



**Bank
Financial
Group**

TD Economics

The Weekly Bottom Line

November 21, 2008

HIGHLIGHTS

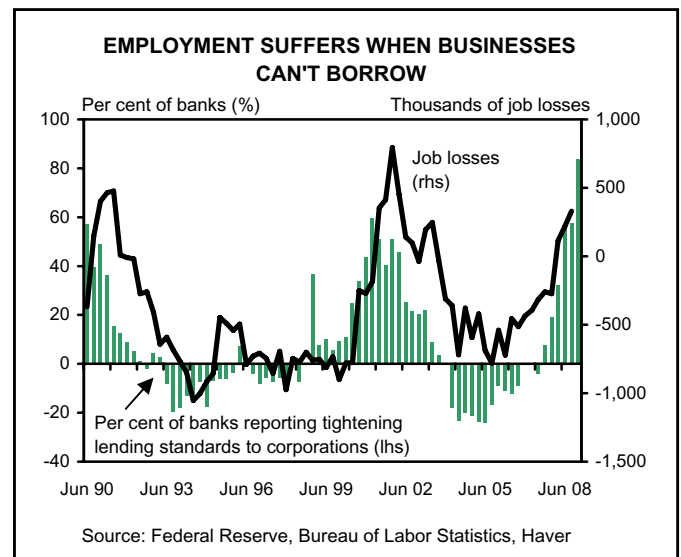
- U.S. inflation rapidly decelerating
- Fed begins new policy of quantitative arming
- Canadian core inflation constant while headline eases from 3.4% to 2.6% y/y

Central banks slashed interest rates and all I got was this lousy economy. That could be the slogan for the hottest selling t-shirt this holiday season, or the refrain phrase for the next Top 40 hit on the radio. But as bad as financial markets have been to date, the worst is still yet to come for the economic news.

Elegantly Wasted

U.S. inflation figures for October reported the first month-over-month decline in core consumer prices (-0.10%) since the early 1980s, and the 1.0% m/m decline in headline inflation (to 3.7% y/y) is the largest monthly fall in U.S. consumer prices in the 60 year history of the series. The drop in headline inflation is being driven by the almost \$100 decline in oil prices since the summer, while the fall in core inflation is a sign of the growing slack building in the labour market. The weekly jobless numbers released this week show the pace of job losses in the U.S. is now past the peaks in either the 2001 or 1990 recession. More job losses mean more slack in the economy and even lower inflation.

And unfortunately, the problems in the credit markets



suggest the pace of job losses will continue to worsen. When businesses have problems borrowing, they have problems investing in factories, machinery, and employees. In fact, the Fed's survey of tightening standards in commercial and industrial lending, which continued to worsen to a new high in the fourth quarter of 2008, tends to lead the peak in U.S. job losses by 6-9 months, which implies weaker consumer spending, business investment, and economic growth in general. Early trade figures out of Asia suggest we may see a significant contraction in U.S. exports in the fourth quarter. Coupled with consumer retrenchment, business investment pull back, and new home construction falling to the slowest pace in the 50 year history of that series, the contraction in U.S. GDP in the fourth quarter could be twice as large as the 3% contraction earlier data were tracking.

Manic Depression

In this environment, the Fed knows what they want but they just don't know how to go about getting it. Inflation worries are out the window, and in fact, the Fed now appears to be turning its attention to creating inflation. While the Fed's target for the fed funds rate remains at 1.00%,

Recent TD Economics Research

November 21, 2008 - Canadian Consumer Price Index
 November 20, 2008 - A Different Look At Canadian Home Prices
 November 20, 2008 - Canadian Wholesale Sales
 November 19, 2008 - The Low Down on a Low Fed Funds Rate
 November 19, 2008 - U.S. Housing Starts
 November 19, 2008 - U.S. Consumer Price Index

