



TD Economics

The Weekly Bottom Line

September 26, 2008

HIGHLIGHTS

- **Lawmakers in Washington continue to dither on the Treasury's \$700 billion bailout plan.**
- **U.S. economic data shows floundering housing market and slumping business investment.**
- **Carney notes global financial turmoil will impact Canada**

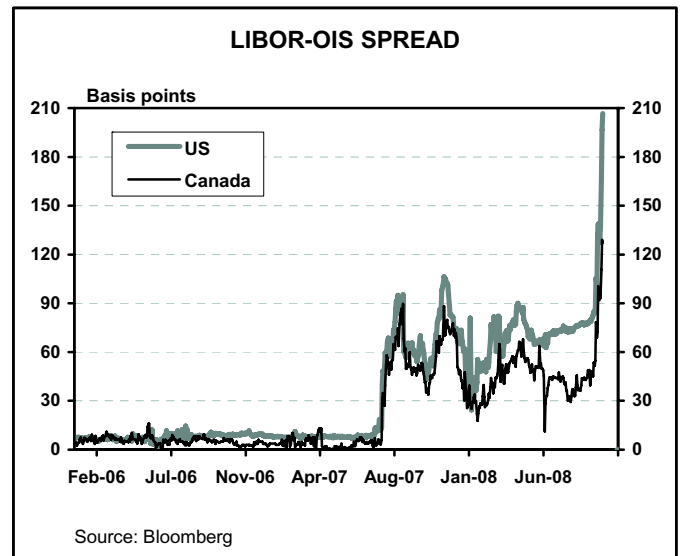
Another week and another attempt in Washington to get things working on Wall Street. The fickle nature of negotiations on the \$700 billion Treasury-backed bailout plan sent markets see-sawing as news that the respective parties had finally agreed on the conditions of the plan proved to be false hope and political wrangling continued to forestall the plan. In reaction, credit spreads shot up 79 basis points by Friday morning. In amongst the political drama, economic news confirmed that the situation in the U.S. housing market remains as sour as ever, and just to top it all off, the week closed with perhaps the biggest U.S. bank failure ever as Washington Mutual went under.

Deal or no deal

Last week it was drama on Wall Street, this week it was drama in Washington. Lawmakers met all week on Capitol Hill trying to reach an agreement on the terms of the Treasury backed Troubled Asset Relief Program (TARP). On Thursday a deal in principle looked to have been reached. The outline of the agreement contained limits on executive compensation, loan modification for struggling homeowners and additional Congressional oversight and approval for use of funds over the first \$250 billion.

Recent TD Economics Research

September 26, 2008 - Will the U.S. Dollar go the way of the British Pound?
 September 25, 2008 - U.S. Durable Goods Orders
 September 25, 2008 - Quarterly Economic Forecast
 September 23, 2008 - Canadian Consumer Price Index
 September 22, 2008 - Canadian Retail Sales



But, just as it seemed things would pull through, house Republicans came out with an alternative proposal based on tax-credits and government sponsored insurance for the troubled securities. By the time markets opened Friday, negotiations were back to square one.

In all likelihood a deal of some form or another will be reached, though trying to bet on its final form is perhaps just slightly less risky than certain types of asset-backed securities. As we have argued in our Quarterly Economic Forecast published earlier this week, actions of policymakers are necessary but will not likely be sufficient to put an immediate end to the credit crisis. Friday's failure of Washington Mutual illustrates what is the fundamental problem in the banking industry – lack of capital. Even if a deal is reached, the process of deleveraging and raising capital will continue to hamper the U.S. and global economies for the next several quarters.

Housing still in a rut, durable goods orders following suit

Even with all the action in Washington, markets managed to find the time to pay attention to the economic data and it wasn't pretty. Another round of dour housing

data was on the menu mid-week with August existing home sales falling by 2.2% to 4.91 million units. In spite of significant home price declines, home sales have been stuck around the 5 million mark for roughly the last year. At current sales rates, the inventory of unsold homes will take over 10 months to work off, keeping continued downward pressure on both supply of new housing and home prices.

