Bank Financial Group

TD Economics

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WORLD ECONOMY AND FINANCIAL MARKETS WEATHERING A GLOBAL MONETARY POLICY REBALANCING

A global rebalancing in monetary policy is underway. In the industrial world, the European Central Bank, the Bank of England, the Bank of Japan, the Reserve Bank of Australia and several others have all raised rates in recent months and financial markets are speculating about more in the future. The Bank of Canada has also signaled that it is likely to join the fray with increases in its benchmark overnight rate this summer. The U.S. Federal Reserve looks likely to remain on hold for the rest of this year, but this is a tighter stance to policy than financial markets had previously assumed, as rate cuts are no longer anticipated. The story is much the same in the developing world, with the Bank of China and monetary authorities in several other emerging markets also taking action to stem potential inflationary pressures.

The trillion dollar question is how the world economy and global financial markets will adjust to higher borrowing costs. Some may worry about the economic consequences, since the catalyst for many business cycle downturns in the past was rising interest rates. Meanwhile, investors might fret about the fallout of tighter monetary policy on asset prices, since up until just a few weeks ago markets seemed priced for perfection – as evidenced by sustained low bond yields, strong stock market gains, low volatility, and tight risk spreads. Overall, we do not expect the adjustment in monetary policy to end in tears, but it is likely to result in more moderate economic growth, greater financial market volatility and more subdued equity market returns.

HIGHLIGHTS

- World economy encountering capacity constraints due to strong growth
- Global rebalancing of monetary policy underway, with Bank of Canada to hike 50bps this summer
- U.S. Fed on hold, but this is a tighter stance than markets had previously expected
- Higher interest rates will temper global growth, but impact will be limited and won't fully show until 2009
- Canadian economy to expand by 2.5% in 2007 and 2008, but this is its near-term speed limit
- Bond yields to rise modestly
- Higher interest rates could create headwinds for equities and lead to greater financial market volatility

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Globalization has allowed world economy to run hot

In order to understand why the global economy should ride out the policy rebalancing remarkably well, one must understand the context of how the world ended up at this point. The global economy has been delivering an outstanding performance this decade. World real GDP is expected to rise at close to 5% this year, the fifth consecutive year of growth well above the long-term trend rate of 3.3% that prevailed in the 1980s and 1990s. The largest gains have been in emerging markets, where real GDP growth so far this decade has averaged 6.5%, more than 2.5 percentage points higher than the previous 20 years.

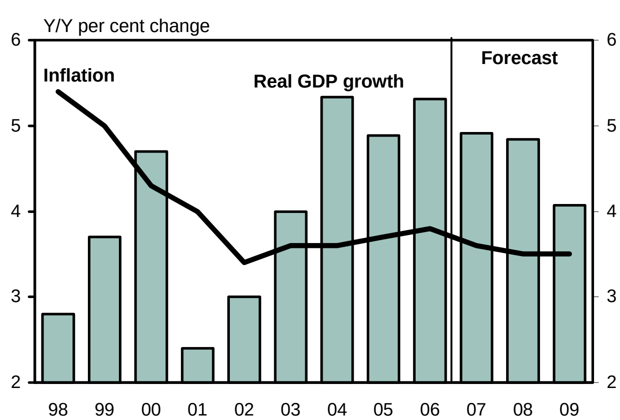
The most remarkable feature of the current economic expansion is that this sustained takeoff has not led to sharply higher inflation around the world, and this has reflected the powerful influence of globalization. The combination of new technologies and structural changes to the economies in many developing nations – including China, India, Russia, and Brazil – allowed the world to redistribute production and tap a huge pool of under utilized labour. This permitted a major increase in world output without running into traditional capacity problems, as production and exports from low cost labour centres created disinflationary pressures.

Capacity limits being encountered

So, the global economy has been firing on virtually all cylinders for the past five years without inflation rearing its ugly head; but, there are natural limits to how long the pace of global economic growth can remain excessive. At some point, the 'easy' gains from globalization will have been realized and capacity pressures will start to be encountered. This is precisely where the world stands today.

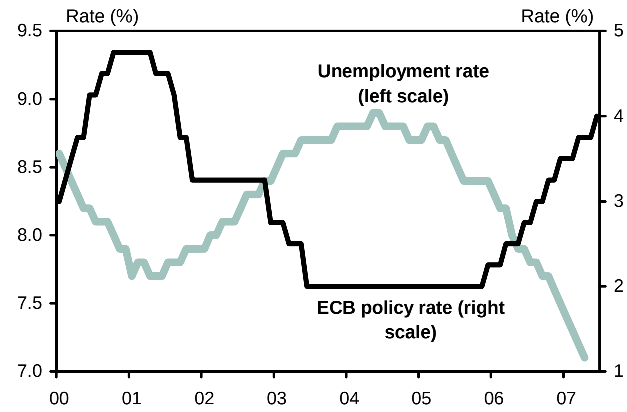
In developing nations, industrial capacity is more easily increased than financial capacity. The rapid growth of commercial opportunities in emerging markets in recent years put more money in the pockets of a growing labour force and more profits in the coffers of businesses. This led to a dramatic increase in savings in developing countries and strained the ability of local financial sectors to perform their traditional role as intermediary between savers and investors. Compounding this stress has been the rapid growth of foreign investor interest in emerging markets.

GLOBAL GROWTH AND INFLATION



Forecast for 2007-09 by TD Economics as at June 2007;
Source: International Monetary Fund.

EUROZONE DOMESTIC CONDITIONS



*France, Germany, Italy, and the U.K;
Source: Eurostat and Haver Analytics.

Quite simply, emerging market financial systems have been swamped by the plethora of investment opportunities and savings. In spite of the dramatic growth of emerging markets – and potential for substantially more – excess savings has flown from developing to advanced nations. Capital controls and the vast accumulation of foreign exchange reserves in developing countries are just two by-products of this. In developed economies, the side effect of capital inflows has been rising asset and real estate prices fueled by low interest rates.

However, no amount of investment or labour arbitrage can substitute for the time needed to build capacity to address sectoral shortages – whether they be the current scarcity of real estate in Australia and Europe, hogs in China, or workers in Alberta. And, these shortages can be the source of inflationary pressures.

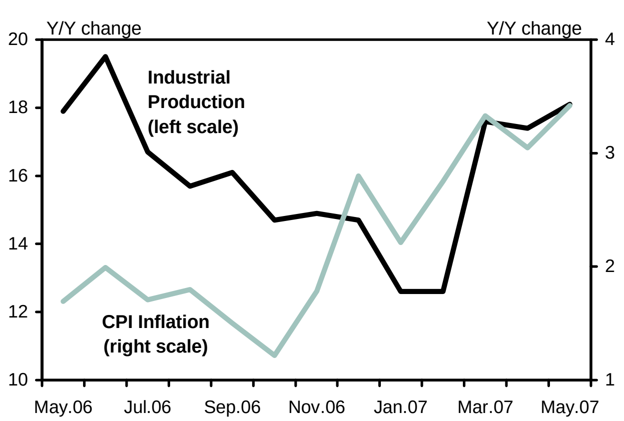
In the industrial world, the capacity constraints are showing up in labour markets. Unemployment rates across the developed world have fallen to low – and in many cases – unprecedented levels. The 7.1% unemployment rate in the 13 nations comprising the Eurozone is the lowest in the region's short collective history. In Germany, the Eurozone's largest economy, the unemployment rate fell by 3.5 percentage points in just the last 24 months. Even in countries where economic growth has been sub-par – such as the

United States that is weathering a housing-led slowdown and Canada that is struggling with an export shock from a strong currency and weak U.S. demand – tight labour markets have been the norm.

Typically, these stretched labour markets would have led to wages being bid up and difficulties in meeting consumer demand. This, in turn, would have fueled rising prices, but openness to trade and cheap emerging market production centres helped dampen these pressures. But in the largest of these emerging markets, China, we are beginning to see evidence of inflationary pressures. Rising wages and the reduction of corporate tax breaks are all putting upward pressure on Chinese prices, and coupled with the strengthening renminbi, are increasing the risk for higher global prices, as well. Globalization to date has been a deflationary phenomenon, but this could change.

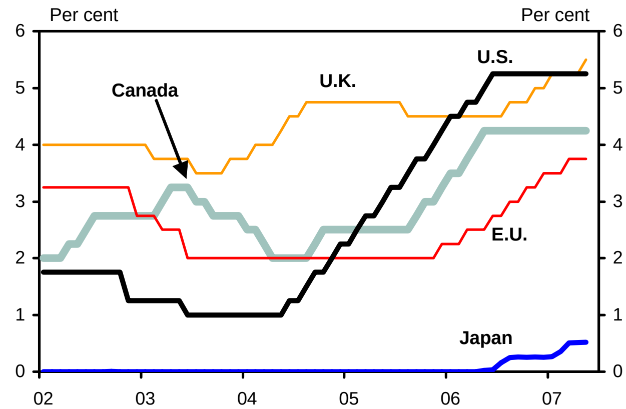
The good news is that even with the diminution of economic slack, inflation expectations have generally remained under wraps. Even with the recent rise in market interest rates, the expected inflation rate implicit in bond yields has increased only marginally. Central banks in the developed world learned a key lesson in the 1970s and 1980s that the maintenance of price stability is the single best objective that they can achieve in order to promote economic well being over the long haul. This is why many central banks have already responded to the inflationary risks arising from developments in asset markets and in the real economy. The Bank of England explicitly tightened monetary policy in 2003 and 2004 to bring the U.K. housing market down to earth. The Fed and the Bank of Canada began raising rates in 2004 to reduce the stimulus to their economies.

