

THE WEEKLY BOTTOM LINE

TD Economics



HIGHLIGHTS OF THE WEEK

November 10, 2011

United States

- This week markets laid siege to Italian sovereign debt, driving yields on 10-year bonds to levels not seen since the country adopted the common currency a decade ago. The longer such rates are sustained, the greater the risk that Italy becomes insolvent, and is forced into a messy default.
- Two things must happen for the crisis to be contained. First, investors must regain confidence in Italy's ability to make good on future debt obligations. Second, the European Central Bank (ECB) must act in a more aggressive role as lender of last resort.
- Stateside, the deficit reduction committee is nearing its November 23rd deadline for coming up with \$1.2 trillion dollars in fiscal savings over the next decade. With continuing economic weakness both at home and abroad, the risk is that policymakers cut spending too much too soon, sucking demand out of the economy at a time when consumers and businesses are still unable to fill the void.

Canada

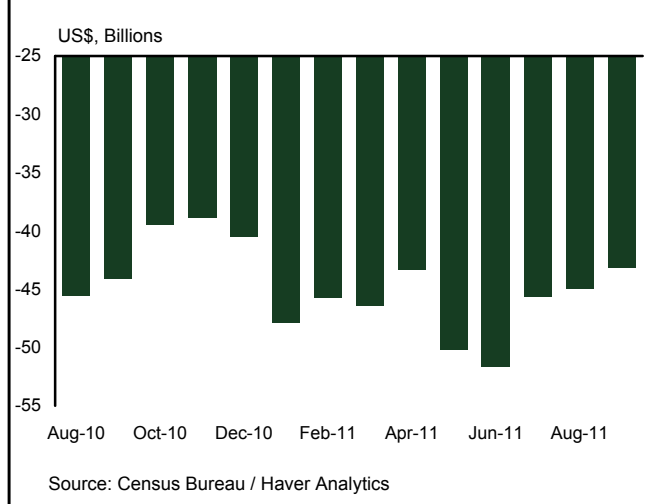
- Canadian financial markets experienced volatility as positive trade news on the home front were not enough to turn around a week marked by developments in Europe.
- Canada's merchandise trade balance returned to a surplus position in September as strong export growth outpaced the increase in imports. Exports rose to the highest level since October 2008. The gains were largely attributable to price increases.

THIS WEEK IN THE MARKETS

	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	1,234	1,261	1,364	1,099
S&P/TSX Comp.	12,108	12,468	14,271	11,178
DAX	5,845	6,133	7,528	5,072
FTSE 100	5,449	5,546	6,091	4,944
Nikkei	8,501	8,640	10,858	8,374
Fixed Income Yields				
U.S. 10-yr Treasury	2.02	2.07	3.74	1.72
Canada 10-yr Bond	2.12	2.21	3.50	2.02
Germany 10-yr Bund	1.75	1.91	3.49	1.67
UK 10-yr Gilt	2.20	2.38	3.88	2.18
Japan 10-yr Bond	0.97	1.00	1.36	0.97
Foreign Exchange Cross Rates				
C\$ (USD per CAD)	0.98	0.99	1.06	0.95
Euro (USD per EUR)	1.36	1.38	1.49	1.29
Pound (USD per GBP)	1.59	1.60	1.67	1.54
Yen (JPY per USD)	77.6	78.0	85.2	75.8
Commodity Spot Prices**				
Crude Oil (\$US/bbl)	97.2	94.1	113.9	75.7
Natural Gas (\$US/MMBtu)	3.54	3.40	4.92	3.35
Copper (\$US/met. tonne)	7608.0	7901.8	10179.5	6721.5
Gold (\$US/troy oz.)	1744.5	1763.8	1900.2	1313.9

*as of 10:00 am on Friday, **Oil-WTI, Cushing, Nat. Gas-Henry Hub, LA (Thursday close price), Copper-LME Grade A, Gold-London Gold Bullion; Source: Bloomberg

