

## The Weekly Bottom Line

April 16, 2021

### Highlights

#### United States

- Headline inflation jumped in March, but it's too soon to sound the alarm. Economic slack is still high, inflation expectations benign, and the Fed unlikely to sit on the sidelines if they drift up persistently.
- Retail sales surged in March, thanks to massive income supports, accelerated vaccine rollouts and loosening restrictions.

#### Canada

- The upcoming week is a big one for Canada. The federal government is releasing a budget for the first time in two years, and the Bank of Canada is following that up with its April Monetary Policy Report two days later.
- Much is expected in the federal budget. Childcare is likely to be an important feature, while climate change, and infrastructure initiatives will also get a nod.

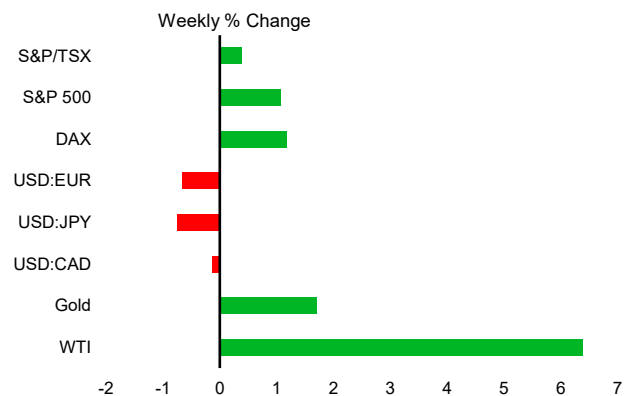
#### Financial

- The issue of corporate taxation is back in the spotlight. President Biden has proposed an increase to the US corporate tax rate and Treasury Secretary Janet Yellen has recommended a global minimum rate of corporate tax.
- These proposals appear to be initiating a sea change. For decades, there has been a race to the bottom, where governments consistently reduced corporate taxes in an effort to attract investment. The race appears to be over.

This Week in the Markets				
	Current*	Week Ago	52-Week High	52-Week Low
<b>Stock Market Indexes</b>				
S&P 500	4173	4129	4173	2737
S&P/TSX Comp.	19312	19228	19322	13899
DAX	15412	15234	15412	10250
FTSE 100	7011	6916	7011	5577
Nikkei	29683	29768	30468	19138
<b>Fixed Income Yields</b>				
U.S. 10-yr Treasury	1.58	1.66	1.74	0.51
Canada 10-yr Bond	1.51	1.50	1.61	0.43
Germany 10-yr Bund	-0.27	-0.30	-0.23	-0.64
UK 10-yr Gilt	0.77	0.77	0.88	0.08
Japan 10-yr Bond	0.09	0.11	0.16	-0.04
<b>Foreign Exchange Cross Rates</b>				
C\$ (USD per CAD)	0.80	0.80	0.81	0.70
Euro (USD per EUR)	1.20	1.19	1.23	1.08
Pound (USD per GBP)	1.38	1.37	1.41	1.21
Yen (JPY per USD)	108.8	109.7	110.7	102.7
<b>Commodity Spot Prices**</b>				
Crude Oil (\$US/bbl)	63.6	59.3	66.1	-37.6
Natural Gas (\$US/MMBtu)	2.57	2.42	16.35	1.33
Copper (\$US/met. tonne)	9297.3	8935.3	9456.3	5000.5
Gold (\$US/troy oz.)	1775.4	1743.9	2063.5	1682.8

\*As of 9:55 AM on Friday. \*\*Oil-WTI, Cushing, Nat. Gas-Henry Hub, LA (Thursday close price). Copper-LME Grade A. Gold-London Gold Bullion. Source: Bloomberg.

### Inventory Draws and Stronger Demand Boosts Oil Prices



Note: Data as of 10:00 AM ET, Friday, April 16, 2021.  
Source: Bloomberg, TD Economics

Global Official Policy Rate Targets	
Central Banks	Current Target
Federal Reserve (Fed Funds Rate)	0.00 - 0.25%
Bank of Canada (Overnight Rate)	0.25%
European Central Bank (Refi Rate)	0.00%
Bank of England (Repo Rate)	0.10%
Bank of Japan (Overnight Rate)	-0.10%