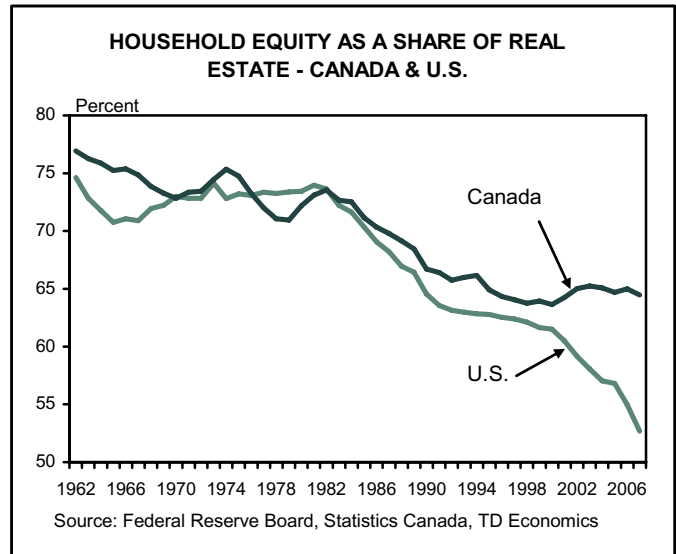
If news from the housing market was the main course, then Thursday's durable goods orders reports was an awfully sour tasting desert. Durable goods orders fell an astonishing 4.5% in August with nearly every sector of the report showing weakness. The report highlights what we have known for quite some time – that it was only a matter of time before tighter lending standards and declining consumer demand began to pull down the business sector. In addition, this report also highlights the increasing risks to the U.S. export sector, which, with the global economy flirting with recession, will not offer as much support to GDP growth relative to recent experience

Carney stresses global nature of crisis

The fate of the global economy was also on the mind Bank of Canada governor Mark Carney as he gave a speech in Montreal this week. Carney's comments echoed our belief that the process of deleveraging and recapitalization is far from over and will continue to stem the flow of global credit. His comments also emphasized that Canadian banks have avoided many of the problems currently facing many of their global counterparts. They are much better capitalized and have suffered fewer losses, putting them in a much better position to handle the fallout.

Whither the Canadian housing market?

We can't end our weekly without some comments on the risks to the Canadian housing market. With all the focus on the housing market collapse in the U.S. and the recent fall in existing home prices in Canada, a considerable amount of attention has been given to the possibility that Canada's housing market will follow the U.S. into the abyss. While there are risks to the Canadian housing market, it is important to keep a few key facts in mind on the differences between the two. The U.S. housing market collapse was brought about by a loosening of lending standards and the explosion of subprime mortgages at the height of the U.S. housing boom. These subprime mortgages were



never really affordable and the majority of them were given with initial teaser interest rates that reset after two years, pushing, on average, mortgage payments up \$350 a month, and causing a wave of home foreclosures.

The housing collapse and astronomical rise in U.S. home foreclosures can be broken down into three stages: At the first stage investors (who made up close to 10% of mortgage originations and had little to no equity in their purchases) simply turned over the keys when prices turned down, adding to excess housing supply and pushing prices down further. The second wave came last year as resetting adjustable rate mortgages given in 2005 reset to higher rates and lower prices made it impossible for borrowers to refinance. The current stage is where negative equity (10% of mortgage holders owe more on their home than it is currently worth) combined with job losses has caused borrowers to simply walk away from their mortgage.

Contrast this with the Canadian market – subprime mortgages never exceeded 5% of the market and resetting adjustable-rate mortgages are non-existent. Moreover, Canadians have a significantly higher level of equity built up in their homes (see graph). While it is true that there are markets in Canada where home prices overshot – like Alberta – and these will likely correct further over the next several months, this is in no way comparable to the kind of declines or financial losses that we have seen south of the border.

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UPCOMING KEY ECONOMIC RELEASES

U.S. Personal Income and Spending - August

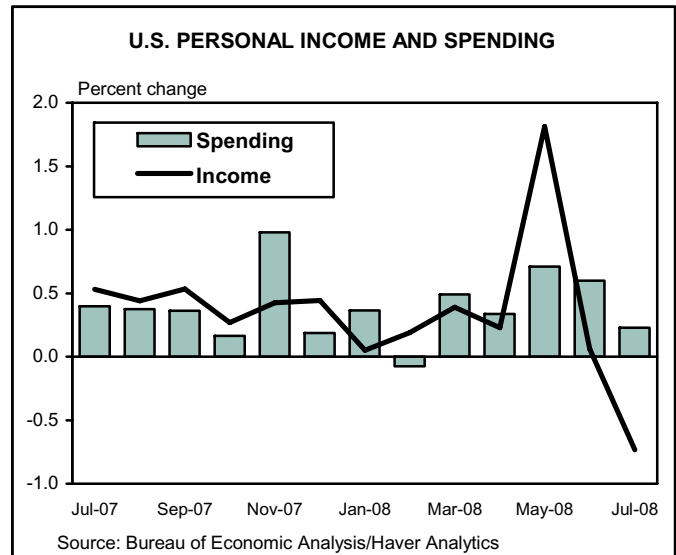
Release Date: September 29/08

July Result: income -0.7% M/M, spending 0.2% M/M; core PCE deflator +0.3% M/M, +2.4% Y/Y

