

TD Economics

The Weekly Bottom Line

October 10, 2008

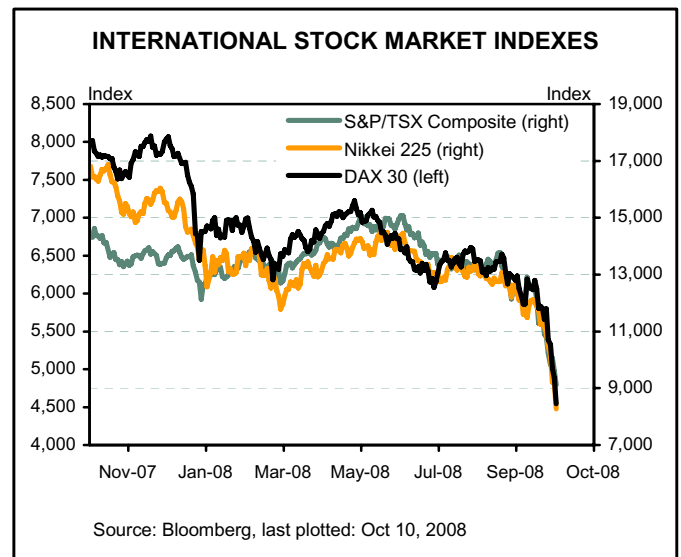
HIGHLIGHTS

- Global equity rout
- Policy makers around the world react, but financial markets fail to respond
- Canada not immune to global slump and credit crunch

Global financial markets this week gave a stunning performance as King Lear: standing naked, gripped with madness, screaming in rage into the storm but to no avail. Betrayed by evil daughters Fear and Panic, and failing to listen in the past to the calming voice of good daughter Rationality, equity markets retreated despite ardent efforts by governments and central banks to stem the rout.

Governments ride to the rescue

Indeed, this week was dominated by national policy makers scrambling to address the global financial distress. For those trying to keep track, here is a quick recap of the latest initiatives. The U.K. government raised the public guarantees on bank deposits and introduced a bank rescue plan that included the government purchase of preferred shares in eight banks and substantial loan guarantees to stimulate interbank lending. Meanwhile, the Bank of England (BoE) doubled the amount of short-term lending available to 200 billion pounds. Ireland and Greece announced a firm guarantee of all bank deposits; while Austria, Germany, Iceland and Portugal made implicit commitments to



do the same. Although a coordinated European plan failed to materialize, the heads of government in Europe agreed to a set of principles for bank rescues. Meanwhile, the German government approved a 50 billion euro bailout package for Munich-based Hypo Real Estate Holding AG. The European Central Bank (ECB) announced changes to their liquidity measures, including moving from periodic auctions to unlimited access and lowering the premium charged on emergency loans. The U.S. Federal Reserve announced the creation of a new facility that will buy 3-month commercial paper from eligible issuers to provide additional liquidity. The Government of Canada announced that it would buy \$25-billion in insured mortgages from financial institutions to provide additional funds at a time that bank financing costs have climbed sharply.

Coordinated central bank rate cuts

Take a breath, because there's more. Central bankers around the world also came together and delivered a surprise coordinated half percentage point rate cut last Tuesday. The Fed, Bank of Canada (BoC), ECB, BoE, Sweden's Riksbank and Swiss National Bank all cut rates – while the Bank of Japan (BoJ) left rates unchanged but

Recent TD Economics Research

October 10, 2008 - Canadian International Trade
 October 10, 2008 - Canadian Employment
 October 9, 2008 - Global Markets
 October 8, 2008 - BOE/ECB Rate Cuts
 October 8, 2008 - Canadian Housing Starts
 October 8, 2008 - Central Banks Rate Cuts
 October 7, 2008 - The Anatomy of the Canadian Job Market

provided a statement supporting the decision of the other monetary authorities. In explaining their actions, the central banks were clear: inflation is no longer a concern and the greatest risk is weakness in the global economy. Investors embraced this assessment, as markets went from speculating about whether or not there would be a global recession to contemplating how long and how deep.