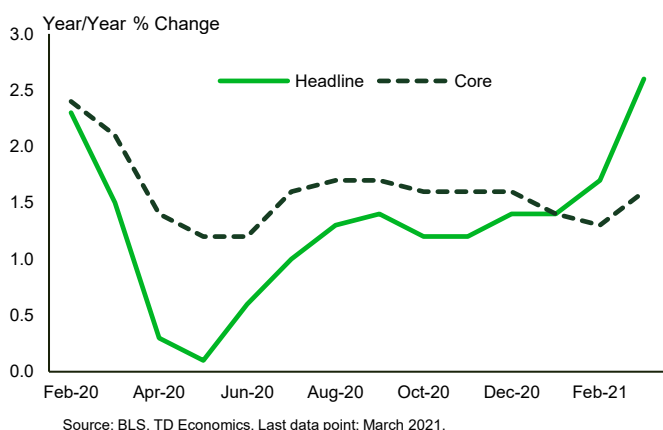
Source: Bloomberg.

## U.S. – Much to Cheer About

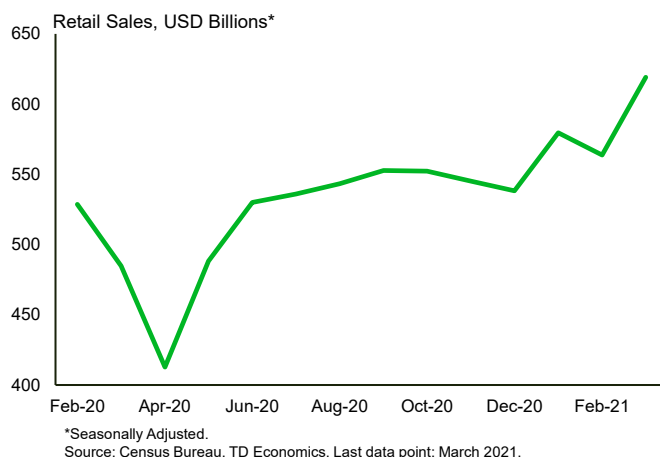
Who said the stock market rally was over? After a slow start to the week, the S&P 500 hit another all time high. As of writing, the index is up 1.3% compared to last week's close. Equities were helped by strong earnings and better than expected economic data. But interestingly, bond yields dropped on the news. At the time of writing, the 10-year Treasury yield was down nine basis points compared to last week. Usually, bond yields rise in response to strong data. The fact that yields drifted lower might seem like an anomaly but is likely due to the market already having priced in the economic recovery and inflation expectations. Meanwhile, growth stocks behaved as expected. Lower yields tend to increase future earnings of growth-oriented companies. So, tech stock rebounded as yields dropped.

On to one of economists' favorite topic these days, inflation! Consumer prices jumped in March (Chart 1). Inflation rose 0.6% month-on-month (m/m), pushing headline inflation to 2.6% year-on-year (y/y). Meanwhile, core inflation (ex. food and energy) was up 0.3% compared to the previous month and 1.6% higher compared to a year ago. The rise in inflation was mostly due to energy prices which went up 5.0% on the month. Energy prices will continue to keep the headline inflation number elevated over the next few months. In fact, year-on-year inflation numbers are likely to push through the 3% mark given the drop in prices in the second quarter of 2020.

**Chart 1: Energy Prices Push Headline Inflation over 2% but Core Inflation Remains Subdued**



**Chart 2: Retail Sales Are Swooshing Up**



Still, its too soon to sound the inflation alarm. The unemployment rate is still 2.5 percentage points (ppts) higher than its pre-recession level and there are roughly eight million fewer jobs. The 5-year U.S. breakeven – a measure of inflation expectations based on the spread between nominal and inflation adjusted Treasury yields – has cooled since hitting its highest point since 2008 in March. Rest assured the Federal Reserve is watching this and other measures of inflation expectations closely. In fact, Fed Vice Chair Richard Clarida said that if inflation expectations were to “drift up persistently [...] that would indicate to me that policy would need to be adjusted.” Clarida also added that the Fed’s “metrics of success” on inflation is keeping inflation expectations anchored at 2%. According to the Vice Chair, inflation expectations most recently stood at 1.96%.

Meanwhile, income supports, accelerated vaccine rollouts and loosening restrictions helped retail sales end the first quarter on a high note (Chart 2). Retail sales surged by 9.8% month-on-month in March, almost four ppts more than market expectations. The level of retail sales was a whopping 17.1% higher than February 2020, just before pandemic-induced restrictions took hold. Going forward, spending is likely remain robust as the job market strengthens and Americans tap into accumulated savings.