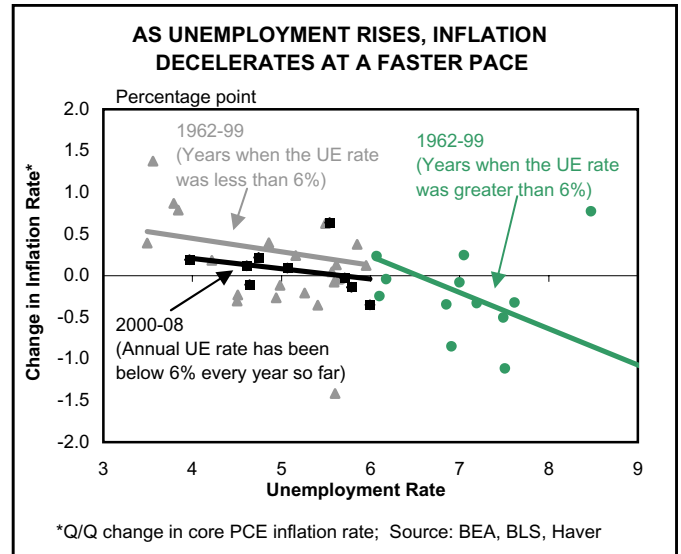
the effective fed funds rate has actually been trading at below 0.50% since late October. On top of that, the Fed has quietly increased the size of their balance sheet by almost \$1.3 trillion over the last two months. The Fed now has over \$2 trillion to deploy into financial markets as needed. At the same time, with short-term market interest rates so low and the Federal Reserve paying 1% on reserves that the banks choose to park with the Fed, excess reserves in the banking sector have increased by \$600 billion over the last two months – more than they hold in deposits – and almost \$300 billion in just the last two weeks. This increase in bank reserves is a double-edged sword. On the one hand, it means there is a lot of cash sitting with banks that could be quickly deployed at a moments notice, rapidly increasing inflation and lending. Unfortunately, holding all these excess reserves means they are not currently lending it, implying credit markets are still too rough for banks to comfortably enter.

Now some of this discussion may sound as nerdy as overhearing a debate at a Star Trek convention on who was the greatest starship captain. But make no mistake. The Fed is gearing up for battle. Lowering interest rates closer and closer to zero has less and less impact on the economy. And all that slack building in the economy so quickly raises the risk of the dreaded “d” word – deflation. In fact, the magnitude and duration of job losses implied by the Fed’s commercial lending survey suggests that even if credit markets were to improve right now, the economic lags discussed above would result in the unemployment rate breaching 8%. And that level of the unemployment rate tends to see core PCE inflation (the Fed’s preferred measure) fall by 1 percentage point each year, running the risk U.S. core inflation could hit 0.0% by 2010.

While the Fed has been fairly mum on these balance sheet moves, it appears they are getting fairly close to the quantitative easing policies followed by Japan – but used there only after deflation had begun. We think the Fed is trying to increase their arsenal so that should a massive intervention be necessary, they have the firepower to back it up. Announcing this policy too early might risk spooking the markets before the Fed’s monetary army is big enough. Right now, the Fed is following a policy of quantitative arming. The easing will come when the Fed starts using that new capital they have to buy new financial instruments to get credit markets moving again. (For more, see http://www.td.com/economics/special/rk1108_fed.pdf).

Tainted Love

Unfortunately, as hard as it tries, the global economy



cannot run away. The Bank of England has now cut interest rates to the lowest level in over 50 years, while inflation has only just started to ease off a nearly two decade high. Headline inflation in Canada fell by 1.0 percentage point in October, the biggest monthly decline since 1959, bringing inflation down to 2.6%. While core inflation remained constant at 1.7% y/y, inflation is not a concern for the Bank of Canada either. It seems highly likely they will cut rates by 50 basis points in December, a week before the Fed likely delivers its next cut. But unlike the Fed, the BoC still has plenty of interest rates cuts they could deliver should the domestic economy worsen, and fortunately, the Canadian economy remains less bad – which is what passes for optimism these days – than its U.S. cousin.

