



TD Economics

The Weekly Bottom Line

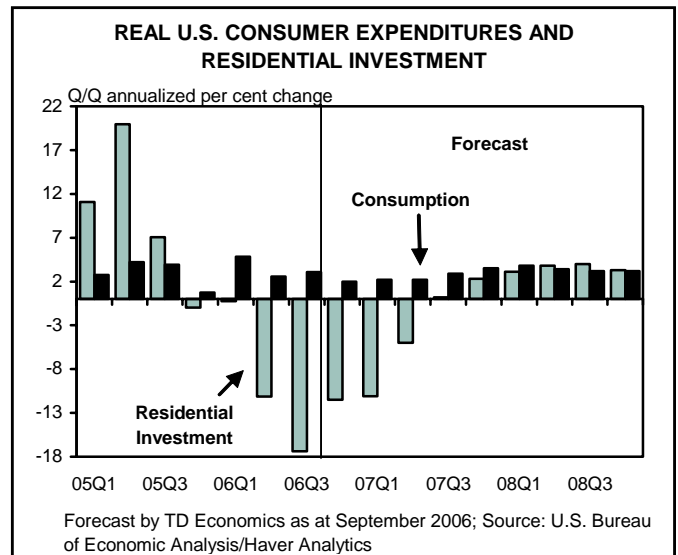
November 17, 2006

HIGHLIGHTS

- U.S. consumers show signs of fatigue as retail sales fall in October
- Inflation fears in the U.S. ease considerably on weak CPI data
- Manufacturing in Canada remains under significant duress

Like vultures circling a traveller lost in the desert, pessimistic economists (are there any other kind?) have been patiently waiting for the correction in the U.S. housing market to undercut consumer spending. But even as the losses in housing continued to mount in the late summer, consumer spending remained firm. In the third quarter of this year while residential investment plummeted by an astonishing inflation-adjusted 17.4%, consumer expenditures grew by a respectable 3.1%. This divergence fostered the belief that perhaps the consumer would be able to ride out the tempest in the housing tea cup. However, October's retail sales report suggests that perhaps the momentum in consumer spending is beginning to ease.

First, retail sales in September were subject to a downward revision, lowering total sales excluding those at gasoline stations from 0.6% to 0.4%. Not only did this revision provide a weaker handoff to the fourth quarter, but it implied a modest downward revision to third quarter consumption – suggesting that the pull-back in spending may



have already begun. Secondly, the fourth quarter got off to a poor start. When the effect of falling gasoline prices are stripped out of October's dismal -0.2% fall in headline sales, the growth rate rises modestly to 0.4%. While this is definitely an improvement, it raises some concern because falling gas prices were cited as one of the factors supporting the consumer through the end of the year. Given the magnitude of the fall in gasoline prices observed to date, if they were unable to generate anything more than a 0.4% increase in non-gasoline station sales, further declines will likely have an equally negligible effect.

So with falling gasoline prices delivering less of a kick than previously thought, the near-term health of the consumer becomes increasingly reliant on personal income growth. Here there are also signs pointing to a moderation in future spending. As fully detailed in last week's release of TD Economics Global Markets, although revised statistics suggest a healthier labour market than previously thought, it appears that wage growth may have reached a peak as the three-month annualized trend of average hourly earnings slipped to 3.6% in October, down from the 4.7% observed two months earlier.

Recent TD Economics Research

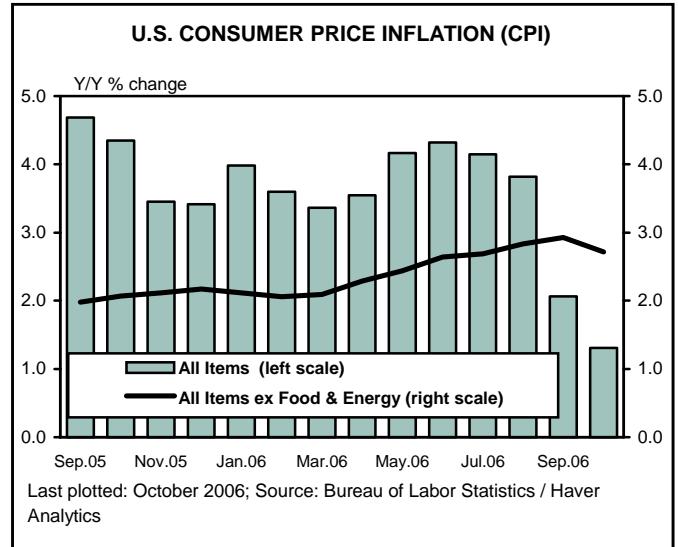
- November 17, 2006 - Fed Conundrum with Elevated Inflation to Persist
- November 16, 2006 - U.S. Industrial Production and Capacity Utilization
- November 16, 2006 - U.S. Consumer Price Index
- November 15, 2006 - Canadian Manufacturing Shipments
- November 14, 2006 - U.S. Retail Sales Commentary
- November 14, 2006 - A Primer on Potential Output