TD Forecast: income +0.2% M/M; spending +0.2% M/M; core PCE deflator +0.2% M/M, 2.5% Y/Y

Consensus: income +0.2% M/M; spending +0.2% M/M; core PCE deflator +0.2% M/M, 2.4% Y/Y

U.S. consumers remain under stress, as the adverse impact of mounting job losses, declining home prices and elevated gasoline prices weigh heavily on consumer's wealth. For August, we expect personal income to rise by only 0.2% M/M, following the dramatic 0.7% M/M drop in June. Spending is expected to be equally tepid, with personal expenditure rising by 0.2% M/M. On the inflation front, the core PCE deflator should rise by 0.2% M/M, bringing the annual rate of core inflation to 2.5% Y/Y, which will be the highest rate of core consumer inflation since September 2006. This, however, will likely be the high water mark for this inflation indicator, as the soften-



ing domestic economy and the retreat in energy prices will likely lead the way in easing the elevated level of consumer inflation pressures in the coming months.

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Canadian Real GDP - July

Release Date: September 30/08

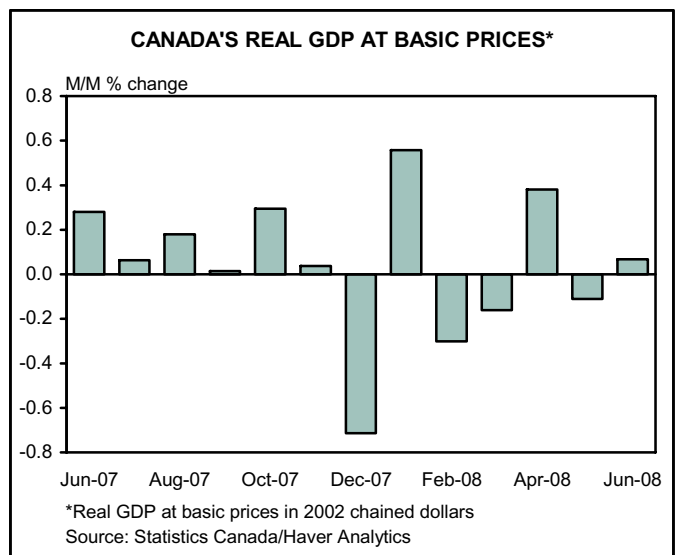
June Result: +0.1% M/M

TD Forecast: +0.3% M/M

Consensus: +0.1% M/M

It has now become clear that the Canadian economy has hit a soft patch. And with a weakening U.S. economy - the key destination for Canadian export products - a softening housing sector and slowing consumer spending, Canadian economic activity is likely to remain subdued for some time. In July, we expect the economy to grow by 0.3% M/M, following the meagre +0.1% M/M in June. The increase in activity is expected to come from the surprising strength in manufacturing sector and wholesale trade activity during the month. On the other hand, slower construction activity and a declining energy sector will continue to weigh heavily on overall economic activity.

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U.S. ISM Manufacturing Report - September

