HIGHLIGHTS

- Hit by rising energy prices and the supply shock from Japan, economic growth weakened in the first half of this year to average under 2.0% annualized. As temporary shocks subside, growth should rebound in the second half of the year to 3.3%.
- Housing will continue to be both a drag on growth and a key downside risk to the outlook. However, while home prices are in decline, the supply overhang is improving. Job growth is key and should support a rise in sales in the months ahead.
- Sovereign debt, both foreign and domestic plays a central role in the forecast. In Europe, the Greek situation will continue to keep financial markets on edge. In the U.S., fiscal restraint will begin to bite and will be a key drag on growth over the forecast horizon.
- U.S. economic growth is forecasted to average 2.5 % through 2011, 3.0% in 2012, and 3.1% in 2013.

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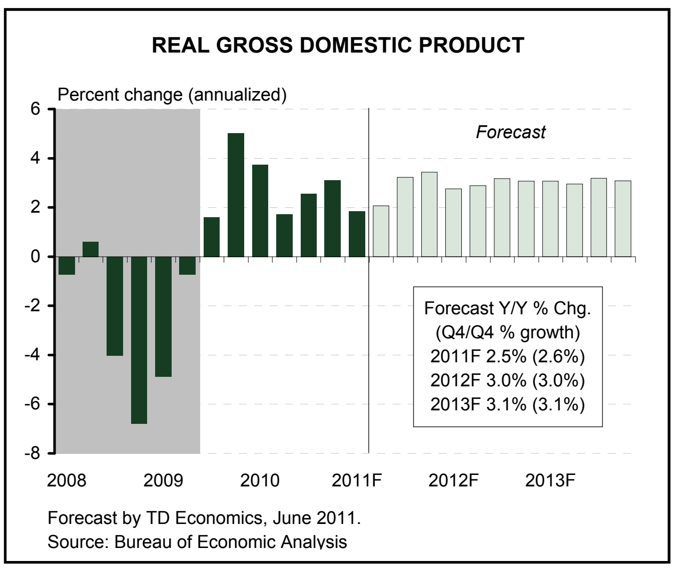
U.S. GROWTH: DOWN, BUT NOT OUT

U.S. economic growth has hit a rough patch. Walloped by a 20% rise in gas prices since the start of the year, consumer spending growth has slowed dramatically from the 4% pace set at the close of last year. The more restrained consumer has been paralleled in sluggish home sales, with prices tumbling back into the red due to the significant overhang of distressed properties. Meanwhile, disruptions to manufacturing supply chains from Japan's natural disaster have undermined production momentum in a sector that has been a key driver behind the recovery to date. To cap off recent downbeat data, May's employment report showed a mere 54,000 job gain – a sharp drop from the more than 220,000 jobs created on average in the three months prior.

The lackluster data in the past two months has reignited the debate as to whether the US recovery has hit a speed bump or a roadblock. We remind readers of two of our long standing views: first, the economy has not lost its ability to rebound, but the recovery is taking place in a post-financial crisis environment, which means that low growth and elevated unemployment are par for the course. Second, with a smaller margin for error on the downside, this has been, and will remain, a risk-filled recovery.

Our expectation that the US economy will expand by roughly 3% in 2012 and 2013 reflects the soft underbelly of this recovery. Given the depth of the recession and that we are now celebrating the two-year anniversary of positive economic growth, which had an annual top speed of only 2.9% for 2010, calling for more of the same for another two years is truly a half-speed recovery. And to our second point, with such a slow pace of growth, downside risks dominate the outlook; foreclosures continue to plague the housing market, state and local governments continue to shed jobs at a startling pace, and policymakers have exhausted their options for additional stimulus. Add to this mix global risks related to European sovereign debt, China's attempt to orchestrate a soft landing and violent swings in commodity prices. All of this highlights the risk-filled environment, and the need for the economy to be fleet of foot to navigate through the economic mine field.



