The Weekly Bottom Line

July 12, 2019

Highlights of the Week

United States

- In a busy week for Fed communication, Chair Powell gave his semiannual testimony to Congress where he confirmed that crosscurrents hitting the outlook would likely require some additional accommodation.
- The Fed Chair also noted that he doesn't see the labor market as particularly hot and, with wage growth subdued, has more room to run.
- Powell also noted the risk that weak inflation could prove more persistent than anticipated. That risk diminished somewhat with the June CPI report, which showed core inflation firming across both goods and services.

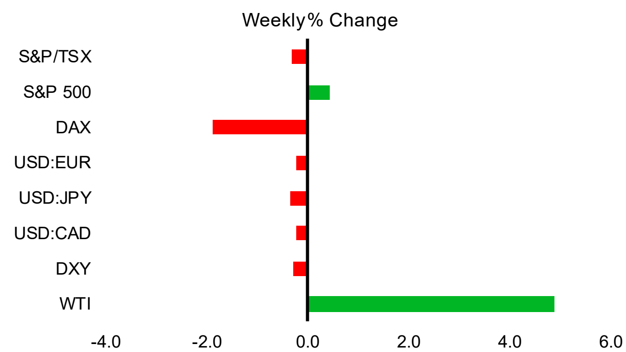
Canada

- The Bank of Canada met expectations this week, holding its policy interest rate at 1.75%. Communication struck a neutral tone, which, with a downgraded outlook, suggests the bar to monetary easing remains high absent a realization of negative risks.
- There is potential upside to the Bank's near-term view of economic growth. Housing activity appears to have come back to life in the second quarter. An economic outperformance would likely further reduce Canadian easing expectations.

This Week in the Markets				
	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	3003	2990	3003	2351
S&P/TSX Comp.	16491	16542	16669	13780
DAX	12335	12569	12860	10382
FTSE 100	7499	7553	7777	6585
Nikkei	21686	21746	24271	19156
Fixed Income Yields				
U.S. 10-yr Treasury	2.12	2.03	3.24	1.95
Canada 10-yr Bond	1.62	1.57	2.60	1.42
Germany 10-yr Bund	-0.21	-0.36	0.57	-0.40
UK 10-yr Gilt	0.83	0.74	1.73	0.68
Japan 10-yr Bond	-0.11	-0.16	0.16	-0.17
Foreign Exchange Cross Rates				
C$ (USD per CAD)	0.77	0.76	0.78	0.73
Euro (USD per EUR)	1.13	1.12	1.18	1.11
Pound (USD per GBP)	1.26	1.25	1.33	1.25
Yen (JPY per USD)	108.1	108.5	114.5	107.2
Commodity Spot Prices**				
Crude Oil ($US/bbl)	60.3	57.3	76.4	42.3
Natural Gas ($US/MMBtu)	2.53	2.29	4.80	2.27
Copper ($US/met. tonne)	5948.0	5890.3	6555.5	5713.8
Gold ($US/troy oz.)	1406.8	1399.3	1423.5	1174.2

*As of 10:53 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. Stands Out As S&P Touches New High



Note: Data as of 10:57 AM ET, Friday, July 12, 2019.
Source: Bloomberg, TD Economics

Global Official Policy Rate Targets	
	Current Target
Federal Reserve (Fed Funds Rate)	2.25 - 2.50%
Bank of Canada (Overnight Rate)	1.75%
European Central Bank (Refi Rate)	0.00%
Bank of England (Repo Rate)	0.75%
Bank of Japan (Overnight Rate)	-0.10%

Source: Central Banks.

U.S. - Chair Powell Asks, "Where's the Heat?"

