

THE WEEKLY BOTTOM LINE

TD Economics



HIGHLIGHTS OF THE WEEK

December 14, 2012

United States

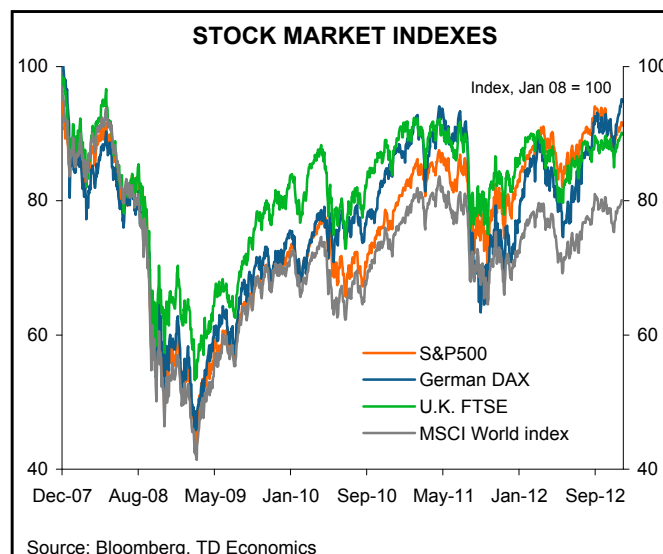
- This week the Fed decided to continue buying agency mortgage-backed securities and longer-term Treasury securities at a combined pace of \$85 billion per month. The Committee also modified its guidance about future changes to the interest rate.
- Namely, they anticipate that the federal funds rate is likely to stay exceptionally low at least as long as the unemployment rate remains above 6.5%, provided that inflation over the next two years is projected to not exceed 2.5%, and that longer-term inflation expectations remain stable.
- Given the current state of the U.S. economy, the introduction of these targets should not alter the conduct of monetary policy for quite some time. The second half of 2015 is still the most likely timeframe for the first rate hike.

THIS WEEK IN THE MARKETS

	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	1,419	1,418	1,466	1,205
S&P/TSX Comp.	12,289	12,160	12,740	11,281
DAX	7,586	7,518	7,615	5,671
FTSE 100	5,919	5,914	5,966	5,260
Nikkei	9,738	9,527	10,255	8,296
Fixed Income Yields				
U.S. 10-yr Treasury	1.71	1.62	2.38	1.39
Canada 10-yr Bond	1.80	1.71	2.29	1.58
Germany 10-yr Bund	1.35	1.30	2.06	1.17
UK 10-yr Gilt	1.87	1.74	2.45	1.44
Japan 10-yr Bond	0.74	0.71	1.05	0.70
Foreign Exchange Cross Rates				
C\$ (USD per CAD)	1.02	1.01	1.03	0.96
Euro (USD per EUR)	1.31	1.29	1.35	1.21
Pound (USD per GBP)	1.61	1.60	1.63	1.53
Yen (JPY per USD)	83.5	82.5	83.7	76.2
Commodity Spot Prices**				
Crude Oil (\$US/bbl)	86.3	85.9	109.5	77.7
Natural Gas (\$US/MMBtu)	3.27	3.33	3.77	1.84
Copper (\$US/met. tonne)	8052.0	8012.3	8737.5	7192.0
Gold (\$US/troy oz.)	1696.1	1704.1	1790.4	1539.6

*as of 9:45 am on Friday, **Oil-WTI, Cushing, Nat. Gas-Henry Hub, LA (Thursday close price), Copper-LME Grade A, Gold-London Gold Bullion; Source: Bloomberg

STOCK MARKET INDEXES



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)	0.75%
Bank of England (Repo Rate)	0.50%
Bank of Japan (Overnight Rate)	0.10%

Source: Central Banks, Haver Analytics

TD ECONOMICS KEY FORECASTS

	Current Rate	2012				2013			
	12/14/12	Q1	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F
Fed Funds Target Rate (%)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
2-yr Govt. Bond Yield (%)	0.23	0.33	0.33	0.23	0.25	0.30	0.30	0.30	0.40
10-yr Govt. Bond Yield (%)	1.71	2.23	1.67	1.65	1.70	1.90	2.00	2.10	2.30
30-yr Govt. Bond Yield (%)	2.88	3.35	2.76	2.82	2.90	3.00	3.10	3.30	3.50
Real GDP (Q/Q % Chg, Annualized)	2.7 (Q3)	2.0	1.3	2.0	1.7	1.9	2.2	2.6	3.1
CPI (Y/Y % Chg.)	1.8 (Nov-12)	2.8	1.9	1.7	2.2	2.0	2.4	2.4	2.2
Unemployment Rate (%)	7.7 (Nov-12)	8.3	8.2	8.1	8.1	8.1	8.0	7.9	7.8