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# Canada - Federal Budget Headlines The Week Ahead

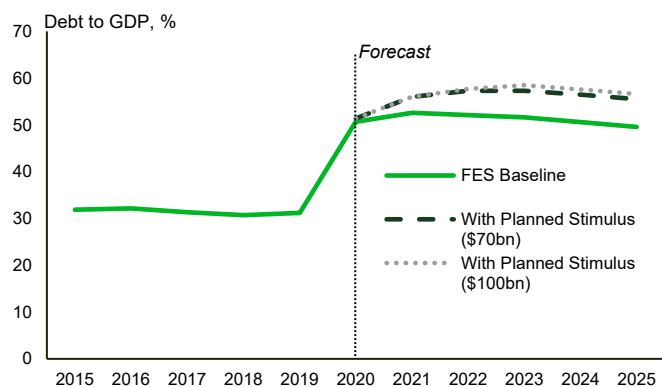
The upcoming week is shaping up to be big one for Canada. The federal government is unveiling its budget for the first time in two years on Monday April 19th. The Bank of Canada will follow that up with a policy announcement and its Monetary Policy Report two days later.

There is a lot of hype around the federal budget. Aside from the two-year delay, this fiscal plan promises to be one that pushes forward long-standing goals of the Liberal government. Topping the list of priorities is childcare. At the party convention last week, Finance Minister Chrystia Freeland told attendees that now was the time to "get this done". It's unclear how exactly policymakers will accomplish this mission, but it's certain that funding for childcare will feature prominently in next week's budget.

There are also expectations that the government will announce more spending on climate change, pharmacare, housing, and infrastructure. We will also get details on how the government plans to spend the \$70 to \$100 billion in funds that were left unallocated in last year's Fall Economic Statement (FES). Given the economy's better-than-expected showing thus far, there may be less need to funnel this money towards the near-term recovery. Still, given the extraordinary nature of the third wave of the pandemic, a share of spending is likely destined to provide immediate support for Canadians and businesses most impacted by the health crisis.

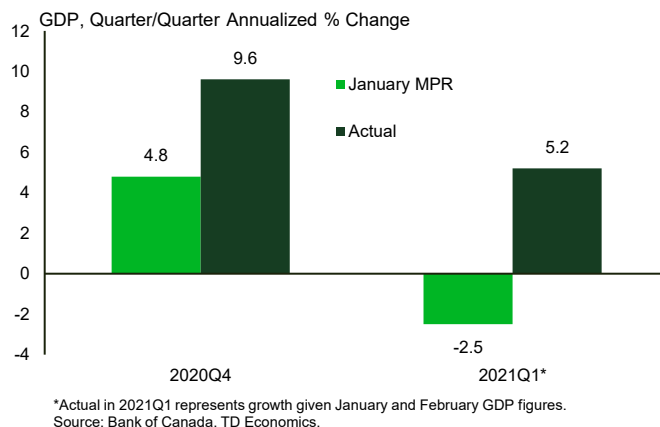
How will the government pay for all of these programs? The answer appears to be by taking on more debt. There are

**Chart 1: Canada's Debt Burden Increased in 2020 and Is Slated to Rise in Coming Years**



Source: Department of Finance, TD Economics.

**Chart 2: Bank of Canada to Revise GDP Projections Higher in April MPR**



\*Actual in 2021Q1 represents growth given January and February GDP figures. Source: Bank of Canada, TD Economics.

some indications that tax increases are on the way, particularly on digital companies. Even still, revenue increases are unlikely to cover all the new spending. With bigger deficits the debt to GDP ratio will continue to head higher. In the FES last November, the government saw the ratio rising by 20 percentage points to a little over 50% in 2020. Additional spending will send the ratio higher over the coming years. We will be looking for details on how and when the government plans to put it on a downward trajectory.

The Bank of Canada (BoC) will be watching the budget closely as it prepares the April Monetary Policy Report (MPR). The Bank had assumed the government will spend \$70 billion of the unallocated funds in the January MPR. This will need to be revised if the budget incorporates something different. In fact, the Bank's previous forecasts will require a hefty upward revision given the resilience shown by the Canadian economy. In January, the Bank expected GDP growth in the fourth quarter of 2020 to be 4.8% q/q annualized, but actual growth came in double that at 9.6% (Chart 2). Likewise, the Bank expected GDP to contract in the first quarter of 2021, but monthly data suggest the economy will see a strong expansion to start the year.

