

THE WEEKLY BOTTOM LINE

TD Economics



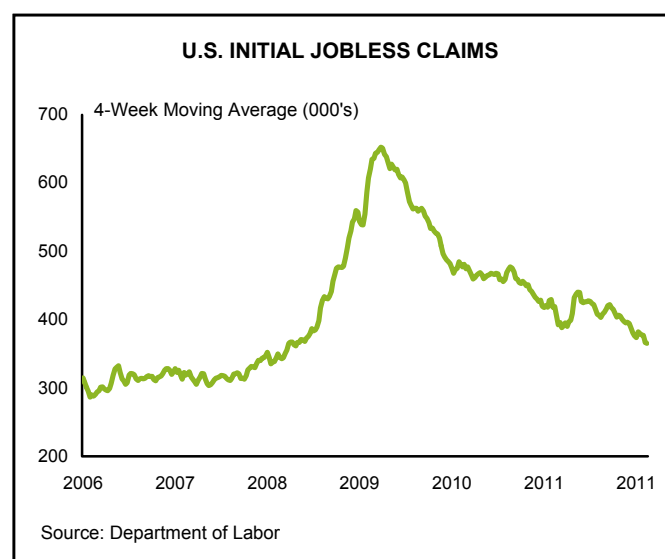
HIGHLIGHTS OF THE WEEK

February 10, 2012

- Near-term fiscal risks to economic growth were mitigated this week after Congressional leaders struck a deal to extend temporary payroll tax cuts and unemployment insurance benefits through the end of 2012. But there is still a risk that fiscal austerity comes to bite in the not-too-distant future.
- Fiscal austerity in a modest growth environment will hurt the economic recovery, not help it. Greece is stark example of what crushing fiscal austerity can do to economic growth prospects. Closer to home, state and local government spending actions offer another example of how fiscal restraint can undermine growth.
- Policy clarity, especially as it concerns future fiscal restraint as outlined in the Budget Control Act, could go a long way in firming up the ground upon which a strong recovery is founded.

THIS WEEK IN THE MARKETS				
	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	1 360	1 343	1 364	1 099
S&P/TSX Comp.	12 456	12 389	14 271	11 178
DAX	6 860	6 693	7 528	5 072
FTSE 100	5 920	5 852	6 087	4 944
Nikkei	9 384	8 947	10 858	8 160
Fixed Income Yields				
U.S. 10-yr Treasury	2.02	1.99	3.59	1.72
Canada 10-yr Bond	2.06	2.05	3.49	1.84
Germany 10-yr Bund	1.93	1.91	3.49	1.67
UK 10-yr Gilt	2.19	2.11	3.81	1.96
Japan 10-yr Bond	0.95	0.98	1.35	0.95
Foreign Exchange Cross Rates				
C\$ (USD per CAD)	1.00	1.00	1.06	0.95
Euro (USD per EUR)	1.32	1.32	1.49	1.27
Pound (USD per GBP)	1.58	1.58	1.67	1.53
Yen (JPY per USD)	79.4	77.6	85.2	75.8
Commodity Spot Prices**				
Crude Oil (\$US/bbl)	103.0	98.7	113.9	75.7
Natural Gas (\$US/MMBtu)	2.48	2.50	4.92	2.25
Copper (\$US/met. tonne)	8286.0	8460.8	9903.5	6721.5
Gold (\$US/troy oz.)	1722.4	1722.0	1900.2	1384.1

*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



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)	1.00%
Bank of England (Repo Rate)	0.50%
Bank of Japan (Overnight Rate)	0.00%