U.S. INTERNATIONAL TRADE BALANCE



GLOBAL OFFICIAL POLICY RATE TARGETS

	Current Target
Federal Reserve (Fed Funds Rate)	0 - 0.25%
Bank of Canada (Overnight Rate)	1.00%
European Central Bank (Refi Rate)	1.25%
Bank of England (Repo Rate)	0.50%
Bank of Japan (Overnight Rate)	0.00%

Source: Central Banks, Haver Analytics

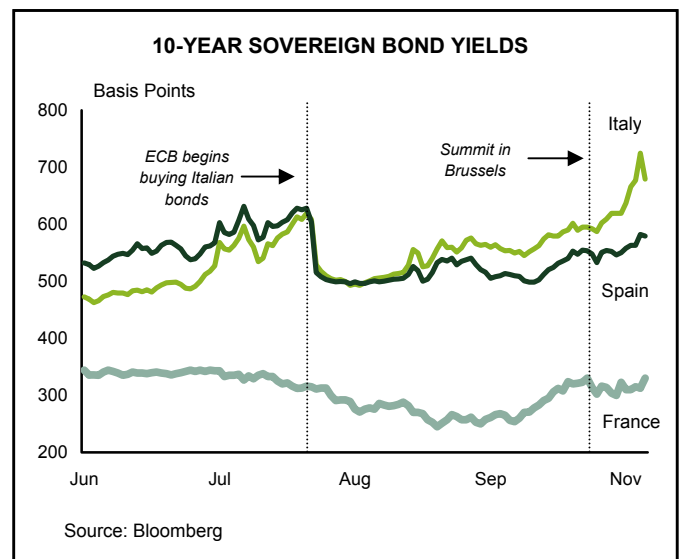
UNITED STATES – THE SACK OF ROME

In 410 AD, the unimaginable suddenly became reality: Rome, the eternal city, was sacked by Visigoth invaders. Indeed, just as ancient Romans thought their capital city was impenetrable until it wasn't, few could have imagined eighteen months ago that Italy, Europe's third largest economy, would succumb to the financial stress it is now under today.

Italy's debt burden, at 120% of GDP, is frighteningly large. Yet unlike Greece, Italy collects more in tax revenue each year than it spends; the country is only in deficit once interest payments are included. The government needs to borrow to finance the interest on its outstanding debt, as well as to roll over maturing debt. Each time Italy is forced to rollover debt at a higher interest rate, the national debt grows. This is what made the events of this week so worrisome. Markets laid siege to Italian sovereign debt, driving yields on 10-year bonds to levels not seen since the country adopted the common currency a decade ago. With investors becoming increasingly weary of lending to Italy, the risk is that the country could soon be forced to borrow at more punitive rates. The longer such rates are sustained, the greater the risk that Italy becomes insolvent, and is forced into a messy default.

For the crisis to be contained, two things must happen. First, investors must regain confidence in Italy's ability to make good on future debt obligations. This means Italy must reign in the public debt by implementing structural reforms to enhance economic competitiveness and boost primary account surpluses. On Tuesday, Italian Premier Silvio Berlusconi announced his intention to resign in order to facilitate the passage of reform legislation. But ambitious economic reforms are unlikely to happen quickly enough to please markets: reforms take time to implement, and even longer for them to have a noticeable effect. Any successful solution, therefore, must involve the European Central Bank (ECB) in a more aggressive role as lender of last resort. In order to buy Italy time to implement reforms, the ECB must expand bond purchases to help keep a lid on the country's borrowing costs. To be sure, the central bank has already begun intervening in Italian debt markets. However, it has been loathe to ramp up purchases in part because it doesn't want to be seen as financing the deficits of the eurozone's more profligate members. This is something the ECB will probably have to stomach if there is to be an orderly resolution to the crisis.

Financial turmoil in Europe remains the number one risk



to the global economic outlook. But there are other risks, too. Stateside, the deficit reduction committee is nearing its November 23rd deadline for coming up with \$1.2 trillion dollars in fiscal savings over the next decade. If the committee cannot reach an agreement, automatic spending cuts would kick in beginning in 2013.

