



TD Economics

The Weekly Bottom Line

August 24, 2007

HIGHLIGHTS

- **Some calm returns to markets**
- **Fed using all tools available except its fed funds rate**
- **Economic data will take on increasing importance**

While nobody is ready to declare the credit crunch to be over, some order of semblance returned to global financial markets this week. Equity markets rallied, led by those that suffered the largest losses during the rout, including Japan's Nikkei (+6.4%), France CAC (+3.2%) and Canada's S&P TSX (+3%). Comparable declines in the prior week in those markets were 9%, 2% and 3%, respectively. On the fixed income side, investors, who had rushed to the safety of U.S. short-term government bonds last week, reversed some of these flows, so the yield curve flattened substantially. Notably, 3-month U.S. Treasury Bills gained half a percentage point this week, partially offsetting the massive 2 percentage point plunge in the previous 5 trading days.

Elsewhere, a similar shift in the pendulum back to those markets with higher perceived risks was apparent. After strengthening against most major currencies in the prior week, the U.S. greenback headed in the opposite direction. The Canadian dollar climbed by over 1 US cent over the past five trading days – retesting the 95 US cent mark. Even larger jumps were recorded by the Australian and New Zealand dollars, which benefited from a rebound in yen carry-trade activity (i.e., the practice whereby investors borrow in Japanese yen and invest the funds in higher-yielding currencies). Accordingly, the Japanese yen, which

had actually strengthened the prior week due to a reversal of carry trades, was one of the few currencies to weaken against the greenback in recent days.

Global commodity markets – which have increasingly gained allure as an investment vehicle – experienced more stable conditions after suffering previous bouts of heavy selling last Friday. The TD Commodity Price Index still lost ground from last Friday, but that was more the result of the passing of Hurricane Dean without much damage in the U.S. production region and a resulting pull back in crude oil and natural gas prices. While much of the focus has been on crude prices slipping back to below US\$70 per barrel, natural gas prices have been quietly tumbling to levels that may trigger additional cuts in drilling activity in Canada's oil patch.

Fed digs into its toolbox

Chalk up some of the improvement in financial conditions to further central bank efforts this week to add reserves to the banking system, strengthen the liquidity of credit markets and shore up investor confidence. On Tuesday, the Fed pulled another tool out of its drawer, reducing its System Open Market Account (SOMA) fee from 1% to 0.5%. (The SOMA fee effectively establishes the upper limit at which the central bank enters into repurchase agreements with investors. A lower fee increases the yield earned by investors.) On the policy front, the Japanese central bank elected to leave its policy rate unchanged on Thursday rather than tightening its settings as some analysts had predicted.

Major financial institutions also made the headlines with efforts of their own. On Thursday, Federal Reserve data revealed that major U.S. banks, which remain liquid and healthy, were showing their support for the Fed's move to cut its discount rate by using the emergency facility to the tune of more than US\$1 billion on average over the past week. Bank of America announced that it plans to purchase US\$2 billion of preferred shares in Countrywide – a troubled sub-prime lender in the United States – which

Recent TD Economics Research

August 24, 2007 - U.S. Durable Goods Orders
 August 21, 2007 - Canadian Retail Sales
 August 21, 2007 - Canadian Consumer Price Index
 August 20, 2007 - The Grey Anatomy of the Current Credit Crunch

helped to alleviate concerns that it was headed for bankruptcy. In Canada, the CEOs of the country's six largest chartered banks said Tuesday they are committed to ensure that markets for bank-sponsored commercial paper, or short-term corporate loans, "continue to perform satisfactorily".