It also appears that the housing market has more ground to give up as housing starts tumbled by 14.6% in October to their lowest level in over six years. In an equally unencouraging development, the number of new building permits issued retreated as well, yielding little optimism for the months to come. With such a weak start to the fourth quarter, it is possible that residential investment will come close to duplicating its disastrous third quarter performance. When you then add in the faltering outlook for consumer spending, the forecast for a mid-cycle slowdown in the U.S. comes increasingly into focus as real GDP growth is expected to remain below 2% for the second quarter in a row in Q4.

Less of a balancing act for the Federal Reserve?

With mounting evidence suggesting that economic growth is continuing to ease, this week's spate of weak inflation numbers could not have been better timed. While falling energy prices contributed to the largest fall in total producer prices since October of 2001, the real surprise was reserved for the 0.9% fall in core producer prices, which was the largest one-month decline in 13 years. Although the magnitude of this fall likely represents a blip in the data, it is consistent with the longer-term trend of easing core producer inflation observed since the start of the year. Consumer prices also came under the spell of falling energy prices as total CPI inflation advanced by a meagre 1.3% – the first time it has been below the 2.0% mark since March 2004. Meanwhile, core prices moderated considerably, increasing by just 0.1% in October, bringing the year-over-year measure down to 2.7%. While this level of core inflation is still higher than the Federal Reserve would like, it does break the trend of seven consecutive months of increases.

Of course, one month of data will not motivate the Federal Reserve to alter their outlook for monetary policy, but it does appear that the economic environment has soured in recent weeks. Indeed, the Federal Open Market Committee (FOMC) minutes released from their October 25th meeting now seem at odds with the current data as members acknowledged at the time that the downside risks to economic growth had diminished by more than the upside risks to inflation. Indeed, just two days after the FOMC meeting the underwhelming third quarter GDP report was released. Even more relevant was the news that the Fed's preferred inflation measure, the core deflator for personal consumption expenditures (PCE), eased to just 2.3%, down from the 2.8% reported in the quarter before. When combined with this week's inflation data, even though core



inflation remains above the Fed's comfort zone, the odds of rate cuts have increased (for more details please see the recently released special report "Fed Conundrum with Elevated Inflation to Persist"). Having said that, it still will likely take a second quarter of below-trend growth to motivate a move, therefore pushing the first dose of monetary stimulus into the spring of 2007.

Plunging manufacturing shipments the lowlight in Canada

With a relatively quiet week on the Canadian data front, September's disastrous manufacturing shipments report stood out like a sore thumb. And as the case with all of this week's economic indicators, falling energy prices played a key role. In fact, much of the 3.3% decline observed in total manufacturing shipments can be traced to the 15.3% fall in shipments of petroleum and coal products. However, all the blame could not be placed on lower energy prices, as the volumes of shipments (adjusted for price changes) fell by 1.2%. It also appears that the near-term health of the sector will likely deteriorate further as both unfilled and new orders were down in September. The saving grace for the sector remains twofold: One, the U.S. economy is expected to recover by the second half of 2007, providing a cyclical boost to sales. And two, manufacturing firms are well positioned to use the elevated value of the dollar to import and install new capital equipment with the aim of improving their productivity and enhancing their competitiveness on the ever-increasing global stage.