We have argued time and again (see [here](#)) that the U.S. must come up with a credible plan to address its fiscal deficit in the medium term. But with continuing economic weakness both at home and abroad, the risk is that policymakers cut spending too much too soon, sucking demand out of the economy at a time when consumers and businesses are still unable to fill the void. Should government paralysis lead to a triggering of the full \$1.2 trillion in cuts, fiscal drag would reduce GDP growth by 3 percentage points, and the country would likely fall back into recession. While we don't expect this to happen, it highlights the magnitude of the fiscal risks building in today's charged political environment. As with any game of political brinkmanship, mistakes are sometimes made.

To be clear, the United States is not Italy; it is not Greece. Its debt right now is perfectly sustainable. The future growth trajectory of that debt is not. The thought that demand for U.S. Treasuries could dry up seems far-fetched for now, especially when investors are today willing to lend to Uncle Sam at rates below inflation. Yet if history is any guide, even the unimaginable has a way of becoming possible when complacency sets in.

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CANADA – NERVOUS EMPLOYERS AND INVESTORS CLOSELY MONITORING NEWS FROM ABROAD

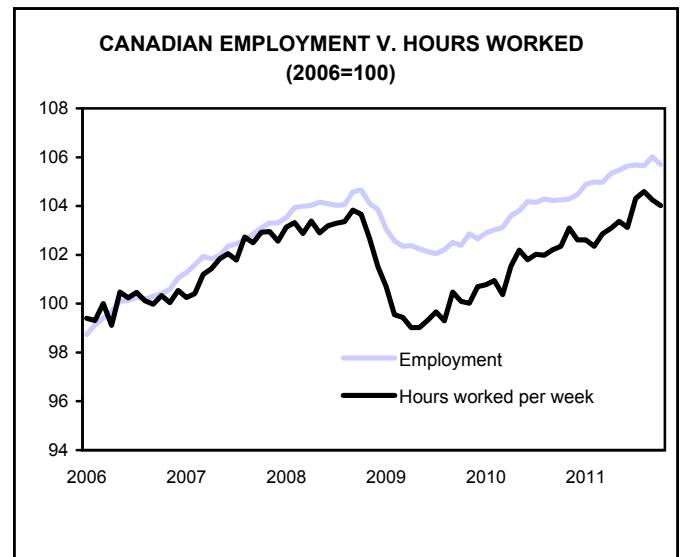
Canadian financial markets are in a nervous mood these days, and with good reason. They face uncertainty in pretty much every direction they look. One key question they are pondering is what impact the financial crisis in Europe will have on Canada. We have grown used to the old axiom that whenever the U.S. economy sneezes, Canada catches a cold; but, what is there to be said about our sensitivity to cross-Atlantic influenza?

So far, the main effect of the European financial and political drama on Canada's economy has been limited to wrecking investor confidence and dampening consumer and business confidence. With their attention consumed with events in Brussels, then Cannes, then Athens, then Rome, Canadian financial markets were not in need of any domestic negative news. Too bad that last week's Labour Force Survey delivered exactly that.

Economists had to work very hard at digging positive news out of the 54,000 job loss reported for October, the largest drop since the beginning of 2009. One mitigating factor about the Canadian employment decline was that it came on the heels of a slightly greater increase in the previous month, with the implication that employment growth on average over the past three months essentially stalled.

Looking beyond the headline total employment number, the picture ranges from the mixed to the negative. Full-time employment creation appears to have levelled off recently, while part-time jobs are on the rise again. Hours worked, which had recently surpassed their pre-recession peak of three years ago, are now starting to trend down back toward that level, and remain quite low on a per-worker basis. Obviously, Canadian employers are currently reluctant to ramp up activity, and there are two potential reasons for that.

The first reason is a lack of confidence about business prospects for the months ahead. Put bluntly, businesses fear a renewed economic downturn. The second explanation is that the hiring spree, which started at the end of 2010, was likely excessive given prospects for the economy. Given that employment usually leads trends in the economy rather than lags, we are inclined to prefer the latter view that employers are simply adjusting in expectation of a slowing economic growth environment. Thus, in this case, as in many others, the word "usually" should be used with caution these days.