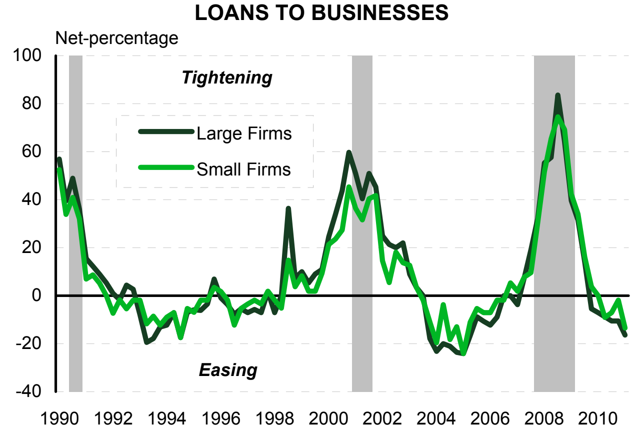
Forecast by TD Economics, June 2011.
Source: Bureau of Economic Analysis

Downside risks dominate in the first half of 2011

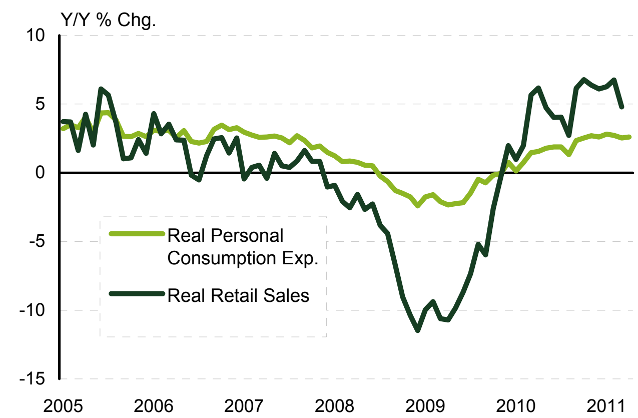
In our last Quarterly Economic Forecast, we noted the risks posed by the combination of rising oil prices and the natural disaster in Japan. We also noted the risks posed by the housing market with its considerable inventory overhang, and Europe's seeming inability to resolve its sovereign debt issues. At the time we pointed to signs that the U.S. economy was continuing the healing process necessary to prompt an acceleration in economic growth: ongoing improvement in credit conditions and continued momentum in job growth. In retrospect, the downside risks came to bear to a greater degree, and economic growth slowed more than anticipated.

Still, our underlying story for the U.S. economy has not changed. Amid recent weakness, signs of resilience remain. Consumer spending slowed in the first two quarters of the year, but remained firmly positive. Unlike the early stages of the recession when consumers were single-mindedly increasing the saving rate, households at this stage in the recovery dipped into savings in order to offset the loss in purchasing power from higher energy prices. This willingness-to-spend behavior bodes well for the second half of the year. Consumer pockets should feel a little heavier given that gas prices have pulled back close to 20 cents a gallon since the peak in May and oil prices have settled at around $100 barrel. Meanwhile, on the production front, supply chain disruptions for car makers are easing. This should spark a rebound in production in response to ongoing pent-up consumer demand.

Just as important in a recession punctuated by a financial crisis, credit markets are continuing their healing process. Commercial and industrial borrowing by small businesses turned positive in early 2011 and hasn't looked back. Furthermore, the Federal Reserve's Senior Loan Officer Survey has shown an increase in both the demand and willingness to supply business credit. Given the importance of small businesses in driving the recovery, signs that they are becoming more engaged should correspond with a stronger job recovery as the year progresses.



*Commercial and industrial
Source: Federal Reserve Senior Loan Officer Survey



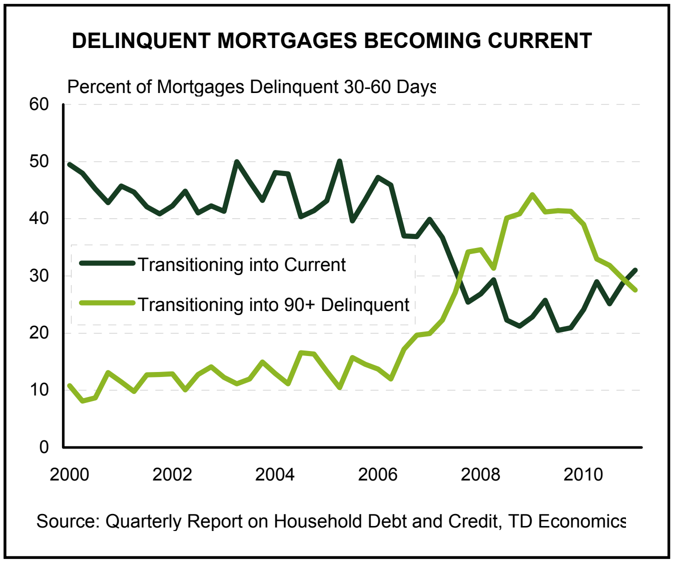
Source: BEA, STL Federal Reserve Board, TD Economics