CHINESE CAPACITY PRESSURES



Source: China National Bureau of Statistics and Haver Analytics.

CENTRAL BANK OFFICIAL INTEREST RATES



Last plotted: May 2007; Source: National Statistical Agencies and Haver Analytics

The Bank of China has increased rates modestly and raised capital ratios for banks to temper growth, but to little avail.

More monetary policy tightening in the pipeline

Despite the tightening in monetary policy that has already occurred, the prevailing economic trends (including the pace of economic growth, the tightness in labour markets and the evidence of some price pressures) are currently telling a large number of central bankers that more rate hikes are needed. Interestingly, these individuals have been warning financial markets for some time that the risk of inflation was intensifying, or at least not diminishing as expected. And, until recently, the warnings were falling on deaf ears. Now the wake up call has been sounded, and markets are acutely aware that the level of world interest rates is headed higher to ensure that inflation and inflation expectations remain well anchored.

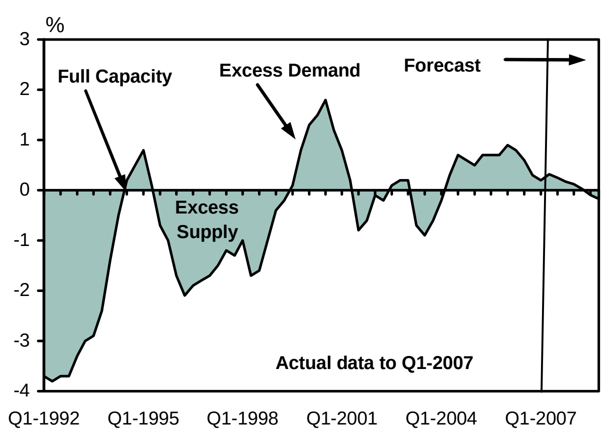
In the months ahead, we expect the European Central Bank, Bank of Japan, Bank of England, and Bank of Canada – every G-7 central bank except the U.S. Federal Reserve – will increase their policy rates. While financial futures markets are currently expecting just one more definite increase from the ECB, we expect two increases this year for a peak of 4.50% in 2007, as well as the distinct possibility of a third increase in the first half of next year, before some policy easing occurs in the second half of 2008. In Japan, policy rates are likely to be sitting half to a full percentage point higher than their current bargain basement level of just 0.50% by the end of 2008. Meanwhile, the Bank of England is expected to lift its short-term benchmark by 50 basis points to 6.00%, which is consistent with the current financial market sentiment. (For more on international monetary policy, see the Global Economic Outlook on page 7.)

Bank of Canada to hike this summer

Turning to North America, the Bank of Canada is also clearly concerned about price pressures – and recent economic developments suggest that it should be. The pace of Canadian economic growth slowed from 3.1% in 2005 to 2.8% in 2006, but this was accompanied by a matching decline in the Bank's estimate of the non-inflationary potential pace of growth in the economy. As a result, no economic slack developed and the economy was judged to be operating at full capacity at the end of last year. In the first quarter of 2007, real GDP rebounded by a strong 3.7% annualized pace and our tracking for the second quarter is currently pointing to a gain of 3.3 %. The implication is that a state of excess demand exists at a time that capacity constraints are being encountered. The latter is reflected in a 33-year low unemployment rate, a record high employment rate and an upward drift in core inflation away from the Bank's 2% target.

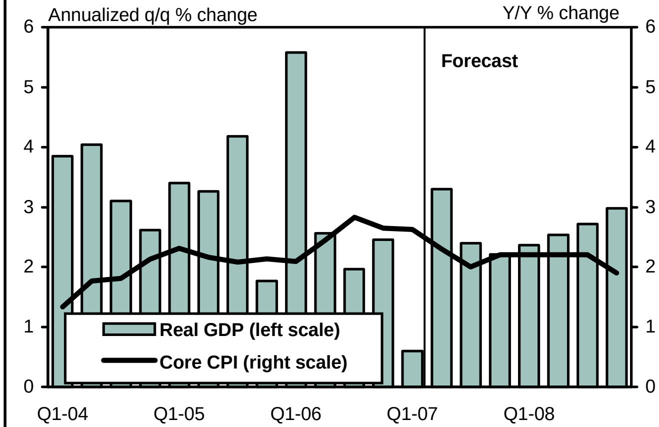
So while the manufacturing sector is struggling under the weight of a strong currency and weak U.S. demand, the Bank is poised to raise rates to ensure that inflation expectations remain well anchored and to bring inflation back to target. The most likely timing is a quarter point increase on July 10th and another quarter point on September 5th – the next two fixed announcement dates.

CANADA'S OUTPUT GAP
Actual Real GDP Less Potential Real GDP



Forecast by TD Economics as at June 2007
Source: Statistics Canada, Bank of Canada

U.S. REAL GROSS DOMESTIC PRODUCT (GDP) & CORE CPI



F: Forecast by TD Economics as at June 2007; Source: U.S. Bureau of Economic Analysis, Bureau of Labor Statistics, Haver Analytics

Fed on hold

In contrast to many other central banks in the industrialized world, the U.S. Federal Reserve is likely to remain on hold in the months ahead. The on-going housing correction has not yet run its course. In fact, the high inventory levels of unsold homes suggests that the economic slowdown is probably only half over. Nevertheless, even with below trend economic growth averaging 2.1% in 2007, the price environment is unlikely to motivate an easing in monetary policy. Projections for core inflation, which excludes the volatile food and energy components, are expected to remain above the lower end of the Fed's implicit tolerance levels, which we view as 2.0 to 2.5% based on the annual change in the core CPI and 1.5 to 2.0% as measured by the core PCE deflator. The labour market is also proving highly resilient to the economic slowdown, with the national unemployment rate likely to remain below 5% for the rest of this year and only nudge above that level in 2008. This outlook is consistent with the Fed's last communiqué that noted that the "predominant policy concern remains the risk that inflation will fail to moderate as expected". So, the stance to U.S. monetary policy is unlikely to be changed, but this realization has led to higher market interest rates, since the consensus view until recently was that the Fed would eventually ease policy.

Global economic expansion will not be derailed

The implication is that the level of benchmark central bank rates will be higher in the second half of 2007 than financial markets had previously expected, and this will have an impact on global economic conditions. However, it is important to stress that the full impact of changes in monetary policy are only felt with a significant lag, as long as 12 to 18 months. One should also recognize that the extent of the future rate hikes is expected to be quite modest and, therefore, the economic impact should prove limited.

To use the Canadian example, the Bank is likely to tighten by 50 basis points. Based on historical experience, a sustained half point increase in the overnight rate knocks 0.065 percentage points off real GDP growth over the first 12 months and 0.35 percentage points over the second 12 months.

Given the lags, the near-term tightening in global monetary policy will have no material impact in slowing world real GDP growth in 2007, which is expected to average 4.9%. Due to the strong momentum in the expansion heading into next year, the most likely scenario is that the robust handoff will keep world growth at 4.8% in 2008 – but this masks a pronounced slowing trend over the course of the year. The main impact from the central bank hikes will be felt heading into 2009, when the pace of the global expansion is expected to fall towards 4%. This may not sound like much deceleration, but it is almost 20% slower than average in the last five years. Moreover, the moderation is likely to prove broadly based across developed and emerging markets.

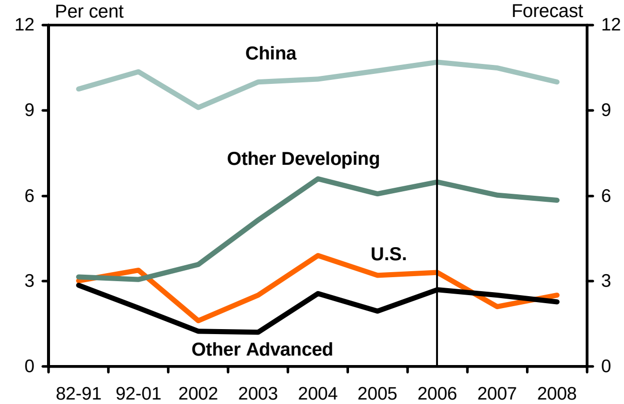
North of the Rio Grande, the story will likely be a bit different. Although the pace of U.S. economic growth will rebound from the meagre 0.6% annualized pace in the first quarter of 2007, the housing correction and its eventual dampening of consumer spending suggests that U.S. real GDP will be hard pressed to rise by more than 2.1% in 2007 and will likely continue to advance at a modest 2.5% in 2008.