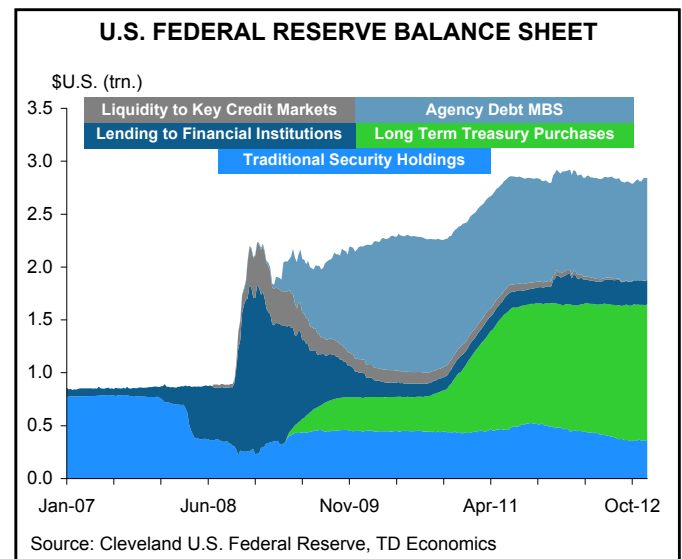
Forecast by TD Economics. Source: Bloomberg, TD Economics

ON GUIDEPOSTS AND MAGIC WANDS

Nobody would dare and doubt the resolve of Fed Chairman Bernanke when he claimed that if “we could wave a magic wand and get unemployment down to 5 percent tomorrow, obviously we would do that”; but, in the absence of magic, Mr. Bernanke and his colleagues at the FOMC decided this week to stick with other tricks from their repertoire. First, they decided to continue buying agency mortgage-backed securities at a pace of \$40 billion per month and longer-term Treasury securities, initially to the tune of \$45 billion per month. Finally, the Committee also modified its guidance about future changes to the interest rate. Namely, they anticipate that the federal funds rate is likely to stay exceptionally low at least as long as the unemployment rate remains above 6.5%, provided that inflation over the next two years is projected not to exceed 2.5%, and that longer-term inflation expectations remain stable. However, Chairman Bernanke emphasized that these thresholds are not automatic triggers for rate increases, but rather guideposts in terms of when the reduction of accommodation could begin.

In continuing its asset purchases, the Fed aims to maintain downward pressure on longer-term interest rates and to keep financial conditions accommodative. This should promote hiring and economic growth while ensuring that inflation over time does not deviate too far from the Fed’s 2% objective. These unconventional actions pursued by the Fed have drawn criticism from many whom believe they have been ineffective at achieving their goals, while increasing the future risks of higher inflation and financial instability.

In the absence of a counterfactual, it is very difficult to assess how effective the Fed actions have been. Regarding the accusation of policy ineffectiveness, there are elements that suggests that the Fed actions have materially lowered mortgage rates, as mortgage originators pass-on a portion of their lower funding costs. For instance, since the Fed ramped up its purchases of MBS in September, conventional 30-year mortgage rates have declined roughly 25 basis points to a record low of 3.31%. Moreover, the spread between this rate and the 30-year MBS fixed rate narrowed from 130 basis points to 107 basis points. The fact that credit has not grown more strongly, thereby fueling a stronger recovery, has to do with the availability of cheap credit and also with the lack of stronger demand from both businesses and households. This has been caused by the necessary healing of households’ balance sheets in the aftermath of the housing market



crash, and by the uncertainty businesses face regarding the economic outlook and future demand.

Regarding the second criticism of inflation risks, wage pressures will most likely remain contained due to high unemployment. In addition, capacity underutilization in most sectors of the economy and a [weak global backdrop](#) will also contribute to keep inflationary pressures contained. Indeed, in [our latest forecast](#) released this week, we foresee the unemployment rate trending down slowly to 7.0% – above the Fed’s threshold – by the end of 2014, whereas core inflation should stabilize at around 2.3% by then. This is consistent with economic growth accelerating to 3.0% in 2014, from 1.9% next year.

On the third criticism of financial instability, this is perhaps the most significant risk that unconventional Fed actions carry. In part because, as Chairman Bernanke has noted, large asset purchases are “a less well understood tool” and the Fed “will be learning over time about how efficacious they are, about what costs they may carry with them in terms of unintended consequences that they might create”. This is why the central bank has repeatedly vowed to modify its program of asset purchases as appropriate if risks become apparent as the balance sheet grows. And on this note, once again we would take the Chairman at his word.