Clearing the housing market

Nonetheless, one of the main reasons that the recovery will continue to proceed at a lackluster pace is ongoing trouble in the housing market. As long as home prices are declining, there can only be limited improvement in household balance sheets. As we have written in our report, "*Setting the Stage for a U.S. Housing Recovery*," there are a number of reasons to be optimistic about the long-run prospects for housing. However, in the near term, supply issues will dominate the outlook. Adding the inventory of existing homes to the shadow inventory of potential foreclosures, it will take well over a year at the current sales pace to clear the excess inventory of homes.

The housing recovery would proceed more quickly if more house hunters would come out of hiding, but unfortunately, existing home sales have sputtered in recent months. Looking through the volatility caused by the temporary homebuyer's credit, home sales today are no higher than they were in late 2008 – and more than two million below their peak levels in 2005. It appears one obstacle to the healing is elevated down payment requirements, which are limiting would-be first-time homebuyers from entering the market.

Importantly, however, every month that the US continues



to tack on more new jobs, the prospects for improved home sales brighten. Furthermore, we cannot ignore the fact there is virtually no new supply entering the market through construction – the number of new homes being built is barely above the number of homes lost to demolition each year. This fact, coupled with falling delinquency rates means that the stock of foreclosures is starting to recede and progress in clearing the housing market is being made.

Ongoing Greek Tragedy

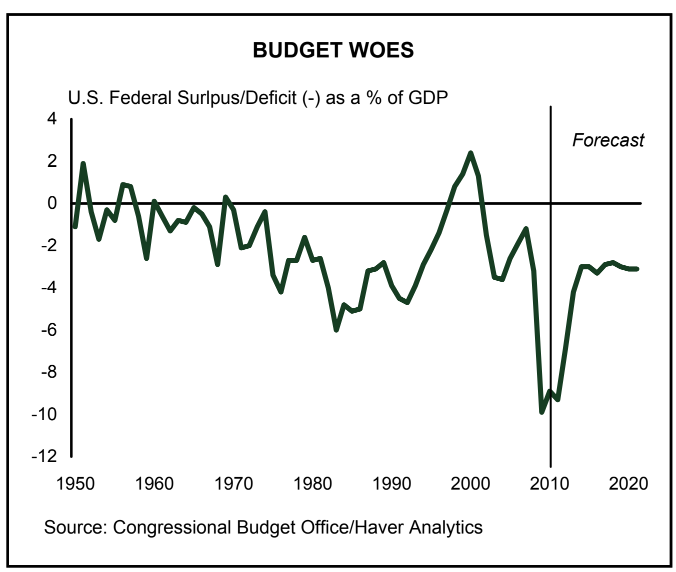
While news on the domestic front has been gloomy, U.S. economic growth has been supported by its export sector that has benefited from a lower U.S. dollar and strong growth in emerging market. But, worries surrounding sovereign debt restructuring in Europe continue to weigh on the global outlook. Greece is unable to borrow in global financial markets and is dependent on the IMF and its central-European benefactors to fund significant budget deficits. With their economy still in a deep recession, Greece's ability to meet its debt obligations has shown little sign of improvement. As we discuss in our Global Outlook, Greece is too small to have a meaningful impact on Euro-zone economic growth; but, the contagion risks to the broader European financial system remain acute. Given the fragility of the economic recovery, policymakers are likely to do all they can to avoid a full-fledged financial crisis, but until markets are satisfied that a resolution has been found, uncertainty will continue to dominate.