Canadian economic growth to average 2.5%

In Canada, our previous forecast anticipated that economic growth would rebound from 2.5% in 2007 to 2.9% in 2008. However, in light of our revised expectations for a half point tightening in monetary policy and an average exchange rate of 96 U.S. cents in the second half of 2007, we have lowered our projection for economic growth to 2.5% in 2008.

This may look like a disappointing performance and it is likely to lead to many comments about how Canada is experiencing a sustained economic slowdown. However, the reality is very different. The forecast is only marginally

GLOBAL GDP GROWTH



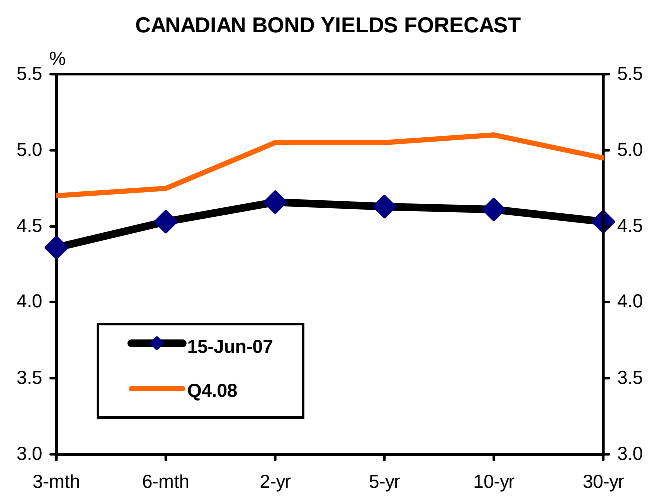
*Forecast by TD Economics as at June 2007;
Source: International Monetary Fund

below the Bank's estimate of potential growth of 2.8% and this means that the TD base case outlook does not fully eliminate the state of excess demand (i.e. an output gap in positive territory) that has already developed. Given Canada's dismal productivity performance in recent years (notwithstanding the temporary rebound in the first quarter of 2007), there is a distinct possibility that the non-inflationary pace of economic growth is even slower than the Bank believes. As a result, real GDP growth in 2007 and 2008 is, in fact, a favourable outcome. Indeed, there is a key risk that the Bank could be forced to engineer a weaker performance with even higher interest rates if Canadian productivity does not improve.

Financial implications

The main conclusion is that the world economic expansion will be dented by the global rebalancing of monetary policy but it should not be thrown off the rails, which leads to the question of how financial markets are likely to cope with higher interest rates.

In terms of cash products, the obvious and immediate impact of the rate hikes will be increased money market rates around the globe. One would expect that the higher short-term rates will feed along the yield curve, boosting bond yields to a lesser extent. However, financial markets are rapidly pricing in the future tightening in monetary policy, suggesting that the increase in bond yields from current levels should prove modest. Moreover, to the extent that the rate hikes do achieve their desired outcome of dampening inflation risks, the well-behaved price environment should limit the rise in yields. However, markets are bound



Source: Bank of Canada, Haver Analytics; Forecast by TD Economics as at June 2007

to be worried about how much tightening in monetary policy is in the pipeline. Markets do tend to overshoot, so there is a risk that bond yields will rise as markets anticipate more hikes than are actually delivered, but then yields would give up some of their increase once the central banks signal that they are done tightening policy.

Equity markets could be adversely affected by even a modest rise in interest rates. The fallout could be two fold. First, higher interest rates will make fixed income products more attractive, while also making equity valuations look more expensive – particularly when one calculates the discounted present value of future corporate earnings. Second, the increase in interest rates is likely to lower corporate profits growth. Similar to the impact on economic growth, the fallout on profits is likely to be most acutely felt in 2009. However, financial markets are forward looking and will anticipate the slower earnings gains when judging equity valuations in coming quarters.

There could also be a sectoral dimension to the exposure of equities. The financial sector, industrial stocks, consumer discretionary stocks, and utilities all tend to fare the worst when interest rate rise. Health, consumer staples and other industries where spending is non-discretionary tend to be the least affected. Commodity industries could also experience lower prices as global growth slows. However, the downside is likely to prove limited. Based on our current assumptions about world real GDP, we expect oil and natural gas prices to decline modestly over the next couple of years. Base metals are expected to experience a significant correction, since prices already appear to exceed fundamentals and the prospects for weaker global demand growth only heightens this assessment. However, there is scope for agriculture and lumber prices to climb. All told, the TD Commodity Price Index could easily fall by 5-10% as global demand growth moderates – but this would still leave most commodity prices (including those for base metals) at extremely high levels.

Higher interest rates might also temper the recent explosive pace of mergers and acquisitions. Takeovers, private equity buyouts, and stock buybacks all tend to be strongest when interest rates are low.

In terms of emerging markets, the increased stability of most developing economies will be a fixture of the global economy. Vast international reserve accumulations ensure the vagaries of investor sentiment will not be enough to reverse economic growth. Additionally, the growth of local-currency debt and other fixed-income products by the government and corporate sectors in emerging markets will provide investors with increased opportunities for diversification. With this liberalization, however, equity prices in the most overvalued markets – especially China – are susceptible to a correction and few will match the gains seen since 2002. Although the near-term risks of inflation may lead interest rates higher, improved monetary credibility will help the secular decline in rates to continue, meaning fixed income prices are likely to rise further over a longer-term time horizon.

Overall, the most likely outcome is that equities will continue to advance, but will not be able to replicate the robust performances delivered over the last few years. Double digit gains are not sustainable and mid-single digit earnings growth will eventually be factored into financial markets. Finally, when financial markets adjust to a changing environment, there is often an increase in volatility and a repricing of risk. This is natural, and it is a trend that we expect to become evident over the forecast horizon.

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GLOBAL ECONOMIC OUTLOOK

Those still looking for a global economic slowdown had better break out the microscope. Although U.S. economic growth has undoubtedly decelerated, it has filtered into Canada and Mexico to a lesser degree than in the past and left the rest of the world virtually unscathed. In fact, global growth – excluding the U.S. – was 5.8% last year and looks likely to slow only to 5.6% in 2007 and 5.4% in 2008. But, with great strength comes great monetary responsibility. There is no question the tight labour markets, modest level of interest rates, and only moderate price pressures worldwide are signs inflation dynamics have changed. The challenge for central banks is discerning the best path for interest rates given uncertainty whether these benign conditions will continue. The primary risk for central banks right now is inflation, and rightfully so, but the chief risk for the global economy lies with the actions of its central banks.

China – Out of the blue

No one economy is more responsible for these muted inflation dynamics than China, and no central bank faces a tougher challenge. After managing a controlled descent in the second half of last year, the economy reaccelerated in the first five months of 2007. As a result, we have substantially revised up our forecast for Chinese GDP growth in 2007 to 10.5% and in 2008 to 10%. While authorities are taking measures to slow economic growth closer to an 8-9% pace, low interest rates mean there is still a negative after-tax return on saving and only a marginal cost to borrowing, so the appropriate incentives are simply not in place.

But beneath this strength lies longer-term concerns of the ability of authorities to manage the economy with traditional market mechanisms. Economic growth is dependent on investment and exports and banks remain too weak to manage risks. As a result, interest rates and the exchange rate are unlikely to play a key role in Chinese economic management for some time. Instead, authorities must rely on structural changes and regulations which are blunter and more difficult to control. In addition, recent changes, such as the increase in taxes on buying and selling stocks, are stopgap measures. Just as sand bags have their place in a flood, these tools can provide time, but also hinder the long-term development of the financial system. They also raise the risk of a choppier path for the Chinese economy. This would make economic management around the world more difficult. Although the Chinese economy accounts for a hefty 15% of the global economy, it is now responsible for nearly a third of annual global growth.

The Pen is mightier than the sword

Unlike the Chinese predicament, the issue for the European Central Bank (ECB) and Bank of Japan (BoJ) is one of words, not action. Both have struggled to telegraph the medium-term pace of interest rates, in part due to their exceptional circumstances. As a result, monetary expectations in these countries have moved on a rolling nature.

