TD Economics

TD Quarterly Economic Forecast

September 18, 2006

U.S. SLOWDOWN UNDERWAY, CANADA IN FOR A BUMPY RIDE

For more than a year, TD Economics has been warning that the dominant theme in 2006 would be a housing-led U.S. economic slowdown. That forecast has now become a reality. Real estate activity has come down quickly and the economic fallout will be felt over the next several quarters. Awareness of the risks posed by a housing correction has grabbed the spotlight in recent months, fuelling talk about a possible U.S. recession. While such an outcome cannot be dismissed, TD Economics does not believe that this is the most likely scenario. As we will argue below, the odds favour the U.S. suffering through a mid-business cycle slowdown, which will see economic growth dip to a modest pace of 2% before recovering. That may be a relatively benign outcome, but it could very well feel like a recession to many people.

For Canada, the timing of the U.S. slowdown is rather unfortunate. Exports have been exerting a drag on the economy since the start of the year and the path ahead looks like more of the same is in store. Exporters are still struggling to adjust to the higher value of the loonie and now they will have to cope with weaker demand in their largest market. The good news is that domestic demand will remain a pillar of strength, as it has since 2002, but it too will likely experience a modestly slower rate of expansion due to a couple of factors. First, there will be the indirect effects from a slowing U.S. economy, including modest job growth. Second, some cooling is expected in the domestic housing market, but nothing like the experience south of the border. The end result will be a four quarter period where Canadian economic growth hovers within a sub-par range of 2-2.5%.

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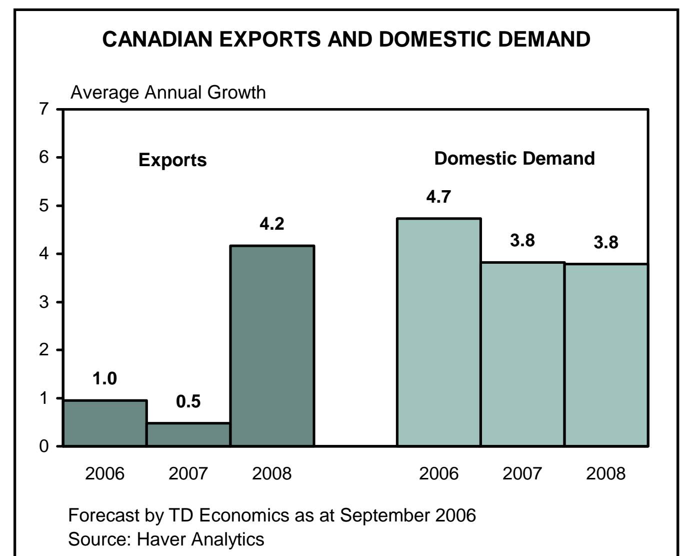
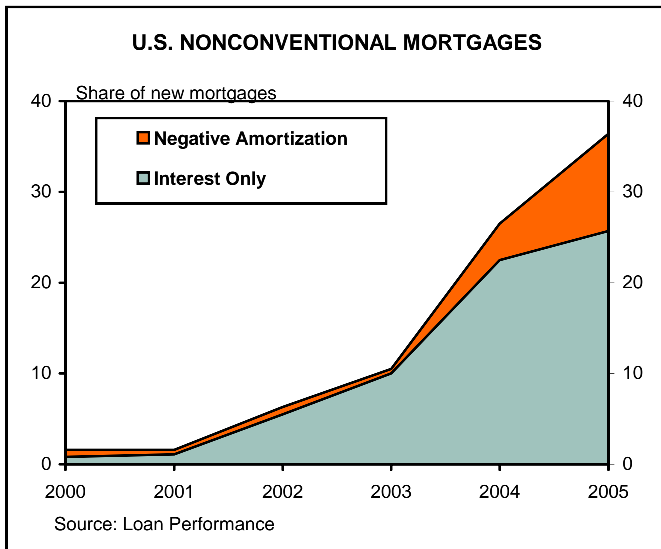


Forecast by TD Economics as at September 2006
Source: Haver Analytics

U.S. housing comes back to earth

Over the past four years, U.S. real estate has been on fire and speculation has been a significant contributor in many major markets, including California, Nevada, Florida and selected cities on the eastern seaboard. For example, prices in Las Vegas, Los Angeles and Miami have almost doubled since 2003, while they are up by close to 50% in New York and San Francisco. The rapid price gains deeply eroded affordability, which fell to the lowest level in 20



years. One might have expected the market to cool under its own weight, but structural factors kept the party going. For example, 36% of all new mortgage origination in 2005 were nonconventional mortgages (i.e. no-interest or negative amortization mortgages).

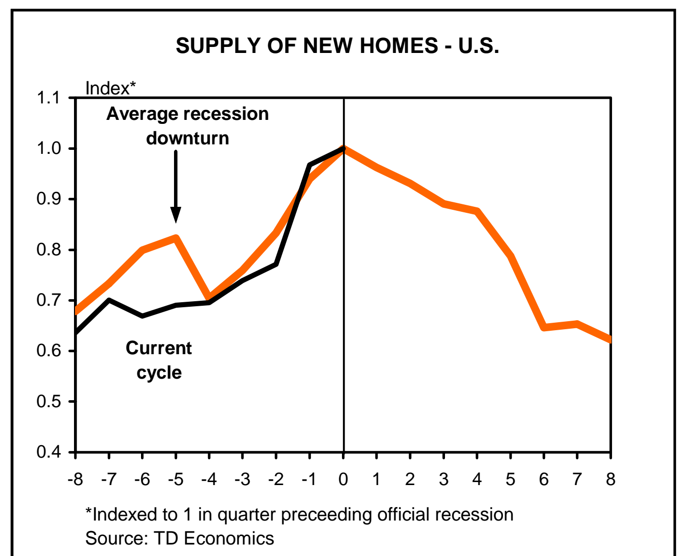
These trends were unsustainable and the housing market party came to an end when the Fed took away the punch bowl with its 17 rate hikes. As of July of this year, U.S. existing home sales have fallen by 13% from their 2005 peak, while new home sales are down 19% from their high point. The weakening in the housing market has already been a blow to consumer finances, with foreclosures up 18% year-over-year in July. Softening demand has caused price growth to flatten out. In July, existing home prices were only 0.9% higher than a year ago and, with the inventory of unsold homes having spiked higher, there is every reason to believe that prices will soften further. TD Economics expects national average home prices to fall by 4% over the next 12 months, wiping out more than $800 million in personal wealth.

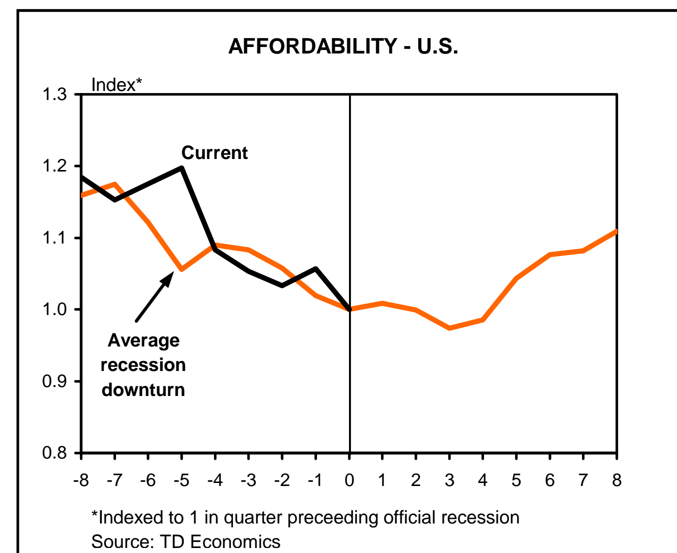
Given the large number of regions that participated in the rapid price growth, this U.S. housing correction will act as a major constraint on the overall economic performance going forward. Over the past few years, the wealth effects from booming housing markets have been a powerful stimulus to consumer spending. The combination of the rising home prices, mortgage refinancing and the cashing-out of home equity all acted to boost personal outlays and are estimated to have accounted for as much as half of consumer spending growth since 2001. A reversal of these trends is likely to cause purse strings to be tightened.

A U.S. slowdown, not a recession

There is now widespread recognition that the rapid cooling in real estate poses material risks to the economy. This has not been lost on the U.S. Federal Reserve. Despite the fact that inflation is running at slightly above its comfort level, the monetary authority has signalled a pause, explicitly betting that moderating economic growth will dampen price pressures.

The prospect for weaker economic conditions has also led to talk of a U.S. recession. This risk is real. The graphs below show that the supply of new homes and affordability over the past several quarters are both paralleling the trends preceding past recessions. While this highlights the risks, we continue to believe that a soft-landing for the economy remains the most likely outcome.