Which one of the two reasons are at play in employers' minds? Probably a bit of both. No matter what the reason, the end result is the same: employment growth in Canada has flattened out, despite the fact that Canada's economy is still putting out reasonably good numbers from time to time. A case in point was today's international trade data release, with a surprise return to a merchandise trade surplus after eight months of deficit.

So, the near-term outlook for both the economy and the job market is for modest growth. The economy likely delivered a solid growth performance in Q3 of 2.5% to 3.5%, but the pace of expansion in Q4 will be materially slower. However, there is enormous uncertainty. Europe remains risk number one for global financial markets and the global economy. Moreover, concerns about the U.S. fiscal situation could heat up in the coming weeks. Political gridlock is running the risk of hampering the U.S. economic recovery. For more on this, see this week's Perspective note "Gridlock in America".

The implication is that international risks are likely to lead to further financial market volatility. The longer it lasts, the greater the possibility that confidence among Canadian businesses and households will erode further. Still, unless the financial situation globally worsens dramatically, Canada should avoid recession – but so much depends on political actions beyond this nation's borders.

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U.S.: UPCOMING KEY ECONOMIC RELEASES

U.S. Retail Sales - October*

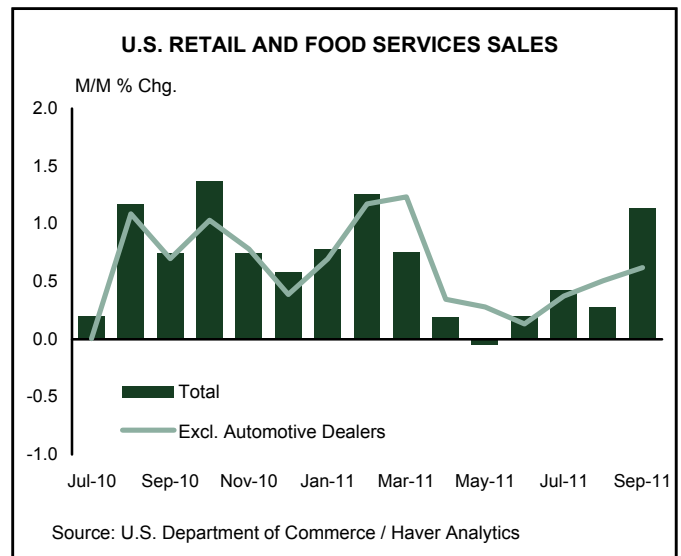
Release Date: November 15, 2011

September Result: Retail Sales 1.1% M/M; ex-autos 0.6% M/M; ex-autos & gas 0.5% M/M

TD Forecast: Retail Sales 0.4% M/M; ex-autos 0.2% M/M; ex-autos & gas 0.6% M/M

Consensus: Retail Sales 0.3% M/M; ex-autos 0.2% M/M; ex-autos & gas 0.3% M/M

The positive momentum in household spending is expected to continue in October, with strong gains in motor vehicle sales more than compensating for the drag from the 4.4% M/M drop in gasoline prices at the pump. During the month, we expect headline sales to rise at a decent 0.4% M/M pace, down from the robust 1.1% M/M bounce the month before. Excluding autos, sales should rise by a more modest 0.2% M/M pace, mostly on account of the expected drop in sales at gasoline stations. Core retail sales, however, should advance by a more respectable 0.6% M/M pace, signalling that the positive momentum in the overall tone of household expenditures in recent months is being sustained. In the coming months, with the economy



continuing to regain its footing and labour market activity slowing improving, we expect the gains in spending to be sustained.