The Eurozone conundrum is that early after its inception in 1999, economic growth was poor but inflation was chronically high. Now, real GDP growth is soaring while, for the first time, the ECB has been able to sustain below target inflation. The Eurozone has proven resilient enough to withstand the combination of slackening U.S. demand, higher taxes, and rising interest rates and has continued to expand noticeably above trend. With such a strong eco-

GLOBAL ECONOMIC OUTLOOK
Annual per cent change unless otherwise indicated

Real GDP	2006 Share* (%)	2005	2006e	Forecast 2007	Forecast 2008
World	99.2	4.9	5.3	4.9	4.8
North America	23.7	3.2	3.4	2.2	2.6
United States	20.1	3.2	3.3	2.1	2.5
Canada	1.8	3.1	2.8	2.5	2.5
Mexico	1.8	2.8	4.8	3.3	3.6
European Union (EU-27)	20.4	1.8	3.0	3.0	2.6
Euro-zone (EU-13)	14.8	1.5	2.9	2.7	2.3
Germany	4.1	1.1	3.0	2.8	2.4
France	3.0	1.7	2.2	2.0	1.9
Italy	2.7	0.2	1.9	1.8	1.5
United Kingdom	3.0	1.9	2.8	2.8	2.5
EU accession members	1.8	3.2	3.8	4.9	4.5
Asia	40.5	7.4	7.6	7.3	7.1
Japan	6.4	1.9	2.2	2.3	2.4
Asian NIC's	3.2	4.7	5.3	4.2	4.7
Hong Kong	0.4	7.5	6.8	5.3	5.5
Korea	1.6	4.2	5.0	4.0	4.5
Singapore	0.2	6.6	7.9	5.5	6.0
Taiwan	1.0	4.0	4.6	4.0	4.5
Russia	2.6	6.4	6.7	6.4	6.0
Australia & New Zealand	1.2	2.7	2.5	2.6	3.2
Developing Asia	27.1	9.3	9.4	9.1	8.8
ASEAN-4	3.7	5.2	5.4	5.5	5.8
China	15.4	10.4	10.7	10.5	10.0
India	6.0	9.2	9.2	8.5	8.0
Central/South America	5.7	4.9	5.4	5.3	4.7
Argentina	0.9	9.2	8.5	7.3	6.0
Brazil	2.6	2.9	3.7	4.6	4.4
Other Developing	9.0	5.7	5.9	6.1	6.3

*Regional wts. do not sum to 100% because some countries omitted
Forecast as at June 2007
Source: International Monetary Fund, national statistical agencies

nomic expansion, and with the ECB still focused on the inflationary pressures of money growth, European interest rates will continue to march higher.

It now appears likely that Eurozone growth will slow only marginally this year – from 2.9% in 2006 to 2.7% in 2007, before higher interest rates slow economic activity to 2.3% in 2008 - still an above average pace for the region. The primary challenge for the ECB, as always, will be finding a monetary policy that is appropriate for its disparate members. The German economic recovery is broad-based, but rising wages also raise inflation fears. The Italian government – which increased taxes in January – is apparently so ecstatic over its fiscal progress that it is discussing tax cuts. The French economy, on the other hand, has yet to share in the European panacea; but, tax reforms suggested by newly elected President Sarkozy may provide a boost next year. One sizeable wildcard is Spain – the fourth largest EU economy – which seems to be doing its best impersonation of the U.S., with a housing market collapse which has yet to leak into the broader economy. Though the uncertainty looks likely to remain for European monetary policy, the risks appear manageable.

In Japan, inflation remains elusive. There has been an ongoing debate as to whether higher interest rates might actually induce economic growth in Japan by increasing the returns on household deposits and freeing up more cash for consumer spending. This argument seems to hold some sway, but ultimately the economy must cooperate. After approaching a 1% y/y pace in mid-2006, the rate of inflation has since returned to 0%, and even briefly dipped below zero. While the expansion of the Japanese economy was remarkably strong in the first quarter of 2007 – with personal consumption and net trade the key drivers – important economic indicators like industrial production, machinery orders, and retail sales have all been trending lower. Combined with the need for some inventory adjustment over the next few quarters, there is a significant risk that the markets' expectations for an interest rate increase from the BoJ as soon as August may be disappointed. Much will depend on the outturn for Q2 GDP growth.

However, the Japanese economic cycle continues to be closely correlated with that in the U.S. With U.S. growth expected to find firmer footing by year-end, further decreases in Japanese unemployment supporting consumers, and a falling yen providing a further lift to the economy, we believe the real risk for higher Japanese rates lies later in 2007 and 2008. The wildcard may be the motivation of the successor to the current Bank of Japan Governor Fukui when he leaves office in March 2008.

Conclusion

Our assessment of economic growth outside of North America is that it is broadly based, and, having shrugged off the U.S. slowdown, is set to continue. Nevertheless, with every G-7 central bank, except the U.S., expected to raise interest rates over the next 12 months, as well as numerous other central banks, there is still a sizeable amount of liquidity being taken out of the system. Given the 1-2 year lag it takes for higher interest rates to work their way through the economy, this monetary tightening will likely not show meaningful dividends until at least 2008, and more likely 2009, when we expect global growth will be closer to 4%. For now, the slowdown will not be televised. And you'll even be hard pressed to find it on AM radio.

Richard Kelly 416-982-2559

ECONOMIC INDICATORS FOR THE G-7 AND EUROPE

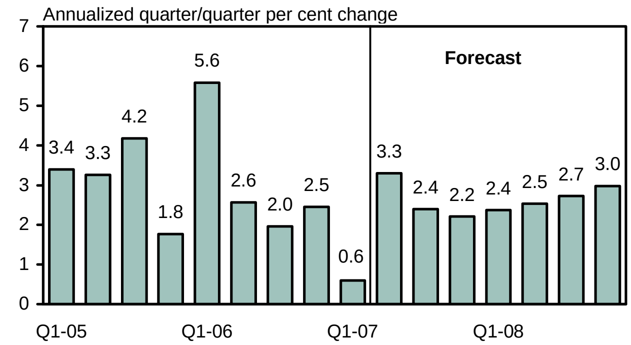
	2004	2005	2006e	Forecast 2007	Forecast 2008
Real GDP (Annual per cent change)					
G-7 (41.17%)*	3.0	2.4	2.9	2.2	2.4
U.S.	3.9	3.2	3.3	2.1	2.5
Japan	2.7	1.9	2.2	2.3	2.4
EU-12	1.8	1.6	2.9	2.7	2.3
Germany	0.8	1.1	3.0	2.8	2.4
France	2.3	1.7	2.2	2.0	1.9
Italy	1.0	0.2	1.9	1.8	1.5
United Kingdom	3.3	1.9	2.8	2.8	2.5
Canada	3.1	3.1	2.8	2.5	2.5
Consumer Price Index (Annual per cent change)					
G-7	2.0	2.3	2.3	2.1	1.9
U.S.	2.7	3.4	3.2	2.8	2.4
Japan	0.0	-0.3	0.2	0.0	0.5
EU-12	2.1	2.2	2.2	1.9	1.9
Germany	1.8	1.9	1.8	2.0	1.8
France	2.3	1.9	1.9	1.4	1.5
Italy	2.3	2.2	2.2	1.8	1.7
United Kingdom	1.3	2.0	2.3	2.6	2.1
Canada	1.8	2.2	2.0	2.6	2.2
Unemployment Rate (Per cent annual averages)					
U.S.	5.5	5.1	4.6	4.6	5.1
Japan	4.7	4.4	4.1	3.8	3.6
EU-12	8.8	8.6	7.9	6.9	7.1
Germany	9.5	9.4	8.4	6.7	6.9
France	9.6	9.7	9.4	8.7	8.8
Italy	8.0	7.7	6.8	6.3	6.9
United Kingdom	4.7	4.8	5.3	5.3	5.3
Canada	7.2	6.8	6.3	6.2	6.3

*Share of 2006 world gross domestic product (GDP)
Forecast as at June 2007
Source: National statistical agencies, TD Economics

U.S. ECONOMIC OUTLOOK

The U.S. economy got off to a slow start in 2007, with first quarter real GDP growth at a mere 0.6%. The details, however, didn't look so bad. Consumer spending rose by more than 4% for a second quarter in a row, as high gasoline prices and deteriorating real estate values proved to be no match for the hard core American shopper. The drag in the quarter was due to three culprits: liquidation of inventories, a widening trade deficit and plummeting residential construction. Of the three, declining residential investment is the only factor that is expected to persist over the forecast horizon. But even here, its influence on the economy should become less and less as the year unfolds. On the other hand, we remain unconvinced that the consumer will be able to hold its position as a pillar of strength. Although solid wage growth has been a key underpinning to consumer spending, it would be a remarkable (and even unprecedented) feat if a sharp deterioration in housing wealth effects did not eventually influence spending behaviour. As such, we continue to believe consumer spending is on borrowed time and will soften dramatically over the next four quarters before staging a gradual and shallow recovery. Likewise, the U.S. economy is expected to turn in a sub-par performance of 2.1% in 2007, before edging up to 2.5% in 2008.