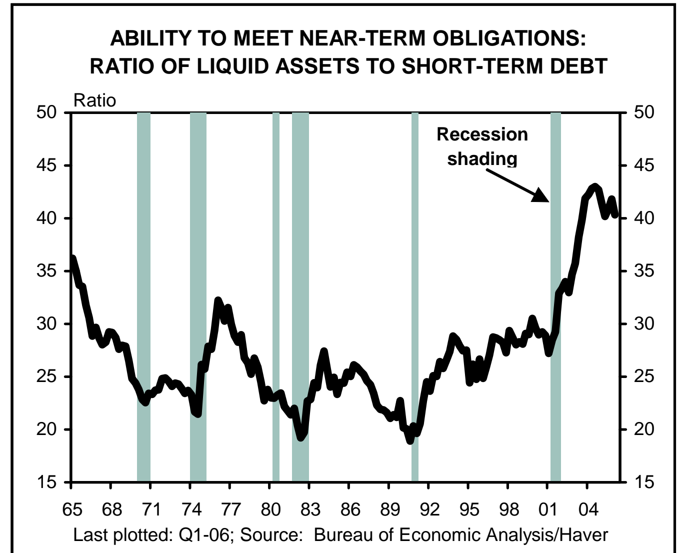




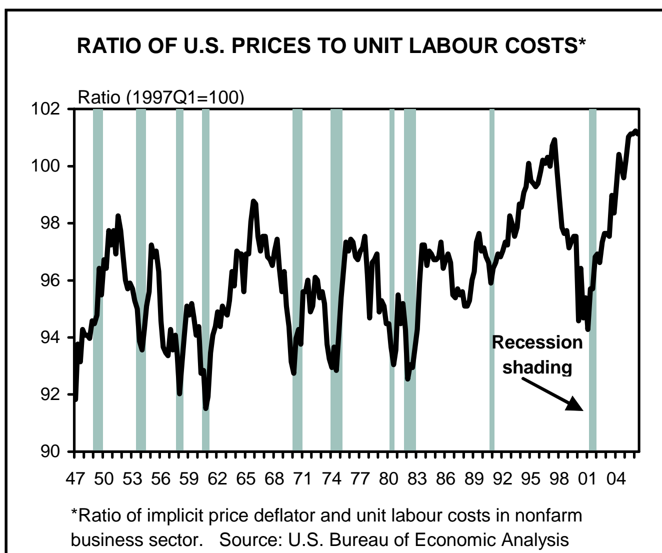
The U.S. is unwinding a major imbalance in its real estate markets, but the rest of its economy is expected to hold up relatively well. On the business front, strong profit growth over the past four years has produced remarkably robust corporate balance sheets. Firms have paid down debt and have remained lean during the current business cycle. This suggests that business investment should remain healthy in the near term.

The corporate behaviour also has labour market implications. Since 2001, businesses have kept payrolls relatively trim, striving for productivity gains to boost output and constrained unit labour costs to lift profits. As the accompanying chart shows, firms have been remarkably successful, illustrating that they are well positioned to ride out a period of tougher economic times. It also means that while the modest payroll growth in past years has been a source of disappointment, job losses in the future should prove limited when economic growth slows. Moreover, the unemployment rate should remain low. In the wake of the 2001 economic downturn, the unemployment rate only rose to 6.3% and the economic moderation in the coming quarters is likely to prove milder than in 2001. This is good news on the consumer front, as outlays are unlikely to plunge so long as labour market conditions do not deteriorate dramatically.

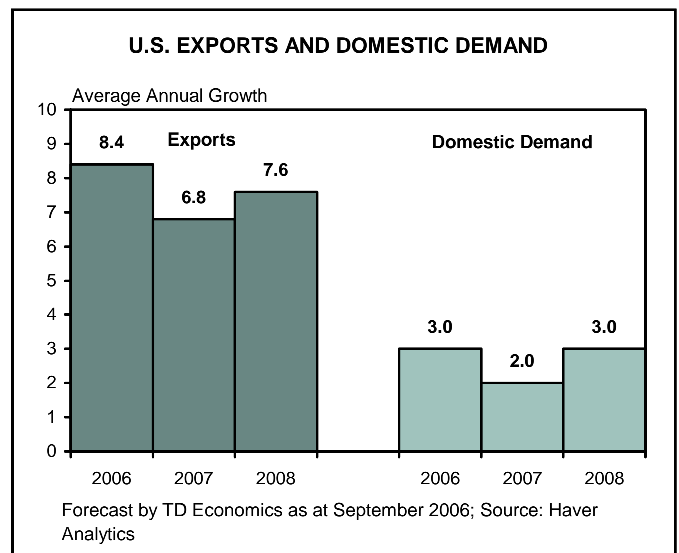
To be sure, personal outlays will slow as the housing wealth effects wane. For example, 15 cents of every dollar of consumer spending is currently on housing-related items, and this is almost a third higher than a decade ago. And, the prevailing low personal savings rate and high debt burden also suggest that personal spending is particularly vulnerable to a change in consumer behaviour. However, the weakness is likely to be concentrated in consumer big-ticket purchases, particularly anything associated with housing. And, as unemployment is likely to remain low, there is good reason to believe that personal income will continue to rise faster than the rate of inflation, which should provide a safety net to spending.



On the monetary policy front, the Fed has put an end to its rate hiking cycle after 17 successive quarter point increases. While the extent of tightening has been substantial, the level of real interest rates remains quite low. This means that higher borrowing costs may be taking some of the speculation out of the housing market, but they should not be a major constraint on consumer spending or business investment. This is a huge difference with other business cycles. Heading into the past three consumer-led re-



*Ratio of implicit price deflator and unit labour costs in nonfarm business sector. Source: U.S. Bureau of Economic Analysis



Forecast by TD Economics as at September 2006; Source: Haver Analytics

cessions, real 1-year interest rates were two-to-three times higher than at the moment. Moreover, as the economy weakens, the Fed is likely to cut rates in order to limit the slowdown, with 100 basis points of easing expected in early 2007.

Government spending will likely remain solid. Although the U.S. fiscal deficit needs to be addressed at some point, the Bush Administration has shown no inclination to do so during its remaining term. As a result, fiscal policy will not be stimulative, but neither will it be restrictive.

Finally, U.S. exports are benefiting from a weak currency and strong economic conditions abroad. While a weaker U.S. economy is bound to constrain global growth, the momentum in the world economy should provide good opportunities for U.S. exports.

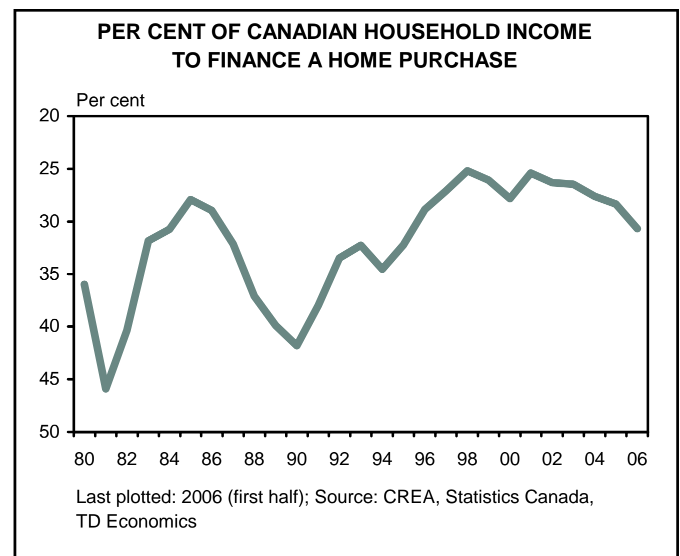
Putting all of the pieces together, we believe that the most likely scenario is for the U.S. economy to experience a mid-business cycle slowdown, with real GDP growth averaging 2.2% over the next four quarters. However, the deceleration in the housing market warrants close monitoring, as a much harder-than-anticipated landing in real estate would have a knock-on effect on the overall economy.

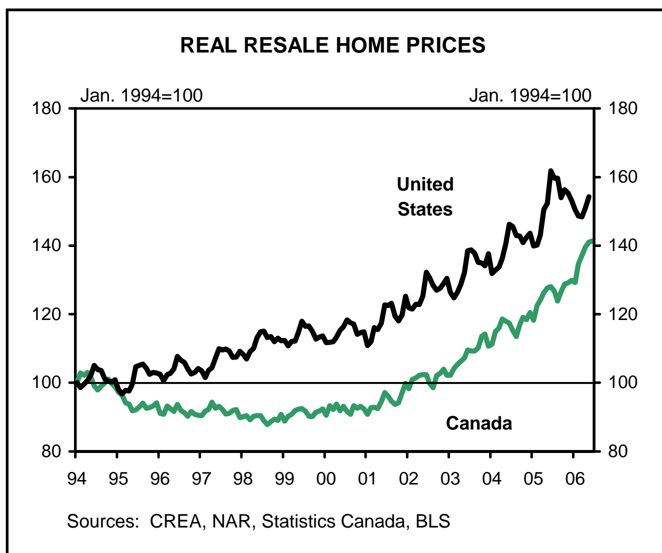
Canada: parallels with U.S. housing are limited

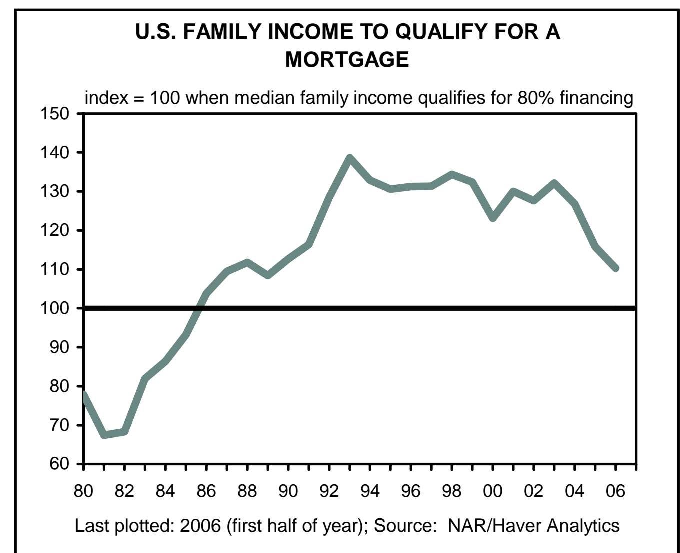
The rapid cooling in U.S. housing markets has led some to speculate whether Canada is in store for a similar experience. We think that this is unlikely.