U.S. CPI - October*

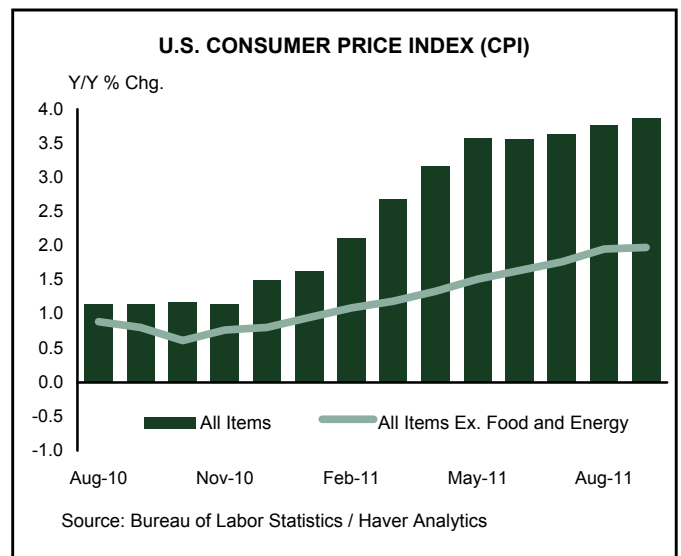
Release Date: November 16, 2011

September Result: CPI 0.3% M/M; Core CPI 0.1% M/M

TD Forecast: CPI 0.1% M/M; Core CPI 0.1% M/M

Consensus: CPI 0.0% M/M; Core CPI 0.1% M/M

After rising sharply to a 3-year high in September, the pace of headline consumer price inflation is expected to begin the slow retreat lower as the drop in commodity prices since the beginning of this year and easing wage pressures result in moderating the inflation rate. In October, headline consumer prices are expected to rise at a very modest 0.1% m/m, marking the slowest pace of gain since June. Weak energy and apparel prices are expected to be the key drivers for the slow gain, partially offsetting gains in other components. On an annual basis, the pace of inflation is expected to moderate to 3.8% y/y from 3.9% y/y the month before. If there are any risks to this call, they are to the downside. Excluding food and energy, consumer prices should also rise at a modest 0.1% m/m pace, though annual core consumer price inflation should accelerate to a new cyclical high of 2.1% y/y (its highest level in 3 years).



Gains in motor vehicle, tobacco prices and OER should be the key sources for the increase in the core measure. Looking ahead, with the economic recovery still weak and commodity prices remaining largely on the downward trajectory, we expect headline inflation rate to begin moderating, though core inflation should firm around the 2.0% y/y mark.

*Forecast by Rates and FX Strategy Group. For further information, contact TDRates&FXResearch@tdsecurities.com.

U.S. Industrial Production and Capacity Utilization - October*

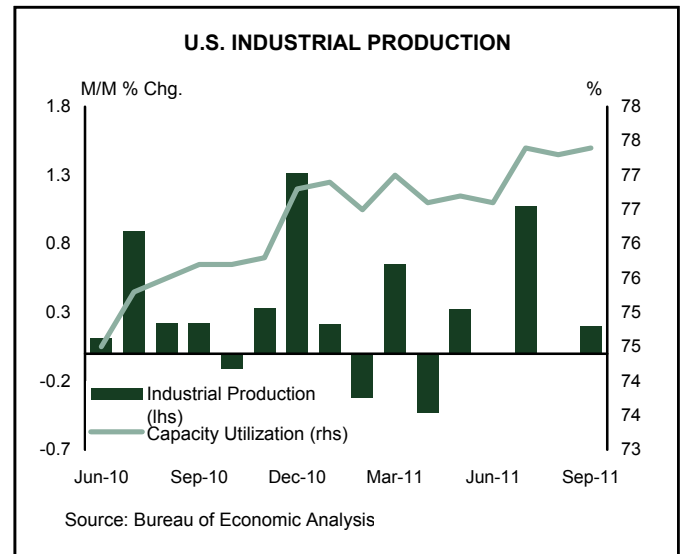
Release Date: November 16, 2011

September Result: Industrial Production 0.2% M/M;
Capacity Utilization 77.4%

TD Forecast: Industrial Production 0.6% M/M;
Capacity Utilization 77.7%

Consensus: Industrial Production 0.4% M/M;
Capacity Utilization 77.6%

With the economy continuing to build on the gains of recent months, industrial production activity should post its sixth consecutive monthly gain in October. We expect a fairly strong performance in total production activity during the month, with the headline index rising at a robust 0.6% M/M pace. Much of this momentum should come from strong manufacturing sector activity, with auto production enjoying another month of healthy gains. Mining activity should also post a decent bump, while utility activity should bounce back from the sharp declines in the previous two months, following unseasonably cold weather in October. And with overall industrial production advancing, we ex-



pect the pace of capacity utilization to hit a new cyclical high of 77.7%, up from 77.4% the month before. In the months ahead, we expect the gains in overall industrial production to be sustained as the economic recovery gathers steam.