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UPCOMING KEY ECONOMIC RELEASES

U.S. Housing Starts - November*

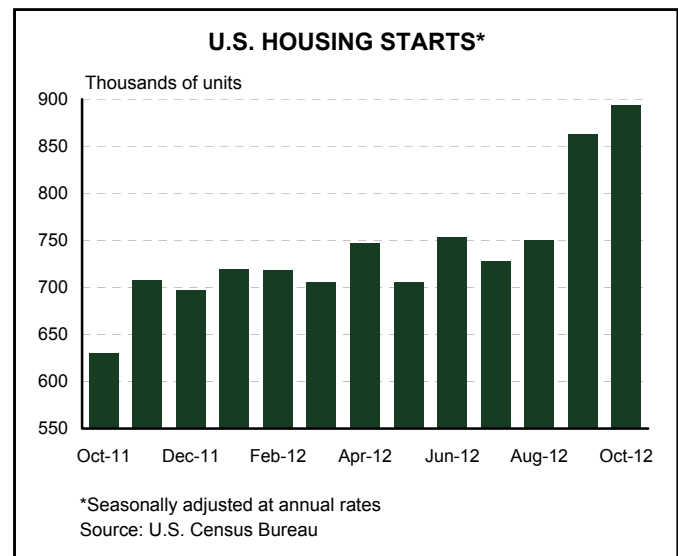
Release Date: December 19, 2012

October Result: 894K

TD Forecast: 850K

Consensus: 873K

New residential construction activity has been on an upswing, with the pace of housing starts surging to a new cycle high in recent months. While the rebound in building activity is largely consistent with the improved tone in housing market activity more generally, the surge in recent months appears to have gone slightly ahead of the market's capacity to absorb it. In November, we expect the level of new construction to moderate to 850K units. Much of the weakness will be the result of the fallout from Hurricane Sandy in the Northeast, which we expect to dampen building activity in November. Permits should increase modestly, rising to 875K units. In the coming months, with housing demand likely to improve and the drag from the hurricane reversed, we expect the recent positive momentum in building activity to be sustained.



U.S. Personal Income & Spending - November*

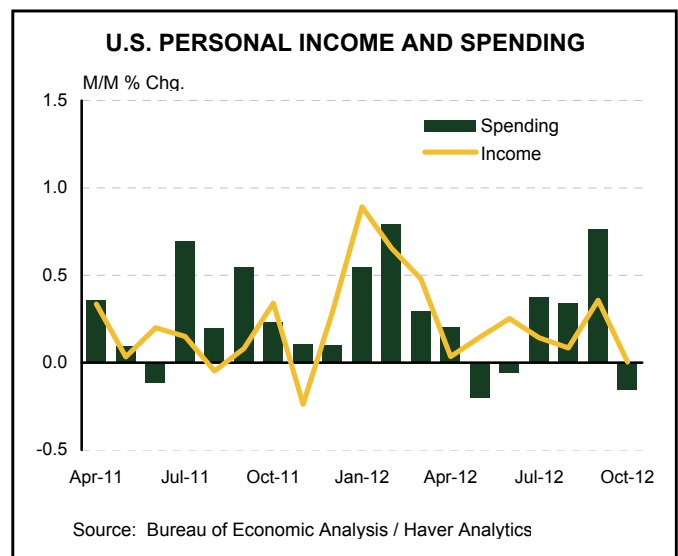
Release Date: December 21, 2012

October Result: Income 0.0% M/M; Spending -0.2% M/M

TD Forecast: Income 0.3% M/M; Spending 0.4% M/M

Consensus: Income 0.3% M/M; Spending 0.4% M/M

Personal income should rebound modestly in November, after essentially grinding to a halt the month before. During the month, we expect the pace of personal income growth to post a relatively decent 0.3% m/m gain, mostly on account of the improvement in labour market activity. Personal spending activity should also improve, boosting a respectable 0.4% m/m which will more than undo the 0.2% m/m decline the month before. This will be consistent with the better tone seen in the November retail sales report, and with core spending activity appearing to have regained some positive momentum we expect real spending to add favourably to economic activity during the month. In terms of inflation, the core PCE deflator should post a very modest 0.1% m/m gain, while the annual pace of core inflation should remain unchanged at 1.6% y/y. In the



coming months, with the pace of economic activity likely to be quite tepid, we expect spending and income growth to improve only moderately, with core PCE inflation pressures remaining largely contained.