Global economic slump in the cards

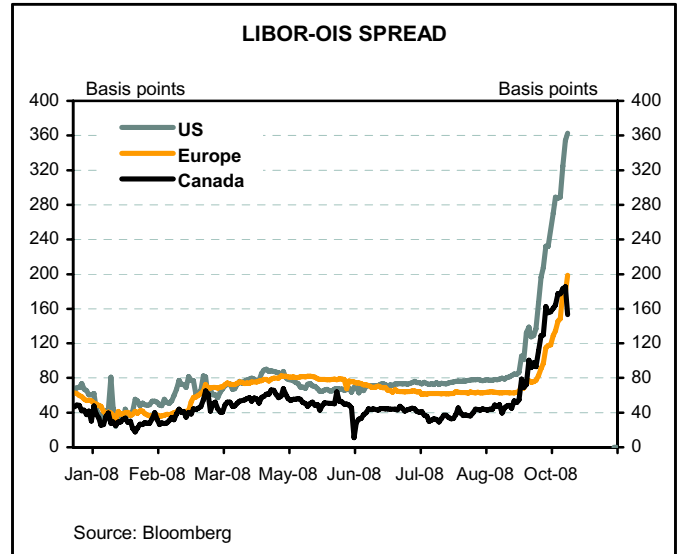
TD Economics has long been of the pessimistic side of economic forecasters and in our last Quarterly Economic Forecast (QEF) we outlined the case that the global economy would experience at least a mild recession. Earlier in the year, markets and central bankers were worried about inflation, but we argued that the slowing world demand and a correction in commodity prices would resolve any price pressures. We also stressed that expectations of a global ‘decoupling’ from the U.S. would prove a fallacy.

What TD Economics failed to anticipate was the degree of financial turmoil, which clearly poses a downside risk to the economic outlook the longer it persists. And, history tells us that every financial crisis must induce investor capitulation before the tide can turn. No one can call the bottom of the market accurately, but the deep correction in recent days certainly has that capitulation feel to it.

Recovery requires lower interbank borrowing costs

The problem is that stock markets are the single best leading economic indicator available, and equities traditionally only turn about two quarters before the economy starts to recover. We’re really only in the early stages of the economic slump and before the economic recovery can take hold there must be a significant decline in the cost of funds between financial institutions. Despite all of the policy actions taken, the interbank lending rate has continued to climb. The inference is that investors should be braced for continued volatility until there are clear signs that the distress in the global financial system is finally subsiding.

To this end, further policy announcements are likely, including central bank rate cuts. TD Economics expects that the Bank of Canada will cut the overnight rate by a further half point to 2.00% on October 21, while the Fed should lower the fed funds rate from 1.50% to 1.00% on October 29. We also anticipate that the ECB has 125 basis points to easing and the BoE has 150 basis points of easing in the months ahead.



Canada hit by two-fold external shock

One of the most frequent questions received this week was about the impact on Main Street. Notwithstanding the latest economic numbers showing solid economic growth in July and the creation of 107,000 net new jobs in September, there is no question that the Canadian economy will be deeply affected by the global recession. Canada is a major exporting nation and the correction in commodity prices combined with weakening demand in the major trading partners will be a blow to the economy. The decline in exports will dampen domestic economic conditions. The credit crunch will also constrain the domestic economy, as evidenced by the Bank of Canada senior loan officer survey released on Friday that showed a tightening in lending conditions. However, it is important to stress that the Canadian economy is fundamentally sound. Canada’s fiscal situation is solid and the Canadian financial system is weathering the recent turmoil far better than its G-7 counterparts due to its better balance sheets and comparatively prudent lending practices in the past. This was also reflected by news this week that the World Economic Forum ranked Canada as having the strongest banking system in the world. The reality is that Canada is being impacted by two external shocks – a global economic downturn and a global increase in financing costs. Due to these factors the Canadian economy will experience little or no growth over the next several quarters and that will impact Canadian households, but the economy will recover when the external problems subside.