*Forecast by Rates and FX Strategy Group. For further information, contact TDRates&FXResearch@tdsecurities.com.

CANADA: UPCOMING KEY ECONOMIC RELEASES

Canadian Manufacturing Shipments - September*

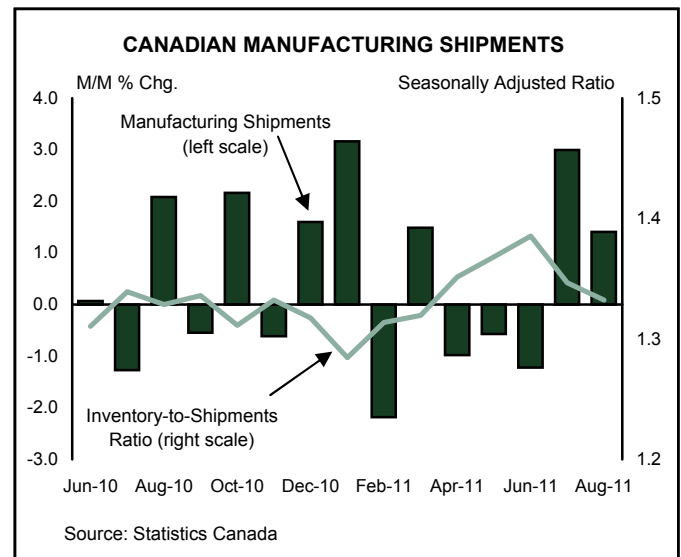
Release Date: November 15, 2011

August Result: 1.4% M/M

TD Forecast: -0.4% M/M

Consensus: N/A

After two consecutive monthly gains in excess of 1.0% manufacturing shipments are due for a modest pullback, and are forecast to fall by 0.4% in September. In terms of the underlying details, we should see weakness concentrated in the energy and automotive sector. Moreover, the overall erosion in confidence reflected in weaker PMI global surveys does pose a downside risk to our forecast. We expect that economic growth will slow heading into the final quarter of the year once the temporary factors supporting Q3 growth fade.



Canadian CPI - October*

Release Date: November 18, 2011

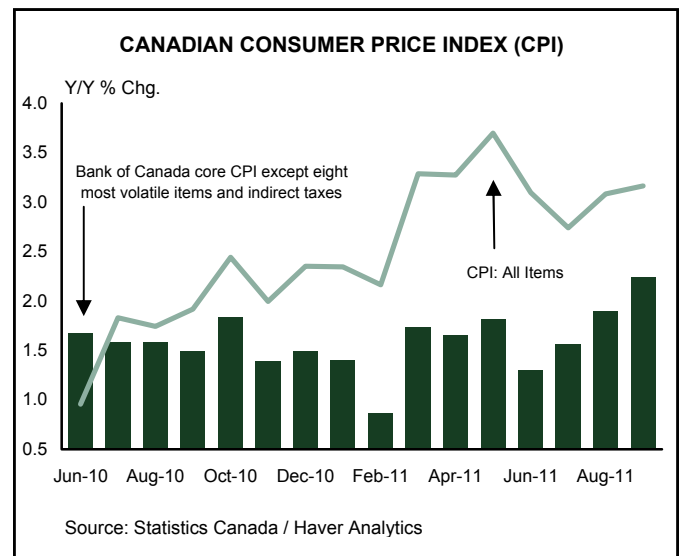
September Result: CPI 0.2% M/M; Core CPI 0.5% M/M

TD Forecast: CPI 0.1% M/M; Core CPI -0.1% M/M

Consensus: CPI N/A; Core CPI N/A

The recent acceleration in both headline and core inflation is expected to have reversed course in October due in part to lower commodity prices, slowing economic momentum, and an unwind of several temporary factors that had previously pushed prices higher. While the non-seasonally adjusted all-items price index is expected to have edged higher by just 0.1% M/M, the seasonally adjusted growth rate will be more pronounced at +0.4% M/M. The monthly increase in the price index corresponds to a year-ago rate of 2.9% for headline inflation, which marks a modest deceleration from the 3.2% pace set in September.

