

The Weekly Bottom Line

July 15, 2022

Highlights

United States

- Market sentiment soured this week on stronger than expected CPI data and a weak start to corporate earnings season.
- US CPI accelerated in June, rising 1.3% m/m, pushing the year-ago measure to a new multidecade high of 9.1%. Core inflation accelerated by 0.7% m/m, as hefty gains were seen across both goods (0.8% m/m) and service (0.7% m/m) categories.
- June retail sales surprised to upside, with both the headline (1% m/m) and control measure (0.8% m/m) recording decent nominal gains. However, sales were lower after adjusting for inflation.

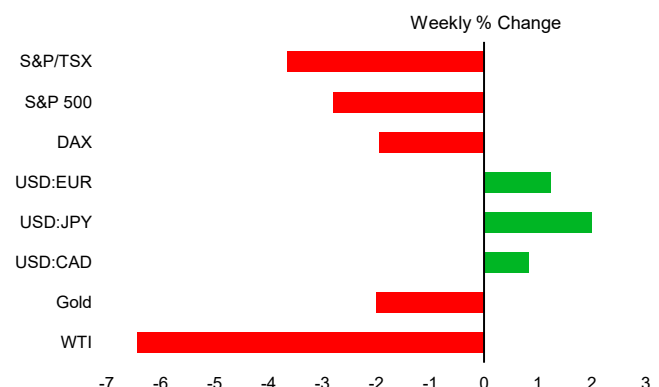
Canada

- The Bank of Canada delivered a surprise 1% rate hike this week as fears over high inflation persist.
- Existing home sales and house prices continue to decline as higher rates pressure markets.
- Next week, all eyes will be on the Canada CPI release, which is expected to show another leg up in inflation.

This Week in the Markets				
	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	3790	3899	4797	3667
S&P/TSX Comp.	18329	19023	22087	18329
DAX	12762	13015	16272	12401
FTSE 100	7126	7196	7672	6844
Nikkei	26788	26517	30670	24718
Fixed Income Yields				
U.S. 10-yr Treasury	2.97	3.08	3.47	1.17
Canada 10-yr Bond	3.12	3.30	3.62	1.12
Germany 10-yr Bund	1.17	1.35	1.77	-0.50
UK 10-yr Gilt	2.12	2.23	2.65	0.51
Japan 10-yr Bond	0.24	0.24	0.26	0.01
Foreign Exchange Cross Rates				
C\$ (USD per CAD)	0.77	0.77	0.81	0.76
Euro (USD per EUR)	1.01	1.02	1.19	1.00
Pound (USD per GBP)	1.18	1.20	1.40	1.18
Yen (JPY per USD)	138.8	136.1	139.0	109.0
Commodity Spot Prices**				
Crude Oil (\$US/bbl)	98.6	104.8	123.7	62.3
Natural Gas (\$US/MMBtu)	6.86	6.39	9.43	3.33
Copper (\$US/met. tonne)	7160.0	7795.0	11299.5	7160.0
Gold (\$US/troy oz.)	1707.6	1742.5	2050.8	1707.6

*As of 10:47 AM on Friday. **Oil-WTI, Cushing, Nat. Gas-Henry Hub, LA (Thursday close price). Copper-LME Grade A. Gold-London Gold Bullion. Source: Bloomberg.

Equities Fall on Growth and Inflation Concerns



Note: Data as of 10:52 AM ET, Friday, July 15, 2022.
Source: Bloomberg, TD Economics.

Global Official Policy Rate Targets	
Central Banks	Current Target
Federal Reserve (Fed Funds Rate)	1.50 - 1.75%
Bank of Canada (Overnight Rate)	2.50%
European Central Bank (Refi Rate)	0.00%
Bank of England (Repo Rate)	1.25%
Bank of Japan (Overnight Rate)	-0.10%

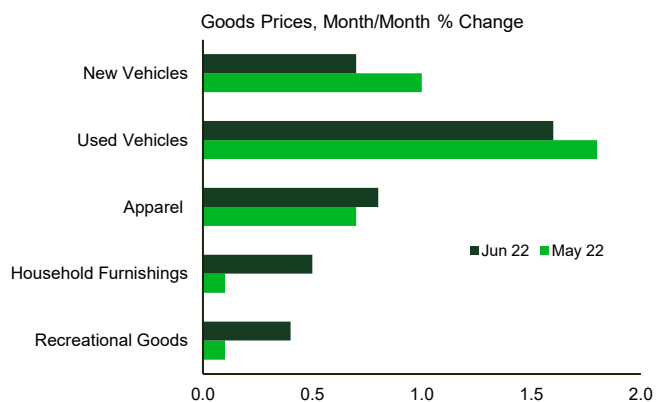
Source: Bloomberg.