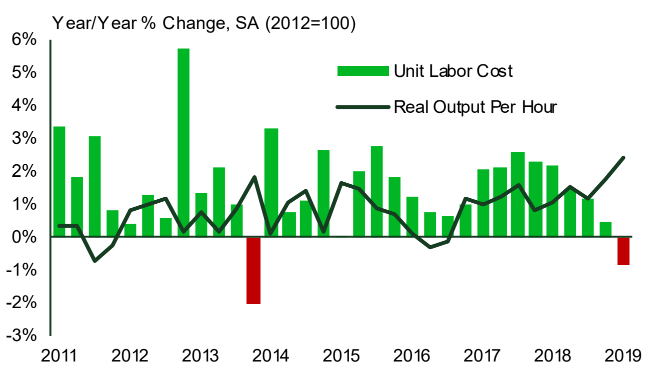
It was a big week for Fed communication. Fed Chair Powell took center stage with his semiannual testimony to Congress, while minutes from the Federal Open Market Committee's (FOMC) June meeting shed light on participants' views of the risks to the economy.

The key takeaway from Powell's prepared remarks was that the Fed Chair still sees crosscurrents and uncertainty as weighing on the outlook. Given that this was the key factor behind the FOMC's increased willingness to provide additional accommodation, this was as clear a signal as any that a July rate cut is happening. Nailing the coffin closed, when the Chair was asked if the strong June jobs report had done anything to change his mind, he replied, "a straight answer…is no."

Between now and the July 31st meeting there are data on retail sales, housing starts, home sales, durable goods orders, and a few others. Even relatively positive outcomes on all these reports are unlikely to move the Fed off that 25-basis point cut. They could, however, go a long way to moving market pricing for additional cuts (almost three by the end of this year). In the meantime, Fed speakers have one more week to communicate their take on economic data before the quiet period preceding the July meeting.

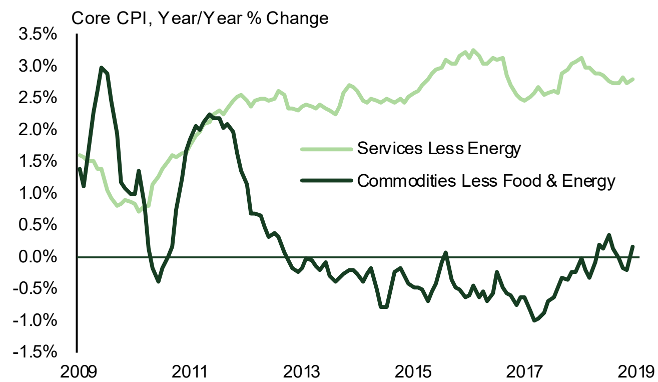
The other message in the Fed's accompanying Monetary Policy Report as well as Powell's Q&A sessions was the recognition that inflation is weak, and the labor market may still have some room to grow – even with an unemployment rate at 3.7%. Perhaps the most interesting response Powell gave over the two days of testimony was to a question about the possibility that lower interest rates would cause the labor market to run hot. His response was: "you know, I guess I would start by saying we don't have any basis for calling this a hot labor market."

Chart 1: Rising Labor Productivity Makes Adding Workers Cheaper



Source: Bureau of Labor Statistics, TD Economics

Chart 2: Inflation Picks Up In June, Weakness Looking Less Persistent



Source: Bureau of Labor Statistics, TD Economics

Powell went on to say that wage growth of 3%, while better than the 2% it was five years ago, is "barely keeping up with productivity." In fact, productivity growth has accelerated over the past year, and, as a result, the cost of adding workers relative to the output they produce has declined (Chart 1). Absent evidence of wage inflation, the Fed is unlikely to get too heated by a low unemployment rate, even if it continues to push further below its long-run estimates.

Nonetheless, sometimes the data zigs just when everyone expects it to zag. While the Fed Chair cited the risk that weak inflation would prove more persistent than anticipated, the CPI out this week showed prices rising firmly in June. Core CPI (excluding food and energy) rose 0.3% on the month – the strongest gain since January 2018. Price growth firmed for both core goods and services (Chart 2). Still, with the year-on-year headline rate at just 1.7% and core at 2.2%, the firetrucks can stay parked for now.