U.S. REAL GROSS DOMESTIC PRODUCT (GDP)



F: Forecast by TD Economics as at June 2007
Source: U.S. Bureau of Economic Analysis/Haver Analytics

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

	2004	2005	2006	Forecast 2007	Forecast 2008
Real GDP	4.2	2.7	3.3	2.1	2.5
Consumer Expenditure	3.9	3.3	3.2	3.2	2.3
Durable Goods	6.0	5.1	5.0	4.7	3.2
Business Investment	9.4	3.1	7.2	4.0	4.0
Non-Residential Structures	2.2	1.2	9.0	7.5	4.0
Machinery & Equipment	11.9	3.9	6.5	2.5	4.0
Residential Construction	10.3	8.2	-4.2	-13.2	-1.2
Govt. Exp. on Goods & Svcs.	2.2	0.3	2.1	1.8	0.9
Final Domestic Demand	4.4	3.0	2.9	2.1	2.1
Exports	8.4	7.0	8.9	5.6	7.4
Imports	10.7	5.6	5.8	3.4	3.9
Change in Non-Farm Inventories ($96 Bn.)	50.0	19.6	40.6	20.4	33.3
Final Sales	3.9	3.0	3.1	2.3	2.4
Int'l Curr. Acct. Bal. ($Bn.)	-668	-792	-857	-889	-917
% of GDP	-5.7	-6.4	-6.5	-6.4	-6.3
Pre-tax Corporate Profits	12.6	14.6	21.4	4.1	2.7
GDP Chain-type Deflator	2.6	3.3	2.9	2.8	2.4
Employment	1.1	1.7	1.9	1.4	0.7
Unemployment Rate (%)	5.5	5.1	4.6	4.6	5.0
Productivity *	3.4	1.7	1.6	1.4	2.4
Real Pers. Disp. Inc. (PDI)**	3.4	1.3	2.6	3.2	3.0
Real PDI Per Person**	2.5	-2.6	1.7	2.3	2.1
Consumer Price Index (CPI)	2.7	3.4	3.3	2.8	3.0
Housing Starts (mn units)	1.95	2.07	1.81	1.44	1.42

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 June 2007; Source: Bureau of Labor Statistics, Bureau of Economic Analysis, TD Economics

Housing correction still not done

The single largest downward influence on GDP growth over the past year has been residential investment. This component has shaved a percentage point off real GDP growth in each of the past three quarters and sharply lower permit issuances, alongside still-high inventory levels, suggest further reductions in activity are in the pipeline. However, while construction is expected to remain a drag on GDP over the next three quarters, the sharpest adjustments are probably in the past. Housing starts are currently tracking 1.53 million units, which is 33% below the peak level reached in January of last year and well below the demographic replacement trend estimated to be between 1.75-1.95 million. In addition, although woes emanating from the sub-prime market are likely to extend another 12-24 months, this influence has not given us cause to downgrade our view on the housing market or the broader economy. The sub-prime market is estimated to have resulted in 130,000-150,000 additional housing starts from 2005 to 2006 than would have otherwise been the case.

But this drawdown was already more than fully factored into our forecast. In addition, the likelihood of contagion to prime mortgage lending behaviour or other financial instruments is deemed to be quite low. (For further information see TD's special report, "*A Primer on the U.S. Sub-prime Market*", April 30, 2007)

Consumers can't hold on forever

The mirror opposite of residential construction has been consumer spending. This is one area where we have underestimated the strength and resilience in the past six months, in part because labour income growth accelerated over this period providing a convenient positive offset. However, it would be inconsistent to believe that rising housing wealth effects can bolster spending when values are on the way up, but not when they are on the way down. Indeed, during his reign, former Fed Chairman Greenspan had repeatedly noted the powerful influences of home wealth effects on consumption. However, the timing of the feed through remains a bit of a black box. It has been estimated that housing wealth effects take a year or more to trickle through the economy, and so the peak impact on consumer spending may not materialize until the second half of this year or later. As a result, we remain committed to the view that it is only a matter of time before a collapsing housing market leaves its markings on American shoppers, consistent with the fact that home equity withdrawal has already fallen 40% since the first quarter of last year and real estate asset growth has slowed to a crawl.

Inventories to have a positive influence on GDP

The subject of inventories tends to elude most economic discussions, but swings in inventories can strongly influence economic growth. Research by the Federal Reserve found that 1/4 of the decline in economic activity during recessions was due to inventory corrections, even though inventories make up just 5% of overall economic activity.

U.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	4.0	3.8	2.4	3.1	2.1	2.7
Real Final Sales	4.0	3.6	2.5	3.3	2.0	2.6
Employment	-0.1	1.6	1.9	1.7	1.1	0.7

Real GDP: Real gross domestic product; Forecast by TD Economics as at June 2007; Source: Bureau of Labor Statistics, Bureau of Economic Analysis, TD Economics

Severe, or extended, adjustments in inventories can also be crippling to production and jobs. The first quarter of 2007 revealed that an unexpected liquidation in inventories shaved one percentage point from GDP growth. This was the second quarter in a row that producers lowered stock levels relative to sales. Is this a precursor of an eventual downturn in the economy? No. Inventories typically lag economic cycles, not lead them. However, improvements in technology and just-in-time inventory management have allowed firms to maintain lower inventories relative to sales (I/S) ratios. As a consequence, the margin for error is thin and it has become more commonplace to have an unintended inventory shortfall during a quarter when demand is unexpectedly strong. That's why over the last two years, there has been three quarters when inventories were outright liquidated in the absence of an economic downturn. This looks to have been what occurred in the last two quarters for retailers, with consumer spending exceeding 4% in each of those quarters following sub-par performance in prior quarters. On the producer side, a strong pick-up in orders for durable goods should prompt higher stock levels in order to meet demand. Given that I/S ratios across wholesalers and retailers are bumping along historic lows, we believe a build-up in inventories over the next three quarters will materially add to GDP growth before having a more neutral influence in 2008.

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CANADA'S ECONOMIC OUTLOOK

Real GDP flew out of the gates in 2007 with 3.7% annualized growth, breaking a three-quarter string of below-potential economic gains that quickly turned the public's opinion about whether Canada was in the midst of an economic slowdown. Meanwhile, employment expanded at its fastest quarterly pace since 1997 and core CPI accelerated to a four-year high of 2.5%, well above the Bank of Canada's target of 2%. All this left the central bank with a greater sense that interest rates would need to rise to keep inflation in check, and financial markets received the message loud and clear. The economy will likely lose some steam this year and next, as the central bank pulls the rate-hike trigger two times to 4.75%. However, this modest increase in interest rates will not be sufficient to severely undermine consumer spending and broader economic growth. Canadian real GDP is expected to expand by 2.5% over the forecast horizon (2007 and 2008), as some of the zip is taken off consumer spending and residential investment. In addition, exporters will continue to face the headwind of modest U.S. demand and a strong currency. With Canadian economic growth remaining subpar, core CPI is expected to edge back towards the Bank's 2% target in 2008.

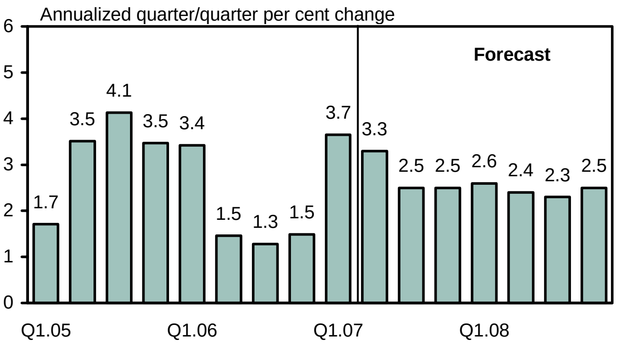
CANADA'S ECONOMIC INDICATORS

Annual per cent change unless otherwise indicated

			Forecast	
	2005	2006	2007	2008
Real GDP	3.1	2.8	2.5	2.5
Consumer Expenditure	3.8	4.2	3.7	2.9
Durable Goods	5.3	7.1	5.8	1.9
Business Investment	10.8	9.9	5.1	7.4
Non-Residential Structures	10.8	12.9	8.6	7.7
Machinery & Equipment	10.8	7.4	2.1	7.2
Residential Construction	3.5	2.1	1.0	0.0
Govt. Exp. on Goods & Svcs.	2.2	3.3	2.8	3.4
Final Domestic Demand	4.6	4.8	3.5	3.4
Exports	2.2	0.7	2.0	2.5
Imports	7.5	5.0	3.3	4.6
Change in Non-Farm Inventories ($97 Bn.)	11.1	9.3	3.9	3.8
Final Sales	2.4	3.0	3.0	2.5
Int'l Curr. Acct. Bal. ($Bn.)	27.9	23.6	28.6	22.8
% of GDP	2.0	1.6	1.9	1.4
Pre-tax Corporate Profits	11.9	5.0	6.3	3.5
GDP Chain-type Deflator	3.4	2.4	2.3	1.9
Employment (%)	1.4	2.0	2.0	1.0
Employment ('000)	220	315	334	168
Unemployment Rate (%)	6.8	6.3	6.2	6.3
Productivity*	2.0	0.7	0.4	1.5
Real Pers. Disp. Income (PDI)**	12.0	4.9	3.7	2.2
Real PDI Per Person**	11.0	3.9	2.7	2.2
Consumer Price Index	2.2	2.0	2.6	2.2
Core CPI	1.6	1.9	2.4	2.0
Housing Starts ('000 units)	224	228	214	193

Real GDP: Real gross domestic product; *Real GDP per employee **After-tax income adjusted for inflation; Forecast by TD Economics as at June 2007; Source: Statistics Canada, Bank of Canada, Canada Mortgage and Housing Corporation, Haver Analytics

CANADIAN REAL GDP



F: Forecast by TD Economics as at June 2007; Source: Statistics Canada/Haver Analytics

Consumer footing to hold firm

A strong job market has kept a fire lit under consumer spending over the past 5 years, and we don't expect a fundamental change over the forecast horizon. Although the labour market softened in the second quarter, this came on the heels of outsized strength in the prior 6 months where the pace of monthly job creation was more than double the historical norm. So, a little pay-back was long overdue. Going forward, slightly higher interest rates will trim some fat off spending, but the increase will not be sufficient to act as a major deterrent to consumers, especially since the unemployment rate is expected to hover near generational lows and income growth to remain firm. And, unlike their neighbors to the south, the balance sheets of most Canadian homeowners will continue to benefit from modestly higher real estate values. All told, consumer confidence should remain intact, creating an ideal backdrop for personal spending growth of about 3% over the next year.