We do think the concerns over the Canadian housing industry have been overblown in making comparisons with the U.S., and even the national average Canadian home price aggregate measure seems distorted, which is why we have started publishing our own series (for more, see http://www.td.com/economics/special/pg1108_hpi.pdf). But Canada and the rest of the world simply cannot escape the clutches of the American economy. And the rapid declines in commodity prices feed into less spending power of Canadian consumers and businesses. We continue to wait for that Bobby McFerrin moment, when financial markets start to think “don’t worry, be happy.” But unfortunately, the economic data continues to confirm our belief that the global economy, U.S. and Canada included, will not start to see a serious recovery until 2010.

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UPCOMING KEY ECONOMIC RELEASES

Canadian Retail Sales - September

Release Date: November 25/08

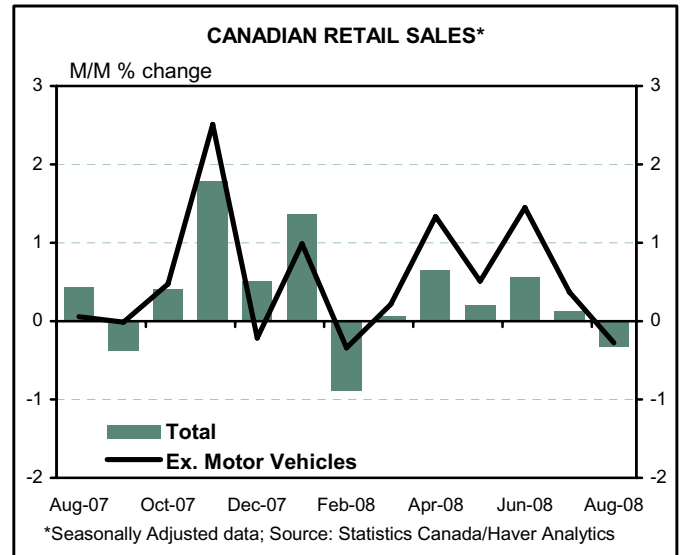
August Result: total -0.3% M/M; ex-autos -0.3% M/M

TD Forecast: total 0.7% M/M; ex-autos 0.4% M/M

Consensus: total 0.3% M/M; ex-autos 0.2% M/M

After slipping last month for the first time since February, Canadian retail sales are expected to post a recovery of sorts in September with a modest 0.7% M/M advance. Much of the improvement in sales should come from the rebound in motor vehicle sales, while the whopping 106K jobs added to Canadian payrolls during the month should also have a favourable impact on consumer spending. Excluding autos, sales are expected to rise by a more modest 0.4% M/M. This pace of advance, however, is unlikely to be sustained as we expect Canadian consumer spending to moderate in the coming months.

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U.S. Durable Goods Orders – October

Release Date: November 26/08

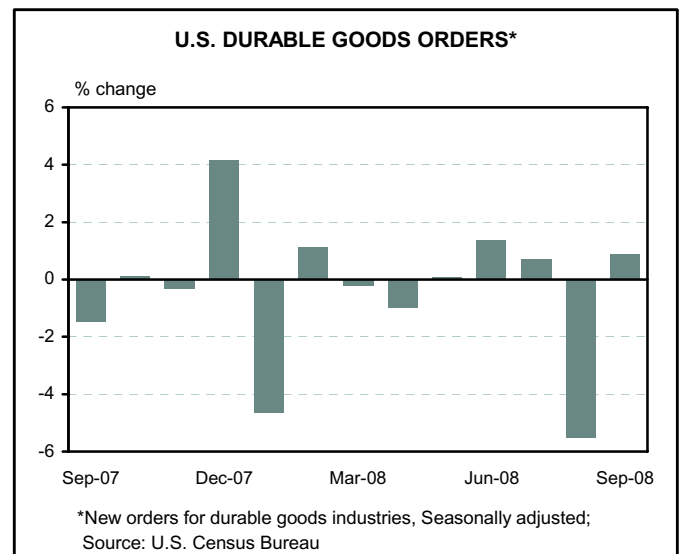
September Result: total 0.8% M/M; ex-transportation -1.1% M/M