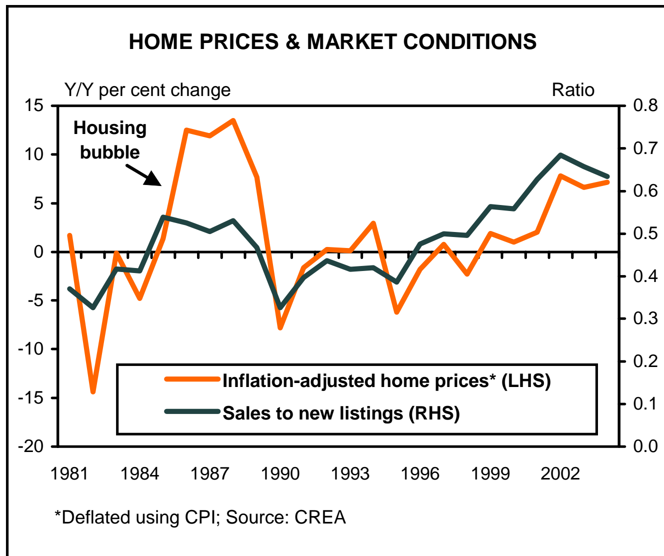
Home prices in Canada have soared in recent years, but the gains have been less than in the United States. Let us consider the experience since 1994, which is roughly when the Canadian market was in a balanced position after having unwound the fallout from the 1989 housing bubble. Despite relatively good economic conditions in the late 1990s, real home prices (excluding the impact of inflation) in Canada were largely flat until 2002. Then the market took off and inflation-adjusted resale prices soared by close to 40% in four years. In contrast, the U.S. market posted solid gains in the late 90s and then experienced a jump in prices since 2001. As a result, U.S. real existing home prices are up 55% from their level in 1994.

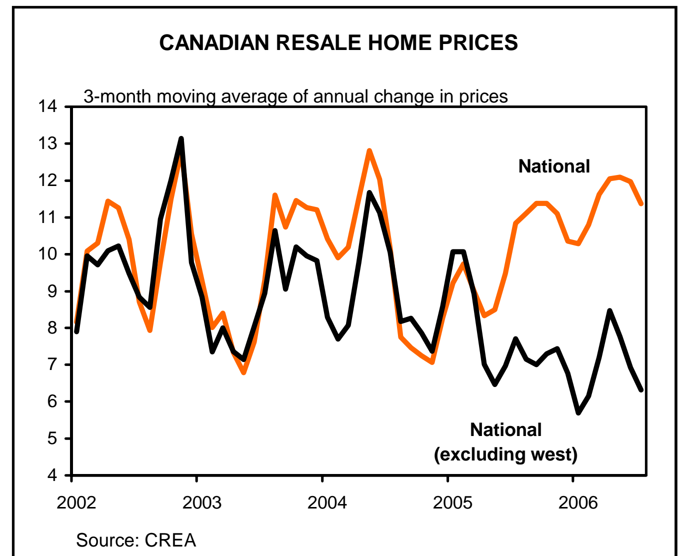
The difference may not sound that great, but when one factors in higher interest rates in the U.S., the comparison on affordability is stark. U.S. affordability, as measured by the National Association of Realtors, fell to a 20-year low in early 2006. Affordability in Canada has also dete-











riorated, but it has only returned to the level that existed in 1995.

There is also clear evidence that the rise in Canadian home prices is largely being driven by economic fundamentals – not speculation. Real estate markets have responded to strong demand growth, which has reflected the lowest unemployment rate in 30 years, strong personal income gains in the past three years, and attractive borrowing costs. However, this is only part of the story.

Supply has also been hard pressed to keep up with demand, with the result that the inventory of unsold homes has remained tight. Moreover, new listings have also struggled to keep pace with sales. These trends can explain much of the price growth in recent years. As the accompanying chart shows, prices tend to rise when sales increase relative to listings. This is perfectly natural from an economics perspective. Bubbles form when prices rise without being supported by supply and demand considerations, and the chart shows this clearly in the late 1980s experience. However, there is no sign of similar speculation at this time.

Furthermore, there is no sign of excessive speculation on the part of builders. Indeed, most construction firms have learned from the mistakes of the past and do not break ground until a high percentage of units are pre-sold. This may have contributed to the tightness in housing markets, but it has also reduced the risks of boom-bust cycles.

The national picture is also heavily distorted by regional developments. The rally in home prices from 2002 to mid-2005 was broadly based across the country. However, over the past year, there have been clear signs of cooling in Central and Atlantic Canada, while the West has marched to a different beat. Home price growth accelerated dramatically in Alberta and has remained at a double digit pace in the major urban centres of British Columbia. As a result, while national average resale home prices have been rising at close to 12% year-over-year this summer, roughly half of that increase has been due to price gains in the West.

The gradual cooling in home price growth in Central and Atlantic Canada suggests that bubbles never formed in these regions. And, while the recent price growth in the West has been unsustainably fast, there are tentative signs that these markets are moving towards a better balance, with sales growth slowing and listings rising. If this leads to slower price growth in the coming months, it would imply that a bubble has not formed. If price growth does not moderate, the warning lights will become brighter.

Domestic Canadian economy will remain solid

So, a gradual cooling in Canadian housing markets should not pose a material threat to the domestic economy, which is likely to continue to grow at a solid pace. Consumer spending on durables is expected to slacken a bit, but wallets should remain open, supported by solid income growth and continued low unemployment. Business investment will remain robust, with purchases of machinery and equipment lifted by high levels of retained earnings and the reduced cost for imported capital when priced in Canadian dollars. Non-residential investment will be bolstered by strong balance sheets, moderate borrowing costs and tight capacity usage in many industries, providing an

offset to weaker residential construction as housing cools. Putting all of the elements together, the outlook is for domestic demand to continue to grow at a strong pace, rising 4.3% annualized in the second half of 2006 and 3.6% over the four quarters of 2007.

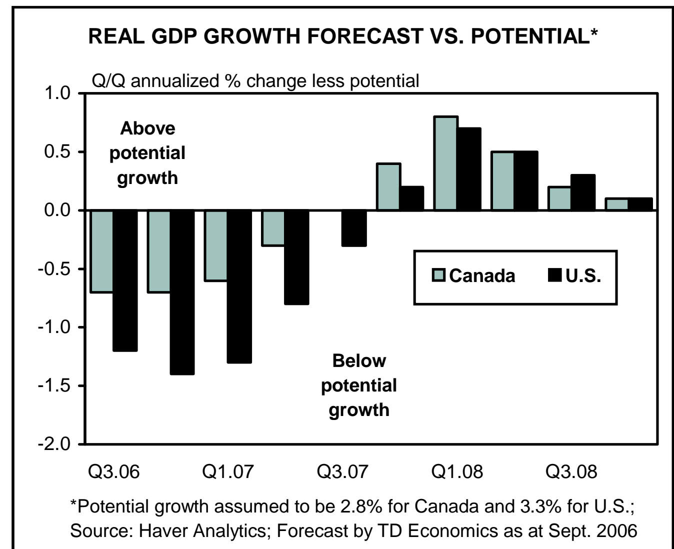
Manufacturing will bear brunt of U.S. slowdown

However, the performance of the overall economy will be marred by the fallout from the U.S. slowdown. Exports to the U.S. represent close to 30% of Canadian real GDP, implying that any decline in shipments to south of the border will quickly lead to a reduction in production. The export-oriented manufacturing sector will bear the brunt of the fallout, with the forest products and auto sectors being particularly vulnerable. And, the timing could not be worse, as manufacturers are still struggling to adjust to a strong exchange rate and high raw material prices. Regionally, the most manufacturing-leveraged provinces will be the hardest hit. This includes Ontario, Quebec, Manitoba and New Brunswick.

It is estimated that as U.S. real GDP growth slows from an average of 3.4% in 2006 to 2.4% in 2007, the result will knock slightly less than half a percentage point off of the Canadian economic expansion. Consequently, Canadian real GDP will remain close to 2% in the second half of 2006 and average just below 2.5% in the first half of 2007, before strengthening thereafter.

Rate cuts and continued strong Canadian dollar

In contrast to the Bank of Canada's view that the Canadian economy will "operate at about its production potential", we believe the rate of real GDP growth will fall short of the economy's long-run potential pace of 2.8% over the next four quarters. This will cause slack to gradually build in the economy, reducing the inflation risks and likely encouraging the Bank of Canada to ease monetary policy by 25 basis points in March of 2007 and a further 25 basis points in April. However, the pace of growth in Canada will only average about 0.5 percentage points below potential next year, compared with a U.S. average of almost a full percentage point below its estimated potential of 3.3%. As a result, while the absolute economic growth numbers will not differ greatly, the accumulation of economic slack will be far less in Canada. This demonstrates the relative outperformance of the Canadian economy and suggests that the Bank will be less aggressive in lowering rates than the U.S. Federal Reserve.



*Potential growth assumed to be 2.8% for Canada and 3.3% for U.S.; Source: Haver Analytics; Forecast by TD Economics as at Sept. 2006

Finally, the Canadian dollar will be buffeted by conflicting forces. The weakening in U.S. demand, and its corresponding global impact, is expected to spark a pullback in commodity prices. Base metals are likely to lose some lustre, dropping 25% over the next four quarters, while oil prices are expected to retreat towards a trough of US$50 a barrel next year before rebounding. Meanwhile, lumber prices have already responded to the weakening U.S. housing market and natural gas prices look unlikely to fall further. Consequently, a modest decline in overall commodity prices will provide a headwind for the Canadian dollar. However, the currency will receive offsetting support from two factors. First, the U.S. dollar is likely to weaken under the weight of the large U.S. current account deficit. Second, the Bank of Canada will cut rates less than the Fed, implying a narrowing in the prevailing negative interest rate spreads, a result that is supportive for the loonie. Overall, the Canadian dollar is expected to trade in a tight range of 87 to 90 U.S. cents in 2007.

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

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GLOBAL ECONOMIC OUTLOOK

The major question facing the global economy over the next six to twelve months is whether global growth can decouple from the U.S. and muster enough economic momentum to ride out the ripple effects of a slowing U.S. market. The world economy has already built up a head of steam in the first half of the year that looks sufficient to push global growth to 5.0% in 2006. This is a full percentage point above potential growth and will mark an increase over the 4.8% pace reached last year. In 2007, moderating U.S. growth - from 3.4% to 2.4% - will shave 0.3 percentage points off the 2006 rate while slower growth in the rest of the world will drag the pace down a further 0.7 percentage points. This will leave global growth at 4.0% in 2007 but represents merely a deceleration to a more sustainable rate of growth and is still a full 1-1½ percentage points above the downturn in 2001-2002. As economic conditions strengthen in 2008, we expect to see the global economy firm and grow at a clip of 4.8%.