*Craig Alexander, VP & Deputy Chief Economist
416-982-8064*

UPCOMING KEY ECONOMIC RELEASES

U.S. Retail Sales - September

Release Date: October 15/08

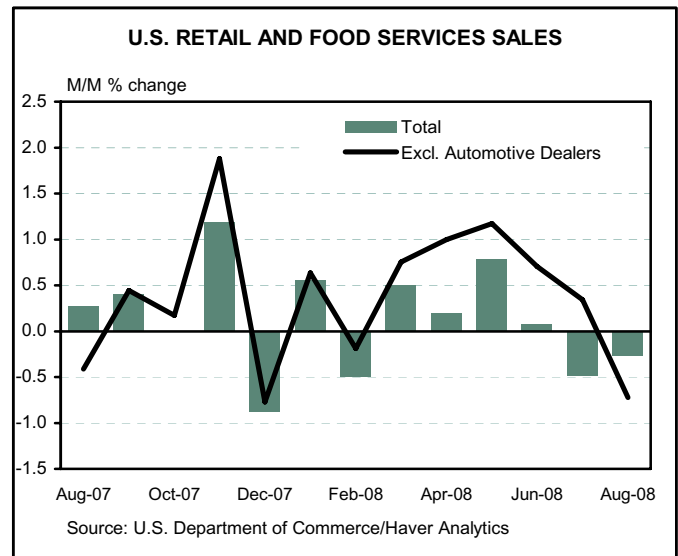
August Result: total -0.3% M/M; ex-autos -0.7% M/M

TD Forecast: total -0.8% M/M; ex-autos -0.1% M/M

Consensus: total -0.6% M/M; ex-autos -0.1% M/M

With a weakening domestic economy, worsening labour market conditions, higher borrowing costs and growing economic anxiety, U.S. consumers appear to have their backs up against the wall. And with most consumer spending related indicators flashing red, our call is for U.S. retail sales to fall by its biggest margin since December last year, with a 0.8% M/M decline in September. However, given that much of the weakness in the headline number will be due to the 8.9% M/M plunge in car purchases, sales excluding autos should post a more modest 0.1% M/M drop. In the months ahead, we expect the downward trend in retail sales to continue as U.S. consumers adjust their spending habits to the new, harsher economic reality.

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U.S. Consumer Price Index - September

Release Date: October 16/08

August Result: core 0.2% M/M, 2.5% Y/Y;

all-items -0.1% M/M, 5.4% Y/Y

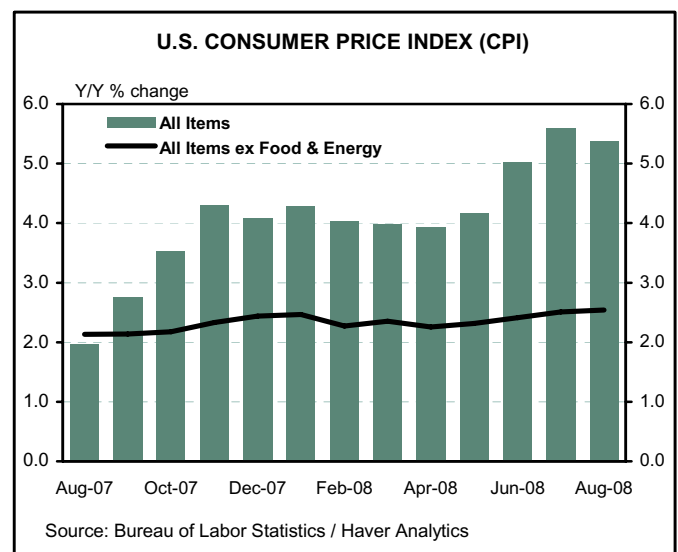
TD Forecast: core 0.2% M/M, 2.5% Y/Y;

all-items 0.1% M/M, 5.1% Y/Y

Consensus: core 0.2% M/M, 2.5% Y/Y;