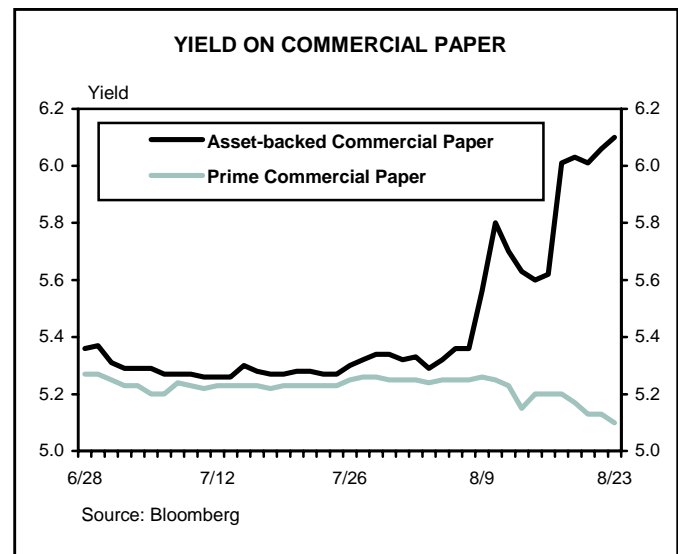
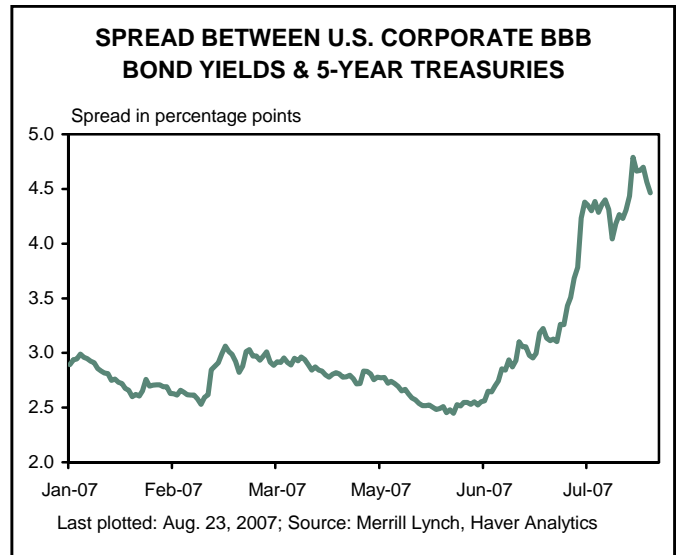
Signs of distress remain

Yet despite this reassuring news, clear signs of distress in the market remain. For one, the commercial paper market remains in a state of paralysis. As shown in the chart, the gap between junk (BBB-rated corporate) bonds and Treasuries, in spite of some modest narrowing this week, remains yawning. And there are clear signs the asset backed commercial paper market continues to be in a state of seizure. The difference between yields on asset backed commercial paper (ABCP) and prime commercial paper has actually widened further in recent days. The Canadian finance company Coventree announced this week that it was unable to renew about \$5 billion of ABCP. In the United States, the amount of commercial paper in the market tumbled by US\$90 billion, or 4%, as investors shunned debt that may be linked to mortgages, which continues to raise worries about access to short-term credit.

As a result, despite the recent stability, there is ongoing pressure on the Fed to use another tool at its disposal – a cut in its benchmark fed funds rate – to mitigate the risks of financial and economic contagion. Indeed, some of the market strength this week has been predicated on the likelihood of Fed rate relief. As of this morning, U.S. money markets were pricing in a 100% probability of a 50 basis point reduction by year-end. Investors remain steadfast in this opinion despite comments this week by Fed President Lacker, who argued that changes in the central bank's primary target rate will depend on the economic outlook rather than a response to market gyrations. And, to date, the case has not been made.

This week, what little data that were released – including U.S. new home sales and durable good orders for July – came in on the strong side. In any event, there will be much importance placed on upcoming U.S. data releases, as investors scour for signs of spill-over from the tightening in liquidity to the broad economy. This would include weekly indicators such as employment insurance claims and mortgage applications that cover the post-crisis period, rather than more backward looking July figures.

The outlook for Canadian monetary policy remains just as uncertain. The CPI report revealed that core inflation eased a notch in July, but at 2.2%, remains above the Bank



of Canada's target. Moreover, most analysts attribute the drop to base effects (i.e., what happened a year ago) rather than any notable cooling in recent pressures. Next week's figures on GDP in the second quarter will confirm that Canada's economy forged ahead at a rate of about 3%, underpinned by brisk consumer spending. But, while these data would have solidified the case for an additional rate hike at the September 5th fixed announcement date (FAD), investors believe the a rate cut of at least a quarter point by year-end is a done deal. In our view, a stand-pat outcome remains most likely. Investors will look to a speech this Monday by Bank of Canada Deputy Governor Duguay for helpful signs on what the Bank will do.