Source: Central Banks, Haver Analytics

TD ECONOMICS KEY FORECASTS									
	Current Rate 2/17/12	2011				2012			
		Q1	Q2	Q3	Q4	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 (%)	0.29	0.82	0.46	0.24	0.25	0.25	0.20	0.20	0.20
10-yr Govt. Bond Yield (%)	2.02	3.47	3.16	1.91	1.88	1.90	1.95	2.25	2.35
30-yr Govt. Bond Yield (%)	3.17	4.51	4.37	2.91	2.89	3.10	3.25	3.50	3.70
Real GDP (Q/Q % Chg, Annualized)	2.8 (Q4)	0.4	1.3	1.8	2.8	2.0	1.9	2.2	2.4
CPI (Y/Y % Chg.)	3.0 (Dec-11)	2.2	3.3	3.8	3.3	2.6	1.7	1.4	1.6
Unemployment Rate (%)	8.3 (Jan-12)	8.9	9.1	9.1	8.7	8.5	8.5	8.4	8.3

f: Forecast by TD Economics. Source: Bloomberg, TD Economics

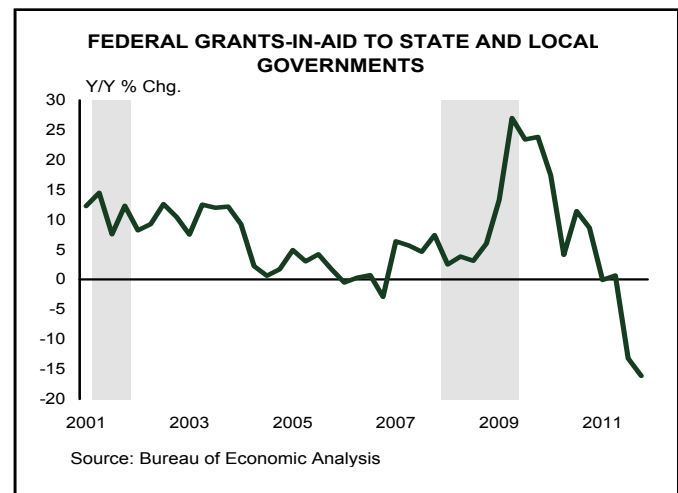
AUSTERITY ANTIDOTE?

Near-term fiscal risks to economic growth were mitigated this week after Congressional leaders struck a deal to extend temporary payroll tax cuts and unemployment insurance benefits through the end of 2012. That leaders managed to reach an agreement without the usual brinkmanship was encouraging, as failure to do so would have dealt a blow to economic momentum just as the recovery is picking up steam. Looking further out, however, there is still significant uncertainty over the future course of government spending, especially as it relates to the draconian budget cuts enshrined in the Budget Control Act (BCA). As such, the risk that fiscal austerity comes to bite in the not-too-distant future persists.

America's policymakers need only look across the Atlantic for a lesson in what crushing fiscal austerity can do to an economy. Greece is entering its fifth year of recession; its GDP contracted 6.8% last year alone. Greece's creditors are sticking to the official script that only through ambitious austerity measures can the country regain the confidence of markets and attract new investment. That line of reasoning may make for textbook macroeconomic policy, but it is tearing at the social fabric of the nation. These days Greek politicians answer to the demands of foreign creditors, not to the demands of its own citizens rioting in the streets of Athens.

Greece is an extreme case, but there are examples here at home of how fiscal austerity is already undermining the economic recovery. Consider the case of state and local governments (SLGs), which have severely scaled back on spending since the downturn. Last year, SLG consumption and investment subtracted nearly 0.3 percentage points off national GDP growth, the largest drag on record since WWII.

For SLGs, austerity is a necessity, not a choice. Unlike the federal government, most states are bound by their constitutions to run balanced budgets. Hence, they have no mechanism with which to lean against the business cycle when tax revenues decline. During the downturn, the federal government essentially ran deficits on the states' behalf through the American Recovery and Reinvestment Act. Federal stimulus money helped limit the degree to which states were forced to cut back on jobs and services when the economy turned sour. Unfortunately, what was once a flood of federal funds is slowing to a trickle, and the recovery in SLG tax revenues has been slower than in previous cycles (for more on that topic see our recent report [here](#)). As a result, the economic drag from SLGs has yet to subside.



As these examples show, fiscal austerity will hurt the economic recovery, not help it. But maintaining the status quo won't lead to faster growth either. Rather than simply extending existing programs, Congress could enact new spending measures to boost aggregate demand directly – through new infrastructure investments, for example. Yet as the European experience demonstrates, what makes for good macroeconomic policy doesn't always gel with social and political realities.