TD Forecast: total -3.0% M/M; ex-transportation -2.0% M/M

Consensus: total -2.5% M/M; ex-transportation -1.5% M/M

Most indicators of U.S. economic activity have been on a downward trajectory, and the pace of decline in October for a number of these economic indicators has been particularly pronounced. As such, with overall U.S. business activity continuing to weaken at a fairly brisk rate, we expect U.S. durable goods orders to post a rather significant 3.0% M/M drop in October, reflecting the growing unwillingness of U.S. businesses to embark on major capital investments during a time of economic recession. Much of the weakness is expected to come from orders for machinery and transportation equipment. Excluding transportation, however, durable goods orders are expected to fall by a smaller 2.0% M/M.

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U.S. Personal Income & Spending - October

Release Date: November 26/08

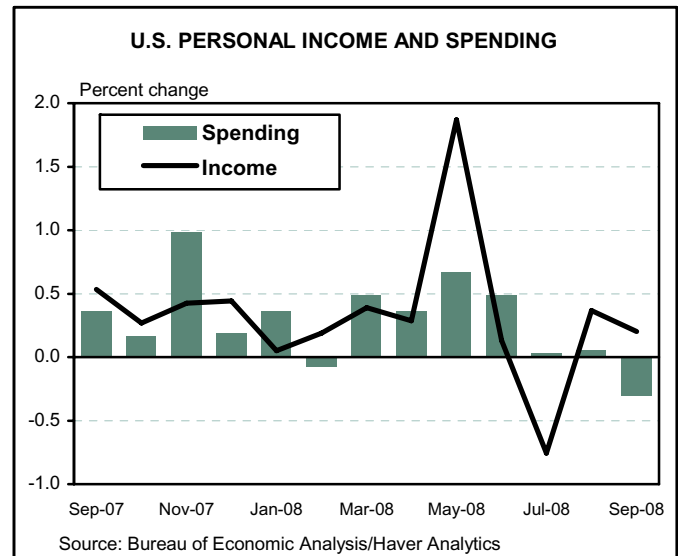
September Result: income 0.2% M/M, spending -0.3% M/M; core PCE deflator 0.2% M/M, 2.4% Y/Y

TD Forecast: income 0.0% M/M; spending -0.9% M/M; core PCE deflator 0.0% M/M, 2.2% Y/Y

Consensus: income 0.1% M/M; spending -0.9% M/M; core PCE deflator 0.1% M/M, 2.3% Y/Y

It is now clear that with a rapidly deteriorating labour market, declining home prices and slumping equity markets sapping household wealth, U.S. consumers are beginning to reduce their spending at a fairly dramatic pace. For October, we expect personal income to remain flat, while personal consumption expenditures should post its second consecutive monthly decline, falling by a massive 0.9% M/M – which will be the largest decline in this indicator in seven years. On the inflation front, the core PCE deflator is expected to remain unchanged on a monthly basis, bringing the core PCE deflator to 2.2% Y/Y. In the coming months, we expect to see further weakness in consumer spending, while the core PCE deflator is expected to moderate even further on account of the growing U.S. economic slack and falling commodity prices.