Nonetheless, this forecast is not without its risks. While a stronger result is possible, the downside risks heading into a U.S. slowdown merit closer attention. While we do not expect the U.S. to slip into a recession over the next year, much of the global forecast is contingent on U.S. growth merely slowing to a moderate pace of 2- 2½% over four quarters. Should the U.S. downturn prove more protracted or severe, history suggests significant decoupling in global growth is unlikely. In fact, each of the last four U.S. downturns was accompanied by recessions in economies accounting for at least half of remaining global output.

The regional picture, as well, provides some areas of concern. Given the huge run-up in commodity prices and abatement now underway, developing countries reliant on commodity exports may face particular strain, seeing growth slow in both 2007 and 2008 and running a greater risk of a sharp adjustment process. Meanwhile, the Japanese recovery from deflation to date - while offering promise for the future - has been sluggish and risks being swamped by a slump in global demand. Alternatively, Chinese and European performances are driving improved prospects in 2006, but there are concerns lurking beneath the headline statistics.

WORLD ECONOMIC OUTLOOK
Annual per cent change unless otherwise indicated

Real GDP	2005 Share* (%)	2005	Forecast 2006	2007	2008
World	99.2	4.8	5.0	4.0	4.8
North America	23.7	3.4	3.4	2.3	3.5
United States	20.1	3.5	3.4	2.4	3.6
Canada	1.8	2.9	2.8	2.3	3.2
Mexico	1.8	3.0	4.4	2.0	3.1
European Union (EU-25)	20.4	1.8	2.7	1.9	2.6
Euro-zone (EU-12)	14.8	1.3	2.3	1.4	2.3
Germany	4.1	1.2	1.8	0.8	2.0
France	3.0	1.2	2.1	1.8	2.3
Italy	2.7	0.1	1.4	0.6	1.5
United Kingdom	3.0	1.8	2.5	2.6	3.0
EU accession members	1.8	4.6	5.5	4.0	3.9
Asia	40.5	7.0	7.0	6.1	6.8
Japan	6.4	2.6	2.7	2.0	3.1
Asian NIC's	3.2	4.6	4.6	3.7	4.9
Hong Kong	0.4	7.3	6.2	4.5	6.0
Korea	1.6	4.0	4.9	4.0	5.5
Singapore	0.2	6.4	5.3	4.2	5.0
Taiwan	1.0	4.1	3.4	3.1	3.4
Russia	2.6	6.4	6.3	5.7	6.1
Australia & New Zealand	1.2	2.5	2.5	2.8	3.1
Developing Asia	27.1	8.6	8.6	7.6	8.2
ASEAN-4	3.7	5.2	4.7	4.3	4.6
China	15.4	9.9	10.3	9.0	9.8
India	6.0	7.5	7.1	6.5	6.6
Central/South America	5.7	4.6	4.6	3.6	4.4
Argentina	0.9	9.2	7.0	4.0	6.0
Brazil	2.6	2.3	3.5	3.3	3.9
Other Developing	9.0	5.8	5.6	4.8	4.6

*Regional wts. do not sum to 100% because some countries omitted
Forecast as at September 2006
Source: International Monetary Fund, national statistical agencies

The devil's in the details of Eurozone growth

Eurozone growth accelerated through the first half of 2006, reporting an annualized second quarter growth rate of 3.6%, nearly twice their historical average. We remain unconvinced that this region can sustain this momentum going forward. Consumer spending in the second quarter was less than half that of the first, and export growth slowed as it did in most G-7 economies. Moreover, the key bright spot for European growth - investment spending - does not appear robust. For one, investment has proven particularly susceptible to slowing U.S. growth, with the last four American downturns seeing investment contract in 75% to 95% of the global economy. What is more, while Eurozone investment growth for 2006 is projected to be the highest in six years, a large share of this is coming from construction, and in some cases primarily public construction. However, European interest rates are rising,

which will slow investment, and past statements by the European Central Bank (ECB) suggest they will raise rates further irregardless of the U.S. slowdown. Emerging from its own housing correction last year, the U.K. looks to be the bright spot for the European economy, bucking the trend, and is expected to post higher growth in 2007 than 2006.

Japan fights to get what China fears - inflation

As Japan tries to put deflation firmly in the rearview mirror, prices have proven stubbornly soft. Recent CPI revisions show deflation continued in the first quarter and the pace of economic growth has eased in each of the first two quarters of 2006 - albeit from a frenzied pace near 4% from October 2005 through March 2006. Unlike the Eurozone, however, there are several reasons to be optimistic. Investment spending in plant and equipment is growing at twice its 2005 pace and represents three out of every four dollars of total investment spending, implying strong prospects for the business sector. Private domestic demand has actually grown by 3.3% since the second quarter of last year and is accelerating. In fact, headline GDP has only been brought down by a retrenchment in public spending of nearly 2% over last year as fiscal stimulus is removed from the economy. Nonetheless, Japanese attention remains firmly focused on bringing a measured amount of inflation back into the economy. The Bank of Japan is left in the unenviable position of not wanting to put the brakes on the economy but needing to raise interest rates from their current near-zero levels. Otherwise, they risk being left flat-footed once again should global demand slacken more than expected, Japanese prices fall, and interest rates - already effectively at zero - have no room to be cut to stimulate the economy out of a deflationary trap.

In China, inflation remains public enemy number one. Typically, higher interest rates could rein in inflation, except Chinese consumers arguably spend too little and businesses finance a large share of expansion through earnings rather than debt. This renders interest rate hikes undesired or ineffective. Alternatively, a stronger exchange rate would raise the price of Chinese exports and slow this sector; however, a stronger exchange rate and higher interest rates would also attract speculative financing from abroad, something the Chinese also fear. In fact, the contentious renminbi has not appreciated against the U.S. dollar at all on a real basis since the authorities revalued the currency last year, fueling Chinese export growth of 33% annually and fears of domestic inflation and overheating. This boxes in policymakers as administrative controls - such as ordering banks to stop new lending - are the only tool left. This is akin to pulling the emergency brake on a moving train and risks jostling free any loose parts.

For these reasons, while we have increased our outlook for Chinese output growth, we also feel there is an equivalent increase in risk as this intransigence increasingly drives economic policy. Moreover, while we feel the global economy will weather the U.S. slowdown rather robustly, these prospects hinge on how the major markets respond to the U.S. slowdown in the face of their own national priorities (and the topic of a TD Economics report forthcoming in October).

Richard Kelly 416-982-2559

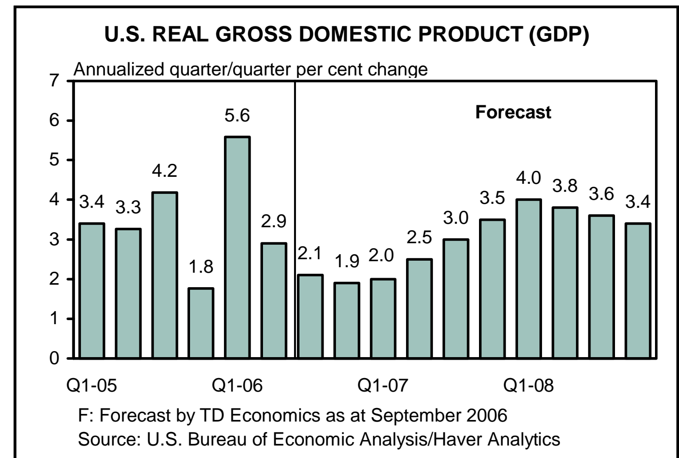
ECONOMIC INDICATORS FOR THE G-7 AND EUROPE

			Forecast		
	2004	2005	2006	2007	2008
Real GDP (Annual per cent change)					
G-7 (41.17%)*	3.1	2.6	2.8	2.0	3.0
U.S.	4.2	3.5	3.4	2.4	3.6
Japan	2.3	2.6	2.7	2.0	3.1
EU-12	1.8	1.4	2.3	1.4	2.3
Germany	1.1	1.2	1.8	0.8	2.0
France	2.0	1.2	2.1	1.8	2.3
Italy	0.9	0.1	1.4	0.6	1.5
United Kingdom	3.1	1.8	2.5	2.6	3.0
Canada	3.3	2.9	2.8	2.3	3.2
Consumer Price Index (Annual per cent change)					
G-7	2.0	2.3	2.7	2.2	2.1
U.S.	2.7	3.4	3.9	2.6	2.4
Japan	0.0	-0.3	0.2	0.7	0.9
EU-12	2.1	2.2	2.4	2.7	2.5
Germany	1.8	1.9	2.1	3.2	2.9
France	2.3	1.9	2.2	2.3	1.9
Italy	2.3	2.2	2.3	2.0	1.9
United Kingdom	1.3	2.0	2.2	2.0	2.1
Canada	1.8	2.2	2.4	1.9	2.2
Unemployment Rate (Per cent annual averages)					
U.S.	5.5	5.1	4.8	5.5	5.6
Japan	4.7	4.4	4.1	3.8	3.6
EU-12	8.9	8.5	7.9	7.7	8.0
Germany	10.6	11.7	8.4	8.4	8.5
France	10.0	9.9	8.9	8.3	8.4
Italy	8.1	7.7	7.5	8.0	8.4
United Kingdom	2.7	2.8	5.3	5.5	5.3
Canada	7.2	6.8	6.3	6.5	6.4

*Share of 2005 world gross domestic product (GDP)
Forecast as at September 2006
Source: National statistical agencies, TD Economics

U.S. ECONOMIC OUTLOOK

After having spent the past year trying to convince market participants that a U.S. economic slowdown would unfold in 2006, we now find ourselves in the unusual position of having to inject some optimism back into market perceptions. A backsliding housing market alongside softening consumer confidence has led to increased market chatter regarding an impending U.S. recession. However, recent developments have not altered our outlook in any meaningful way. Rather, they serve to entrench our belief that unwinding housing wealth effects will lead to a U.S. slowdown over the next four quarters, with real GDP growth hovering in the 2-2.5% range over that period. We place the risk of a recession at only a 1-in-4 probability, with growth in exports, business investment and household incomes expected to remain reasonably solid. We believe real GDP growth for all of 2007 will average 2.4% before rebounding to a 3.6% pace in 2008.