Policy options running thin

Should European debt default risks materialize or the domestic risks not subside, the options available to both government and monetary policy makers in the United States to counter the soft patch in growth are dwindling. As the Federal Reserve comes to the end of its second asset purchase program, some are calling for third round of quantitative easing. Chairman Bernanke has signaled that additional monetary stimulus would only be warranted under exceptional circumstances, and that the cost-benefit tradeoff has turned less attractive towards additional stimulus. This opinion has been echoed by a number of Fed members, including Vice Chairman Janet Yellen who has commented that stimulative monetary policy could contribute to the mispricing of risk in financial markets. What is more, while the asset purchase program was likely successful in turning around inflationary expectations and pulling up equity markets, it likely also had some hand in the run-up in oil prices, which was obviously counter productive in stimulating economic growth. All told, with inflation on the upswing and long-run inflation expectations no longer flashing deflation fears, the likelihood of additional monetary stimulus is very low.

In Washington, budget negotiations have devolved into a game of partisan brinkmanship. The debate is focused solely on how much to cut from government expenditures rather than on what the Federal government could do to support the recovery. Likewise, state and local governments are grappling with budget shortfalls of their own. Indeed, fiscal austerity is the name of the political game.

Improving the position of government balance sheets will imply both cutbacks to spending as well as eventual tax increases. Our forecast has built in the spending cuts of $60 billion sought by Republicans early this year (to avoid government shutdown) as well as the winding down



of temporary stimulus measures and the expiration of the payroll tax cut, and the investment tax credit. These will subtract just over a half a percentage point from economic growth in 2012. In 2013, we assume the expiration of the Bush-era tax cuts on those earning more than $250,000 and have assumed that the trend towards fiscal belt tightening continues. We anticipate fiscal tightening to subtract 0.5 percentage points from economic growth in 2013.

While cuts in near-term spending will likely continue over the next several years, they alone will not be enough to put the U.S. back on a sustainable fiscal footing. To do that, policymakers must engage in deeper tax and entitlement reform.

With respect to the path to fiscal solvency, there are two scenarios that could play out. In the first scenario economic rational wins out and the two parties succeed in reaching a compromise in mapping out a multi-year plan to address the fiscal problems. Part of this is likely to occur as part of the negotiations for raising the debt ceiling limit, (which is estimated to be reached on August 2). However, the more meaningful changes are likely to occur following the next Presidential election in 2012. This is our base case outlook and we expect taxes to be increased and the long-term spending trajectory to be lowered. Since the fiscal tightening occurs gradually over time and is not done in a slash and burn manner, it exerts a modest drag on growth but does not derail the recovery. In the second scenario – call it "political gridlock," – the parties cannot come to an agreement despite the fact that this will lead to financial pressures, including a much weaker U.S. dollar and higher U.S. bond yields as markets anticipate a debt downgrade. In our view, the first scenario appears be the most likely, and as history suggests, political parties will eventually reach a compromise. But, we must acknowledge that the risks of the latter scenario are not insignificant.

Bottom Line

U.S. economic growth slowed considerably in the first half of this year. The moderation was due in part to temporary factors that have since eased or will abate in the coming months. As a result, economic growth is likely to rebound in the second half of the year. Nonetheless, the economic recovery will remain constrained by the more long lasting legacies of the financial crisis. In particular, while progress is being slowly made in the housing market, it will take several years and additional home price declines to clear the market of its excess inventory. Moreover, the need for government's to rein in their spending is rapidly approaching. In an environment of slow economic progress and a still elevated unemployment rate, monetary policy is likely to remain accommodative over the next several years. Yet, as long as the economy continues to move forward, the need for emergency measures also diminishes. No doubt we are in a risk-filled recovery, but also one in which gradual progress is a major theme.