Even if additional government spending is out of the question, there is another avenue through which fiscal measures can prove sufficiently stimulative. It is one that is relatively cheap and, politically, more palatable. Policy clarity, especially as it concerns future fiscal restraint as outlined in the BCA, could go a long way in firming up the ground upon which a strong recovery is founded. Unfortunately, policy outcomes have grown increasingly unpredictable in Washington these days. That this week's deal was struck at the final hour – the benefits would have expired at the end of the month and Congress is in recess next week – is symptomatic of the day-to-day policy uncertainty that is undermining the economy.

The economy has exuded budding momentum over the last two months. The labor market is showing renewed strength, and signs of progress in the housing market persist. For all its problems, the United States economy is still among the best-positioned in the developed world. Corporate balance sheets are healthy, and households' net wealth is higher here than in Europe. But the federal government needs to do a better job of promoting this recovery. If not, what has already been a long recovery will get longer still.

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**RECENT KEY ECONOMIC INDICATORS: FEBRUARY 13 - 17, 2012**

Release Date	Economic Indicators	Data for Period	Units	Current	Prior	
United States						
Feb 14	NFIB Small Business Optimism	Jan	Index	93.9	93.8	
Feb 14	Import Price Index	Jan	M/M % Chg.	0.3	-0.1	
Feb 14	Advance Retail Sales	Jan	M/M % Chg.	0.4	0.0	R▼
Feb 14	Retail Sales Less Autos	Jan	M/M % Chg.	0.7	-0.5	R▼
Feb 14	Retail Sales Ex Auto & Gas	Jan	M/M % Chg.	0.6	-0.2	R▼
Feb 14	Retail Sales "Control Group"	Jan	M/M % Chg.	0.7	-0.4	
Feb 14	Business Inventories	Dec	M/M % Chg.	0.4	0.3	
Feb 15	MBA Mortgage Applications	10-Feb	W/W % Chg.	-0.1	7.5	
Feb 15	Empire Manufacturing	Feb	Index	19.53	13.48	
Feb 15	Total Net TIC Flows	Dec	Billions	87.1	42.9	R▼
Feb 15	Net Long-term TIC Flows	Dec	Billions	17.9	61.3	R▲
Feb 15	Industrial Production	Jan	M/M % Chg.	0.0	1.0	R▲
Feb 15	Capacity Utilization	Jan	%	78.5	78.6	R▲
Feb 15	NAHB Housing Market Index	Feb	Index	29	25	
Feb 16	Producer Price Index	Jan	M/M % Chg.	0.1	-0.1	
Feb 16	PPI Ex Food & Energy	Jan	M/M % Chg.	0.4	0.3	
Feb 16	Initial Jobless Claims	11-Feb	Thousands	348	361	R▲
Feb 16	Continuing Claims	4-Feb	Thousands	3426	3526	R▲
Feb 16	Housing Starts	Jan	Thousands	699	689	R▲
Feb 16	Building Permits	Jan	Thousands	676	671	R▼
Feb 16	Bloomberg Consumer Comfort	12-Feb	Index	39.8	-41.7	
Feb 16	Bloomberg Economic Expectations	Feb	Index	-7	-19	
Feb 16	Mortgage Delinquencies	4Q	Q/Q % Chg.	7.58	7.99	
Feb 16	MBA Mortgage Foreclosures	4Q	Q/Q % Chg.	4.38	4.43	
Feb 16	Philadelphia Fed.	Feb	Index	10.2	7.3	
Feb 17	Consumer Price Index	Jan	M/M % Chg.	0.2	0.0	
Feb 17	CPI Ex Food & Energy	Jan	M/M % Chg.	0.2	0.1	
Feb 17	Leading Indicators	Jan	M/M % Chg.	0.4	0.5	R▲
Canada						
Feb 16	Int'l Securities Transactions	Dec	Billions	7.38	14.64	R▼
Feb 16	Manufacturing Sales	Dec	M/M % Chg.	0.6	1.9	R▲
Feb 17	Consumer Price Index	Jan	M/M % Chg.	0.4	-0.6	
Feb 17	Bank of Canada CPI Core	Jan	M/M % Chg.	0.2	-0.5	
Feb 17	Leading Indicators	Jan	M/M % Chg.	0.7	0.7	R▼
International						
Feb 12	JN Gross Domestic Product	4Q	Q/Q % Chg.	-0.6	1.7	R▲
Feb 14	EC Zew Survey (Econ. Sentiment)	Feb	Index	-8.1	-32.5	
Feb 14	GE Zew Survey (Econ. Sentiment)	Feb	Index	5.4	-21.6	
Feb 15	EC Euro-Zone GDP s.a.	4Q	Q/Q % Chg.	-0.3	0.1	R▼
Feb 15	EC Euro-Zone Trade Balance s.a.	Dec	Billions	7.5	6.1	
Feb 15	AU Unemployment Rate	Jan	%	5.1	5.2	
Feb 17	GE Producer Prices	Jan	Y/Y % Chg.	3.4	4.0	