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RECENT KEY ECONOMIC INDICATORS
November 17 - November 21, 2008

Release Date	Economic Indicators	Data for Period	Units	Current	Prior	
Canada						
Nov. 19	International Securities Transactions	Sept.	\$C, blns	-0.267	-0.833	R▼
Nov. 19	Leading Indicators	Oct.	M/M % chg.	-0.4	-0.3	R▼
Nov. 20	Wholesale Sales	Sept.	M/M % chg.	1.5	-1.5	
Nov. 21	Consumer Price Index (CPI)	Oct.	Y/Y % chg.	2.6	3.4	
Nov. 21	CPI - excl. 8 most volatile items	Oct.	Y/Y % chg.	1.7	1.7	
United States						
Nov. 17	Empire Manufacturing Index	Nov.	Index	-25.4	-24.6	
Nov. 17	Industrial Production	Oct.	Y/Y % chg.	1.3	-3.7	R▼
Nov. 17	Capacity Utilization Rate	Oct.	%	76.4	75.5	R▼
Nov. 18	Producer Price Index (PPI)	Oct.	% change	-2.8	-0.4	
Nov. 18	PPI excl. food and energy	Oct.	% change	0.4	0.4	
Nov. 18	NAHB Housing Market Index	Nov.	Index	9	14	
Nov. 18	ABC Consumer Confidence	16-Nov.	Index	-52	-50	
Nov. 19	Consumer Price Index (CPI)	Oct.	Y/Y % chg.	3.7	4.9	
Nov. 19	CPI Ex Food and Energy	Oct.	Y/Y % chg.	2.2	2.5	
Nov. 19	Housing Starts	Oct.	Thousands	791	828	R▲
Nov. 20	Philadelphia Fed Index	Nov.	Index	-39.3	-37.5	
Nov. 20	Leading Indicators	Oct.	% change	-0.8	0.1	R▼

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR
November 24 - November 28, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Nov. 25	Retail Sales	Sept.	M/M % chg.	0.3	-0.3
Nov. 25	Retail Sales (Ex. Autos)	Sept.	M/M % chg.	0.2	-0.3
Nov. 27	<i>Bank of Canada Deputy Governor Duguay speaks on financial system stability in Pictou, Nova Scotia.</i>				
Nov. 28	Current Account	Q3-08	\$C, blns	5.1	6.8
Nov. 28	Industrial Product Prices	Oct.	M/M % chg.	-1.5	-1.2
Nov. 28	Raw Materials Price Index	Oct.	M/M % chg.	-7.0	-7.2
United States					
Nov. 24	Existing Home Sales	Oct.	M/M % chg.	-2.7	5.5
Nov. 25	S&P/CS Composite-20	Sept.	Y/Y % chg.	-16.9	-16.6
Nov. 25	Consumer Confidence	Nov.	Index	38.5	38.0
Nov. 25	Richmond Fed. Manufacturing Index	Nov.	Index	--	-26
Nov. 25	House Price Index	Sept.	M/M % chg.	--	-0.6
Nov. 26	Durable Goods Orders	Oct.	% Chg.	-2.5	0.9
Nov. 26	Personal Income	Oct.	% change	0.1	0.2
Nov. 26	Personal Spending	Oct.	% change	-0.9	-0.3
Nov. 26	PCE Core	oct.	Y/Y % chg.	2.3	2.4
Nov. 26	PCE Deflator	Oct.	Y/Y % chg.	3.2	4.2
Nov. 26	Chicago Purchasing Managers Index	Nov.	Index	38.0	37.8
Nov. 26	New Home Sales	Oct.	Thousands	449	464