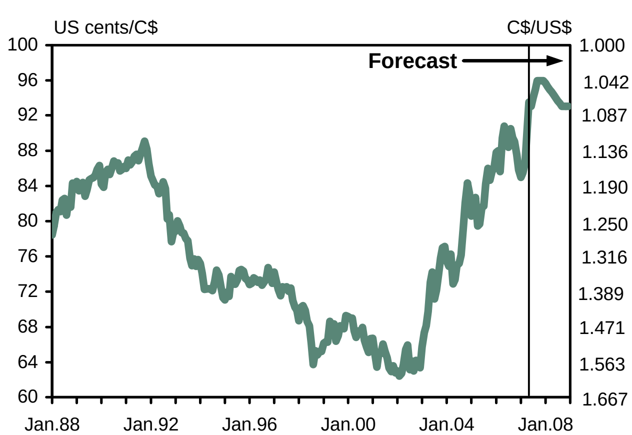
Business investment needs to be reinvigorated

A 6% drop in machinery and equipment (M&E) investment in the first quarter was a bit of a head-scratcher. The outturn goes against common wisdom that a high Canadian dollar should be encouraging greater investment, since M&E imports from the U.S. have been dramatically cheapened by the currency appreciation. Just over half of the decline in M&E in the first quarter was due to industrial machinery, where investment has soured for two consecutive quarters. This follows four years of 7-13% annual growth, so perhaps a temporary break in investment is not that unusual after all. However, if businesses choose not to invest in an ideal environment of cheap imports and high corporate savings, we don't know what conditions would be needed for them to do so. And, this incentive should be even greater now that the Canadian dollar has risen from an average value of 88 cents last year to 93-94 cents in the second quarter. It is likely that the loonie will average in the 93-96 cent range through the remainder of this year and next. As such, we're betting that Canadian firms will increase their investment intentions over the forecast horizon back to a 7-8% annualized quarterly pace.

Trade balance will offer slight drag to GDP growth

The international trade sector should remain a modest drag on overall GDP growth in the coming quarters, with export growth tending to lag that of imports. Exports will bend under the weight of a loss in competitiveness from a

CANADIAN DOLLAR



Last actual: May 2007; Forecast by TD Economics as at June 2007
Source: Bank of Canada

CANADA'S ECONOMIC INDICATORS
Fourth-quarter-over-fourth-quarter per cent change

	Q4-03	Q4-04	Q4-05	Q4-06	Forecast Q4-07	Forecast Q4-08
Real GDP	1.5	11.7	3.2	1.9	3.0	2.4
Real Final Sales	1.4	10.0	3.9	2.8	2.6	2.6
Employment (%)	1.8	1.6	1.6	1.9	1.7	1.1

Real GDP: Real gross domestic product; Forecast by TD Economics as at June 2007; Source: Statistics Canada, Haver Analytics

high-flying loonie alongside meager demand from the dominant U.S. market. Although the Canadian dollar has gained ground versus its American counterpart, the dynamics have moved in the opposite direction with other major trading partners. For instance, against the Euro and the British pound, the loonie has depreciated about 7.5% and 6%, respectively, since the start of 2006. This has resulted in stronger demand from non-American markets that is helping to keep a floor under export growth. In fact, in recent years, Canadian firms have been sending more and more goods to offshore markets, such that the share of exports to the U.S. has fallen from a peak of 84% in 2002 to 77% in the past quarter. The gap has been filled by demand from the U.K., Europe and Asia, especially for raw materials. However, since non-American markets make up just 23% of all export demand, downward influences from the U.S. will remain the dominant factor over the near-term.

On the flip side, the high Canadian dollar relative to the U.S. dollar has cheapened the cost of imported goods. About 66% of Canada's imports are shipped in from the United States. This, in combination with continued strength in domestic demand, should underpin quarterly import growth of 4-5% through 2007 and 2008. Tallying it up, the current account surplus is expected to narrow to 1.3% of GDP by the end of 2008, well below the 2.5% ratio recorded in the first quarter of this year. However, on the global stage, Canada's current account surplus will still be the envy of many of its major trading partners, where current account deficits have become the norm.

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FINANCIAL OUTLOOK

The "I" word – inflation – is back, and fixed-income markets have taken a real beating as a result. North American bond yields had already been trekking higher since mid-May, but the top finally blew off the pressure cooker on June 7th, when the 10-year U.S. Treasury yield soared by 15bps and another 15bps the following Tuesday. As a result, the 10-year Treasury yield is now more than 65 basis points higher than it was only a month ago. And, in contrast to recent trends, Canadian bonds outperformed their U.S. counterparts. Moreover, the damage was not limited to bonds – equities sold off, credit spreads widened a notch, and currencies slipped against the Greenback. Indisputably, there has been a noticeable shift in market sentiment. That begs the question – what is behind this shift in perceptions, and where do we go from here?

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.

Global tightening

The driver behind the recent turmoil is mounting concern that global inflation pressures may be bubbling up, and that the world's central banks will need to tighten monetary policy more than expected. News that the Reserve Bank of New Zealand pushed its policy rate to a sky-high 8.0% in early June was one key catalyst, but not the only one. A string of strong indicators in Australia has been fuelling expectations that the Reserve Bank of Australia will need to push the 6.25% cash rate higher. The ECB also raised rates recently, and tough talk from President Trichet has convinced the markets that more hikes are in the cards. Although the Bank of England kept its rate unchanged at its most recent policy meeting, expectations are that it will need to tighten further. Meanwhile, the Bank of Canada has shifted its policy bias towards tight-

INTEREST RATE OUTLOOK

	Spot Rate	2006				2007				2008			
	6/19/2007	Q1	Q2	Q3	Q4	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
CANADIAN FIXED INCOME													
Overnight Target Rate (%)	4.25	3.75	4.25	4.25	4.25	4.25	4.25	4.75	4.75	4.75	4.75	4.75	4.75
3-mth T-Bill Rate (%)	4.43	3.91	4.32	4.17	4.12	4.20	4.35	4.65	4.65	4.65	4.70	4.70	4.70
2-yr Govt. Bond Yield (%)	4.68	4.01	4.41	3.91	4.03	3.98	4.75	4.85	4.95	5.05	5.05	5.05	5.05
5-yr Govt. Bond Yield (%)	4.65	4.16	4.47	3.88	3.99	4.02	4.75	4.85	4.95	5.05	5.05	5.05	5.05
10-yr Govt. Bond Yield (%)	4.64	4.26	4.58	4.00	4.09	4.11	4.70	4.80	4.95	5.05	5.10	5.10	5.10
30-yr Govt. Bond Yield (%)	4.54	4.26	4.61	4.09	4.14	4.20	4.60	4.70	4.85	4.95	4.95	4.95	4.95
10-yr-2-yr Govt. Spread (%)	-0.04	0.25	0.17	0.09	0.06	0.13	-0.05	-0.05	0.00	0.00	0.05	0.05	0.05
U.S. FIXED INCOME													
Fed Funds Target Rate (%)	5.25	4.75	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.25
3-mth T-Bill Rate (%)	4.64	4.60	5.03	4.88	5.02	5.06	4.85	4.95	5.05	5.15	5.20	5.20	5.20
2-yr Govt. Bond Yield (%)	4.98	4.82	5.15	4.68	4.81	4.57	5.00	5.05	5.10	5.15	5.15	5.15	5.15
5-yr Govt. Bond Yield (%)	5.04	4.81	5.09	4.58	4.69	4.53	5.05	5.15	5.20	5.25	5.25	5.30	5.30
10-yr Govt. Bond Yield (%)	5.13	4.85	5.14	4.63	4.70	4.64	5.10	5.20	5.30	5.35	5.40	5.40	5.40
30-yr Govt. Bond Yield (%)	5.24	4.89	5.19	4.76	4.81	4.84	5.20	5.30	5.40	5.45	5.50	5.55	5.55
10-yr-2-yr Govt. Spread (%)	0.15	0.03	-0.01	-0.05	-0.11	0.07	0.10	0.15	0.20	0.20	0.25	0.25	0.25
CANADA-U.S. SPREADS													
3-mth T-Bill Rate (%)	-0.21	-0.69	-0.71	-0.71	-0.90	-0.86	-0.50	-0.30	-0.40	-0.50	-0.50	-0.50	-0.50
2-yr Govt. Bond Yield (%)	-0.30	-0.81	-0.74	-0.77	-0.78	-0.59	-0.25	-0.20	-0.15	-0.10	-0.10	-0.10	-0.10
5-yr Govt. Bond Yield (%)	-0.39	-0.65	-0.62	-0.70	-0.70	-0.51	-0.30	-0.30	-0.25	-0.20	-0.20	-0.25	-0.25
10-yr Govt. Bond Yield (%)	-0.49	-0.59	-0.56	-0.63	-0.61	-0.53	-0.40	-0.40	-0.35	-0.30	-0.30	-0.30	-0.30
30-yr Govt. Bond Yield (%)	-0.70	-0.63	-0.58	-0.67	-0.67	-0.64	-0.60	-0.60	-0.55	-0.50	-0.55	-0.60	-0.60

f: Forecast by TD Economics as at June 2007; All forecasts are for end of period. Source: Bloomberg, TD Economics ening, and a hike at its next policy meeting looks highly likely. Even in the U.S., a string of strong economic reports and ongoing hawkish talk from Fed officials have been fuelling chatter that the Fed may increase rates before the end of the year.

