TD Economics

The Weekly Bottom Line

February 21st, 2020

Highlights of the Week

United States

- COVID-19 continues to pose challenges for China's economy as well as global manufacturing supply chains. Factories have been slow to open as quarantines keep workers at home.
- While the situation on the ground appears to be improving, global supply chains are starting to feel the impact. Some multinationals have already warned sales would be hit in the first quarter.
- The Fed remains alert to the risks to U.S. growth posed by the virus and will act if necessary. However, it expects the shock to be temporary. On the plus side, past rate cuts are feeding through to gains in the housing sector.

Canada

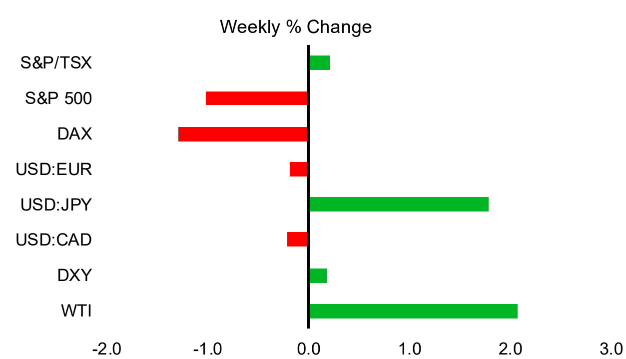
- Financial markets continued to weigh the impacts of COVID-19 this week. Risk-off sentiment prevailed, but the S&P/TSX Composite managed to eke out a modest 0.2% gain.
- Domestically, news on upcoming changes to mortgage stress testing rules are expected to reduce benchmark mortgage rates in the near-term.
- On the data front, weak manufacturing and retail sales prints reaffirmed a soft Q4. Headline CPI inflation came in slightly higher than expectations, but the core measures edged lower to 2%.

This Week in the Markets

	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	3345	3380	3386	2743
S&P/TSX Comp.	17879	17848	17944	15996
DAX	13567	13744	13789	11347
FTSE 100	7397	7409	7687	7067
Nikkei	23387	23688	24084	20261
Fixed Income Yields				
U.S. 10-yr Treasury	1.47	1.58	2.75	1.46
Canada 10-yr Bond	1.28	1.37	1.94	1.09
Germany 10-yr Bund	-0.44	-0.40	0.18	-0.71
UK 10-yr Gilt	0.57	0.63	1.30	0.41
Japan 10-yr Bond	-0.06	-0.03	0.02	-0.29
Foreign Exchange Cross Rates				
C$ (USD per CAD)	0.76	0.75	0.77	0.74
Euro (USD per EUR)	1.09	1.08	1.14	1.08
Pound (USD per GBP)	1.30	1.30	1.33	1.20
Yen (JPY per USD)	111.7	109.8	112.2	105.3
Commodity Spot Prices**				
Crude Oil ($US/bbl)	52.8	52.1	66.4	49.6
Natural Gas ($US/MMBtu)	2.01	1.93	4.25	1.82
Copper ($US/met. tonne)	5708.0	5750.8	6555.5	5503.5
Gold ($US/troy oz.)	1639.8	1584.1	1639.8	1270.7

*As of 11:48 AM on Friday. **Oil-WTI, Cushing, Nat. Gas-Henry Hub, LA (Thursday close price). Copper-LME Grade A. Gold-London Gold Bullion. Source: Bloomberg.

Markets Down on COVID-19 Fears



Note: Data as of 12:05 PM ET, Friday, February 21, 2020.
Source: Bloomberg, TD Economics

Global Official Policy Rate Targets

	Current Target
Federal Reserve (Fed Funds Rate)	1.50 - 1.75%
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. - All Eyes On COVID-19

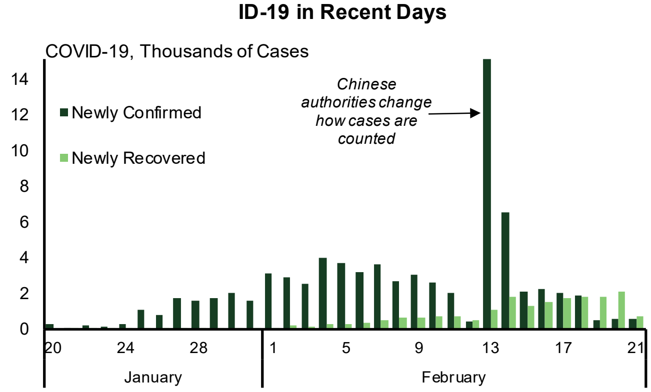
Another busy week comes to a close, with markets hanging on to every development, rumored or not, from the COVID-19 outbreak in China. The S&P500 hit a record high on Wednesday, but promptly retreated on Thursday upon news that many multinationals (i.e. Adidas, Puma, P&G) warned that COVID-19 might impact sales in the first quarter. At the time of writing, the S&P500 stood 1% lower than where it was at the start of the week.