U.S. ECONOMIC INDICATORS
Annual per cent change unless otherwise indicated

			Forecast		
	2004	**2005**	**2006**	**2007**	**2008**
Real GDP	3.9	3.2	3.4	2.4	3.6
Consumer Expenditure	3.9	3.5	3.1	2.5	3.3
Durable Goods	6.4	5.5	4.8	2.4	5.6
Business Investment	5.9	6.8	7.9	5.4	5.3
Non-Residential Structures	2.2	1.1	8.8	6.0	5.4
Machinery & Equipment	7.3	8.9	7.4	5.2	5.3
Residential Construction	9.9	8.6	-3.1	-8.6	2.3
Govt. Exp. on Goods & Svcs.	1.9	0.9	2.0	1.5	0.7
Final Domestic Demand	4.0	3.6	3.0	2.0	3.0
Exports	9.2	6.8	8.4	6.8	7.6
Imports	10.8	6.1	6.0	2.4	3.7
Change in Non-Farm Inventories ($96 Bn.)	47.0	19.6	43.3	34.4	46.7
Final Sales	3.5	3.5	3.1	2.5	3.4
Int'l Curr. Acct. Bal. ($Bn.)	-665	-792	-851	-859	-864
% of GDP	-5.7	-6.4	-6.4	-6.2	-5.9
Pre-tax Corporate Profits	19.1	12.5	20.3	1.4	6.1
GDP Chain-type Deflator	2.8	3.0	3.0	2.2	2.0
Employment	1.1	1.5	1.3	0.5	1.1
Unemployment Rate (%)	5.5	5.1	4.8	5.5	5.6
Productivity *	3.0	2.3	2.3	2.6	3.1
Real Pers. Disp. Inc. (PDI)**	3.6	1.2	3.1	3.4	3.7
Real PDI Per Person**	2.7	0.3	-0.9	2.5	2.8
Consumer Price Index (CPI)	2.7	3.4	3.5	2.5	1.9
Housing Starts ('000 units)	1,950	2,073	1,860	1,641	1,687

Real GDP: Real gross domestic product; * Real private non-farm business output per hour; ** After-tax income adjusted for inflation; Forecast by TD Economics as at Sept 2006; Source: Bureau of Labor Statistics, Bureau of Economic Analysis, TD Economics

Reality check – consumers not about to backpedal

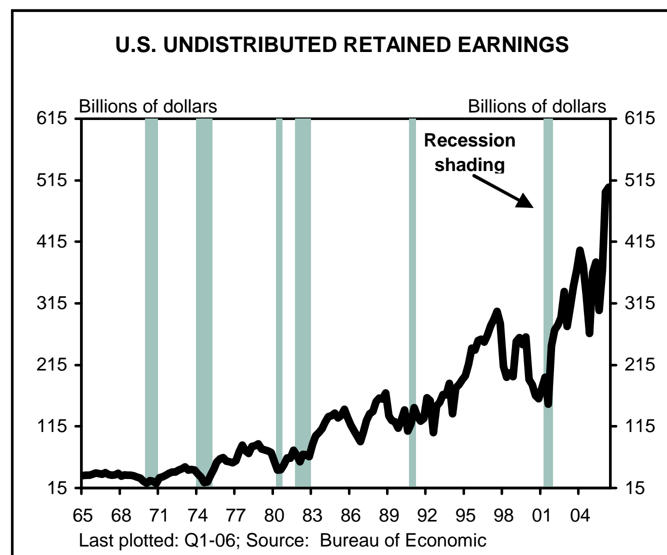
Real consumer spending will slow to a 2.5% annual pace in 2007, marking the slowest annual pace since 2001. That year was demarcated by a recession, but we believe 2007 will be spared the same fate. The 2001 recession was led by an implosion in the tech bubble that resulted in plummeting stock prices and a sharp pull-back in business investment. Consumer spending, however, never missed a beat, despite labour market turmoil that saw 2.7 million jobs disappear over a two-and-a-half year period. It is for this reason that the recession went down in the history books as one of the mildest and shortest lived. Of course, consumer spending at that time was aided by rock-bottom interest rates, which is not the case now, nor likely to be so over our forecast horizon.

However, there are a number of supportive features in the current business cycle that should keep a floor under household purchases. For one, we believe interest rates have already peaked. In the past three consumer-led recessions, real 1-year interest rates were 2-to-3 times higher than they are today. This mitigates the risk of a credit crunch and high consumer delinquency rates. In fact, even though American consumers have experienced rising debt service costs, particularly over the past year, the delinquency rate for residential real estate loans is still hovering near historic lows and is less than half of 2001 levels. Provided incomes and jobs remain supported, there is lit-

tle reason for this barometer of consumer health to backtrack by any significant degree in the coming two years. And this brings us to our second point. Businesses are likely to reflect more cautious hiring intentions during the cyclical slowdown, such that labour market weakness will be unavoidable in 2006 and 2007. However, we don't foresee outright job losses sustained over this period, and a gradual rise in the unemployment rate towards a peak of 5.7% next year is modest by historical standards. Both of these should limit fraying in consumer confidence as well as sustain income growth, which is already exhibiting remarkable stability. Real after-tax personal income accelerated to a 2.8% annual pace in the second quarter and still-tight labour markets argue for continued strength within the 3-3.5% range through our forecast horizon.

Corporate America in the driver's seat

The labour market has three supportive factors emanating from the corporate sector. First, corporate America already went through significant job restructuring at the start of the decade. Hiring since that period has been muted relative to other recovery cycles, so it's unlikely that job overhang will be a problem in this cyclical slowdown. Second, as part of those restructuring efforts, corporations slashed the debt side of their ledger sheets, leaving retained earnings hovering near an all-time high. This provides a savings cushion to weather an economic slowdown that was simply not present during past economic downturns. It is for this reason that we think businesses will not shelve investment intentions, even as profit growth slows to a fourth-over-fourth pace of just 4.3% in 2007



U.S. ECONOMIC INDICATORS

Fourth-quarter-over-fourth-quarter per cent change

	Q4-03	Q4-04	Q4-05	Forecast Q4-06	Q4-07	Q4-08
Real GDP	3.7	3.4	3.1	3.1	2.8	3.7
Real Final Sales	3.7	3.1	3.2	3.1	2.8	3.5
Employment	-0.1	1.6	1.4	1.2	0.4	1.5

Real GDP: Real gross domestic product; Forecast by TD Economics as at Sept 2006; Source: Bureau of Labor Statistics, Bureau of Economic Analysis, TD Economics

from double-digit gains in the prior two years. Firms will also be acutely aware of the importance to maintain their global competitive position, such that investment in machinery and equipment is still expected to expand by a healthy 5% annual clip over 2007 and 2008. Lastly, not all corporations (and hence job demand) will be equally affected within the economic cycle. One area that will likely maintain, and possibly even gain, momentum is the export sector.

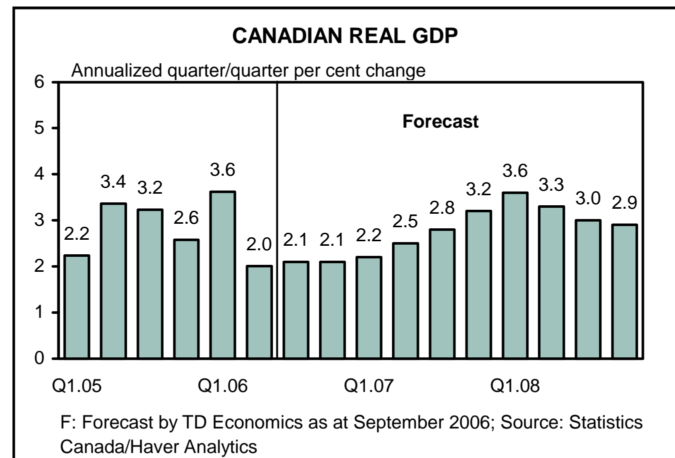
Exports to prop up GDP

Exporters are definitely reaping the benefits of an improved competitive position through a lower valued greenback. Since mid-2003, real exports have expanded at an average quarterly pace of 8.8% (annualized), marking the strongest string of advances since the mid-1990s. This robust performance in the export sector came on the heal of a 27% depreciation in the trade-weighted U.S. dollar alongside more synchronized growth in the global economy. And, there is little reason to expect a reversal in the greenback's weakness given the near-term economic headwinds. What's more, structural hurdles in the form of massive fiscal and current account deficits suggest that the risks to the U.S. dollar are stacked to the downside. This means that the export sector should remain a key growth sector in the U.S. economy. Meanwhile, the slowdown in domestic demand will crimp import growth, thereby allowing the trade balance to actually contribute roughly half a percentage point to real GDP growth in 2007 and 2008. By extension, the trade deficit as a share of GDP will shrink, but only by a hair. Since imports are twice the size of exports, the growth differential between the two would need to be greater and sustained over a longer time period in order to produce a significant improvement in the deficit-to-GDP ratio.