Given that backdrop, it's not surprising that the bond market has sold off. Certainly, the risks are heavily tilted towards further tightening overseas. Most advanced economies are operating at or above their capacity limits , growth prospects remain solid, and perhaps most importantly, policy rates are still accommodative in many countries. On that front, the markets seem to have it right.

Does the U.S. need to tighten?

Where the markets may be off base, however, is in assuming that rates in the U.S. may need to rise this year as well. To be fair, rather than pricing in rate hikes, the market has merely priced out the rate cuts that had previously been assumed. Still, there has been a lot of market chatter about potential rate hikes in 2007, and that has definitely come into play.

We do not see Fed rate hikes as the most likely outcome – in fact, we still see unchanged rates over the next year. To be sure, much of the speculation about the Fed increasing rates is the result of the recent spate of strong economic data. But it's important to put this into context. The U.S. economy is coming off a very poor quarter, having almost completely stalled out in the opening quarter of the year. Against that backdrop, a rebound does not come as a surprise. However, we do not expect that momentum to be sustained. The housing market will remain a drag on the economy and consumers are facing significant headwinds. In addition, core inflation has been coming down, not going up. Core CPI inflation has come down from a peak of 2.7% at the beginning of the year to 2.2% now. The core PCE deflator has come down to 2.0% — the top of what most Fed officials see as their comfort zone.

In sum, Fed officials may still be talking tough. But the Fed funds rate is likely to remain unchanged for the foreseeable future, and that will help anchor longer-term yields.

Canada – Time to hike

In contrast, the case for Bank of Canada rate hikes has continued to build, and we now expect two increases in the overnight rate, with a first move in July, and another in September. With the recent round of market turmoil having sharply widened the negative gap between Canadian and U.S. yields, the ingredients are certainly there for the two to converge to some extent in the months ahead.

The case for the Bank of Canada to hike is compelling. Core inflation is running squarely above the BoC's target at 2.5%, and the near-term trend is even more troubling. Judging by the Bank of Canada's measure of the output gap, the Canadian economy is operating through its capacity limits. Other indicators support that assessment. Moreover, at 3.7%, GDP growth in the opening quarter of the year was more than a full percentage point above the Bank's expectations, as spelled out as recently as the April 26 Monetary Policy Report, and the second quarter is also set to come in above the 2.3% clip the Bank was expecting. Moreover, the trend growth rate of productivity is unimpressive – to say the last – and as a result, the year-over-year increase in unit labour costs is its strongest since 1991.

The only source of uncertainty on that front is the Canadian dollar. The loonie's most recent run has not been entirely driven by strong fundamentals, and that may dampen the Bank's enthusiasm for rate hikes. Our view is that the currency will continue to gain ground, topping out at about 96 U.S. cents by the end of the year. That may not be enough to prevent the Bank from hiking, but it will limit the extent of the moves.

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FOREIGN EXCHANGE OUTLOOK

Currency	Exchange Rate	Spot Price	2006		2007				2008			
		6/19/2007	Q3	Q4	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Canadian dollar	USD per CAD	0.936	0.895	0.858	0.867	0.930	0.960	0.960	0.950	0.940	0.930	0.930
Canadian dollar	CAD per USD	1.069	1.118	1.166	1.154	1.075	1.042	1.042	1.053	1.064	1.075	1.075
Japanese yen	JPY per USD	123.4	118	119	118	120	118	115	112	109	106	107
Euro	USD per EUR	1.340	1.267	1.320	1.337	1.310	1.280	1.280	1.300	1.310	1.320	1.320
U.K. pound	USD per GBP	1.987	1.873	1.958	1.978	1.912	1.869	1.855	1.884	1.899	1.899	1.899
Swiss franc	CHF per USD	1.240	1.251	1.220	1.214	1.252	1.281	1.273	1.246	1.229	1.212	1.212
Australian dollar	USD per AUD	0.844	0.746	0.789	0.809	0.840	0.820	0.810	0.790	0.770	0.760	0.750
Mexican peso	MXN per USD	10.76	10.98	10.82	11.05	10.80	10.80	10.85	10.90	10.90	10.95	10.95

f: Forecast by TD Economics as at June 2007; 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			
	Q2	Q3	Q4	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	05	06	07F	08F	05	06	07F	08F
Real GDP	1.5	1.3	1.5	3.7	3.3	2.5	2.5	2.6	2.4	2.3	2.5	3.1	2.8	2.5	2.5	3.2	1.9	3.0	2.4
Consumer Expenditure	3.8	5.1	3.7	3.9	3.3	3.0	2.9	3.0	2.9	2.3	2.2	3.8	4.2	3.7	2.9	3.8	4.5	3.3	2.6
Durable Goods	7.9	11.1	4.7	6.6	6.0	2.2	1.0	2.0	2.0	1.0	1.5	5.3	7.1	5.8	1.9	4.3	9.1	3.9	1.6
Business Investment	7.5	9.7	6.8	-0.6	4.9	7.7	7.9	7.8	7.3	7.0	7.1	10.8	9.9	5.1	7.4	13.2	8.2	4.6	7.3
Non-Res. Structures	10.5	12.6	11.8	5.3	7.0	8.6	8.0	8.2	7.7	6.2	6.2	10.8	12.9	8.6	7.7	13.9	12.3	7.2	7.1
Machinery & Equipment	5.0	7.1	2.3	-6.0	3.5	7.1	7.8	7.4	7.0	7.5	7.7	10.8	7.4	2.1	7.2	12.6	4.7	3.0	7.4
Residential Construction	-5.2	-6.2	-0.1	7.5	1.5	0.6	-0.5	-0.8	-0.2	1.0	0.5	3.5	2.1	1.0	0.0	2.4	-0.7	2.2	0.1
Government Expenditure on Goods & Services	3.2	1.5	3.0	2.7	2.5	3.5	3.5	4.3	3.2	2.8	2.0	2.2	3.3	2.8	3.4	2.6	3.1	3.1	3.1
Final Domestic Demand	3.6	4.2	3.7	9.0	3.2	3.6	3.5	3.7	3.4	3.0	2.8	4.6	4.8	3.5	3.4	5.0	4.4	3.3	3.2
Exports	-1.8	2.6	2.7	2.1	2.7	1.4	1.9	2.3	2.7	3.5	3.9	2.2	0.7	2.0	2.5	4.5	-0.9	2.0	3.1
Imports	9.8	6.2	-0.9	2.6	3.0	4.7	5.0	4.9	4.5	4.2	4.4	7.5	5.0	3.3	4.6	7.1	3.0	3.8	4.5
Change in Non-Farm Inventories ($97 Bn)	16.9	11.9	-0.7	2.8	3.5	4.2	5.2	5.0	4.1	2.9	3.1	11.1	9.3	3.9	3.8	---	---	---	---
Final Sales	-1.0	2.7	5.3	8.0	3.1	2.3	2.2	2.6	2.7	2.6	2.5	2.4	3.0	3.0	2.5	3.9	2.8	2.6	2.6
International Current Account Balance ($Bn)	17.3	22.7	18.5	26.0	29.8	29.1	29.4	25.1	23.7	21.4	21.0	27.9	23.6	28.6	22.8	---	---	---	---
% of GDP	1.2	1.6	1.3	1.7	2.0	1.9	1.9	1.6	1.5	1.3	1.3	2.0	1.6	1.9	1.4	---	---	---	---
Pre-tax Corp. Profits	5.8	9.3	-0.8	13.0	6.3	3.5	2.4	2.6	5.0	3.6	3.5	11.9	5.0	6.3	3.5	14.8	-0.6	6.2	3.7
% of GDP	13.7	13.9	13.8	13.9	14.0	14.0	13.9	13.8	13.8	13.8	13.8	13.8	13.7	13.9	13.8	---	---	---	---
GDP Deflator (Y/Y)	3.1	2.0	0.9	2.4	2.3	2.2	2.4	1.4	1.7	2.2	2.3	3.4	2.4	2.3	1.9	-3.3	0.9	2.4	2.3
Nominal GDP	3.1	2.9	1.9	10.2	4.6	3.5	3.9	4.4	5.3	5.1	4.4	6.5	5.2	4.9	4.5	7.5	2.9	5.5	4.8
Labour Force	1.9	1.6	1.2	3.7	1.2	1.3	1.2	1.2	1.2	1.2	1.2	0.9	1.4	1.9	1.2	0.9	1.5	1.9	1.2
Employment (%)	2.9	0.6	2.4	3.9	1.0	1.1	0.8	1.0	1.1	1.1	1.2	1.4	2.0	2.0	1.0	1.6	1.9	1.7	1.1
Employment ('000s)	116	23	97	160	40	45	35	40	45	45	50	220	315	334	168	261	306	280	180
Unemployment Rate (%)	6.2	6.4	6.1	6.1	6.2	6.3	6.3	6.2	6.2	6.4	6.4	6.8	6.3	6.2	6.3	---	---	---	---
Personal Disp. Income	-0.7	5.8	5.6	8.5	2.4	3.7	4.3	3.4	4.0	3.4	3.0	4.3	6.4	5.0	3.6	4.6	6.3	4.7	3.4
Pers. Savings Rate (%)	1.7	1.8	2.2	2.6	2.3	2.1	2.0	1.8	1.6	1.6	1.4	1.6	2.3	2.2	1.6	---	---	---	---
Cons. Price Index (Y/Y)	2.6	1.7	1.3	1.8	2.3	2.7	3.5	2.9	2.1	1.9	2.0	2.2	2.0	2.6	2.2	2.3	1.3	3.5	2.0
Core CPI (Y/Y)	1.8	2.1	2.2	2.2	2.5	2.4	2.3	2.2	2.1	2.0	2.0	1.6	1.9	2.4	2.0	1.6	2.2	2.3	2.0
Housing Starts ('000s)	228	220	222	222	219	210	205	200	195	190	185	224	228	214	193	---	---	---	---
Productivity: Real GDP / worker (Y/Y)	0.9	0.4	-0.1	-0.6	0.4	0.6	1.3	1.8	1.5	1.4	1.4	2.0	0.7	0.4	1.5	1.6	-0.1	1.3	1.4