COVID-19 continues to depress China's economy. Recent reports indicate that factories have been slow to open as quarantines continue to keep workers stuck in their homes. The Chinese authorities have issued guidelines to local officials to help get people back to work, but this would have to be done carefully so as not to undermine containment efforts.

It appears that the virus is slowly being brought under control. As of now, 76,775 people have been infected with COVID-19, and 2,247 have died. The number new cases have come down significantly over the past few days, and the number of recoveries has steadily risen since the start of the month (Chart 1).

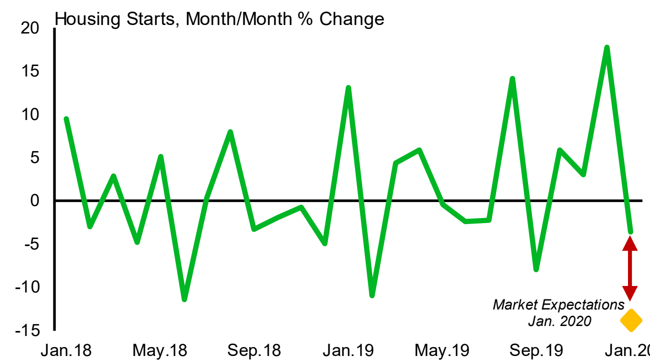
Despite the good signs, global manufacturing supply chains are beginning to feel the effects of the virus. Foxconn, Samsung, and various car manufacturers have all faced supply chain disruptions. Companies have also looked to continue production by bypassing China. Samsung, for example, has moved parts of its manufacturing process for its newest Galaxy phone from China to Vietnam. The longer China takes to contain the virus, the more likely it is that manufacturers will explore other locations.

Chart 1: More Recoveries Than New Cases of COVID-19 in Recent Days



Source: John Hopkins, TD Economics

Chart 2: Housing Starts Outperformed Market Expectations in January



Source: Census Bureau, TD Economics

The Federal Reserve is closely watching how the impact of COVID-19 is felt by global economies. In the first Federal Open Market Committee meeting of the year, participants saw tentative signs of stabilization in global growth, but they judged the outbreak to be a key uncertainty in their outlook. If the virus has a greater and more meaningful impact on growth, the Fed may provide more monetary support this year.

If the virus is contained, and Chinese factories are back to normal production soon, we expect the Fed to stand pat in 2020, as it watches the effects of past interest rate cuts move through the economy. Indeed, we have already seen this in the housing market, which finished 2019 on solid footing, and is showing signs of continued momentum in 2020. Although housing starts declined in January by 3.6% month-over-month, it was coming off of a strong December and it was significantly stronger than market expectations of -11.2% (Chart 2). Part of this was likely due to warmer weather, but it is also a testament to the underlying strength in the property sector.

Like housing starts, existing home sales also contracted in January, also coming off a solid December. On the other hand, permits rose strongly in January. With labor markets healthy, mortgage rates low, and a large number of millennials still to move into homeownership, we could continue to see strength in the housing market this year.

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Canada - More Soft Signals

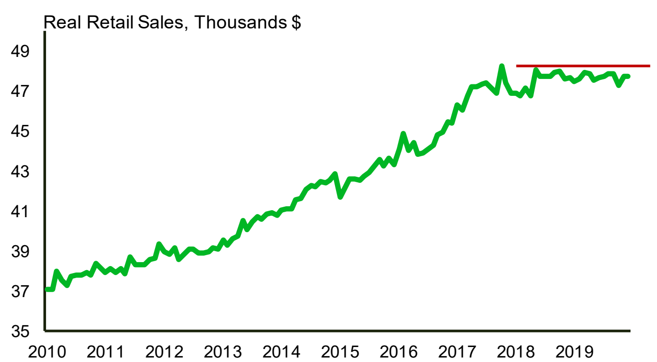
This was a relatively eventful week both globally and domestically. Financial markets continued to weigh the impacts of the coronavirus outbreak. The S&P/TSX edged up only 0.2% higher on the week. As of writing, the benchmark WTI oil price was up near 2% on the week as markets weighed supply-side risks in Libya and Venezuela against weakening demand expectations. Reflecting deteriorating risk sentiment, a further downshift in bond yields, and renewed market expectations of central bank stimulus, gold prices shot up to around US$1,640, the highest level since 2013.