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Canada - Bank of Canada Signals High Bar to Cuts

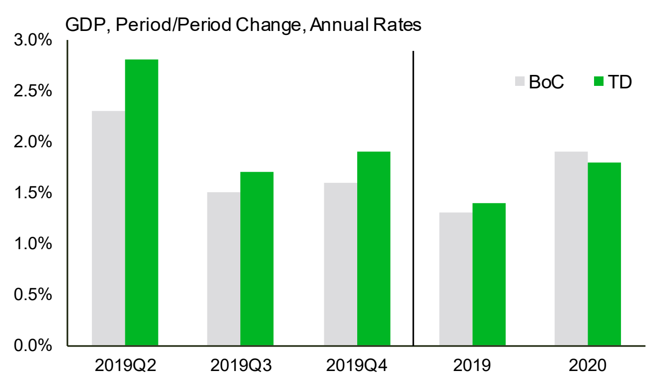
It was a relatively quiet week in Canadian markets. Despite a modest climb in oil prices, the S&P/TSX composite index was set to end the week relatively flat. So too the loonie, which despite some mid-week volatility, sat pretty close to where it started the week as of mid-morning Friday.

The main economic events, both here and elsewhere this week were central bank driven, and Wednesday was the main event. South of the border, Federal Reserve Chair Jerome Powell's testimony to Congress all but confirmed that a policy interest rate cut would be coming at the end of this month (see commentary). With most major economy central banks leaning towards additional stimulus in the wake of softening momentum, the Bank of Canada had a fine line to walk given relatively healthy domestic data and the external negative risks.

And walk the line they did. The statement that came with Wednesday's decision to leave the key overnight interest rate at 1.75% went right down the middle: the external risks were front and centre, and the economic outlook was downgraded a touch, but there were few signals that Canadian monetary easing is on the table (See our thoughts). Instead, the message was again one of risk management. The Bank stands ready to act in the event of a deterioration in economic activity, but this is not their base case, and they feel no urgency to replicate the expected 'insurance' cuts of the Federal Reserve.

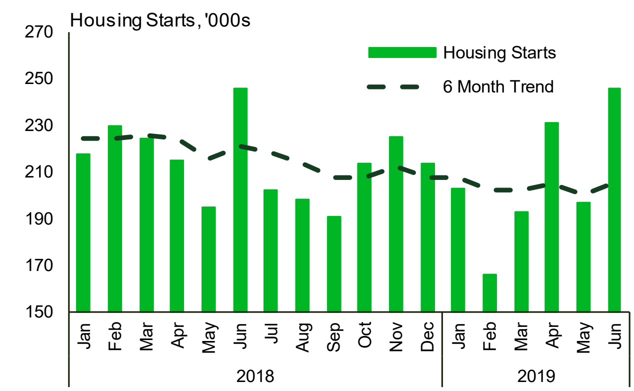
There is also an argument to be made that the Bank of Canada is trying to avoid a situation where markets become convinced of easing to the point where a failure to act may create undue volatility. The evidence for this may be the Bank's relatively conservative economic growth forecast. Compared to our view, the Bank of Canada envisions a slightly more modest pace of activity this year (Chart 1).

Chart 1: Bank of Canada Cautious On Near-Term Economic Outlook



Source: Bank of Canada, Bloomberg, TD Economics. Bank of Canada Q4 figure is approximate.

Chart 2: Spring Recovery Evident In Home Starts



Source: CMHC, TD Economics

A significant part of the Bank of Canada's cautious near-term view is related to housing. This appears to be a note of caution given the available data. Even allowing for a modest pull-back of activity in June (figures are due Monday), resales popped nicely in the second quarter. So too has homebuilding activity. Housing starts shook off their winter blues (Chart 2; see our commentary), and the more lagged investment data also points to healthy activity early in the quarter.

