nov. 21	CPI - excl. 8 most volatile items	Oct.	Y/Y % chg.	1.9	1.7
United States					
Nov. 17	Empire Manufacturing Index	Nov.	Index	-26.1	-24.6
Nov. 17	*Kansas City Fed President Hoenig speaks on financial regulation in New York.*				
Nov. 17	Industrial Production	Oct.	Y/Y % chg.	0.2	-2.8
Nov. 17	Capacity Utilization Rate	Oct.	%	76.4	76.4
Nov. 18	Producer Price Index (PPI)	Oct.	% change	0.7	0.3
Nov. 18	PPI excl. food and energy	Oct.	% change	0.2	0.5
Nov. 18	NAHB Housing Market Index	Nov.	Index	14	14
Nov. 18	ABC Consumer Confidence	16-Nov.	Index	-49	-50
Nov. 19	Consumer Price Index (CPI)	Oct.	Y/Y % chg.	4.1	4.9
Nov. 19	CPI Ex Food and Energy	Oct.	Y/Y % chg.	2.4	2.5
Nov. 19	Housing Starts	Oct.	Thousands	780	817
Nov. 19	*Fed Vice Chairman Kohn speaks on monetary policy and asset prices at Cato conference.*				
Nov. 19	*Richmond Fed President Lacker speaks on Subprime Crisis at Cato Conference.*				
Nov. 19	*FOMC releases minutes from Oct. 28-29 meeting*				
Nov. 20	Philadelphia Fed Index	Nov.	Index	-35.0	-37.5
Nov. 20	Leading Indicators	Oct.	% change	-0.6	0.3
Nov. 20	*Treasury Secretary Paulson speaks on the U.S. economy and financial markets in Washington.*				
Nov. 20	*St. Louis Fed President Bullard speaks on the current economic environment at Indiana Economic Conference.*				
Nov. 21	*Richmond Fed President Lackers speaks on financial conditions and economic outlook in Maryland.*				
Nov. 21	*Philadelphia Fed President Plosser speaks on financial crisis at the Philadelphia Fed Bank.*				
Nov. 21	*Chicago Fed President Evans speaks at the Economic Club of Indiana.*				

Source: Bloomberg, TD Economics

G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
Nov. 16	18:50	Japan	Gross Domestic Product (prelim.)	Q3-08	Q/Q % chg.	0.0	0.7
	18:50	Japan	Tertiary Industry Index	Sept.	% change	-0.5	-1.4
Nov. 17	5:00	EU-12	Trade Balance (SA)	Sept.	Eur, blns	-5.7	-6.1
	8:30	U.S.	Empire Manufacturing Index	Nov.	Index	-26.1	-24.6
	9:00	*U.S.*	*Kansas City Fed President Hoenig speaks on financial regulation in New York.*				
	9:15	U.S.	Industrial Production	Oct.	Y/Y % chg.	0.2	-2.8
	9:15	U.S.	Capacity Utilization Rate	Oct.	%	76.4	76.4
	19:30	*AU*	*Reserve Bank of Australia publishes November board minutes.*				
Nov. 18	1:00	Japan	Leading Index CI	Sept.	Index	--	89.2
	1:00	Japan	Coincident Index CI	Sept.	Index	--	100.8
	4:30	U.K.	CPI (YoY)	Oct.	Y/Y % chg.	4.8	5.2
	4:30	UK	Retail Price Index ex. Mort. Int. Payments (RPIX)	Oct.	Y/Y % chg.	5.2	5.5
	8:30	U.S.	Producer Price Index (PPI)	Oct.	% change	0.7	0.3
	8:30	U.S.	PPI excl. food and energy	Oct.	% change	0.2	0.5
	13:00	U.S.	NAHB Housing Market Index	Nov.	Index	14	14
	17:00	U.S.	ABC Consumer Confidence	16-Nov.	Index	-49	-50
	18:50	Japan	All Industry Activity Index	Sept.	% change	-0.1	-1.8
	19:30	AU	New Motor Vehicle Sales	Oct.	Y/Y % chg.	--	-8.2
Nov. 19	*4:30*	*U.K.*	*Bank of England Minutes*				
	8:30	Canada	International Securities Transactions	Sept.	$C, blns	-1.0	-0.7
	8:30	Canada	Leading Indicators	Oct.	M/M % chg.	-0.2	-0.2
	8:30	U.S.	Consumer Price Index (CPI)	Oct.	Y/Y % chg.	4.1	4.9
	8:30	U.S.	CPI Ex Food and Energy	Oct.	Y/Y % chg.	2.4	2.5
	8:30	U.S.	Housing Starts	Oct.	Thousands	780	817
	9:00	*U.S.*	*Fed Vice Chairman Kohn speaks on monetary policy and asset prices at Cato conference.*				
	13:30	*U.S.*	*Richmond Fed President Lacker speaks on Subprime Crisis at Cato Conference.*				
	14:00	*U.S.*	*FOMC releases minutes from Oct. 28-29 meeting*				
	18:50	Japan	Merchandise Trade Balance	Oct.	¥, blns	71.8	88.5
	23:00	*Japan*	*Bank of Japan Monetary Policy Meeting*				
Nov. 20	2:00	Germany	Producer Prices	Oct.	Y/Y % chg.	7.3	8.3
	4:30	U.K.	Retail Sales	Oct.	Y/Y % chg.	1.4	1.8
	4:30	U.K.	M4 Money Supply	Oct.	Y/Y % chg.	12.7	12.4
	8:30	Canada	Wholesale Sales	Sept.	M/M % chg.	-0.8	-1.5
	8:35	*Canada*	*BoC Governer Mark Carney speaks at the Canada-UK Chamber of Commerce on building continuous markets.*				
	10:00	U.S.	Philadelphia Fed Index	Nov.	Index	-35.0	-37.5
	10:00	U.S.	Leading Indicators	Oct.	% change	-0.6	0.3
	18:30	*U.S.*	*Treasury Secretary Paulson speaks on the U.S. economy and financial markets in Washington.*				
	21:00	*U.S.*	*St. Louis Fed President Bullard speaks on the current economic environment at Indiana Economic Conference.*				
	--	*Japan*	*Bank of Japan Target rate Decision*	21-Nov	%	0.3	0.3
Nov. 21	3:00	France	Purchasing Managers Index (Manufacturing)	Nov.	Index	40.0	40.6
	3:00	France	Purchasing Managers Index (Services)	Nov.	Index	46.7	47.5
	3:30	Germany	Purchasing Managers Index (Manufacturing)	Nov.	Index	42.0	42.9
	3:30	Germany	Purchasing Managers Index (Services)	Nov.	Index	47.5	48.3
	4:00	EU-12	Purchasing Managers Index (Manufacturing)	Nov.	Index	40.5	41.1
	4:00	EU-12	Purchasing Managers Index (Services)	Nov.	Index	45.0	45.8
	4:00	EU-12	Purchasing Managers Index (Composite)	Nov.	Index	42.8	43.6
	7:00	Canada	Consumer Price Index (CPI)	Oct.	Y/Y % chg.	3.4	3.4
	7:00	Canada	CPI - excl. 8 most volatile items	Oct.	Y/Y % chg.	1.9	1.7
	8:15	*U.S.*	*Richmond Fed President Lackers speaks on financial conditions and economic outlook in Maryland.*				
	12:15	*U.S.*	*Philadelphia Fed President Plosser speaks on financial crisis at the Philadelphia Fed Bank.*				
	12:40	*U.S.*	*Chicago Fed President Evans speaks at the Economic Club of Indiana.*				

* Eastern Standard Time; Sources: Bloomberg, TD Economics