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. 24	4:00	Germany	IFO - Business Climate	Nov.	Index	88.7	90.2
	4:00	Germany	IFO - Current Assessment	Nov.	Index	96.8	99.9
	4:00	Germany	IFO - Expectations	Nov.	Index	81.0	81.4
	4:00	EU	Current Account Balance	Sept.	Eur, blns	--	-8.4
	10:00	U.S.	Existing Home Sales	Oct.	M/M % chg.	-2.7	5.5
Nov. 25	0:00	Japan	<i>Bank of Japan Monthly Report</i>				
	2:45	France	Business Confidence Indicator	Nov.	Index	85	88
	2:45	France	Production Outlook Indicator	Nov.	Index	-67	-66
	5:00	EU	<i>OECD November Economic Outlook table released</i>				
	8:30	Canada	Retail Sales	Sept.	M/M % chg.	0.3	-0.3
	8:30	Canada	Retail Sales (Ex. Autos)	Sept.	M/M % chg.	0.2	-0.3
	9:00	U.S.	S&P/CS Composite-20	Sept.	Y/Y % chg.	-16.9	-16.6
	10:00	U.S.	Consumer Confidence	Nov.	Index	38.5	38.0
	10:00	U.S.	Richmond Fed. Manufacturing Index	Nov.	Index	--	-26
10:00	U.S.	House Price Index	Sept.	M/M % chg.	--	-0.6	
Nov. 26	--	Germany	Consumer Price Index (prelim.)	Nov.	Y/Y % chg.	--	2.4
	4:30	UK	Gross Domestic Product (GDP) (prelim.)	Q3-08	Q/Q % change	-0.5	-0.5
	8:30	U.S.	Durable Goods Orders	Oct.	% Chg.	-2.5	0.9
	8:30	U.S.	Personal Income	Oct.	% change	0.1	0.2
	8:30	U.S.	Personal Spending	Oct.	% change	-0.9	-0.3
	8:30	U.S.	PCE Core	Oct.	Y/Y % chg.	2.3	2.4
	8:30	U.S.	PCE Deflator	Oct.	Y/Y % chg.	3.2	4.2
	9:45	U.S.	Chicago Purchasing Managers Index	Nov.	Index	38.0	37.8
	10:00	U.S.	New Home Sales	Oct.	Thousands	449	464
	16:45	NZ	Trade Balance	Oct.	NZ\$, mlns	-1,000.0	-1,183.0
	18:50	Japan	<i>Bank of Japan Monetary Policy Meeting Minutes for Oct. 14 and Oct. 31</i>				
Nov. 27	3:55	Germany	Unemployment Change	Nov.	Thousands	-4	-26
	3:55	Germany	Unemployment Rate	Nov.	%	7.5	--
	4:00	EU-12	M3 Money Supply Growth	Oct.	Y/Y % chg.	8.1	8.6
	5:00	EU-12	Business Climate Indicator	Nov.	Index	-1.57	-1.34
	5:00	EU-12	Consumer Confidence	Nov.	Index	-25	-24
	5:00	EU-12	Economic Confidence	Nov.	Index	78.4	80.4
	5:00	EU-12	Industrial Confidence	Nov.	Index	-21	-18
	5:00	EU-12	Services Confidence	Nov.	Index	-8	-6
	18:30	Japan	Jobless Rate	Oct.	%	4.2	4.0
	18:30	Japan	Household Spending	Oct.	Y/Y % chg.	-3.5	-2.3
	18:30	Japan	Tokyo CPI excl. perishables	Nov.	Y/Y % chg.	0.3	0.4
	18:50	Japan	Industrial Production (prelim.)	Oct.	Y/Y % chg.	-6.4	0.2
	18:50	Japan	Retail Trade	Oct.	% change	-0.9	-0.5
19:05	Canada	<i>Bank of Canada Deputy Governor Duguay speaks on financial system stability in Pictou, Nova Scotia.</i>					
Nov. 28	0:00	Japan	Housing Starts	Oct.	Y/Y % chg.	29.5	54.2
	5:00	EU-12	CPI Estimate	Nov.	Y/Y % chg.	2.5	3.2
	5:00	EU-12	Unemployment Rate	Oct.	%	7.6	7.5
	8:30	Canada	Current Account	Q3-08	\$C, blns	5.1	6.8
	8:30	Canada	Industrial Product Prices	Oct.	M/M % chg.	-1.5	-1.2
	8:30	Canada	Raw Materials Price Index	Oct.	M/M % chg.	-7.0	-7.2

* Eastern Standard Time; Sources: Bloomberg, TD Economics

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