F: Forecast by TD Economics as at June 2007

Source: Statistics Canada, Bank of Canada, Canada Mortgage and Housing Corporation, Haver Analytics

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	Q4	Q1	Q2 F	Q3 F	Q4 F	Q1 F	Q2 F	Q3 F	Q4 F	05	06	07 F	08 F	05	06	07 F	08 F
Real GDP	2.6	2.0	2.5	0.6	3.3	2.4	2.2	2.4	2.5	2.7	3.0	2.7	3.3	2.1	2.5	2.4	3.1	2.1	2.7
Consumer Expenditure	2.6	2.8	4.2	4.4	2.1	2.3	2.1	2.2	2.5	2.7	3.0	3.3	3.2	3.2	2.3	2.7	3.6	2.7	2.6
Durable Goods	-0.1	6.4	4.4	8.8	2.8	2.0	1.7	3.1	4.4	4.9	4.6	5.1	5.0	4.7	3.2	2.0	7.4	3.8	4.2
Business Investment	4.4	10.0	-3.1	2.9	8.1	5.6	2.7	3.2	3.7	4.2	4.8	3.1	7.2	4.0	4.0	1.1	6.1	4.8	4.0
Non-Res. Structures	20.3	15.7	0.8	5.1	12.9	3.6	2.2	3.5	4.0	4.2	4.3	1.2	9.0	7.5	4.0	0.7	11.3	5.9	4.0
Machinery & Equipment	-1.4	7.7	-4.8	2.0	6.1	6.5	3.0	3.1	3.6	4.2	5.0	3.9	6.5	2.5	4.0	1.3	4.0	4.4	4.0
Residential Construction	-11.1	-18.7	-19.8	-15.4	-7.5	-6.1	-2.1	0.2	0.8	1.4	2.4	8.2	-4.2	-13.2	-1.2	8.4	-12.8	-7.9	1.2
Govt. Consumption & Gross Investment	0.8	1.7	3.4	1.0	2.4	1.2	0.7	0.6	0.7	0.9	1.2	0.3	2.1	1.8	0.9	0.0	2.7	1.3	0.9
Final Domestic Demand	1.6	2.0	1.9	2.5	2.2	2.0	1.7	1.9	2.2	2.5	2.8	3.0	2.9	2.1	2.1	2.4	2.7	2.1	2.3
Exports	6.2	6.8	10.6	-0.6	6.3	7.7	7.5	7.2	7.7	7.3	7.0	7.0	8.9	5.6	7.4	7.3	9.4	5.2	7.3
Imports	1.4	5.6	-2.6	5.7	4.7	5.1	3.2	3.3	3.9	4.4	5.2	5.6	5.8	3.4	3.9	4.9	3.3	4.7	4.2
Change in Non-Farm Inventories ($96 Bn)	52.2	53.3	20.0	-7.8	25.4	31.1	33.0	33.7	33.0	32.7	33.8	19.6	40.6	20.4	33.3	---	---	---	---
Final Sales	2.1	1.9	3.7	1.6	2.3	2.1	2.1	2.3	2.5	2.7	2.9	3.0	3.1	2.3	2.4	2.5	3.3	2.0	2.6
International Current Account Balance ($Bn)	-871	-918	-783	-836	-896	-913	-913	-915	-916	-917	-919	-792	-857	-889	-917	---	---	---	---
% of GDP	-6.6	-6.9	-5.8	-6.1	-6.5	-6.5	-6.4	-6.4	-6.3	-6.3	-6.2	-6.4	-6.5	-6.4	-6.3	---	---	---	---
Pre-tax Corporate Profits including IVA&CCA	5.9	16.4	-1.2	5.0	3.3	-0.6	4.1	1.4	3.4	4.2	4.2	14.6	21.4	4.1	2.7	14.3	18.3	2.9	3.3
% of GDP	12.1	12.4	12.2	12.3	12.2	12.0	12.0	11.9	11.8	11.8	11.8	10.7	12.2	12.1	11.8	---	---	---	---
GDP Deflator (Y/Y)	3.3	3.0	2.6	2.7	2.7	2.8	3.0	2.7	2.3	2.3	2.2	3.3	2.9	2.8	2.4	3.5	2.6	3.0	2.2
Nominal GDP	5.9	3.9	4.1	4.7	6.9	4.5	4.9	4.9	4.6	4.8	5.0	6.1	6.3	5.0	4.9	6.1	5.7	5.2	4.8
Labour Force	1.8	1.6	1.9	1.3	0.2	1.0	1.0	0.9	0.9	0.8	0.8	1.3	1.4	1.2	0.9	1.4	1.5	0.9	0.9
Employment	1.5	1.6	1.5	1.5	1.2	1.1	0.8	0.5	0.6	0.6	1.0	1.7	1.9	1.4	0.7	1.9	1.7	1.1	0.7
Change in Empl. ('000s)	520	529	509	497	423	372	274	183	195	193	353	2,273	2,478	1,845	1,012	2,456	2,251	1,566	1,994
Unemployment Rate (%)	4.7	4.7	4.5	4.5	4.5	4.6	4.7	4.8	5.0	5.1	5.1	5.1	4.6	4.6	5.0	---	---	---	---
Personal Disp. Income	2.5	5.7	5.4	8.2	4.5	5.5	5.2	6.0	5.0	5.0	5.1	4.3	5.5	5.8	5.3	3.4	5.1	5.9	5.3
Pers. Savings Rate (%)	-1.4	-1.4	-0.9	-0.8	-1.5	-1.2	-1.1	-0.7	-0.6	-0.5	-0.4	-0.4	-1.0	-1.1	-0.5	---	---	---	---
Cons. Price Index (Y/Y)	4.0	3.4	1.9	2.4	2.6	2.5	3.7	3.3	2.3	2.2	2.0	3.4	3.3	2.8	3.0	3.8	1.9	3.7	2.0
Core CPI (Y/Y)	2.5	2.8	2.6	2.6	2.3	2.0	2.2	2.2	2.2	2.2	1.9	2.2	2.5	2.3	2.2	2.2	2.6	2.2	1.9
Housing Starts (mns)	1.86	1.70	1.55	1.46	1.45	1.43	1.43	1.42	1.42	1.42	1.43	2.07	1.81	1.44	1.42	---	---	---	---
Productivity: Real Output per hour (y/y)	1.9	0.9	1.6	0.9	1.1	1.7	1.7	2.1	2.2	2.5	2.6	1.7	1.6	1.4	2.4	1.2	1.6	1.7	2.6

F: Forecast by TD Economics as at June 2007
Source: U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Analysis, TD Economics