Release Date: October 1/08

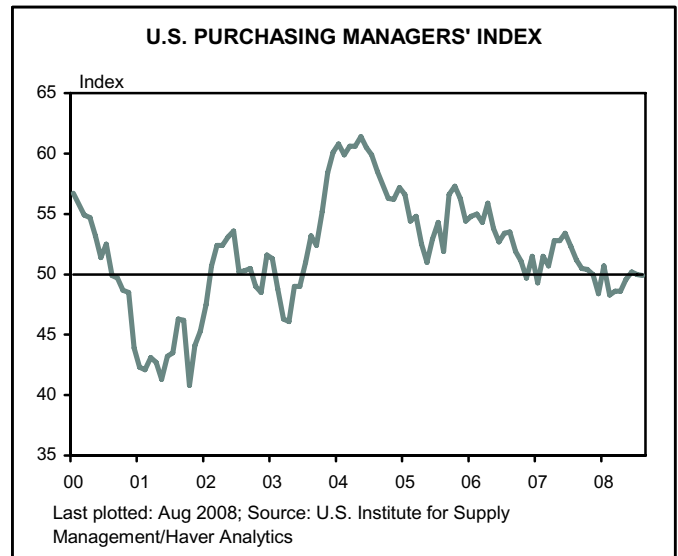
August Result: 49.9

TD Forecast: 48.0

Consensus: 50.0

After hovering on or close to the 50-threshold for the past few months, we expect the U.S. ISM manufacturing index to begin its descent in September, falling to 48.0. Slowing export demand and waning domestic demand suggests U.S. manufacturing sector activity will slow down in September, after the resiliency shown in the first half of the year. Looking ahead, with durable goods orders posting a massive 4.5% M/M drop in August, we expect manufacturing sector activity to remain weak in September, as the pipeline of orders is clearly weak. As such, we not only expect the ISM manufacturing index to be below 50 in September, but remain there for quite some time.

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U.S. Nonfarm Payrolls - September

Release Date: October 3/08

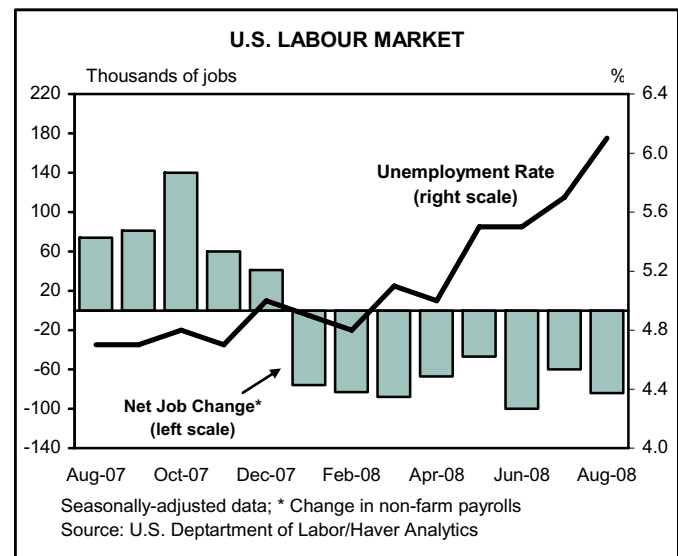
August Result: -84K; unemployment rate 6.1%

TD Forecast: -100K; unemployment rate 6.1%

Consensus: -100K; unemployment rate 6.1%

With declining export demand and weakening consumer spending, new cracks in the U.S. economic landscape are becoming ever more apparent by the day. As such, we expect the deterioration in the U.S. labour market to accelerate further in the coming months. For September, our call is for the U.S. economy to shed 100K jobs, following the 84K jobs that were lost in August. Despite the drop in the nonfarm payroll, the unemployment rate (which is obtained from a separate survey) is expected to hold steady at 6.1%. In the coming months, we expect U.S. businesses to further lighten their workforce, adding to the 605K jobs that have been lost so far this year as sluggish domestic and declining foreign demand for their products temper demand for workers. If there are any risks to this forecast, it is to the downside.

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RECENT KEY ECONOMIC INDICATORS
September 22 - September 26, 2008

		Data for	Units	Current	Prior	
Canada						
Sep 22	Retail Sales	Jun.	M/M % chg.	0.1	0.6	R▲
Sep 22	Retail Sales (Ex. Autos)	Jun.	M/M % chg.	0.4	1.5	R▲
Sep 23	Consumer Price Index	Aug.	Y/Y % chg.	3.5	3.4	
Sep 23	Bank of Canada CPI Core	Aug.	Y/Y % chg.	1.7	1.5	
United States						
Sep 22	<i>Paulson, Bernanke Testify on Credit Turmoil at Senate Panel</i>					
Sep 22	<i>Bernanke, Paulson, Cox Testify on Financial Crisis</i>					
Sep 23	Richmond Fed. Manufacturing Index	Sept.	Index	-18.0	-16.0	
Sep 23	House Price Index	July	M/M % chg.	-0.6	-0.3	R▼
Sep 23	ABC Consumer Confidence	21-Sept.	Index	-41.0	-41.0	
Sep 24	MBA Mortgage Applications	19-Sept.	% change	-10.6	33.4	
Sep 24	Existing Home Sales	Aug.	Millions	4.91	5.02	R▲
Sep 24	<i>Bernanke testifies at Congress Joint Economic Committee</i>					
Sep 24	<i>Paulson, Bernanke Testify on Financial Crisis at House Panel</i>					
Sep 25	Durable Goods Orders	Aug.	% change	-4.5	0.8	R▼
Sep 25	Initial Jobless Claims	20-Sept.	Thousands	493.0	461.0	R▲
Sep 25	Continuing Claims	13-Sept.	Thousands	3542.0	3479.0	R▲
Sep 25	New Home Sales	Aug.	Thousands	460.0	520.0	R▲
Sep 25	<i>Fed Governor Evan, ECB's Gonzalez-Paramo Give Welcoming Remarks</i>					
Sep 26	<i>Fed Governor Fisher Speaks to Investors, Economists in New York</i>					
Sep 26	U. of Michigan Confidence Index	Sept.	Index	70.3	73.1	
Sep 26	<i>St. Louis Fed's Bullard To Speak at Tennessee Economic Meeting</i>					