Source: Bloomberg, TD Economics



UPCOMING ECONOMIC RELEASES AND EVENTS: FEBRUARY 20 - 24, 2012

Release Date	Time*	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
United States						
Feb 21	8:30	Chicago Fed Activity Index	Jan	Index	--	0.17
Feb 22	7:00	MBA Mortgage Applications	17-Feb	W/W % Chg.	--	-1.0
Feb 22	10:00	<i>Revisions: Existing Home Sales</i>				
Feb 22	10:00	Existing Home Sales	Jan	Millions	4.65	4.61
Feb 23	8:30	Initial Jobless Claims	18-Feb	Thousands	355	--
Feb 23	8:30	Continuing Claims	11-Feb	Thousands	3430	--
Feb 23	9:45	Bloomberg Consumer Comfort	19-Feb	Index	--	-39.8
Feb 23	10:00	House Price Index	Dec	M/M % Chg.	0.4	1.0
Feb 23	10:00	House Price Purchase Index	4Q	Q/Q % Chg.	--	0.2
Feb 23	11:00	Kansas City Fed Manf. Activity	Feb	Index	9	7
Feb 24	9:55	U. of Michigan Confidence	Feb	Index	72.5	72.5
Feb 24	10:00	New Home Sales	Jan	Thousands	315	307
Feb 24	10:45	<i>Fed's Williams Speaks in New York</i>				
Feb 24	11:35	<i>Fed's Bullard Speaks on Housing, Monetary Policy in NY</i>				
Feb 24	13:30	<i>Fed's Plosser Speaks on Monetary Policy in NYC</i>				
Feb 24	13:30	<i>Fed's Dudley to Speak on Monetary Policy in NY</i>				
Canada						
Feb 21	8:30	Retail Sales	Dec	M/M % Chg.	-0.2	0.3
Feb 21	8:30	Retail Sales Less Autos	Dec	M/M % Chg.	0.2	0.3
Feb 21	8:30	Wholesale Sales	Dec	M/M % Chg.	0.5	-0.4
Feb 23	10:30	<i>Bank of Canada Review</i>				
Feb 24	9:45	<i>Bank of Canada's Carney Speaks in NY</i>				
International						
Feb 20	2:45	FR Business Confidence Indicator	Feb	Index	92	91
Feb 21	10:00	EC Euro-Zone Consumer Confidence	Feb	Index	-20.1	-20.7
Feb 22	1:30	FR Consumer Price Index	Jan	Index	2.6	2.5
Feb 22	4:00	EC PMI Composite	Feb	Index	50.5	50.4
Feb 22	4:00	EC PMI Manufacturing	Feb	Index	49.4	48.8
Feb 22	4:00	EC PMI Services	Feb	Index	50.6	50.4
Feb 23	4:00	GE IFO - Business Climate	Feb	Index	108.8	108.3
Feb 23	4:00	GE IFO - Current Assessment	Feb	Index	116.5	116.3
Feb 23	4:00	GE IFO - Expectations	Feb	Index	102.0	100.9

* Eastern Standard Time; Source: Bloomberg, TD Economics



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