all-items 0.1% M/M, 5.1% Y/Y

After reaching a cyclical high watermark of 5.6% Y/Y in July, U.S. headline consumer inflation should continue trending downwards in September on account of the dramatic easing in global energy prices and the weakening domestic economy. However, the extent of the moderation in consumer prices will likely be tempered by rising foods prices, which are likely to grow by a further 0.3% M/M. In September, we expect consumer prices to rise by a modest 0.1% M/M, bringing the annual rate of price inflation down to 5.1% Y/Y. Core consumer prices should rise by 0.2% M/M, with core consumer price inflation remaining unchanged at 2.5% Y/Y for the third straight month. Looking ahead, we expect to see further easing in



consumer prices as the growing slack in U.S. economic activity and softer commodity prices temper consumer price inflation further.

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Canadian Manufacturing Shipments - August

Release Date: October 16/08

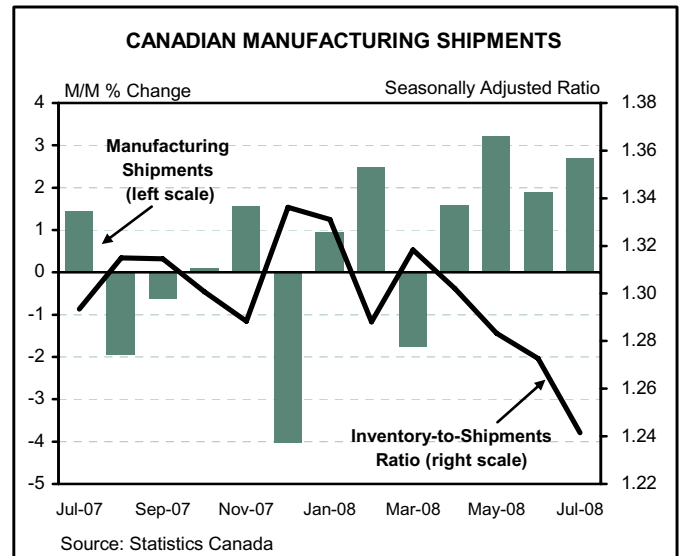
July Result: +2.7% M/M

TD Forecast: -1.0% M/M

Consensus: -0.5% M/M

After advancing by over 1.5% M/M for the past four months, we expect the surprising resiliency in the Canadian manufacturing sector to come to an end in August. In fact, with the weakening U.S. and Canadian economies providing the backdrop, Canadian manufacturing shipments should post its first monthly drop since March, falling by 1.0% M/M in August. Much of the decline will come from the retrenchment in auto-related shipments to the U.S., while weakness in the shipments of energy related products will also be a source of drag. In the coming months, manufacturing sector activity should moderate even further as the weakness in Canadian and the U.S. consumer spending dampen demand for Canadian manufacturing products.

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U.S. Housing Starts - September

Release Date: October 17/08

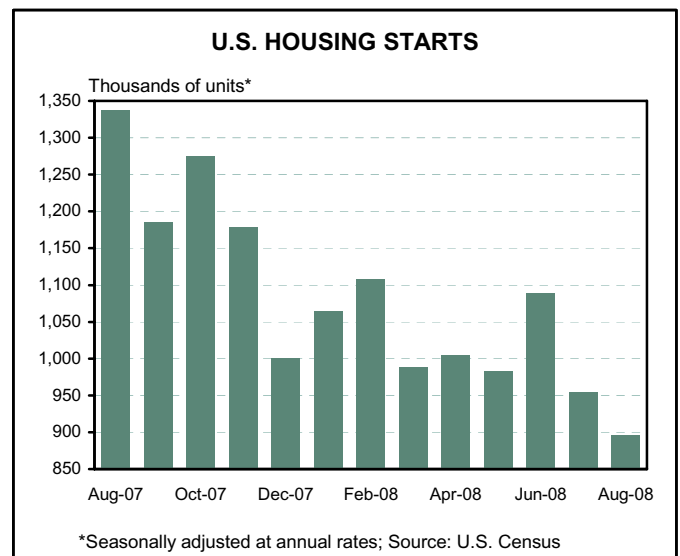
August Result: 895K

TD Forecast: 880K

Consensus: 880K

The combination of a weak domestic economy, elevated levels of unsold homes and deteriorating labour market conditions have been weighing heavily on U.S. housing market activity. As a result, new residential construction activity has been weak as builders attempt to work-off the excess inventories. On the demand side, potential home buyers have continued to postpone home purchases hoping for better deals down the road, which has further depressed activity. As such, for September, we expect housing starts to fall to 880K. Looking ahead, starts should continue trending lower before perhaps reaching bottom in the coming months.