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR

September 29 - October 3, 2008

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Sep 30	Industrial Product Prices	Aug.	M/M % chg.	-0.2	0.4
Sep 30	Raw Materials Price Index	July	M/M % chg.	-3.5	1.4
Sep 30	Gross Domestic Product	Aug.	M/M % chg.	0.2	0.1
United States					
Sep 29	Personal Income	Aug.	% change	0.2	-0.7
Sep 29	PCE Deflator	Aug.	Y/Y % chg.	4.5	4.5
Sep 29	Personal Spending	Aug.	% change	0.2	0.2
Sep 29	PCE Core	Aug.	Y/Y % chg.	2.4	2.4
Sep 29	<i>Fed's Hoenig Speaks in Gering, Nebraska, on Economy, Policy</i>				
Sep 30	S&P/CS Composite-20	July	Y/Y % chg.	-16.0	-15.9
Sep 30	Chicago Purchasing Managers Index	Sept.	Index	53.5	57.9
Sep 30	Consumer Confidence	Sept.	Index	55.0	56.9
Sep 30	<i>Atlanta Fed Governor Lockhart to Speak on Economy in New Orleans</i>				
Oct 1	Domestic Vehicle Sales	Sept.	Millions	10.2	10.4
Oct 1	Total Vehicle Sales	Sept.	Millions	13.5	13.7
Oct 1	MBA Mortgage Applications	26-Sept.	% change	-	-10.6
Oct 1	ADP Employment Change	Sept.	Thousands	-50.0	-33.0
Oct 1	ISM Manufacturing Composite Index	Sept.	Index	49.5	49.9
Oct 1	Construction Spending	Aug.	% change	-0.5	-0.6
Oct 2	Initial Jobless Claims	27-Sept.	Thousands	475.0	493.0
Oct 2	Factory Orders	Aug.	% change	-2.9	1.3
Oct 2	<i>St. Louis Fed's Bullard To Speak at Bloomington Indiana</i>				
Oct 3	Unemployment rate	Sept.	%	6.1	6.1
Oct 3	Change in Non-Farm Payrolls	Sept.	Thousands	-100.0	-84.0
Oct 3	ISM Non-Manufacturing Composite Index	Sept.	Index	50	50.6