After accelerating rapidly over the last two months the core price index is expected to fall by 0.1% M/M on both a seasonally-adjusted and non-adjusted basis. This forecast is based on a partial reversal of last month's jump in clothing prices and the normalization of car prices following the expiry of a wide range of discounts in September. On the other side of the coin, higher shelter costs will prevent a large drop in the core index. On a year-ago basis, core inflation is expected to retreat sharply to 1.7% which will be a welcome development for the Bank of Canada given



the 0.2% breach of the 2% target last month. Keep in mind that this reprieve in core inflation will likely prove to be temporary, as core is expected to move above target in both November and December and the fourth quarter as a whole is forecast to stand at 2.0%. The underlying rate of inflation is expected to then moderate in 2012 in tandem with weaker economic growth.

*Forecast by Rates and FX Strategy Group. For further information, contact TDRates&FXResearch@tdsecurities.com.

**RECENT KEY ECONOMIC INDICATORS: NOVEMBER 7 - 10, 2011**

Release Date	Economic Indicators	Data for Period	Units	Current	Prior	
United States						
Nov 7	Consumer Credit	Sep	US, Blns	7.386	-9.682	R▼
Nov 8	NFIB Small Business Optimism	Oct	Index	90.2	88.9	
Nov 8	IBD/TIPP Economic Optimism	Nov	Index	40.6	40.3	
Nov 8	JOLTs Job Openings	Sep	Thousands	3354	3129	R▲
Nov 9	MBA Mortgage Applications	4-Nov	W/W % Chg.	10.3	0.2	
Nov 9	Wholesale Inventories	Sep	M/M % Chg.	-0.1	0.1	R▼
Nov 10	Import Price Index	Oct	M/M % Chg.	-0.6	0.0	R▼
Nov 10	Trade Balance	Sep	US, Blns	-43.1	-44.9	R▲
Nov 10	Initial Jobless Claims	4-Nov	Thousands	390	400	R▲
Nov 10	Continuing Claims	28-Oct	Thousands	3615	3707	R▲
Nov 10	Bloomberg Consumer Comfort	6-Nov	Index	-51.6	-53.2	
Canada						
Nov 8	Housing Starts	Oct	Thousands	207.6	208.8	R▲
Nov 9	New Housing Price Index	Sep	M/M % Chg.	0.2	0.1	
Nov 10	Int'l Merchandise Trade	Sep	Billions	1.25	-0.49	R▲
International						
Nov 7	EC Sentix Investor Confidence	Nov	Index	-21.2	-18.5	
Nov 7	EC Euro-Zone Retail Sales	Sep	Y/Y % Chg.	-1.5	-1.0	
Nov 7	GE Industrial Prod. (nsa wda)	Sep	Y/Y % Chg.	5.4	8.4	R▲
Nov 8	GE Trade Balance	Sep	Billions	17.4	11.8	
Nov 8	FR Trade Balance (Euros)	Sep	Millions	-6303	-4310	R▲
Nov 8	JN Current Account Balance	Sep	Y/Y % Chg.	-21.4	-64.3	
Nov 9	AU Unemployment Rate	Oct	%	5.2	5.3	R▲
Nov 10	FR Consumer Price Index	Oct	Y/Y % Chg.	2.3	2.2	
Nov 10	GE Consumer Price Index	Oct	Y/Y % Chg.	2.5	2.5	
Nov 10	UK BOE Announces Rates	10-Nov	%	0.50	0.50	