Beata Caranci 416-982-8067

CANADA'S ECONOMIC OUTLOOK

The economic forecast for Canada is really a tale of two economies experiencing markedly different conditions. On one hand, you have the export sector which will likely endure several miserable quarters as the slowing in the U.S. economy is expected to intensify over the rest of this year and into early 2007. The second and more upbeat tale is that of Canada's domestic economy, which will remain strong. Although the rate of growth will moderate a touch, domestic demand will remain firmly above an annualized growth rate of 3.0%. While the confluence of these two narratives will pull real Gross Domestic Product (GDP) growth below its trend pace for the next four quarters, the strength in domestic demand will likely keep the quarterly growth profile above 2.0% annualized. Heading into the second half of 2007, an anticipated recovery in the U.S. economy returns some momentum to export growth and the modicum of excess capacity generated over the three previous quarters will be quickly erased, as economic growth returns to its above-trend pace through the end of 2008. All told, the fourth-over-fourth quarter real GDP growth rate is expected to slow to 2.5% this year, down from the 2.8% observed in 2005 before edging higher to 2.7% in 2007 and 3.2% by 2008.



F: Forecast by TD Economics as at September 2006; Source: Statistics Canada/Haver Analytics

CANADA'S ECONOMIC INDICATORS
Annual per cent change unless otherwise indicated

		Forecast		
	2005	**2006**	**2007**	**2008**
Real GDP	2.9	2.8	2.3	3.2
Consumer Expenditure	3.9	4.0	3.4	3.0
Durable Goods	5.8	5.4	3.7	3.1
Business Investment	9.4	8.9	7.9	8.0
Non-Residential Structures	7.9	8.2	6.3	6.8
Machinery & Equipment	10.5	9.3	8.7	8.6
Residential Construction	3.2	2.8	-1.1	0.4
Govt. Exp. on Goods & Svcs.	2.7	3.7	3.4	3.6
Final Domestic Demand	4.5	4.7	3.8	3.8
Exports	2.1	1.0	0.5	4.2
Imports	7.1	5.9	4.5	4.9
Change in Non-Farm Inventories ($97 Bn.)	12.4	13.0	13.6	11.3
Final Sales	2.5	2.7	2.2	3.4
Int'l Curr. Acct. Bal. ($Bn.)	31.8	20.2	15.9	16.8
% of GDP	2.3	1.4	1.1	1.1
Pre-tax Corporate Profits	10.6	3.5	1.7	4.4
GDP Chain-type Deflator	3.2	1.8	0.9	1.9
Employment (%)	1.4	1.9	1.0	1.2
Employment ('000)	220	309	170	206
Unemployment Rate (%)	6.8	6.3	6.5	6.4
Productivity*	2.0	0.8	1.3	1.9
Real Pers. Disp. Income (PDI)**	2.5	3.8	2.5	3.9
Real PDI Per Person**	1.5	2.8	1.5	3.9
Consumer Price Index	2.2	2.4	1.9	2.2
Core CPI	1.6	1.9	1.7	2.0
Housing Starts ('000 units)	224	227	189	170

Real GDP: Real gross domestic product; *Real GDP per employee **After-tax income adjusted for inflation; Forecast by TD Economics as at September 2006; Source: Statistics Canada, Bank of Canada, Canada Mortgage and Housing Corporation, TD Economics

A key subplot in Canada's economic forecast is the significant degree of regional variation across the provincial economies (for provincial forecast details, please see the upcoming Provincial Economic Update). Despite the expectation of a modest correction in commodity prices, strong fundamentals will support a relatively high price level, allowing Western Canada to lead all other regions in economic growth. This dominance will carry over to the labour market, as continued labour shortages are expected to keep wage growth high and unemployment rates low. Across Central and Eastern Canada, both economic and employment growth will likely be curtailed as manufacturing-dominated provinces will bear the brunt of the deteriorating economic conditions south of the border. However, domestic strength will help support many service industries, limiting the severity of the economic fallout from the U.S. slowdown.

U.S. to lean heavily on exports…

The fundamental source of weakness in the Canadian economic outlook is the slowing in the U.S. economy over the next three quarters. This represents an added complication for Canadian exporters who will continue to struggle with the effects of the elevated currency and enhanced competition from low-cost producers abroad. While there is a touch of near-term strength in the third quarter supporting export growth, weakening U.S. demand for Canadian products will lead to two consecutive quarters of negative export growth thereafter, shaving a tenth of a percentage point from real GDP growth in each quarter. As the U.S. economy begins to recover though the second half of 2007, export growth returns to positive territory, but remains at a moderate level though the end of 2008 as growth is hampered by the strength in the Canadian dollar over this period.

… While domestic strength supports growth

The major offset to the weakness in Canada's export profile is sustained growth in domestic demand, led by consumer expenditures. While the pace of job creation is expected to moderate somewhat in the quarters to come, the unemployment rate will remain near a generational low, providing the basis for continued wage gains, which in turn will help support consumer spending. Nevertheless, the growth rate of consumer expenditures is expected to ease somewhat over the coming quarters, reaching a trough of 2.8% growth in the second quarter of 2007. Part of this slowing reflects the lagged effect of past interest rate hikes and a slower rate of wealth accumulation as the housing boom wanes. Consumption is then expected to rebound over the second half of 2007 in response to improved economic conditions in the United States and to a smaller degree, the lagged effect of a modest reduction in lending rates by the Bank of Canada over the first half of the year (see the following financial chapter).

The prospects for residential investment in Canada highlights one of the main reasons why less economic slack will build on this side of the border compared to the United States. While a fall in residential investment is forecast for both countries, the decline in Canada is minor relative to that in the United States, reflecting the smaller run-up in home prices over the last 6 years and less speculative activity. In Canada, the decline in residential activity will likely be more pronounced across the Central and Eastern provinces as growth out west will continue to remain robust, providing a boost to the national average. Meanwhile, housing starts are expected to ease to a demographically-supported level of 170,000 units by the end of 2008.

Business investment will also contribute to the strength of domestic demand. Firms are well positioned to increase investment spending given the expectation of respectable corporate profit growth and strong balance sheet positions. Capital intensive developments across Western Canada will help ensure a robust growth rate of investment for both non-residential projects as well as for new machinery and equipment. Many non-exporting firms will also benefit from the elevated value of the dollar as they are expected to increase their imports of new capital equipment, most of which is priced in U.S. dollars. The high level of investment in capital goods will also contribute to the forecast for a steady increase in labour productivity over the next two years, which is expected to reach a year-over-year peak of 2.0% by the end of 2008.

CANADA'S ECONOMIC INDICATORS

Fourth-quarter-over-fourth-quarter per cent change

				Forecast		
	Q4-03	Q4-04	Q4-05	Q4-06	Q4-07	Q4-08
Real GDP	1.5	3.7	2.8	2.5	2.7	3.2
Real Final Sales	1.4	2.3	3.6	2.1	2.9	3.4
Employment (%)	1.8	1.5	1.6	1.6	1.0	1.3

Real GDP: Real gross domestic product; Forecast by TD Economics as at September 2006; Source: Statistics Canada, TD Economics

Economic growth to remain above trend through 2008

By 2008, economic activity in Canada will be supported both by export growth and robust domestic demand. As the glow from the U.S. recovery in late 2007 begins to fade, economic growth in Canada over 2008 is expected to gradually converge towards its trend rate of 2.8% by the final quarter of the year.

David Tulk 416-982-2557

FINANCIAL OUTLOOK

Both the Bank of Canada and the U.S. Federal Reserve have now transitioned out of monetary tightening mode, and into a relatively hazy period of interest rates on hold. Indeed, the Bank of Canada has left its overnight rate unchanged at 4.25% at its last two fixed announcement dates, while the U.S. Federal Reserve kept its Fed funds rate unchanged at 5.25% at the August decision. In response to this change in stance, the bond market has rallied substantially on both sides of the border, with the yield on 10-year benchmark government bonds declining by roughly 35 basis points in the U.S. and a larger 45 basis points in Canada.

We think the recent rally has been too sharp and too soon. Both central banks will remain on hold for several months – into early 2007, at a minimum – and that suggests that bond yields could rise modestly in the near-term. However, the tide will likely shift once again in late 2006 and early 2007, as rate cuts are telegraphed by the central banks and as inflation risk premiums decline.

For monthly updates and a more in-depth discussion of the interest rate and foreign exchange rate forecasts, please see the monthly Global Markets report, available at www.td.com/economics.

Federal Reserve moves to the sidelines

In the U.S., the outlook for interest rates is rendered uncertain by a complicated dynamic. Although the U.S. economy appears to be weakening, U.S. inflation remains stubbornly high. The Federal Reserve is bound by an obligation to maintain both healthy economic growth and stable inflation. As such, it is hardly certain what the Fed's next move will be. However, we believe that a string of pauses is likely to be broken by an eventual rate cut – not a hike.

U.S. economic growth lost momentum in the second quarter and is poised to continue softening in the months ahead. The U.S. housing market is clearly in decline, while consumer spending growth is threatening to weaken. As a