Source: Bloomberg, TD Economics

G-7 ECONOMIC RELEASES AND EVENTS

Date	Time*	Country	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period	
Sep 28	17:45	NZ	Trade Balance	Aug.	Millions	-912.0	-781.0	
	19:50	Japan	Retail Trade	Aug.	Y/Y % chg.	0.2	2.0	
Sep 29	5:00	EU	Consumer Confidence Indicator	Sept.	Index	-19.0	-19.0	
	5:00	EU	Economic Confidence	Sept.	Index	87.3	88.8	
	8:30	U.S.	Personal Income	Aug.	% change	0.2	-0.7	
	8:30	U.S.	PCE Deflator	Aug.	Y/Y % chg.	4.5	4.5	
	8:30	U.S.	Personal Spending	Aug.	% change	0.2	0.2	
	8:30	U.S.	PCE Core	Aug.	Y/Y % chg.	2.4	2.4	
	19:30	Japan	Jobless Rate	Aug.	%	4.1	4.0	
	19:30	Japan	Household Spending	Aug.	Y/Y % chg.	-1.3	-0.5	
	19:50	Japan	Industrial Production	Aug.	Y/Y % chg.	-6.0	2.4	
	20:45	US	<i>Fed Governor Hoenig Speaks in Gering, Nebraska, on Economy, Policy</i>					
Sep 30	2:45	France	Producer Prices	Sept	Y/Y % chg.	6.8	7.3	
	3:55	Germany	Unemployment Rate	Sept.	Per cent	7.6	7.6	
	4:30	U.K.	Gross Domestic Product	Q2	Q/Q % ann.	0.0	0.0	
	4:30	U.K.	Current Account Balance	Q2	UK\$, blns	-9.7	-8.4	
	5:00	EU	CPI Estimate	Sept.	Y/Y % chg.	3.6	3.8	
	8:30	Canada	Industrial Product Price Index	Aug.	M/M % chg.	-0.2	0.4	
	8:30	Canada	Raw Materials Price Index	July	M/M % chg.	-3.5	1.4	
	8:30	Canada	Gross Domestic Product	Aug.	M/M % chg.	0.2	0.1	
	9:00	U.S.	S&P/C-S Composite-20	July	Y/Y % chg.	-16.0	-15.9	
	10:00	U.S.	Chicago Purchasing Managers Index	Sept.	Index	53.5	57.9	
	10:00	U.S.	Consumer Confidence	Sept.	Index	55.0	56.9	
	13:00	U.S.	<i>Atlanta Fed Governor Lockhart to Speak on Economy in New Orleans</i>					
	17:00	U.S.	ABC Consumer Confidence	28-Sep	Index	-43.0	-41.0	
Oct 1	---	U.S.	Domestic Vehicle Sales	Sept.	Millions	10.2	10.4	
	1:00	Japan	Vehicle Sales	Sept.	Y/Y % chg.	--	-14.9	
	2:00	Germany	Retail Sales	Sept.	Y/Y % chg.	-2.6	0.0	
	3:50	France	Purchasing Manager's Index (Manufacturing)	Sept.	Index	43.6	43.6	
	3:55	Germany	Purchasing Manager's Index (Manufacturing)	Sept.	Index	48.1	48.1	
	4:00	EU	Purchasing Manager's Index (Manufacturing)	Sept.	Index	45.3	45.3	
	4:30	UK	Purchasing Manager's Index (Manufacturing)	Sept.	Index	45.0	45.9	
	5:00	EU	Unemployment Rate	Aug.	%	7.3	7.3	
	--	U.S.	Total Vehicle Sales	Sept.	Millions	13.5	13.7	
	7:00	U.S.	MBA Mortgage Applications	26-Sept.	% change	--	-10.6	
	8:15	U.S.	ADP Employment Change	Sept.	Thousands	-50.0	-33.0	
	10:00	U.S.	ISM Manufacturing Composite Index	Sept.	Index	49.5	49.9	
	10:00	U.S.	Construction Spending	Aug.	M/M % chg.	-0.5	-0.6	
	19:50	Japan	Monetary Base	Sept.	Y/Y % chg.	--	-0.2	
	21:30	AU	Trade Balance	Aug.	AU, mlns	200.0	-717.0	
Oct 2	2:00	U.K.	Nation Wide Housing Prices	Sept.	Y/Y % chg.	-12.4	-10.5	
	5:00	EU	Euro-Zone PPI	Aug.	Y/Y % chg.	8.4	9.0	
	7:45	EU	ECB Rate Announcement	2-Oct	%	4.25	4.25	
	8:30	U.S.	Initial Jobless Claims	27-Sept.	Thousands	475	493	
	10:00	U.S.	Factory Orders	Aug.	% change	-2.9	1.3	
	20:00	U.S.	<i>St. Louis Fed Governor Bullard To Speak at Bloomington Indiana</i>					
Oct 3	5:00	EU	Retail Sales	Aug.	Y/Y % chg.	-2.4	-2.8	
	3:50	France	Purchasing Manager's Index (Services)	Sept.	Index	50.4	50.4	
	3:55	Germany	Purchasing Manager's Index (Services)	Sept.	Index	49.3	49.3	
	4:00	EU	Purchasing Manager's Index (Composite)	Sept.	Index	47.0	47.0	
	4:00	U.K.	Purchasing Manager's Index (Services)	Sept.	Index	47.0	49.2	
	8:30	U.S.	Unemployment rate	Sept.	%	6.1	6.1	
	8:30	U.S.	Change in Non-farm Payrolls	Sept.	Thousands	-100.0	-84.0	
	10:00	U.S.	ISM Non-Manufacturing Composite Index	Sept.	Index	50.0	50.6	

* Eastern Standard Time; Sources: Bloomberg, TD Economics

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