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

RECENT KEY ECONOMIC INDICATORS: DECEMBER 10-14, 2012

Release Date	Economic Indicator/Event	Data for Period	Units	Current	Prior	
United States						
Dec 11	NFIB Small Business Optimism	Nov	Index	87.5	93.1	
Dec 11	Trade Balance	Oct	USD, Blns	-42.2	-40.3	R▲
Dec 11	Wholesale Inventories	Oct	M/M % Chg.	0.6	1.1	
Dec 11	JOLTs Job Openings	Oct	Thousands	3675.0	3547.0	R▼
Dec 12	Import Price Index	Nov	M/M % Chg.	-0.9	0.3	R▼
Dec 12	FOMC Rate Decision	12-Dec	%	0.25	0.25	
Dec 12	Monthly Budget Statement	Nov	USD, Blns	-172.1	-137.3	
Dec 13	Advance Retail Sales	Nov	M/M % Chg.	0.3	-0.3	
Dec 13	Retail Sales Less Autos	Nov	M/M % Chg.	0.0	0.0	
Dec 13	Producer Price Index	Nov	M/M % Chg.	-0.8	-0.2	
Dec 13	PPI Ex Food & Energy	Nov	M/M % Chg.	0.1	-0.2	
Dec 13	Initial Jobless Claims	8-Dec	Thousands	343.0	372.0	R▲
Dec 13	Continuing Claims	1-Dec	Thousands	3198.0	3221.0	R▲
Dec 13	Bloomberg Consumer Comfort	9-Dec	Index	-34.5	-33.8	
Dec 13	Business Inventories	Oct	M/M % Chg.	0.4	0.7	
Dec 14	Consumer Price Index	Nov	M/M % Chg.	-0.3	0.1	
Dec 14	CPI Ex Food & Energy	Nov	M/M % Chg.	0.1	0.2	
Dec 14	Industrial Production	Nov	%	1.1	-0.7	R▼
Dec 14	Capacity Utilization	Nov	%	78.4	77.7	R▼
Canada						
Dec 10	Housing Starts	Nov	Thousands	196.1	203.5	R▼
Dec 11	International Merchandise Trade	Oct	CAD, Blns	-0.17	-1.01	R▼
Dec 13	New Housing Price Index	Oct	M/M % Chg.	0.2	0.2	
Dec 13	Capacity Utilization Rate	3Q	%	80.9	80.9	R▼
Dec 14	Manufacturing Sales	Oct	M/M % Chg.	-1.4	0.0	R▼
International						
Dec 9	JN Adjusted Current Account Total	Oct	Yen, Blns	414.1	-142.0	
Dec 10	GE Trade Balance	Oct	Euros, Blns	15.8	16.9	
Dec 10	FR Industrial Production	Oct	Y/Y % Chg.	-3.6	-2.5	
Dec 10	FR Manufacturing Production	Oct	Y/Y % Chg.	-4.0	-2.6	R▼
Dec 11	EC ZEW Survey (Econ. Sentiment)	Dec	Index	7.6	-2.6	
Dec 12	FR Consumer Price Index	Nov	Y/Y % Chg.	1.4	1.9	
Dec 12	UK ILO Unemployment Rate	Oct	%	7.8	7.8	
Dec 12	EC Euro-Zone Ind. Prod. wda	Oct	Y/Y % Chg.	-3.6	-2.8	R▼
Dec 14	FR PMI Manufacturing	Dec P	Index	44.6	44.5	
Dec 14	FR PMI Services	Dec P	Index	46.0	45.8	
Dec 14	GE PMI Manufacturing	Dec A	Index	46.3	46.8	
Dec 14	GE PMI Services	Dec A	Index	52.1	49.7	
Dec 14	EC PMI Manufacturing	Dec A	Index	46.3	46.2	
Dec 14	EC PMI Composite	Dec A	Index	47.3	46.5	
Dec 14	EC PMI Services	Dec A	Index	47.8	46.7	
Dec 14	EC Eurozone Employment	3Q	Y/Y % Chg.	-0.7	-0.7	R▼
Dec 14	EC Euro-Zone CPI	Nov	Y/Y % Chg.	2.2	2.2	
Dec 14	EC Euro-Zone CPI Core	Nov	Y/Y % Chg.	1.4	1.5	