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RECENT KEY ECONOMIC INDICATORS
October 6 - October 10, 2008

		Data for	Units	Current	Prior	
Canada						
Oct. 6	Building Permits	Aug	M/M % chg.	-13.5	2.6	R▲
Oct. 6	IVEY Purchasing Managers Index	Sep.	Index	61.0	51.5	
Oct. 8	Bank of Canada Rate	8-Oct.	%	2.5	3.0	
Oct. 8	Housing Starts	Sep.	Thousands	217.6	217.4	R▲
Oct. 10	Unemployment Rate	Sep.	%	6.1	6.1	
Oct. 10	Net Change in Employment	Sep.	Thousands	106.9	15.2	
Oct. 10	International Merchandise Trade	Aug.	\$. blns	5.8	4.2	R▼
Oct. 10	New Housing Price index	Aug.	M/M % chg.	0.0	0.1	
United States						
Oct. 6	<i>Fed Governors Volcker, Ferguson Speak in New York on Financial Supervision</i>					
Oct. 6	<i>Fed Governor Evans Speaks on Economic Outlook in Texas</i>					
Oct. 6	<i>Fed Governor Fisher Speaks in Wichita Falls, Texas, on Fed, Economy</i>					
Oct. 7	<i>Fed Governor Stern Speaks in Chicago on Financial Shock</i>					
Oct. 7	<i>Bernanke Speaks to Economics Conference in Washington</i>					
Oct. 7	<i>Minutes of Sept. 16 FOMC Meeting</i>					
Oct. 7	Consumer Credit	Aug.	US\$, blns	-7.9	5.2	
Oct. 7	ABC Consumer Confidence	5-Oct.	Index	-43.0	-41.0	
Oct. 8	MBA Mortgage Applications	3-Oct.	% change	2.2	-23.0	
Oct. 8	FOMC Rate Decision	8-Oct.	%	1.5	2.0	
Oct. 8	<i>Philadelphia Fed Governor Plosser Speaks on Fed Policies in New York</i>					
Oct. 8	Pending Home Sales	Aug.	M/M % chg.	7.4	-2.7	R▲
Oct. 9	Initial Jobless Claims	4-Oct	Thousands	478.0	498.0	R▲
Oct. 9	Continuing Claims	27-Sep	Thousands	3,659.0	3,603.0	R▲
Oct. 9	Wholesale Inventories	Aug.	% change	1.0	1.7	
Oct. 9	<i>Fed Governor Stern Speaks in Minneapolis on Financial Shock</i>					
Oct. 9	<i>Boston Fed Governor Rosengren Speaks at University of Wisconsin</i>					
Oct. 10	Trade Balance	Aug.	US\$, blns	-59.1	-61.3	R▲
Oct. 10	Import Price Index	Sep.	Y/Y % chg.	14.5	18.7	R▲