Given the stronger recovery, the Bank will likely begin tapering the asset-purchase program next week. However, it may wait to see the impacts of the third wave before making a call on the overnight rate, which it had previously said will remain at the effective lower bound until sometime in 2023.

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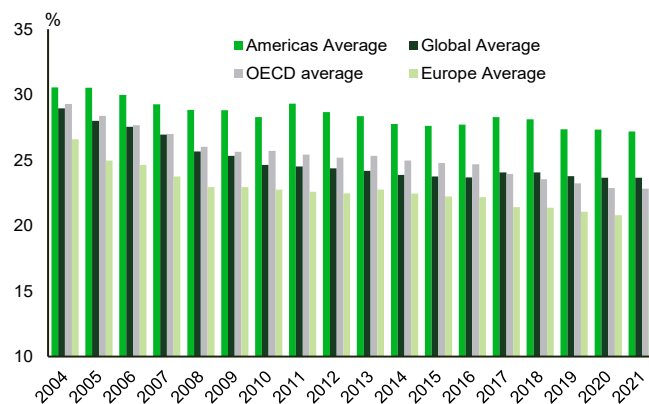
## Financial - U.S. Corporate Taxes, Under the Microscope

Corporate taxation has been the topic du jour for policy makers in recent weeks. In addition to President Biden's push to raise the U.S. corporate tax rate to 28%, Treasury Secretary Janet Yellen recently proposed a global minimum tax for larger multinational corporations, in order to "level the playing field" and avoid tax leakage.

This push comes after years of governments around the world actively reducing tax rates in order to attract corporate investment. Since 2004, the average global corporate tax rate has declined from 29%, to 23.7% in 2021 (Chart 1). For the U.S., it was only four years ago that the Trump administration passed one of the largest corporate tax cuts in modern history. The Tax Cuts and Jobs Act (TCJA) of 2017 reduced the U.S. corporate tax rate from 35% to 21%, with the intent of triggering a corporate investment boom. Corporate investment has disappointed, but the policy did result in a greater percentage of profits being retained by large corporations. To be exact, corporate earnings after tax and interest payments rose from 67% of total operating earnings at the end of 2017, to 75% by the end of 2018. Corporations retained a larger share of the pie, while investors in these companies saw a valuation adjustment and strong price appreciation.

The international story is also telling. U.S. companies have spent years setting up and investing in holding companies (non-bank) domiciled in lower taxed countries. Indeed, roughly half of U.S. foreign investment has been in holding companies, with the majority of this investment in Europe. The TCJA eased this trend by lowering the corporate tax rate to more competitive international levels. Conversely, the Biden administration is proposing a different approach by proposing to raise the tax on overseas profits from 10% to 21%. The new strategy will calculate the minimum tax on a country-by-country basis, which should help address the tax avoidance issue.

**Chart 1: The Decline in Global Corporate Tax Rates**



Source: KPMG, TD Economics.

Policy analysts know that U.S. corporate taxes are both controversial and convoluted. From an economic perspective, it is imperative the Biden administration strikes the right balance to ensure that corporate incentives to invest remain in place. Assuming the administration is successful in unwinding a large portion of the Trump administration's corporate tax cut, it must also make sure it does not erode U.S. competitiveness. Hence the focus on rewriting the rules globally. Thus far, we have seen supportive voices from Europe, stating that an agreement on corporate taxation could bring about stability. While there is a big difference between voicing support for ending tax avoidance and actually signing onto a U.S.-led agreement, this is a step in the right direction.