So, given the Bank of Canada took a neutral tone to go with this downgraded outlook, it stands to follow that the market would dial back cut expectations as the Bank of Canada's forecast is modestly exceeded. This suggests a reluctance to ease monetary policy unless necessary – data dependence, not outlook dependence, in effect, and a different approach from their U.S. counterparts. In effect, the Bank of Canada appears to be comfortable takin a reactive approach, rather than a proactive one. Clearly, should negative risks materialize, we'd be in a different world, but for now, if you're enjoying the drop in mortgage rates, thank Chair Powell, not Governor Poloz.

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U.S.: Upcoming Key Economic Releases

U.S. Retail Sales - June*

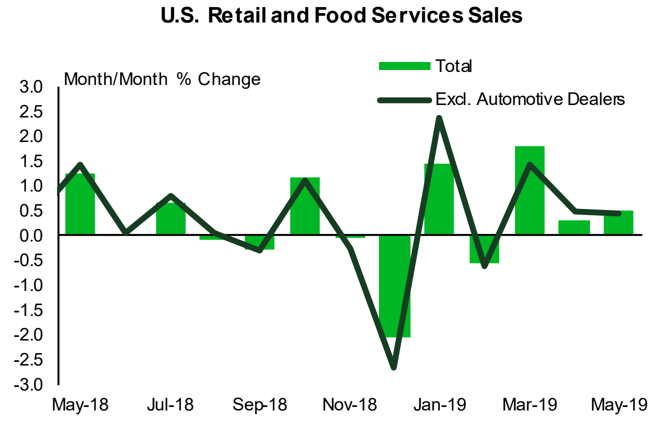
Release Date: July 16, 2019

Previous: 0.5%, ex auto: 0.5%, control group: 0.5%

TD Forecast: 0.1%, ex auto: 0.1%, control group: 0.3%

Consensus: 0.2%, ex auto: 0.2%, control group: 0.3%

We expect another firm increase in sales in the key control group (+0.3% m/m) to be the main driver behind a 0.1% gain in headline retail sales, as consumer fundamentals remain sound (healthy labor market, steady real wages and high confidence levels). A firm gain in core sales should more than offset both a decline in sales at gasoline stations, which reflect a drop in gasoline prices in June, and a minor retreat in auto sales following a 0.6% increase in May. On net, retail sales should end the quarter with average annual growth at 3.2%, up from 2.8% in Q1.



Source: U.S. Department of Commerce, TD Economics

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

Canada: Upcoming Key Economic Releases

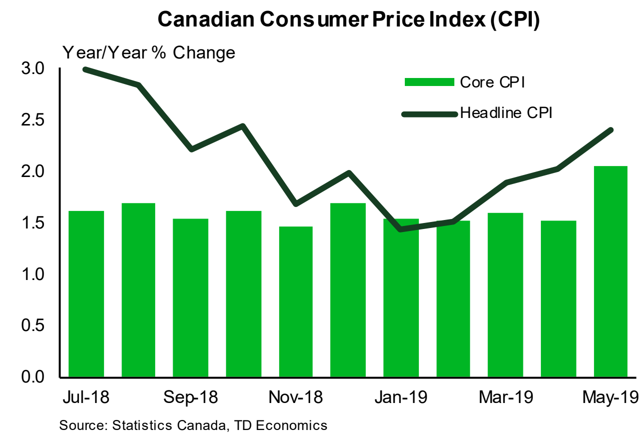
Canadian Consumer Price Index - June*

Release Date: July 17 , 2019

Previous: 0.4% m/m, 2.4% y/y

TD Forecast: -0.2% m/m, 2.1% y/y

Consensus: -0.3% m/m, 1.9% y/y



TD looks for headline inflation to decelerate to 2.1% y/y in June, with prices down 0.2% from May. Lower gasoline prices will provide the main driver for the monthly print; gasoline prices fell by 8% for the month as a whole, which should shave 0.3pp off the headline print in June. Elsewhere, food prices should see modest gains following the recent strength in producer prices. Still, 3.5% is likely to mark the peak for food price inflation since FX passthrough from a stronger Canadian dollar should start to provide some relief in the coming months. We also see scope for a pullback in telecom prices after new "unlimited" data plans were introduced by major service providers in early June. Looking past the headline, exclusion-based core measures (ie. ex food and energy) should hold stable given the large drag from energy prices, while the Bank of Canada's preferred core measures are likely to edge lower to 2.0% y/y on average.