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR

October 13 - October 17, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Oct 14	New Motor Vehicle Sales	Aug.	M/M % chg.	-13.5	2.6
Oct 16	Manufacturing Shipments	Aug.	M/M % chg.	-0.5	--
United States					
Oct 12	<i>Dallas Fed's Fisher to Speak on Financial Crisis in Washington</i>				
Oct 13	<i>Kansas City Fed's Hoenig to Speak on Regulation in Washington</i>				
Oct 14	<i>Fed's Plosser Introduces Zambia Gov. Fundanga in Philadelphia</i>				
Oct 14	Monthly Budget Statement	Sept.	US\$, blns	54.0	112.9
Oct 14	ABC Consumer Confidence	12-Oct	Index	--	-43.0
Oct 14	<i>St. Louis Fed's Bullard To Speak at Economic Club of Memphis</i>				
Oct 14	<i>Fed's Yellen Speaks on Economic Outlook in Palo Alto</i>				
Oct 15	MBA Mortgage Applications	10-Oct	% change	--	2.0
Oct 15	<i>Boston Fed's Rosengren Speaks on Economic Outlook in Boston</i>				
Oct 15	Producer Price Index	Sept.	Y/Y % chg.	8.7	9.6
Oct 15	Producer Price Index (Ex. Food & Energy)	Sept.	Y/Y % chg.	3.8	3.6
Oct 15	Advance Retail Sales	Sept.	% change	-0.6	-0.3
Oct 15	Retail Sales Less Autos	Sept.	% change	-0.2	-0.7
Oct 15	Empire Manufacturing	Oct.	% change	-10.0	-7.4
Oct 15	Business Inventories	Aug.	% change	0.5	1.1
Oct 15	<i>Bernanke Speaks to Economic Club of New York</i>				
Oct 15	<i>Fed Releases Beige Book Economic Report</i>				
Oct 15	<i>Fed Vice Chairman Donald Kohn Speaks on Economy in New York</i>				
Oct 16	<i>Fed's Stern Speaks in Houghton, Michigan</i>				
Oct 16	Consumer Price Index (CPI)	Sept.	Y/Y % chg.	5.1	5.4
Oct 16	CPI Ex Food and Energy	Sept.	Y/Y % chg.	2.5	2.5
Oct 16	Initial Jobless Claims	11-Oct	Thousands	470.0	478.0
Oct 16	Continuing Claims	4-Oct	Thousands	--	3,659.0
Oct 16	Industrial Production	Sept.	Y/Y % chg.	-0.8	-1.1
Oct 16	Capacity Utilization Rate	Sept.	%	77.9	78.7
Oct 16	<i>St. Louis Fed's Bullard To Speak on U.S. Growth Potential</i>				
Oct 16	Philadelphia Fed Index	Oct.	Index	-10.0	3.8
Oct 16	NAHB Housing Market Index	Oct.	Index	17.0	18.0
Oct 16	<i>Boston Fed's Rosengren Speaks About Foreclosures in Boston</i>				
Oct 17	Housing Starts	Sept.	Thousands	875.0	895.0
Oct 17	Building Permits	Sept.	Thousands	843.0	857.0
Oct 17	U. of Michigan Confidence Index	Oct. P	Index	67.0	70.3
Oct 17	<i>St. Louis Fed's Bullard To Moderate Panel on Economic Policy</i>				
Oct 17	<i>Fed's Evans Speaks on Economic Outlook in Wisconsin</i>				