Derek Burleton
AVP & Director of Economic Studies
416-982-2514

UPCOMING KEY ECONOMIC RELEASES

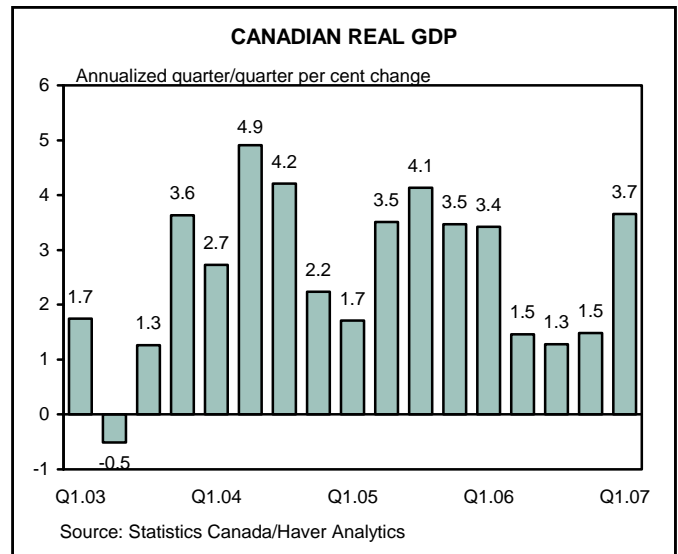
Canadian Real GDP - Q2-07

Release Date: August 31/07

TD Forecast: 3.3%

Consensus: 2.8%

We're forecasting another quarter of above-potential growth in Canada, with GDP coming in at 3.3% in Q2. Although the monthly GDP numbers are only pointing to about 2.6% GDP growth (assuming that June GDP comes in flat), we see an upside risk to that result. For one, the consumer spending story (consumption is over half of GDP) is looking extremely strong for Q2. Not only did average hourly wages of permanent workers increase by 5.8% at an annualized rate, which is the second-strongest increase in the last decade, but real retail sales recorded a monstrous 10.8% gain. Plus, real imports of machinery and equipment, which correlate very well with business spending on M&E, snapped back from the 7.8% fall in Q1, advancing by 10.7% in Q2, which bodes well for business investment. And although international trade is ex-



pected to subtract from GDP growth, the impact will be negligible, since the 5.9% increase in real imports of goods only barely outpaced exports of goods, which gained 5.7% in Q2.

Jacqui Douglas 416-982-7784

U.S. Personal Income and Spending - July

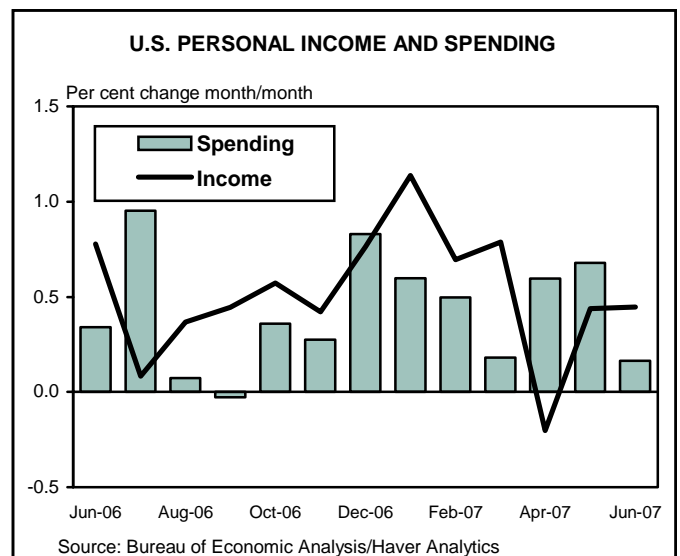
Release Date: August 31/07

TD Forecast: income 0.4%; spending 0.4%

Consensus: income 0.3%; spending 0.4%

We're expecting to see decent growth in both U.S. income and spending in July, with 0.4% increases in each. Income growth is likely to register another healthy gain, due to the strength in average hourly wages from the payrolls survey. And the retail sales report indicates that spending will pick up a bit, after last month's meagre 0.1% increase, although we don't expect the strength from late 2006-early 2007 to continue. For the core PCE deflator, we expect to see a 0.2% M/M increase, which could drive the Y/Y number back up to 2.0%, from 1.9% in June. This will just reinforce the Fed's reluctance to lower the fed funds rate, and refusal to see the slowdown in core inflation as "sustained."