Source: Bloomberg, TD Economics

UPCOMING ECONOMIC RELEASES AND EVENTS: NOVEMBER 11 - 18, 2011

Release Date	Time*	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
United States						
Nov 11	9:55	U. of Michigan Confidence	Nov	Index	61.5	60.9
Nov 11	13:15	<i>Fed's Yellen Speaks at Banking Conf. in Chicago</i>				
Nov 11	14:45	<i>Fed's Williams Speaks on Panel at IMF Conference</i>				
Nov 14	--	Mortgage Delinquencies	3Q	Q/Q % Chg.	--	8.44
Nov 14	--	MBA Mortgage Foreclosures	3Q	Q/Q % Chg.	--	4.43
Nov 15	--	<i>Chicago Fed Conference on Increases in Farmland Values</i>				
Nov 15	8:30	<i>Fed's Bullard to Speak on Economy in St. Louis</i>				
Nov 15	8:30	Producer Price Index	Oct	M/M % Chg.	-0.1	0.8
Nov 15	8:30	PPI Ex Food & Energy	Oct	M/M % Chg.	0.1	0.2
Nov 15	8:30	Advance Retail Sales	Oct	M/M % Chg.	0.4	1.1
Nov 15	8:30	Retail Sales Less Autos	Oct	M/M % Chg.	0.2	0.6
Nov 15	8:30	Retail Sales Ex Auto & Gas	Oct	M/M % Chg.	0.2	0.5
Nov 15	8:30	Empire Manufacturing	Nov	Index	-2.15	-8.48
Nov 15	10:00	Business Inventories	Sep	M/M % Chg.	0.3	0.5
Nov 15	10:08	<i>Fed's Williams Speaks in Scottsdale, Arizona</i>				
Nov 15	12:30	<i>Fed's Fisher Speaks on Too Big to Fail in New York</i>				
Nov 16	7:00	MBA Mortgage Applications	11-Nov	W/W % Chg.	--	10.3
Nov 16	8:30	Consumer Price Index	Oct	M/M % Chg.	0.00	0.30
Nov 16	8:30	CPI Ex Food and Energy	Oct	M/M % Chg.	0.10	0.10
Nov 16	9:00	<i>New York Fed's Dahlgren to Speak on Panel in Washington, DC</i>				
Nov 16	9:00	Net Long-term TIC Flows	Sep	Billions	--	57.9
Nov 16	9:00	Total Net TIC Flows	Sep	Billions	--	89.6
Nov 16	9:15	Industrial Production	Oct	M/M % Chg.	0.4	0.2
Nov 16	9:15	Capacity Utilization	Oct	%	77.7	77.4
Nov 16	10:00	NAHB Housing Market Index	Nov	Index	18	18
Nov 16	12:45	<i>Fed's Rosengren Speaks on Economy in Boston</i>				
Nov 17	8:30	Housing Starts	Oct	Thousands	610	658
Nov 17	8:30	Building Permits	Oct	Thousands	600	594
Nov 17	8:30	Initial Jobless Claims	11-Nov	Thousands	--	390
Nov 17	8:30	Continuing Claims	4-Nov	Thousands	--	3615
Nov 17	9:45	Bloomberg Economic Expectations	Nov	Index	--	-45
Nov 17	9:45	Bloomberg Consumer Comfort	13-Nov	Index	--	--
Nov 17	10:00	Philadelphia Fed.	Nov	Index	10.0	8.7
Nov 17	12:30	<i>Fed's Pianalto Speaks on Economy in Kentucky</i>				
Nov 18	10:00	Leading Indicators	Oct	M/M % Chg.	0.5	0.2
Canada						
Nov 15	8:30	Manufacturing Sales	Sep	M/M % Chg.	--	1.4
Nov 17	8:30	Int'l Securities Transactions	Sep	Billions	--	7.92
Nov 17	10:30	<i>Bank of Canada Review</i>				
Nov 17	21:15	<i>Jean Boivin Speaks at Thompson Chamber of Commerce</i>				
Nov 18	7:00	Consumer Price Index	Oct	M/M % chg.	--	0.2
Nov 18	7:00	Bank of Canada CPI Core	Oct	M/M % chg.	--	0.5
Nov 18	8:30	Leading Indicators	Oct	M/M % chg.	--	-0.1
International						
Nov 15	5:00	EC Euro-Zone GDP s.a.	3Q	Q/Q % Chg.	0.1	0.2

* Eastern Standard Time; Source: Bloomberg, TD Economics



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