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Recent Key Economic Indicators: Apr 12 - 16, 2021					
Release Date	Economic Indicator/Event	Data for Period	Units	Current	Prior
<b>United States</b>					
Apr 13	NFIB Small Business Optimism	Mar	Index	98.2	95.8
Apr 13	Consumer Price Index	Mar	M/M % Chg.	0.6	0.4
Apr 13	Consumer Price Index	Mar	Y/Y % Chg.	2.6	1.7
Apr 13	Consumer Price Index Ex Food and Energy	Mar	M/M % Chg.	0.3	0.1
Apr 13	Consumer Price Index Ex Food and Energy	Mar	Y/Y % Chg.	1.6	1.3
Apr 15	Empire Manufacturing	Apr	Index	26.3	17.4
Apr 15	Initial Jobless Claims	Apr 10	Thsd	576.0	769.0
Apr 15	Retail Sales Advance	Mar	M/M % Chg.	9.8	-2.7
Apr 15	Retail Sales Ex Auto and Gas	Mar	M/M % Chg.	8.2	-3.1
Apr 15	Capacity Utilization	Mar	%	74.4	73.4
Apr 15	Industrial Production	Mar	M/M % Chg.	1.4	-2.6
Apr 15	Manufacturing (SIC) Production	Mar	M/M % Chg.	2.7	-3.7
Apr 15	Business Inventories	Feb	M/M % Chg.	0.5	0.4
Apr 15	NAHB Housing Market Index	Apr	Index	83.0	82.0
Apr 16	Building Permits	Mar	Thsd	1766.0	1720.0
Apr 16	Housing Starts	Mar	Thsd	1739.0	1457.0
<b>Canada</b>					
Apr 12	BoC Business Outlook Future Sales	1Q	Q/Q % Chg.	52.0	48.0
Apr 15	Manufacturing Sales	Feb	M/M % Chg.	-1.6	3.1
Apr 15	Existing Home Sales	Mar	M/M % Chg.	5.2	6.6
Apr 16	Wholesale Trade Sales	Feb	M/M % Chg.	-0.7	4.0
<b>International</b>					
Apr 12	EZ Retail Sales	Feb	Y/Y % Chg.	-2.9	-5.2
Apr 13	UK Monthly Gross Domestic Product (3M/3M)	Feb	M/M % Chg.	-1.6	-1.4
Apr 15	CH Gross Domestic Product	1Q	Y/Y % Chg.	18.3	6.5
Apr 15	CH Retail Sales	Mar	Y/Y % Chg.	34.2	-
Apr 15	CH Surveyed Jobless Rate	Mar	%	5.3	5.5
Apr 16	EZ Consumer Price Index	Mar	Y/Y % Chg.	1.3	0.9

Source: Bloomberg, TD Economics.

Upcoming Economic Releases and Events: Apr 19 - 23, 2021						
Release Date	Time*	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
<b>United States</b>						
Apr 22	8:30	Initial Jobless Claims	Apr 17	Thsd	638.0	576.0
Apr 22	10:00	Existing Home Sales	Mar	Mlns	6.20	6.22
Apr 23	9:45	Markit US Manufacturing PMI	Apr	Index	60.0	59.1
Apr 23	9:45	Markit US Services PMI	Apr	Index	61.5	60.4
Apr 23	10:00	New Home Sales	Mar	Thsd	875.0	775.0
<b>Canada</b>						
Apr 19	8:30	Housing Starts	Mar	Thsd	255.0	245.9
Apr 20	8:30	Teranet/National Bank HPI	Mar	Y/Y % Chg.	-	9.8
Apr 21	8:30	Consumer Price Index	Mar	Y/Y % Chg.	-	1.1
Apr 21	8:30	Consumer Price Index NSA	Mar	M/M % Chg.	-	0.5
Apr 21	10:00	Bank of Canada Rate Decision	Apr 21	%	0.25	0.25
Apr 21	11:00	<i>Bank of Canada's Macklem Speaks to Press After Decision</i>				
<b>International</b>						
Apr 20	2:00	UK ILO Unemployment Rate 3Mths	Feb	%	5.1	5.0
Apr 21	2:00	UK Consumer Price Index	Mar	Y/Y % Chg.	0.8	0.4
Apr 22	7:45	EZ ECB Main Refinancing Rate	Apr 22	%	0.00	0.00
Apr 22	19:30	JN Natl Consumer Price Index	Mar	Y/Y % Chg.	-0.2	-0.4
Apr 22	20:30	JN Jibun Bank Japan PMI Mfg	Apr	Index	-	52.7
Apr 23	2:00	UK Retail Sales Ex Auto Fuel	Mar	Y/Y % Chg.	4.2	-1.1
Apr 23	4:00	EZ Markit Eurozone Manufacturing PMI	Apr	Index	62.0	62.5
Apr 23	4:30	UK Markit UK PMI Manufacturing SA	Apr	Index	59.0	58.9

Source: Bloomberg, TD Economics.

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