INTEREST RATE OUTLOOK

	Spot Rate	2006				2007				2008			
	9/14/2006	Q1	Q2	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
CANADIAN FIXED INCOME													
Overnight Target Rate (%)	4.25	3.75	4.25	4.25	4.25	4.00	3.75	3.75	4.00	4.25	4.25	4.25	4.25
3-mth T-Bill Rate (%)	4.15	3.91	4.32	4.20	4.20	3.90	3.75	3.85	4.10	4.25	4.25	4.25	4.25
2-yr Govt. Bond Yield (%)	4.00	4.01	4.41	4.10	4.05	3.90	3.85	4.20	4.40	4.50	4.55	4.60	4.60
5-yr Govt. Bond Yield (%)	4.03	4.16	4.47	4.15	4.05	3.95	3.95	4.30	4.55	4.60	4.65	4.70	4.75
10-yr Govt. Bond Yield (%)	4.13	4.26	4.58	4.25	4.20	4.10	4.15	4.50	4.65	4.70	4.75	4.80	4.85
30-yr Govt. Bond Yield (%)	4.22	4.26	4.61	4.35	4.35	4.30	4.30	4.60	4.70	4.75	4.80	4.85	4.90
10-yr-2-yr Govt. Spread (%)	0.13	0.25	0.17	0.15	0.15	0.20	0.30	0.30	0.25	0.20	0.20	0.20	0.25
U.S. FIXED INCOME													
Fed Funds Target Rate (%)	5.25	4.75	5.25	5.25	5.25	4.75	4.25	4.25	4.50	4.75	4.75	4.75	4.75
3-mth T-Bill Rate (%)	4.94	4.60	5.03	5.05	4.95	4.65	4.25	4.30	4.55	4.75	4.75	4.75	4.75
2-yr Govt. Bond Yield (%)	4.83	4.82	5.15	4.85	4.60	4.40	4.20	4.55	4.85	4.95	5.00	5.05	5.05
5-yr Govt. Bond Yield (%)	4.72	4.81	5.09	4.85	4.60	4.45	4.30	4.65	5.00	5.05	5.10	5.15	5.20
10-yr Govt. Bond Yield (%)	4.78	4.85	5.14	4.90	4.70	4.55	4.50	4.85	5.10	5.15	5.20	5.25	5.30
30-yr Govt. Bond Yield (%)	4.90	4.89	5.19	5.05	4.85	4.75	4.65	5.00	5.20	5.25	5.30	5.35	5.40
10-yr-2-yr Govt. Spread (%)	-0.05	0.03	-0.01	0.05	0.10	0.15	0.30	0.30	0.25	0.20	0.20	0.20	0.25
CANADA-U.S. SPREADS													
3-mth T-Bill Rate (%)	-0.79	-0.69	-0.71	-0.85	-0.75	-0.40	-0.35	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50
2-yr Govt. Bond Yield (%)	-0.83	-0.81	-0.74	-0.75	-0.55	-0.50	-0.35	-0.35	-0.45	-0.45	-0.45	-0.45	-0.45
5-yr Govt. Bond Yield (%)	-0.69	-0.65	-0.62	-0.70	-0.55	-0.50	-0.35	-0.35	-0.45	-0.45	-0.45	-0.45	-0.45
10-yr Govt. Bond Yield (%)	-0.65	-0.59	-0.56	-0.65	-0.50	-0.45	-0.35	-0.35	-0.45	-0.45	-0.45	-0.45	-0.45
30-yr Govt. Bond Yield (%)	-0.68	-0.63	-0.58	-0.70	-0.50	-0.45	-0.35	-0.40	-0.50	-0.50	-0.50	-0.50	-0.50

f: Forecast by TD Economics as at Sept. 14, 2006; All forecasts are for end of period. Source: Bloomberg, TD Economics

result, GDP growth in the U.S. should decelerate to an approximately 2.0% annualized pace over the next few quarters, which will clearly raise alarm bells at the Fed. However, it is equally true that U.S. core CPI remains higher than the Fed would like. Fortunately, much of the risk associated with an elevated inflation rate is mitigated by contained inflation expectations, the fact that the cost of owning a home may be overstated in the measure, and the prospect of declining inflation thanks to the outlook for sub-par economic growth. Thus, we expect the Fed to cut interest rates by 100 basis points over the span of the first half of 2007. As this outcome becomes more obvious to the market over time, we would expect U.S. bond yields to decline and the yield curve to flatten over the 3-month to 5-year segment, but steepen over the 5-year to 30-year segment.

Bank of Canada on hold

In Canada, the situation is just as nuanced as in the U.S., although for different reasons. Inflation is not as pressing a concern in Canada. At the time of writing, core CPI sits at a 2.0% year-over-year rate - bang on the Bank of Canada's target. Of greater concern is the relative balance between booming domestic demand, which has grown at a robust pace for several consecutive years, and the prospects for weaker foreign demand. It appears that domestic demand should hold up for the time being, but a myriad of challenges continue to confront Canadian exports, ranging from the strong Canadian dollar to the prospect of softer U.S. demand in the future.

The Bank of Canada recently reiterated that it is content to leave interest rates unchanged based upon the Bank's outlook for the economy and inflation over the next several years. However, we feel that the Bank of Canada may be overly optimistic in its forecast, especially given the downward tilt of the U.S. economy that should leak through to Canada. As a result, although the Bank of Canada is unlikely to be forced into action over the next several months, we foresee an eventual need for the Bank to cut interest rates by a cumulative 50 basis points in early 2007, with the first quarter point cut likely coming in March and the second quarter point in April. This represents a more modest and a later easing than in the U.S., which reflects the fact that less economic slack will build in the Canadian economy. As with the U.S., once the prospect for rate cuts is priced into markets, Canadian bond yields should decline. Again, a flattening along the short-end of the yield curve and steepening along the long-end is anticipated. Canadian bonds yields should decline by less than in the U.S., implying a relative underperformance by the Canadian bond market.

Canadian dollar to dip, but only slightly

Although Canadian interest rates will remain below their U.S. counterparts, the gap will narrow, which is positive for the Canadian dollar. Merger and acquisition flows may also continue to provide muscle to the loonie. However, we remain of the view that the Canadian dollar could soften a touch over the next twelve months.

The major downward influence for the loonie is likely to come from commodities, which have had a dominant impact on the Canadian dollar over the past year. On this front, both oil and base metal prices are expected to decline in the months ahead. Supporting this view, one can compellingly argue that many commodities have exceeded their fundamentally-justified price levels. An additional driver of declining commodity prices will likely stem from the U.S. economic slowdown, which will limit the demand growth for commodities. Thus, the U.S. slowdown should result in a softer Canadian dollar. We forecast the currency at 1.136 (88 U.S. cents/C$) by year-end, and at 1.149 (87 U.S. cents/C$) by the mid-point of next year.

Eric Lascelles 416-982-8979
Marc Levesque 416-982-8785

FOREIGN EXCHANGE OUTLOOK

Currency	Exchange Rate	Spot Price	2006				2007				2008			
		9/14/2006	Q1	Q2	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Canadian dollar	USD per CAD	0.894	0.857	0.896	0.890	0.880	0.875	0.870	0.875	0.880	0.890	0.900	0.900	0.900
Canadian dollar	CAD per USD	1.119	1.167	1.116	1.124	1.136	1.143	1.149	1.143	1.136	1.124	1.111	1.111	1.111
Japanese yen	JPY per USD	117.5	118	114	115	112	109	108	107	105	104	105	106	107
Euro	USD per EUR	1.273	1.211	1.279	1.285	1.310	1.320	1.330	1.330	1.340	1.330	1.320	1.310	1.300
U.K. pound	USD per GBP	1.887	1.737	1.848	1.890	1.912	1.920	1.930	1.933	1.934	1.928	1.919	1.912	1.906
Swiss franc	CHF per USD	1.252	1.305	1.223	1.222	1.183	1.167	1.150	1.150	1.134	1.128	1.121	1.130	1.154
Australian dollar	USD per AUD	0.754	0.711	0.742	0.760	0.780	0.780	0.760	0.740	0.720	0.700	0.710	0.720	0.720
Mexican peso	MXN per USD	10.98	10.90	11.34	11.00	11.00	11.20	11.30	11.40	11.50	11.60	11.65	11.70	11.75

f: Forecast by TD Economics as at Sept. 13, 2006; All forecasts are for end of period; Source: Federal Reserve of New York, TD Economics