In Canada, changes to stress testing rules announced by the Minister of Finance Bill Morneau made headlines. While further details are still likely to emerge, these changes are expected to modestly bring down benchmark rates in the near term. The changes may prompt modest upward revisions in home sales and price forecasts, especially amid notably tight housing markets.

Provincially, British Columbia kicked off the budget release schedule, showcasing a largely "stay the course" budget that aims to remain in the black for the next three years. The budget contained little in the way of policy changes, but highlighted a hefty capital spending package that may lift the province's net debt to GDP ratio. All told, B.C. still maintains one of the healthiest fiscal positions in Canada.

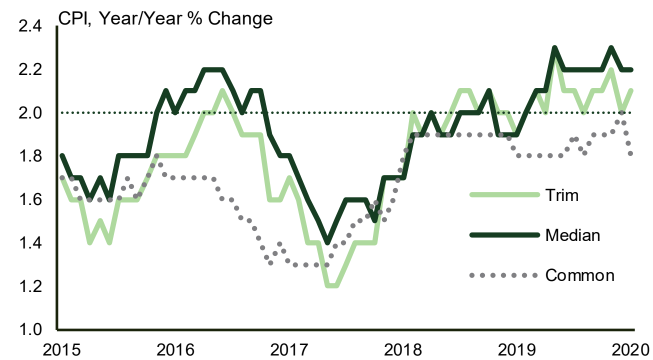
On the economic data front, Statistics Canada released three reports this week that served to confirm the narrative of a weak Q4 and soft momentum heading into 2020. Manufacturing sales saw 0.7% headline decline and a 0.4% drop in volumes. Transitory factors have been contributing to the weakness in shipments. However, the overall trend has been unambiguously weak, and the sector suffers from an inventory overhang that will weigh on future production. On a related note, the continuation of the rail blockades for a second week will likely weigh on February's shipments and contribute further to inventory build-ups.

Chart 1: Retail Sales Volumes Have Been Effectively Flat Since 2018



Source: Statistics Canada, TD Economics

Chart 2: BoC Core Inflation Measures Still Around Target



Source: Statistics Canada, TD Economics

Also disappointing, nominal and real retail sales were flat in December. The sector capped off its worst performance seen since 2009, despite surging population. While e-commerce sales were up an impressive 31.5% y/y, this category still represents a relatively small share of overall retail trade.

Finally, headline CPI inflation came in at 2.4%, slightly higher than expectations. A a range of transitory factors (e.g. oil prices) have driven the headline higher. The Bank of Canada's core measures edged lower in January to average 2.0%. With lackluster economic growth in Q4 and soft momentum heading into 2020, a widening output gap may put downward pressure on prices in the months ahead.

These weak signals are unlikely to go by unnoticed to the Bank of Canada, which has turned more dovish in its recent communications. Indeed, the central bank has been paying close attention to consumer spending, which has remained lackluster. Financial stability concerns and well-anchored inflation were reasons the central bank remained on hold last year, but with downside risks building we still expect a rate cut in the second quarter of this year.

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U.S.: Upcoming Key Economic Releases

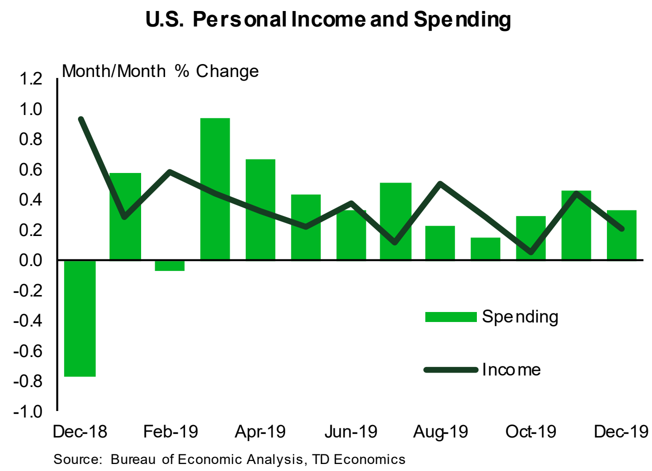
U.S. Personal Income & Spending- January*

Release Date: February 28th, 2020

Previous: Spending 0.1% m/m; income: 0.2%

TD Forecast: Spending 0.1% m/m; income: 0.5%

Consensus: Spending 0.1% m/m; income: 0.3%



CPI and PPI data point to an above-trend 0.3% m/m rise in the core PCE index; we estimate 0.28% before rounding. The y/y change likely rose to 1.8% from 1.6%, due in part to base effects, with more risk of 1.9% than 1.7%. (Core prices rose just 0.04% m/m in January 2019.) Even so, the pace remains below the 2.0-2.5% range that Fed officials appear to be aiming for "for a time." We're also looking for fairly solid increases in personal income and spending at 0.5% and 0.4% m/m, respectively. The gain in income should reflect the COLA adjustment as well as a rise in federal government pay, while spending was likely led by the auto and food segments.