Jacqui Douglas 416-982-7784



RECENT KEY ECONOMIC INDICATORS Aug. 20-24, 2007

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
Aug. 21	Consumer Price Index (CPI)	July	Y/Y % chg.	2.2	2.2	
Aug. 21	CPI - excl. 8 most volatile items	July	Y/Y % chg.	2.3	2.5	
Aug. 21	Leading Indicators	July	% change	0.4	0.3	R▲
Aug. 21	Retail Sales	June	% change	-0.9	2.6	R▼
Aug. 21	Retail Sales - excl. autos	June	% change	-0.3	2.1	R▼
United States						
Aug. 20	Leading Indicators	July	% change	0.4	-0.3	
Aug. 23	Weekly Initial Jobless Claims	18-Aug	Thousands	322	324	R▲
Aug. 24	Durable Goods Orders	July	% change	5.9	1.9	R▲
Aug. 24	New Home Sales	July	Thousands	870	846	R▲

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR Aug. 27- 31, 2007

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Aug. 27	<i>Bank of Canada Deputy Governor Duguay gives speech on "The Bank's Research Agenda and the Future of Inflation Targeting" to the Canadian Association for Business Economics at Queen's University in Kingston, ON</i>				
Aug. 30	Industrial Product Price Index	July	% change	-0.7	-1.3
Aug. 30	Raw Materials Price Index	July	% change	0.6	0.6
Aug. 30	Current Account (BOP)	Q2-07	\$C, blns	8.0	6.5
Aug. 31	Real GDP at Basic Prices	June	% change	0.1	0.3
Aug. 31	Real Gross Domestic Product	Q2-07	Ann. % chg.	2.8	3.7
United States					
Aug. 27	Existing Home Sales	July	Millions	5.7	5.8
Aug. 28	Consumer Confidence	Aug.	Index	105.0	112.6
Aug. 28	Richmond Fed Index	Aug.	Index	1.0	4.0
Aug. 28	<i>Minutes of the August 7th FOMC meeting released</i>				
Aug. 30	Weekly Initial Jobless Claims	25-Aug	Thousands	320	322
Aug. 30	Real Gross Domestic Product (prelim.)	Q2-07	Ann. % chg.	4.1	3.4
Aug. 30	Personal Consumption (prelim)	Q2-07	Ann. % chg.	1.5	1.3
Aug. 31	Personal Income	July	% chg.	0.3	0.4
Aug. 31	Personal Spending	July	% chg.	0.4	0.1
Aug. 31	PCE Deflator	July	Y/Y % chg.	n/a	2.3
Aug. 31	PCE Core	July	Y/Y % chg.	2.0	1.9
Aug. 31	Chicago Purchasing Managers Index	Aug.	Index	53	53
Aug. 31	Factory Orders	July	% change	0.7	0.6
Aug. 31	<i>Fed Governor Bernanke gives the opening speech at the Kansas Fed's Symposium in Jackson Hole, WY</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
Aug. 27	10:00	U.S.	Existing Home Sales	July	Millions	5.70	5.75
	19:45	Canada	<i>Bank of Canada Deputy Governor Duguay gives speech on "The Bank's Research Agenda and the Future of Inflation Targeting" to the Canadian Association for Business Economics at Queen's University in Kingston, ON</i>				
	19:50	Japan	<i>Bank of Japan Policy setting meeting minutes for July released</i>				
Aug. 28	--	Germany	Consumer Price Index (prelim.)	Aug.	Y/Y % chg.	1.9	1.9
	4:00	EU-12	M3 Money Supply Growth	July	Y/Y % chg.	11.1	10.9
	4:00	Germany	IFO Business Climate Survey	Aug.	Index	105.4	106.4
	4:00	Germany	IFO Survey - Current Assessment	Aug.	Index	110.7	111.3
	4:00	Germany	IFO Survey - Business Expectations	Aug.	Index	100.2	101.8