Source: Bloomberg, TD Economics

G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
Oct 12	8:45 18:45	U.S. NZ	<i>Dallas Fed Governor Fisher to Speak on Financial Crisis in Washington</i> Retail Sales	Aug.	M/M % chg.	--	-0.8
Oct 13	2:45 8:15 19:01 21:30	France U.S. U.K. AU	Current Account <i>Kansas City Fed Governor Hoenig to Speak on Regulation in Washington</i> RICS Home Price Balance NAB Business Confidence	Aug. Sept. Sept.	Eur, blns % change Index	-4.0 -85.0 --	-3.8 -81.0 -7.0
Oct 14	1:00 2:30 2:45 4:30 4:30 5:00 5:00 8:30 12:15 14:00 17:00 19:50 19:50 20:30 22:00	Japan France France U.K. U.K. EU-12 EU-12 Canada EU US U.S. Japan Japan U.S. U.S.	Consumer Confidence Bank of France Business Sentiment Consumer Price Index CPI (YoY) Retail Price Index ZEW Survey - Economic Sentiment Industrial Production (wda) New Motor Vehicle Sales <i>ECB's Trichet Speaking in New York</i> Monthly Budget Statement ABC Consumer Confidence Current Account Total Trade Balance - BoP Basis <i>St. Louis Fed Governor Bullard To Speak at Economic Club of Memphis</i> <i>Fed Governor Yellen Speaks on Economic Outlook in Palo Alto</i>	Sept. Sept. Sept. Sept. Sept. Oct. Aug. Aug. Sept. 12-Oct Aug. Aug.	Index Index Y/Y % chg. Y/Y % chg. Y/Y % chg. Index Y/Y % chg. M/M % chg. US\$, blns Index ¥, blns ¥, blns	29.9 92.0 3.1 5.0 4.9 -57.5 -1.6 -1.0 54.0 -- 1,198.3 -146.0	30.5 94.0 3.2 4.7 4.8 -40.9 -1.7 -0.8 112.9 -43.0 1,531.8 232.2
Oct 15	0:30 2:00 4:30 5:00 7:00 8:05 8:30 8:30 8:30 8:30 8:30 10:00 12:15 14:00 19:00	Japan Germany U.K. EU-12 U.S. U.S. U.S. U.S. U.S. U.S. U.S. U.S. U.S. U.S. U.S.	Industrial Production Consumer Price Index Jobless Claims Change Euro-Zone CPI MBA Mortgage Applications <i>Boston Fed Governor Rosengren Speaks on Economic Outlook in Boston</i> Producer Price Index Producer Price Index (Ex. Food & Energy) Advance Retail Sales Retail Sales Less Autos Empire Manufacturing Business Inventories <i>Bernanke Speaks to Economic Club of New York</i> <i>Fed Releases Beige Book Economic Report</i> <i>Fed Vice Chairman Donald Kohn Speaks on Economy in New York</i>	Aug. F Sept. F Sept. Sept. 10-Oct Sept. Sept. Sept. Sept. Sept. Oct. Aug.	Y/Y % chg. Y/Y % chg. Thousands Y/Y % chg. % change Y/Y % chg. Y/Y % chg. % change % change % change % change % change	-- 2.9 36.0 3.6 -- 8.7 3.8 -0.6 -0.2 -10.0 0.5	-6.9 2.9 32.5 3.6 2 9.6 3.6 -0.3 -0.7 -7.4 1.1
Oct 16	00:00 8:30 8:30 8:31 8:30 8:30 9:15 9:15 9:30 10:00 13:00 20:00	U.S. Canada U.S. U.S. U.S. U.S. U.S. U.S. U.S. U.S. U.S. U.S.	<i>Fed Governor Stern Speaks in Houghton, Michigan</i> Manufacturing Shipments Consumer Price Index (CPI) CPI Ex Food and Energy Initial Jobless Claims Continuing Claims Industrial Production Capacity Utilization Rate <i>St. Louis Fed's Bullard To Speak on U.S. Growth Potential</i> Philadelphia Fed Index NAHB Housing Market Index <i>Boston Fed Governor Rosengren Speaks About Foreclosures in Boston</i>	Aug. Sept. Sept. 11-Oct 4-Oct Sept. Sept. Oct. Oct.	M/M % chg. Y/Y % chg. Y/Y % chg. Thousands Thousands Thousands Y/Y % chg. % Index Index	-0.5 5.1 2.5 470 -- -0.8 77.9 -10.0 17.0	-- 5.4 2.5 478 3659.0 -1.1 78.7 3.8 18.0
Oct 17	5:00 8:30 8:30 10:00 12:45 14:00	EU U.S. U.S. U.S. U.S. U.S.	Trade Balance (seasonally adjusted) Housing Starts Building Permits U. of Michigan Confidence Index <i>St. Louis Fed governor Bullard To Moderate Panel on Economic Policy</i> <i>Fed Governor Evans Speaks on Economic Outlook in Wisconsin</i>	Aug. Sept. Sept. Oct. P Oct.	Eur\$, blns Thousands Thousands Index	-5.4 875.0 843.0 67.0	-6.4 895.0 857.0 70.3

* Eastern Standard Time; Sources: Bloomberg, TD Economics

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