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

Canada: Upcoming Key Economic Releases

Canadian Real GDP- Q4 & December*

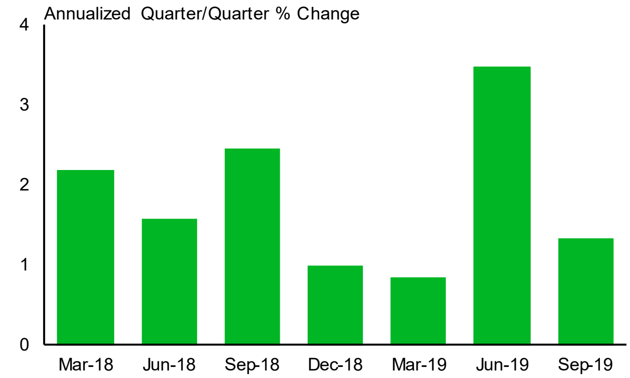
Release Date: February 28th, 2020

Previous: 0.1%

TD Forecast: 0.1%

Consensus: 0.1%

Canadian Real GDP



Source: Statistics Canada, TD Economics

The Canadian economy likely came to a standstill in the fourth quarter, with our final growth tracking 0.0% (q/q, annualized). Weakness appears widespread. Consumer spending, which has been soft throughout the year, looks to have slowed further in Q4, with durable spending likely contracting (led by a pullback in auto sales). Fixed investment – both residential and non – probably grew, but at a slower pace than in the double-digit growth recorded in the previous quarter. Inventories, meanwhile, likely subtracted from growth once again, marking the third quarter in a row. Finally, both exports and imports look to have pulled back in the quarter, but with exports falling more, net-trade will once again pull down the headline.

Turning to the monthly figures TD looks for industry-level GDP to increase by 0.1% in December on a relatively strong showing from the services sector. The transport sector should see a tailwind with the resolution of the CN Rail strike on November 27th, while the real estate sector is also forecast to provide a modest lift to overall activity. The picture is murkier on the goods side of the economy however: real manufacturing shipments fell by 0.4% in December, and the utilities sector could have an outsized drag on activity following a period of unusually mild weather.

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

Recent Key Economic Indicators: Feb 17 - 21, 2020						
Release Date		Economic Indicator/Event	Data for Period	Units	Current	Prior
United States						
Feb 18		Empire Manufacturing	Feb	Index	12.9	4.8
Feb 18		NAHB Housing Market Index	Feb	Index	74.0	75.0
Feb 19		Building Permits	Jan	Thsd	1551.0	1420.0
Feb 19		FOMC Meeting Minutes	Jan 29			
Feb 19		Housing Starts	Jan	Thsd	1567.0	1626.0
Feb 19		Producer Price Index Ex Food and Energy	Jan	M/M % Chg.	0.4	0.2
Feb 19		Producer Price Index Final Demand	Jan	M/M % Chg.	0.5	0.1
Feb 20		Initial Jobless Claims	Feb 15	Thsd	210.0	206.0
Feb 21		Existing Home Sales	Jan	Mlns	5.5	5.5
Feb 21		Markit US Manufacturing PMI	Feb	Index	50.8	51.9
Feb 21		Markit US Services PMI	Feb	Index	49.4	53.4
Canada						
Feb 18		Manufacturing Sales	Dec	M/M % Chg.	-0.7	-1.0
Feb 19		Consumer Price Index	Jan	Y/Y % Chg.	2.4	2.2
Feb 19		Consumer Price Index Core- Common	Jan	Y/Y % Chg.	1.8	2.0
Feb 19		Consumer Price Index Core- Median	Jan	Y/Y % Chg.	2.2	2.2
Feb 19		Consumer Price Index Core- Trim	Jan	Y/Y % Chg.	2.1	2.0
Feb 19		Consumer Price Index NSA	Jan	M/M % Chg.	0.3	0.0
Feb 20		Teranet/National Bank HPI	Jan	Y/Y % Chg.	2.1	1.9
Feb 21		Retail Sales	Dec	M/M % Chg.	0.0	1.1
Feb 21		Retail Sales Ex Auto	Dec	M/M % Chg.	0.5	0.5
International						
Feb 18	UK	ILO Unemployment Rate 3Mths	Dec	Y/Y % Chg.	3.8	3.8
Feb 19	UK	Consumer Price Index	Jan	Y/Y % Chg.	1.8	1.3
Feb 20	JN	Natl Consumer Price Index	Jan	Y/Y % Chg.	0.7	0.8
Feb 20	UK	Retail Sales Ex Auto Fuel	Jan	Y/Y % Chg.	1.2	0.7
Feb 21	EZ	Consumer Price Index	Jan	Y/Y % Chg.	1.4	1.4
Feb 21	EZ	Markit Eurozone Manufacturing PMI	Feb	Index	49.1	47.9