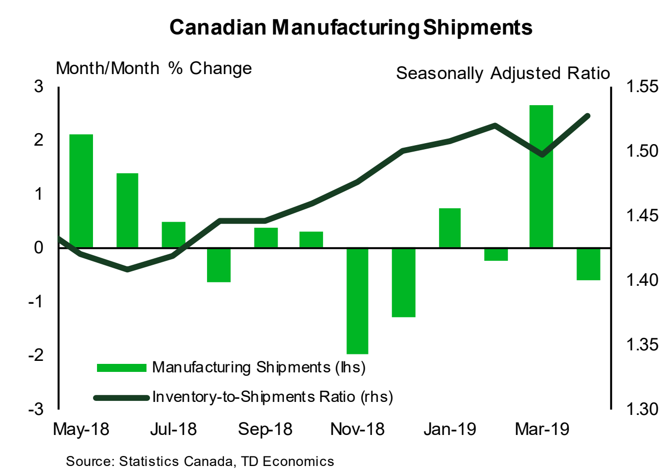
Canadian Manufacturing Sales - May*

Release Date: July 17, 2019

Previous: -0.6%

TD Forecast: 1.6%

Consensus: 1.5%



TD looks for manufacturing sales to rebound by 1.6% in May, driven by a sharp pickup in transportation products. Motor vehicles are only part of the story after temporary production shutdowns drove an 8.9% decline in manufacturing shipments last month. international trade for May showed a large rebound in motor vehicle exports, but also revealed a record $2.92bn in monthly aerospace exports. Outside of the transportation sector, forestry products will weigh on the headline print after a major logging company announced it will temporarily shutter production at 13 lumber mills starting April 29th. Manufacturing volumes should rise in line with the nominal series owing to flat producer prices in May, which will provide a tailwind to monthly GDP.

Canada: Upcoming Key Economic Releases

Canadian Retail Sales - May*

Release Date: July 19, 2019

Previous: 0.1%, ex-auto: 0.1%

TD Forecast: 0.3%, ex-auto: 0.6%

Consensus: 0.3%, ex-auto: 0.3%

Retail sales are forecast to rise by 0.3% in May as lower auto sales provide an offset to a pickup in core retail measures. New vehicle sales are projected to edge lower on softer passenger car sales, and we expect a muted contribution from gasoline stations as the tailwind from higher prices dissipates. On the other end of the spectrum, the recreation component should provide a source of strength as NBA playoff spending makes its impact felt; restaurant sales are not included in the retail report, but the supplementary food and beverage survey should show similar gains. Building materials and home furnishings will provide another source of strength on the recent recovery in existing home sales. Retail volumes should see little change on account of the 0.3% (sa) increase in consumer prices, consistent with some moderation in household consumption from the 3.5% gain in Q1.

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

Recent Key Economic Indicators: July 8 - 12, 2019						
Release Date		Economic Indicator/Event	Data for Period	Units	Current	Prior
United States						
Jul 09		NFIB Small Business Optimism	Jun	Index	103.3	105.0
Jul 10		Wholesale Trade Sales	May	M/M % Chg.	0.1	-0.4
Jul 10		FOMC Meeting Minutes	Jun 19			
Jul 11		Initial Jobless Claims	Jul 06	Thsd	209.0	222.0
Jul 11		Real Avg Hourly Earning	Jun	Y/Y % Chg.	1.5	1.3
Jul 11		Consumer Price Index Ex Food and Energy	Jun	Y/Y % Chg.	2.1	2.0
Jul 11		Consumer Price Index	Jun	Y/Y % Chg.	1.6	1.8
Jul 11		Consumer Price Index Ex Food and Energy	Jun	M/M % Chg.	0.2	0.1
Jul 11		Consumer Price Index	Jun	M/M % Chg.	0.1	0.1
Jul 12		Producer Price Index Final Demand	Jun	M/M % Chg.	0.1	0.1
Jul 12		Producer Price Index Ex Food and Energy	Jun	M/M % Chg.	0.3	0.2
Canada						
Jul 09		Housing Starts	Jun	Thsd	245.7	196.8
Jul 10		Bank of Canada Rate Decision	Jul 10	%	1.75	1.75
International						
Jul 09	CH	Consumer Price Index	Jun	Y/Y % Chg.	2.7	2.7
Jul 10	UK	Manufacturing Production	May	Y/Y % Chg.	0.0	-1.0