CANADIAN ECONOMIC OUTLOOK

Period-Over-Period Annualized Per Cent Change Unless Otherwise Indicated

	2006			2007				2008				Annual Average				4th Qtr/4th Qtr			
	Q2A	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	05	06F	07F	08F	05	06F	07F	08F
Real GDP	2.0	2.1	2.1	2.2	2.5	2.8	3.2	3.6	3.3	3.0	2.9	2.9	2.8	2.3	3.2	2.8	2.5	2.7	3.2
Consumer Expenditure	4.2	3.9	3.7	3.4	2.8	3.0	3.2	3.2	3.0	2.9	2.9	3.9	4.0	3.4	3.0	3.8	4.4	3.1	3.0
Durable Goods	4.8	4.5	4.0	3.8	3.0	3.2	3.3	3.3	3.0	2.9	2.8	5.8	5.4	3.7	3.1	4.5	6.3	3.3	3.0
Business Investment	7.3	8.1	8.0	7.7	7.5	8.5	8.3	8.3	7.9	7.3	7.4	9.4	8.9	7.9	8.0	9.8	8.1	8.0	7.7
Non-Res. Structures	5.5	5.9	6.2	6.4	6.0	7.0	7.0	7.2	6.8	6.0	6.1	7.9	8.2	6.3	6.8	10.3	6.5	6.6	6.5
Machinery & Equipment	8.8	9.3	9.0	8.3	8.2	9.2	9.0	8.8	8.5	8.0	8.0	10.5	9.3	8.7	8.6	9.3	9.0	8.7	8.3
Residential Construction	-5.2	-2.0	-0.4	-1.3	-0.6	-0.3	-0.2	0.0	1.2	1.6	1.5	3.2	2.8	-1.1	0.4	1.8	1.1	-0.6	1.1
Government Expenditure on Goods & Services	4.7	4.8	3.7	2.8	2.2	3.8	3.9	4.1	3.6	3.3	3.0	2.7	3.7	3.4	3.6	3.0	3.9	3.2	3.5
Final Domestic Demand	4.1	4.4	4.2	3.6	3.2	3.8	3.9	4.0	3.8	3.6	3.6	4.5	4.7	3.8	3.8	4.6	4.6	3.6	3.7
Exports	-1.2	1.1	-1.2	-0.9	1.2	3.1	4.5	4.8	4.5	4.3	4.3	2.1	1.0	0.5	4.2	4.5	-1.3	1.9	4.5
Imports	9.4	7.2	4.7	3.3	2.9	3.7	5.4	5.6	5.1	4.9	4.9	7.1	5.9	4.5	4.9	6.9	4.7	3.8	5.1
Change in Non-Farm Inventories ($97 Bn)	15.2	13.5	13.8	14.4	14.4	13.0	12.6	12.2	11.7	11.0	10.3	12.4	13.0	13.6	11.3	---	---	---	---
Final Sales	-0.1	1.9	1.7	1.9	2.6	3.5	3.5	3.6	3.5	3.3	3.3	2.5	2.7	2.2	3.4	3.6	2.1	2.9	3.4
International Current Account Balance ($Bn)	16.8	16.6	14.7	13.9	15.1	17.2	17.4	17.3	16.7	16.5	16.7	31.8	20.2	15.9	16.8	---	---	---	---
% of GDP	1.2	1.2	1.0	1.0	1.0	1.2	1.2	1.1	1.1	1.1	1.1	2.3	1.4	1.1	1.1	---	---	---	---
Pre-tax Corp. Profits	1.7	1.5	-0.6	0.4	3.2	3.8	4.9	5.8	3.9	3.3	3.3	10.6	3.5	1.7	4.4	14.8	-3.1	3.1	4.1
% of GDP	13.7	13.7	13.6	13.5	13.5	13.5	13.4	13.4	13.4	13.4	13.3	13.8	13.7	13.5	13.4	---	---	---	---
GDP Deflator	-1.0	-0.1	0.3	1.2	1.4	1.8	2.0	2.1	1.8	1.7	1.6	3.2	1.8	0.9	1.9	4.1	-0.2	1.6	1.8
Nominal GDP	0.9	1.9	2.4	3.4	3.8	4.7	5.3	5.8	5.2	4.8	4.6	6.2	4.6	3.2	5.1	7.2	2.2	4.3	5.1
Labour Force	2.0	1.6	1.0	0.9	1.1	1.3	1.3	1.2	1.2	1.2	1.2	0.9	1.4	1.2	1.2	0.9	1.5	1.2	1.2
Employment (%)	3.1	1.0	0.7	0.8	0.9	1.1	1.2	1.2	1.2	1.2	1.2	1.4	1.9	1.0	1.2	1.6	1.6	1.0	1.3
Employment ('000s)	127	43	30	32	36	46	50	53	58	54	51	220	309	170	206	260	265	164	216
Unemployment Rate (%)	6.2	6.4	6.3	6.5	6.5	6.4	6.4	6.4	6.3	6.4	6.4	6.8	6.3	6.5	6.4	---	---	---	---
Personal Disp. Income	-2.4	3.4	3.8	4.0	3.7	4.3	4.3	4.4	4.5	4.4	4.4	4.2	5.6	3.5	4.4	4.5	4.7	4.1	4.4
Pers. Savings Rate (%)	1.0	0.3	0.1	-0.1	0.2	0.5	0.8	0.8	1.0	1.3	1.7	1.2	1.1	0.4	1.2	---	---	---	---
Cons. Price Index (Y/Y)	2.6	2.3	2.2	1.9	1.8	1.9	2.1	2.4	2.3	2.1	2.1	2.2	2.4	1.9	2.2	2.3	2.2	2.1	2.1
Core CPI (Y/Y)	1.8	2.0	2.0	1.6	1.5	1.8	2.0	2.0	2.0	2.0	2.0	1.6	1.9	1.7	2.0	1.6	2.0	2.0	2.0
Housing Starts ('000s)	229	220	212	206	194	180	175	170	168	170	170	224	227	189	170	---	---	---	---
Productivity: Real GDP / worker (Y/Y)	0.7	0.5	0.8	0.6	1.3	1.5	1.7	1.9	1.9	2.0	1.9	2.0	0.8	1.3	1.9	1.2	0.8	1.7	1.9

F: Forecast by TD Economics as at September 2006

Source: Statistics Canada, Bank of Canada, Canada Mortgage and Housing Corporation, TD Economics

U.S. ECONOMIC OUTLOOK

Period-Over-Period Annualized Per Cent Change Unless Otherwise Indicated

	2006			2007				2008				Annual Average				4th Qtr/4th Qtr			
	Q2	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F	05	06F	07F	08F	05	06F	07F	08F
Real GDP	2.9	2.1	1.9	2.0	2.5	3.0	3.5	4.0	3.8	3.6	3.4	3.2	3.4	2.4	3.6	3.1	3.1	2.8	3.7
Consumer Expenditure	2.6	3.6	2.0	2.2	2.2	2.9	3.5	3.8	3.4	3.2	3.2	3.5	3.1	2.5	3.3	2.9	3.2	2.7	3.4
Durable Goods	0.5	5.4	0.8	1.2	2.0	4.0	6.7	6.2	5.7	6.4	5.2	5.5	4.8	2.4	5.6	2.5	6.3	3.4	5.9
Business Investment	4.7	8.8	7.8	4.8	3.3	3.9	4.4	5.7	6.3	6.5	6.4	6.8	7.9	5.4	5.3	5.6	8.7	4.1	6.2
Non-Res. Structures	22.2	8.3	6.8	5.3	2.7	2.6	3.8	6.9	6.9	6.5	5.9	1.1	8.8	6.0	5.4	1.8	11.3	3.6	6.5
Machinery & Equipment	-1.6	9.0	8.2	4.6	3.5	4.4	4.7	5.2	6.0	6.4	6.7	8.9	7.4	5.2	5.3	7.0	7.6	4.3	6.1
Residential Construction	-9.8	-16.3	-11.5	-11.1	-5.0	0.2	2.3	3.1	3.8	4.0	3.3	8.6	-3.1	-8.6	2.3	9.0	-9.7	-3.5	3.6
Govt. Consumption & Gross Investment	0.9	1.7	1.9	1.4	1.3	1.3	1.1	0.5	0.4	0.3	0.7	0.9	2.0	1.5	0.7	1.2	2.4	1.3	0.5
Final Domestic Demand	1.7	2.5	1.8	1.6	1.8	2.6	3.1	3.4	3.2	3.1	3.1	3.6	3.0	2.0	3.0	3.2	2.8	2.2	3.2
Exports	5.1	5.6	7.9	6.7	6.9	7.0	6.9	8.3	8.1	8.0	7.2	6.8	8.4	6.8	7.6	6.7	8.1	6.9	7.9
Imports	0.6	5.4	2.6	1.3	1.9	2.6	3.1	3.9	4.4	4.7	4.9	6.1	6.0	2.4	3.7	5.2	4.4	2.2	4.5
Change in Non-Farm Inventories ($96 Bn)	54.8	45.8	36.0	31.9	36.5	34.5	34.8	37.6	44.8	50.5	53.9	19.6	43.3	34.4	46.7	---	---	---	---
Final Sales	2.3	2.4	2.3	2.2	2.3	3.1	3.5	3.8	3.6	3.4	3.2	3.5	3.1	2.5	3.4	3.2	3.1	2.8	3.5
International Current Account Balance ($Bn)	-858	-860	-851	-852	-857	-861	-864	-865	-866	-865	-862	-792	-851	-859	-864	---	---	---	---
% of GDP	-6.5	-6.4	-6.3	-6.3	-6.2	-6.2	-6.1	-6.0	-6.0	-5.9	-5.8	-6.4	-6.4	-6.2	-5.9	---	---	---	---
Pre-tax Corporate Profits including IVA&CCA	13.2	1.7	-8.1	0.0	4.8	5.0	7.8	6.7	6.1	5.2	3.9	12.5	20.3	1.4	6.1	12.8	14.2	4.4	5.5
% of GDP	12.3	12.2	11.8	11.7	11.7	11.7	11.8	11.8	11.8	11.8	11.7	10.7	12.1	11.7	11.8	---	---	---	---
GDP Deflator (Y/Y)	3.3	3.0	2.6	2.5	2.2	2.1	2.1	2.0	1.9	1.9	2.0	3.0	3.0	2.2	2.0	3.1	2.6	2.1	2.0
Nominal GDP	6.3	4.3	3.6	4.7	4.6	5.0	5.4	6.2	5.7	5.5	5.4	6.3	6.5	4.6	5.6	6.4	5.8	4.9	5.7
Labour Force	1.7	1.7	1.2	1.1	1.0	0.9	0.9	1.0	1.0	1.0	1.1	1.3	1.3	1.2	1.0	1.4	1.3	1.0	1.0
Employment	1.2	0.9	0.9	0.2	0.1	0.6	0.7	1.1	1.5	1.7	1.7	1.5	1.3	0.5	1.1	1.4	1.2	0.4	1.5
Change in Empl. ('000s)	403	306	295	63	22	217	238	386	512	576	594	2,035	1,792	723	1,500	1,917	1,564	541	2,546
Unemployment Rate (%)	4.6	4.8	5.0	5.2	5.5	5.6	5.7	5.7	5.7	5.6	5.5	5.1	4.8	5.5	5.6	---	---	---	---
Personal Disp. Income	5.7	5.3	5.6	6.3	5.0	5.3	5.2	6.4	5.6	5.4	5.4	4.1	6.0	5.6	5.6	3.4	5.8	5.5	5.7
Pers. Savings Rate (%)	-0.7	-0.9	-0.2	0.2	0.3	0.4	0.3	0.5	0.6	0.7	0.8	-0.4	-0.5	0.3	0.7	---	---	---	---
Cons. Price Index (Y/Y)	4.0	4.1	3.9	3.7	2.9	2.0	2.0	2.3	2.4	2.4	2.4	3.4	3.5	2.5	1.9	3.7	2.9	2.4	1.8
Core CPI (Y/Y)	2.5	2.7	2.6	2.5	2.1	2.0	2.0	2.0	2.0	2.1	2.1	2.2	2.5	2.2	2.1	2.1	2.6	2.0	2.1
Housing Starts (mils)	1.88	1.76	1.68	1.64	1.63	1.64	1.66	1.67	1.68	1.70	1.70	2.1	1.9	1.6	1.7	---	---	---	---
Productivity: Real Output per hour (y/y)	2.6	1.8	2.3	1.9	2.3	2.8	3.3	3.4	3.3	3.1	2.7	2.3	2.3	2.6	3.1	2.5	2.3	3.3	2.7

F: Forecast by TD Economics as at Sept 2006
Source: U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Analysis, TD Economics