David Tulk, Economist
416-982-2557

UPCOMING KEY ECONOMIC RELEASES

Canadian Retail Trade - September

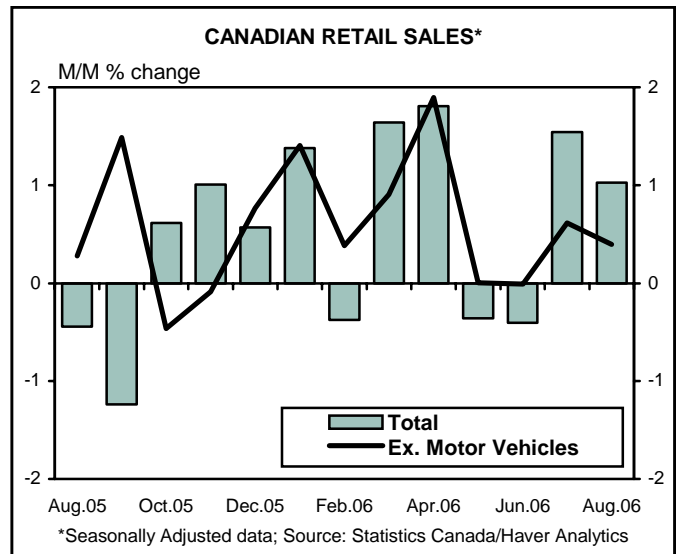
Release Date: November 21/06

TD Forecast: -1.0%; ex-auto -0.5%

Consensus: -0.4%; ex-auto +0.1%

Canadian retail sales appear set to record a lacklustre performance in September. The obvious reason is that gasoline prices were sharply lower over the month, which prompted lower gasoline station revenues. But this is not the only downward influence for the month. Motor vehicle sales were reported 4% lower over the month, which will also provide a drag. A further hint of weakness stems from a soft U.S. retail sales performance. All told, we forecast a 1.0% drop in Canadian retail sales, although the ex-auto measure should be somewhat better – down just 0.5%. Although this is clearly not a barn-burner of a performance, we would emphasize that the inflation-adjusted figure is likely to be somewhat better – roughly flat – and that Canadian consumers remain in reasonably healthy shape.

Eric Lascelles 416-982-8979



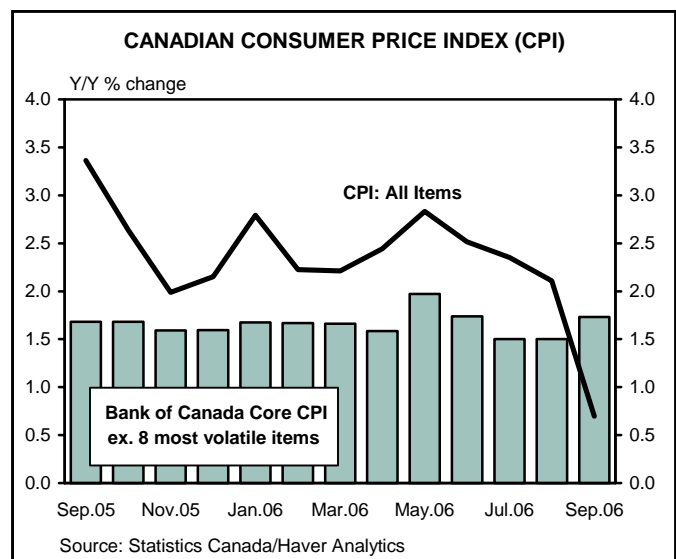
Canadian Consumer Price Index - October

Release Date: November 22/06

TD Forecast: Core 0.0%; Headline -0.3%

Consensus: Core +0.1%; Headline -0.1%

After a month of very robust core price gains, we are inclined to believe that a somewhat softer month is in store for October. Accordingly, we forecast an unchanged level of core CPI. Part of this weakness is related to the aforementioned possible unwinding, but part is also due to seasonal factors that traditionally push prices downward in October. Our forecast would have been weaker yet were it not for property tax increases, which are factored into the October numbers and could be substantial. Overall, though, the more muted core CPI increase should alleviate some of the fears that had been raised by the previous month's hot performance. In turn, the annual pace of core CPI should remain unchanged at 1.7%. However, we warn that there may be some confusion surrounding this subject as Statistics Canada has announced its intent to begin measuring core inflation excluding indirect taxes. If this does indeed transpire, the Y/Y number should be unchanged at 2.3%. Overall CPI – which includes volatile



items like many energy and food products – is likely to decline outright according to our math, by roughly 0.3%. The primary reason for this is that gasoline prices continued to fall into October. This should put the annual pace at 0.9%, up from 0.7% in the prior month.

Eric Lascelles 416-982-8979

RECENT KEY ECONOMIC INDICATORS November 13-17, 2006

Date	Economic Indicators	Data for	Units	Current	Prior	
Canada						
Nov. 15	New Motor Vehicle Sales	Sept.	% change	-4.2	3.1	R▲
Nov. 15	Manufacturing Shipments	Sept.	% change	-3.3	-0.7	R▼
Nov. 16	International Securities Transactions	Sept.	\$C, blns	-3.1	0.1	R▼
United States						
Nov. 14	Producer Price Index (PPI)	Oct.	% change	-1.6	-1.3	
Nov. 14	PPI excl. food and energy	Oct.	% change	-0.9	0.6	
Nov. 14	Retail Sales	Oct.	% Chg.	-0.2	-0.8	R▼
Nov. 14	Retail Sales ex. autos	Oct.	% Chg.	-0.4	-1.2	R▼
Nov. 14	Business Inventories	Sept.	% Chg.	0.4	0.6	
Nov. 15	Empire Manufacturing Survey	Nov.	Index	26.7	22.9	
Nov. 16	Consumer Price Index (CPI)	Oct.	% change	-0.5	-0.5	
Nov. 16	CPI - excl. food and energy	Oct.	% change	0.1	0.2	
Nov. 16	Weekly Initial Jobless Claims	11-Nov	Thousands	308	310	R▲
Nov. 16	Industrial Production	Oct.	% change	0.2	-0.6	
Nov. 16	Capacity Utilization	Oct.	Per cent	82.2	82.1	R▲
Nov. 16	Philadelphia Fed Index	Nov.	Index	5.1	-0.7	
Nov. 17	Housing Starts	Oct.	Thousands	1,486	1,740	R▼
Nov. 17	Building Permits	Oct.	Thousands	1,535	1,638	R▲