Source: Bloomberg, TD Economics.

Upcoming Economic Releases and Events: July 15 - 19, 2019						
Release Date	Time*	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
United States						
July 15	8:30	Empire Manufacturing	Jul	Index	2.0	-8.6
July 15	8:50	*Fed's John Williams speaks at SIFMA in New York, NY*				
July 16	8:30	Retail Sales Advance	Jun	M/M % Chg.	0.2	0.5
July 16	8:30	Retail Sales Ex Auto and Gas	Jun	M/M % Chg.	-	0.5
July 16	9:15	Capacity Utilization	Jun	%	78.1	78.1
July 16	9:15	Industrial Production	Jun	M/M % Chg.	0.1	0.4
July 16	9:15	Manufacturing (SIC) Production	Jun	M/M % Chg.	0.2	0.2
July 16	10:00	Business Inventories	May	M/M % Chg.	0.4	0.5
July 16	10:00	NAHB Housing Market Index	Jul	Index	64.0	64.0
July 17	8:30	Building Permits	Jun	Thsd	1300.0	1294.0
July 17	8:30	Housing Starts	Jun	Thsd	1258.0	1269.0
July 17	14:00	U.S. Federal Reserve Releases Beige Book				
July 18	8:30	Initial Jobless Claims	July 19	Thsd	-	209.0
July 18	14:15	*Fed's John Williams speaks at the CEBRA in New York, NY*				
July 19	11:05	*Fed's James Bullard speaks at the CEBRA in New York, NY*				
July 19	16:30	*Fed's Eric Rosengren participates in a panel at the CEBRA in New York, NY*				
Canada						
July 15	9:00	Existing Home Sales	Jun	M/M % Chg.	-	1.9
July 17	8:30	Consumer Price Index	Jun	Y/Y % Chg.	-	2.4
July 17	8:30	Consumer Price Index Core- Common %	Jun	Y/Y % Chg.	-	1.8
July 17	8:30	Consumer Price Index Core- Median %	Jun	Y/Y % Chg.	-	2.1
July 17	8:30	Consumer Price Index Core- Trim %	Jun	Y/Y % Chg.	-	2.3
July 17	8:30	Consumer Price Index NSA	Jun	M/M % Chg.	-	0.4
July 17	8:30	Manufacturing Sales	May	M/M % Chg.	-	-0.6
July 18	8:30	Teranet/National Bank HPI	Jun	Y/Y % Chg.	-	0.7
July 19	8:30	Retail Sales	May	M/M % Chg.	-	0.1
July 19	8:30	Retail Sales Ex Auto	May	M/M % Chg.	-	0.1
International						
July 16	4:30 UK	ILO Unemployment Rate 3Mths	May	%	-	3.8
July 17	4:30 UK	Consumer Price Index	Jun	Y/Y % Chg.	-	2.0
July 17	5:00 EZ	Consumer Price Index	Jun	Y/Y % Chg.	-	1.2
July 18	4:30 UK	Retail Sales Ex Auto Fuel	Jun	Y/Y % Chg.	-	2.2
July 18	19:30 JN	Natl Consumer Price Index	Jun	Y/Y % Chg.	0.7	0.7

* Eastern Standard Time. Source: Bloomberg, TD Economics.

Disclaimer