U.S. ECONOMIC OUTLOOK

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

	2011				2012				2013				Annual Average			4th Qtr/4th Qtr		
	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F	11F	12F	13F	11F	12F	13F
Real GDP	1.8	2.1	3.2	3.4	2.7	2.9	3.2	3.1	3.1	2.9	3.2	3.1	2.5	3.0	3.1	2.6	3.0	3.1
Consumer Expenditure	2.2	1.5	3.0	2.9	2.5	2.7	3.1	3.0	2.8	3.0	3.1	2.9	2.6	2.7	2.9	2.4	2.8	2.9
Durable Goods	8.9	-0.1	10.2	8.7	6.1	6.7	7.9	7.5	5.0	5.2	4.5	3.7	9.1	7.1	5.8	6.8	7.1	4.6
Business Investment	3.4	3.1	10.2	12.4	4.4	6.3	8.5	8.2	8.4	7.7	9.2	8.4	7.1	7.6	8.2	7.2	6.9	8.4
Non-Res. Structures	-16.8	1.2	-0.2	1.0	1.6	2.8	3.5	5.6	4.1	6.5	6.9	9.0	-3.4	1.9	5.3	-4.0	3.4	6.6
Machinery & Equipment	11.6	3.7	13.9	16.5	5.4	7.5	10.2	9.1	9.8	8.1	10.0	8.2	11.1	9.5	9.2	11.3	8.0	9.0
Residential Construction	-3.3	-5.0	0.9	5.4	7.2	6.9	7.4	7.5	11.7	16.0	16.8	17.6	-3.3	5.2	11.9	-0.6	7.2	15.5
Govt. Consumption & Gross Investment	-5.1	0.3	-0.7	-0.5	-0.8	-1.2	-1.5	-1.1	-1.3	-1.9	-2.1	-1.6	-1.0	-0.9	-1.5	-1.5	-1.2	-1.7
Final Domestic Demand	0.7	1.3	2.9	3.2	2.1	2.4	2.8	2.9	2.8	2.8	3.1	3.0	2.2	2.5	2.8	2.0	2.5	2.9
Exports	9.2	9.8	8.1	8.2	7.8	7.9	8.1	7.8	8.2	8.3	8.2	8.0	8.7	8.1	8.1	8.8	7.9	8.2
Imports	7.6	2.2	6.2	6.7	4.3	3.9	5.4	6.0	5.6	6.6	7.1	6.9	4.7	5.0	6.0	5.7	4.9	6.6
Change in Non-Farm Inventories	54.9	51.3	55.5	58.9	64.2	64.0	64.9	66.4	66.3	65.5	67.4	68.8	55.1	64.9	67.0	---	---	---
Final Sales	0.6	2.2	3.0	3.3	2.5	2.9	3.2	3.0	3.1	3.0	3.1	3.0	2.6	2.9	3.1	2.3	2.9	3.1
International Current Account Balance ($Bn)	-498	-490	-461	-471	-467	-465	-468	-480	-486	-500	-516	-532	-480	-470	-509	---	---	---
% of GDP	-3.3	-3.2	-3.0	-3.0	-3.0	-2.9	-2.9	-2.9	-2.9	-3.0	-3.0	-3.1	-3.1	-2.9	-3.0	---	---	---
Pre-tax Corporate Profits including IVA&CCA	5.3	6.1	7.4	6.9	2.9	3.2	3.6	2.9	3.1	2.9	3.6	4.5	7.2	4.5	3.3	6.4	3.2	3.5
% of GDP	11.3	11.4	11.4	11.5	11.4	11.4	11.4	11.3	11.2	11.2	11.1	11.1	11.4	11.4	11.2	---	---	---
GDP Deflator (Y/Y)	1.6	1.7	1.7	2.1	2.0	1.8	1.6	1.7	1.8	1.9	1.9	2.0	1.8	1.8	1.9	2.1	1.7	2.0
Nominal GDP	3.8	4.6	5.5	5.1	4.3	4.5	4.9	4.9	5.3	4.9	5.1	5.0	4.3	4.8	5.0	4.8	4.7	5.1
Labor Force	-1.5	0.8	1.0	1.1	1.2	1.3	1.3	1.3	1.3	1.2	1.2	1.1	-0.1	1.2	1.3	0.4	1.3	1.2
Employment	1.3	1.6	1.9	2.0	1.8	1.9	2.0	2.0	1.9	1.8	2.0	1.9	1.2	1.9	1.9	1.7	1.9	1.9
Change in Empl. ('000s)	431	519	602	637	591	627	666	663	633	606	675	645	1,586	2,469	2,573	2,189	2,547	2,559
Unemployment Rate (%)	8.9	9.0	8.9	8.8	8.8	8.6	8.5	8.4	8.3	8.2	8.0	7.8	8.9	8.6	8.1	---	---	---
Personal Disp. Income	4.6	2.9	4.7	4.9	2.1	4.8	5.0	5.1	2.0	4.7	5.1	5.0	3.7	4.0	4.2	4.3	4.2	4.2
Pers. Savings Rate (%)	5.1	4.8	4.7	4.8	4.3	4.4	4.3	4.3	3.7	3.6	3.5	3.5	4.8	4.3	3.6	---	---	---
Cons. Price Index (Y/Y)	2.2	3.4	3.4	3.3	2.6	2.1	2.2	2.2	2.1	2.0	2.0	2.1	3.1	2.2	2.1	3.3	2.2	2.1
Core CPI (Y/Y)	1.1	1.4	1.6	2.0	2.1	2.1	2.2	2.1	2.0	1.9	1.9	2.0	1.5	2.1	2.0	2.0	2.1	2.0
Housing Starts (mns)	0.58	0.55	0.58	0.60	0.62	0.63	0.65	0.68	0.73	0.78	0.83	0.89	0.58	0.64	0.81	---	---	---
Productivity: Real Output per hour (y/y)	1.3	2.0	1.9	1.8	1.6	1.8	1.6	1.5	1.5	1.5	1.4	1.4	1.7	1.6	1.5	1.8	1.5	1.4