Source: Bloomberg, TD Economics.

Release Date	Time*		Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
Upcoming Economic Releases and Events: Feb 24 - 28, 2020							
United States							
Feb 24	15:00		*Fed's Mester speaks on the economy at NABE Conference in Washington, D.C.*				
Feb 25	9:00		S&P CoreLogic CS US HPI NSA	Dec	Y/Y % Chg.	-	3.5
Feb 25	10:00		Conf. Board Consumer Confidence	Feb	Index	132.5	131.6
Feb 25	15:15		*Fed's Clarida speaks at NABE Conference in Washington, D.C.*				
Feb 26	10:00		New Home Sales	Jan	Thsd	710.0	694.0
Feb 27	8:30		Personal Consumption	4Q	M/M % Chg.	-	1.8
Feb 27	8:30		Gross Domestic Product Annualized	4Q	Q/Q % Chg.	2.2	2.1
Feb 27	8:30		Core Personal Consumption Expenditure	4Q	Q/Q % Chg.	-	1.3
Feb 27	8:30		Durable Goods Orders	Jan	M/M % Chg.	-1.5	2.4
Feb 27	8:30		Durables Ex Transportation	Jan	M/M % Chg.	0.2	-0.1
Feb 27	8:30		Cap Goods Orders Nondef Ex Air	Jan	M/M % Chg.	-	-0.8
Feb 27	8:30		Initial Jobless Claims	Feb 22	Thsd	-	210.0
Feb 27	10:00		Pending Home Sales	Jan	M/M % Chg.	2.0	-4.9
Feb 27	11:30		*Fed's Evans speaks in Mexico City, Mexico*				
Feb 28	8:30		Advance Goods Trade Balance	Jan	Blns	-68.4	-68.3
Feb 28	8:30		Retail Inventories	Jan	M/M % Chg.	-	0.0
Feb 28	8:30		Personal Income	Jan	M/M % Chg.	0.3	0.2
Feb 28	8:30		Real Personal Spending	Jan	M/M % Chg.	-	0.1
Feb 28	8:30		Personal Consumption Expenditure Deflator	Jan	Y/Y % Chg.	-	1.6
Feb 28	8:30		Personal Consumption Expenditure Core Deflator	Jan	Y/Y % Chg.	1.7	1.6
Feb 28	9:15		*Fed's Bullard speaks on the economy and monetary policy*				
Canada							
Feb 24	8:30		Wholesale Trade Sales	Dec	M/M % Chg.	0.0	-1.2
Feb 25	12:30		*BoC's Lane speaks in Montreal, QC*				
Feb 27	8:30		Current Account Balance	4Q	Blns	-	-9.9
Feb 28	6:00		CFIB Business Barometer	Feb	Index	-	55.3
Feb 28	8:30		Gross Domestic Product	Dec	M/M % Chg.	-	0.1
Feb 28	8:30		Industrial Product Price	Jan	M/M % Chg.	-	0.1
Feb 28	8:30		Quarterly Gross Domestic Product Annualized	4Q	Q/Q % Chg.	-	1.3
International							
Feb 25	7:00	MX	Gross Domestic Product	4Q	Y/Y % Chg.	-	-0.3
Feb 27	18:50	JN	Industrial Production	Jan	Y/Y % Chg.	-3.1	-3.1
Feb 27	18:50	JN	Retail Sales	Jan	Y/Y % Chg.	-0.9	-2.6
Feb 27	18:30	JN	Jobless Rate	Jan	%	2.2	2.2
Feb 27	18:30	JN	Tokyo Consumer Price Index	Feb	Y/Y % Chg.	0.5	0.6
Feb 28	20:00	CH	Manufacturing PMI	Feb	Index	46.0	50.0
Feb 28	5:00	EZ	Consumer Price Index	Feb	Y/Y % Chg.	1.2	1.4
Feb 28	7:00	IN	Gross Domestic Product	4Q	Y/Y % Chg.	4.6	4.5

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