Source: Bloomberg, TD Economics

UPCOMING NORTH AMERICAN ECONOMIC CALENDAR November 20-24, 2006

Release Date	Economic Indicators	Data for Period	Units	Consensus Forecast	Prior
Canada					
Nov. 20	Wholesale Sales	Sept.	% change	0.3	0.5
Nov. 21	Retail Sales	Sept.	% change	-0.4	1.0
Nov. 21	Retail Sales - excl. autos	Sept.	% change	0.1	0.4
Nov. 21	Leading Indicators	Oct.	% change	0.4	0.4
Nov. 22	Consumer Price Index (CPI)	Oct.	Y/Y % chg.	1.0	0.7
Nov. 22	CPI - excl. 8 most volatile items	Oct.	Y/Y % chg.	1.7	1.7
United States					
Nov. 20	Leading Indicators	Oct.	% change	0.2	0.1
Nov. 20	<i>Dallas Fed President Fisher speaks in Berlin on Germany's economic prospects</i>				
Nov. 21	<i>Fed Governor Warsh speaks on market discipline at the NYSE in New York, NY</i>				
Nov. 21	<i>Richmond Fed President Lacker speaks to the Richmond Association for Business Economists</i>				
Nov. 22	Weekly Initial Jobless Claims	18-Nov	Thousands	310	308

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. 20	8:30	Canada	Wholesale Sales	Sept.	% change	0.3	0.5
	10:00	U.S.	Leading Indicators	Oct.	% change	0.2	0.1
	14:00	U.S.	<i>Dallas Fed President Fisher speaks in Berlin on Germany's economic prospects</i>				
	19:30	AU	New Motor Vehicle Sales	Oct.	% change	n/a	3.0
Nov. 21	0:00	Japan	<i>Bank of Japan Monetary Policy meeting minutes for October released</i>				
	2:45	France	Real Gross Domestic Product (prelim.)	Q3-06	Q/Q % chg.	0.0	0.0
	6:00	U.K.	CBI November Industrial trends survey released				
	8:30	Canada	Retail Sales	Sept.	% change	-0.4	1.0
	8:30	Canada	Retail Sales - excl. autos	Sept.	% change	0.1	0.4
	8:30	Canada	Leading Indicators	Oct.	% change	0.4	0.4
	10:00	U.S.	<i>Fed Governor Warsh speaks on market discipline at the NYSE in New York, NY</i>				
	12:00	U.S.	<i>Richmond Fed President Lacker speaks to the Richmond Association for Business Economists</i>				
18:50	Japan	Trade Balance	Oct.	¥, blns	771.4	1,010.9	
Nov. 22	2:45	France	Consumer Spending	Oct.	% change	1.0	-2.7
	4:30	U.K.	<i>Bank of England minutes released</i>				
	7:00	Canada	Consumer Price Index (CPI)	Oct.	Y/Y % chg.	1.0	0.7
	7:00	Canada	CPI - excl. 8 most volatile items	Oct.	Y/Y % chg.	1.7	1.7
	8:30	U.S.	Weekly Initial Jobless Claims	18-Nov	Thousands	310	308
Nov. 23	4:00	EU-12	Current Account Balance	Sept.	Eur, blns	n/a	-6.9
	4:00	Germany	IFO Business Climate Survey	Nov.	Index	105.2	105.3
	4:00	Germany	IFO Survey - Current Conditions	Nov.	Index	112.0	111.8
	4:00	Germany	IFO Survey - Business Expectations	Nov.	Index	98.8	99.2
	4:30	U.K.	Total Business Investment (prelim.)	Q3-06	Y/Y % chg.	1.1	1.6
	16:45	NZ	Trade Balance	Oct.	NZ, mlns	n/a	-587.0
Nov. 24	2:45	France	Business Confidence Indicator	Nov.	Index	107.0	108.0
	2:45	France	Production Outlook Indicator	Nov.	Index	18.0	19.0
	4:30	U.K.	Real Gross Domestic Product (prelim.)	Q3-06	Q/Q % chg.	0.7	0.7
	---	Germany	Consumer Price Index (prelim.)	Nov.	Y/Y % chg.	1.4	1.1

* 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.