F: Forecast by TD Economics as at June 2011

Source: U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Analysis, TD Economics

INTEREST RATE OUTLOOK	Spot Rate 06/14/11	2011 Q1F	2011 Q2F	2011 Q3F	2011 Q4F	2012 Q1F	2012 Q2F	2012 Q3F	2012 Q4F	2013 Q1F	2013 Q2F	2013 Q3F	2013 Q4F
Fed Funds Target Rate (%)	0.25	0.25	0.25	0.25	0.25	0.75	1.00	1.00	1.00	1.25	1.50	1.75	2.00
3-mth T-Bill Rate (%)	0.01	0.10	0.10	0.25	0.55	1.05	1.10	1.15	1.30	1.45	1.70	1.95	2.10
2-yr Govt. Bond Yield (%)	0.41	0.60	0.50	0.85	1.25	1.65	1.85	1.90	2.00	2.35	2.50	2.65	2.95
5-yr Govt. Bond Yield (%)	1.60	2.00	1.65	1.90	2.50	2.70	2.85	3.00	3.10	3.25	3.35	3.50	3.70
10-yr Govt. Bond Yield (%)	3.00	3.40	3.00	3.50	3.85	4.00	4.15	4.20	4.20	4.25	4.35	4.50	4.65
30-yr Govt. Bond Yield (%)	4.23	4.60	4.30	4.75	4.75	4.75	4.65	4.60	4.60	4.63	4.68	4.75	4.83
10-yr-2-yr Govt. Spread (%)	2.60	2.80	2.50	2.65	2.60	2.35	2.30	2.30	2.20	1.90	1.85	1.85	1.70

f: Forecast by TD Economics as at June 2011; All forecasts are for end of period. Source: Bloomberg, TD Economics

FOREIGN EXCHANGE OUTLOOK Currency	Exchange Rate	Spot Price 06/14/11	2011 Q1	2011 Q2F	2011 Q3F	2011 Q4F	2012 Q1F	2012 Q2F	2012 Q3F	2012 Q4F	2013 Q1F	2013 Q2F	2013 Q3F	2013 Q4F
Trade-wtd. USD	Jan-1997=100	95.6	96.5	94.9	94.1	94.7	95.8	94.8	93.6	92.9	94.3	93.9	93.8	93.3
Canadian dollar	USD per CAD	1.03	1.03	1.03	1.01	1.00	1.00	1.02	1.03	1.05	1.05	1.05	1.03	1.03
Japanese yen	JPY per USD	80.43	83.0	80.0	81.0	85.0	90.0	91.0	92.0	95.0	99.0	99.0	100.0	100.0
Euro	USD per EUR	1.44	1.42	1.44	1.48	1.45	1.40	1.42	1.45	1.45	1.40	1.40	1.38	1.38
U.K. pound	USD per GBP	1.62	1.60	1.64	1.64	1.67	1.65	1.69	1.75	1.77	1.75	1.75	1.77	1.77
Swiss franc	CHF per USD	0.85	0.92	0.85	0.81	0.84	0.89	0.88	0.87	0.87	0.91	0.91	0.94	0.94
Australian dollar	USD per AUD	1.06	1.03	1.06	1.05	1.04	1.02	1.00	0.97	0.94	0.91	0.88	0.85	0.85
NZ dollar	USD per NZD	0.81	0.76	0.82	0.80	0.80	0.80	0.80	0.78	0.76	0.73	0.70	0.67	0.65

f: Forecast by TD Economics as at June 2011; All forecasts are for end of period; Source: Federal Reserve, Bloomberg, TD Economics