	10:00	U.S.	Consumer Confidence	Aug.	Index	105.0	112.6
	10:00	U.S.	Richmond Fed Index	Aug.	Index	1.0	4.0
	14:00	U.S.	<i>Minutes of the August 7th FOMC meeting released</i>				
Aug. 29	19:50	Japan	Retail Sales	July	% change	-2.5	0.9
	21:30	AU	Current Account Balance	Q2-07	AU\$, blns	-15.7	-15.4
Aug. 30	3:55	Germany	Unemployment Change	Aug.	Thousands	-35.0	-45.0
	3:55	Germany	Unemployment Rate	Aug.	Per cent	8.9	9.0
	4:00	EU-12	Purchasing Managers Index (Retail)	Aug.	Index	n/a	46.2
	4:00	Germany	Purchasing Managers Index (Retail)	Aug.	Index	n/a	45.9
	4:00	France	Purchasing Managers Index (Retail)	Aug.	Index	n/a	46.7
	8:30	U.S.	Weekly Initial Jobless Claims	25-Aug	Thousands	320	322
	8:30	Canada	Industrial Product Price Index	July	% change	-0.7	-1.3
	8:30	Canada	Raw Materials Price Index	July	% change	0.6	0.6
	8:30	Canada	Current Account (BOP)	Q2-07	\$C, blns	8.0	6.5
	8:30	U.S.	Real Gross Domestic Product (prelim.)	Q2-07	Ann. % chg.	4.1	3.4
	8:30	U.S.	Personal Consumption (prelim.)	Q2-07	Ann. % chg.	1.5	1.3
	18:00	France	Unemployment Rate	July	Per cent	8.0	8.0
	18:00	France	Unemployment Change	July	Thousands	-15.0	-34.0
	19:30	Japan	Jobless Rate	July	Per cent	3.7	3.7
	19:30	Japan	Workers' Household Spending	July	Y/Y % chg.	0.2	0.1
	19:30	Japan	Tokyo CPI excl. perishables	Aug.	Y/Y % chg.	-0.1	-0.1
	19:50	Japan	Industrial Production (prelim.)	July	% change	-0.5	1.3
	21:30	AU	Retail Sales	July	% change	0.6	1.4
21:30	AU	Trade Balance	July	AU, mlns	-1,000	-1,751	
Aug. 31	1:00	Japan	Housing Starts	July	Y/Y % chg.	-0.1	6.0
	2:00	Germany	Retail Sales	July	% change	0.5	0.7
	5:00	EU-12	Industrial Confidence Index	Aug.	Index	4.0	5.0
	5:00	EU-12	Consumer Confidence Index	Aug.	Index	-2.0	-2.0
	5:00	EU-12	Business Climate Indicator	Aug.	Index	1.30	1.35
	5:00	EU-12	Economic Confidence Index	Aug.	Index	110.2	111.0
	5:00	EU-12	Services Confidence Index	Aug.	Index	20.0	21.0
	5:00	EU-12	Unemployment Rate	July	Per cent	6.9	6.9
	5:00	EU-12	Consumer Price Index	Aug.	Y/Y % chg.	1.8	1.8
	8:30	U.S.	Personal Income	July	% chg.	0.3	0.4
	8:30	U.S.	Personal Spending	July	% chg.	0.4	0.1
	8:30	Canada	Real GDP at Basic Prices	June	% change	0.1	0.3
	8:30	Canada	Real Gross Domestic Product	Q2-07	Ann. % chg.	2.8	3.7
	8:30	U.S.	PCE Deflator	July	Y/Y % chg.	n/a	2.3
	8:30	U.S.	PCE Core	July	Y/Y % chg.	2.0	1.9
	9:45	U.S.	Chicago Purchasing Managers Index	Aug.	Index	52.8	53.4
	10:00	U.S.	Factory Orders	July	% change	0.7	0.6
	10:00	U.S.	<i>Fed Governor Bernanke gives the opening speech at the Kansas Fed's Symposium in Jackson Hole, WY</i>				

* Eastern Standard Time; Sources: Bloomberg, TD Economics

The information contained in this report has been prepared for the information of our customers by TD Bank Financial Group. The information has been drawn from sources believed to be reliable, but the accuracy or completeness of the information is not guaranteed, nor in providing it does TD Bank Financial Group assume any responsibility or liability.