* Eastern Standard Time; Source: Bloomberg, TD Economics



UPCOMING ECONOMIC RELEASES AND EVENTS: DECEMBER 17-21, 2012

Release Date	Time*	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
United States						
Dec 17	8:30	Empire Manufacturing	Dec	Index	-1.00	-5.22
Dec 17	9:00	Net Long-term TIC Flows	Oct	USD, Blns	25.0	3.3
Dec 18	8:30	Current Account Balance	3Q	USD, Blns	-103.6	-117.4
Dec 18	10:00	NAHB Housing Market Index	Dec	Index	47	46
Dec 19	8:30	Housing Starts	Nov	M/M % Chg.	-2.4	3.6
Dec 19	8:30	Building Permits	Nov	M/M % Chg.	0.8	-2.7
Dec 20	8:30	GDP QoQ (Annualized)	3Q T	Q/Q % Chg.	2.8	2.7
Dec 20	10:00	Philadelphia Fed. Business Outlook Survey	Dec	Index	-3.0	-10.7
Dec 20	10:00	House Price Index	Oct	M/M % Chg.	0.2	0.2
Dec 20	10:00	Existing Home Sales	Nov	M/M % Chg.	2.3	2.1
Dec 20	10:00	Philadelphia Fed. Leading Indicators	Nov	Index	-0.2	0.2
Dec 21	8:30	Personal Income	Nov	M/M % Chg.	0.3	0.0
Dec 21	8:30	Personal Spending	Nov	M/M % Chg.	0.4	-0.2
Dec 21	8:30	Chicago Fed Nat Activity Index	Nov	Index	--	-0.56
Dec 21	8:30	PCE Deflator	Nov	M/M % Chg.	-0.1	0.1
Dec 21	8:30	PCE Core	Nov	M/M % Chg.	0.1	0.1
Dec 21	8:30	Durable Goods Orders	Nov	M/M % Chg.	0.5	0.0
Dec 21	8:30	Durables Ex Transportation	Nov	M/M % Chg.	-0.4	1.5
Dec 21	8:30	Cap Goods Orders Nondef Ex Air	Nov	M/M % Chg.	-1.0	1.7
Dec 21	8:30	Cap Goods Ship Nondef Ex Air	Nov	M/M % Chg.	--	-0.4
Dec 21	11:00	Kansas City Fed. Manf. Activity	Dec	Index	-5	-6
Canada						
Dec 17	8:30	International Securities Transactions	Oct	CAD, Blns	--	13.90
Dec 17	9:00	Existing Home Sales	Nov	M/M % Chg.	--	-0.1
Dec 19	8:30	Wholesale Sales	Oct	M/M % Chg.	0.4	-1.4
Dec 19	9:00	Teranet/National Bank HPI	Nov	M/M % Chg.	--	-0.2
Dec 20	8:30	Retail Sales	Oct	M/M % Chg.	0.1	0.1
Dec 20	8:30	Retail Sales Less Autos	Oct	M/M % Chg.	0.2	0.0
Dec 21	8:30	Gross Domestic Product	Oct	M/M % Chg.	0.1	0.0
Dec 21	8:30	Consumer Price Index	Nov	M/M % Chg.	-0.1	0.2
Dec 21	8:30	Core Consumer Price Index	Nov	M/M % Chg.	0.1	0.3
International						
Dec 17	5:00	EC Euro-Zone Labour Costs	3Q	Y/Y % Chg.	--	1.6
Dec 17	5:00	EC Euro-Zone Trade Balance SA	Oct	Euros, Blns	--	11.3
Dec 18	4:30	UK PPI Input NSA	Nov	Y/Y % Chg.	-0.1	0.1
Dec 18	4:30	UK PPI Output NSA	Nov	Y/Y % Chg.	2.5	2.5
Dec 18	4:30	UK Consumer Price Index	Nov	Y/Y % Chg.	2.7	2.7
Dec 18	4:30	UK Core Consumer Price Index	Nov	Y/Y % Chg.	2.7	2.6
Dec 19	4:30	UK <i>Bank of England Minutes</i>				
Dec 19	5:00	EC Construction Output WDA	Oct	Y/Y % Chg.	--	-2.6
Dec 19	16:45	NZ GDP	3Q	Y/Y % Chg.	2.5	2.6
19-20 Dec		JN BOJ Target Rate	20-Dec	%	0.10	0.10
Dec 20	2:00	GE Producer Prices	Nov	Y/Y % Chg.	1.4	1.5
Dec 20	4:30	UK Retail Sales Ex Auto Fuel	Nov	Y/Y % Chg.	2.2	1.1
Dec 20	4:30	UK Retail Sales w/ Auto Fuel	Nov	Y/Y % Chg.	1.5	0.6
Dec 21	4:30	UK Current Account	3Q	GBP, Blns	-14.1	-20.8

* Eastern Standard Time; Source: Bloomberg, TD Economics



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