GLOBAL ECONOMIC OUTLOOK					
Annual per cent change unless otherwise indicated					
	2007 Share*		Forecast		
Real GDP	(%)	2010	2011	2012	2013
World	99.1	4.5	3.6	3.7	3.6
North America	25.5	3.1	2.6	3.0	3.1
United States	21.4	2.9	2.5	3.0	3.1
Canada	2.0	3.2	2.8	2.5	2.3
Mexico	2.1	5.5	4.2	3.9	4.1
European Union (EU-27)	23.7	1.8	1.9	1.6	1.7
Euro-zone (EU-16)	16.1	1.7	1.8	1.5	1.6
Germany	4.4	3.5	2.7	1.9	1.8
France	3.2	1.4	1.5	1.6	1.7
Italy	2.8	1.2	1.0	1.0	1.1
United Kingdom	3.3	1.5	1.7	2.0	2.1
EU accession members	3.4	2.4	2.4	1.7	1.8
Asia	35.5	7.3	5.6	5.9	5.5
Japan	6.6	4.0	0.1	2.9	1.9
Asian NIC's	3.7	8.3	5.0	4.6	4.6
Hong Kong	0.5	6.5	5.0	4.5	4.7
Korea	1.9	6.1	4.6	4.3	4.2
Singapore	0.3	13.9	5.9	5.0	4.9
Taiwan	1.1	11.0	5.4	5.1	4.9
Russia	3.2	4.0	4.7	4.3	4.4
Australia & New Zealand	1.4	2.7	2.0	4.1	3.4
Developing Asia	20.6	9.0	7.9	7.4	7.1
ASEAN-4	3.1	6.9	5.3	4.9	4.9
China	10.9	10.3	9.1	8.8	8.3
India	4.6	8.7	8.0	7.4	7.2
Central/South America	6.1	5.6	4.4	4.2	4.1
Argentina	0.8	8.1	5.3	5.0	4.0
Brazil	2.8	7.5	5.0	4.8	4.7
Other Developing	8.4	4.3	2.7	2.6	2.5

*Regional wts. do not sum to 100% because some countries omitted
Forecast as at June 2011
Source: International Monetary Fund, national statistics agencies

ECONOMIC INDICATORS FOR THE G-7 AND EUROPE				
		Forecast		
	2010	2011	2012	2013
Real GDP (Annual per cent change)				
G-7 (41.17%)*	2.8	1.9	2.5	2.4
U.S.	2.9	2.5	3.0	3.1
Japan	4.0	0.1	2.9	1.9
EU-16	1.7	1.8	1.5	1.6
Germany	3.5	2.7	1.9	1.8
France	1.4	1.5	1.6	1.7
Italy	1.2	1.0	1.0	1.1
United Kingdom	1.5	1.7	2.0	2.1
Canada	3.2	2.8	2.5	2.3
Consumer Price Index (Annual per cent change)				
G-7	1.4	2.5	1.9	1.7
U.S.	1.6	3.1	2.2	2.1
Japan	-0.7	0.1	0.2	0.3
EU-16	1.6	2.3	2.1	2.0
Germany	1.2	2.3	2.1	1.9
France	1.7	2.0	2.0	2.0
Italy	1.6	2.1	1.9	1.9
United Kingdom	3.3	4.4	2.7	1.9
Canada	1.8	2.8	2.2	2.1
Unemployment Rate (Per cent annual averages)				
U.S.	9.6	8.9	8.6	8.1
Japan	5.1	4.7	4.4	4.3
EU-16	10.1	9.1	8.3	8.0
Germany	7.1	6.5	6.5	6.7
France	9.8	9.8	9.7	8.9
Italy	8.4	8.4	8.1	7.9
United Kingdom	7.8	7.6	7.3	7.2
Canada	8.0	7.6	7.4	7.1

*Share of 2007 world gross domestic product (GDP)
Forecast as at June 2011
Source: National statistics agencies, TD Economics