U.S. - Gotta Bend Before You Can Break

Market sentiment decisively shifted to risk-off mode this week, as a stronger than expected print on CPI and a weak start to corporate earnings season helped cast further doubt on the economic outlook. At the time of writing, the S&P 500 is down 2% on the week and has now had one of the worst starts to a year in nearly a century. The deteriorating market sentiment led to a further widening in the yield curve inversion – highlighting the growing fear among market participants that a recession may be on the horizon. The 10Y-2Y spread now sits at -20 basis points (bps). The sour market sentiment also spilled over to commodity markets, with WTI down 8% to \$98 per-barrel on the week.

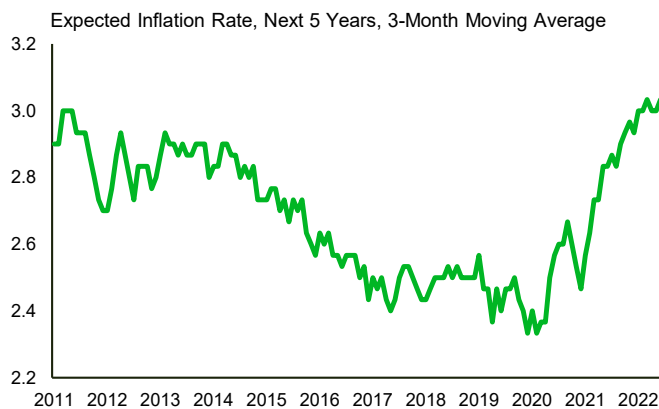
Any hopes of inflationary pressures easing in June were quickly dashed on Wednesday following the Bureau of Labor Statistics’ release of last month’s CPI data. Headline CPI accelerated by 1.3% month-on-month (m/m), pushing the year-ago measure to a new multidecade high of 9.1%. Indeed, with fuel prices having surged by 11% last month, and more recent gains in food prices showing incredible persistence, a further acceleration in the headline measure was inevitable. What was not anticipated, however, was the uptick in core inflation (0.7% m/m). Perhaps most disconcerting was the breadth in price gains across core, particularly among goods categories (Chart 1). Further gains in goods prices are at odds with more recent spending data, which has shown consumers pulling back on purchases of most discretionary goods in recent months. While inflation is notoriously a lagged indicator, it was thought that the combination of weakening demand and anecdotal reports of retailers carrying excess inventory would soon start to exert downward pressure on goods prices. That narrative has

Chart 1: Goods Prices Remain Strong in June



Source: Bureau of Labor Statistics, TD Economics.

Chart 2: Inflation Expectations Turn Lower in July, But Remain Elevated



Source: University of Michigan, TD Economics.

yet to come to fruition, and that detail will not be lost on policymakers when they meet later this month.

Perhaps one piece of encouraging news came from the July reading of the University of Michigan consumer confidence survey, which showed that expectations for inflation over the next five years now sit at 2.8% – down from last month’s reading of 3.1% (Chart 2). Chair Powell highlighted the recent upward drift in inflation expectations as being one of the key contributors in the FOMC’s decision to raise rates more forcefully in June. While the turn lower will provide some relief to policymakers, it won’t be enough to dissuade them from pushing ahead with another supersized hike later this month. This sentiment has been mirrored in market pricing, with odds a near coin toss on whether the Fed will raise by 75bps or 100bps.

The big question now is to what extent higher interest rates will ultimately weigh on domestic demand. Retail sales data for June showed that consumers are remaining somewhat resilient, with both headline (1.0% m/m) and the control (0.8% m/m) up on the month. That said, consumer spending is only tracking around 1% q/q (annualized) for the second quarter, which is a marked slowdown from the 4.5% averaged through the second half of last year. With inflation continuing to erode purchasing power and rates expected to move decisively higher through year-end, the hope is that consumers will only bend under the weight of the dual-income shock and not completely break.

Thomas Feltmate, Director | 416-944-5730

Canada - BoC Delivers Shock 1% Hike

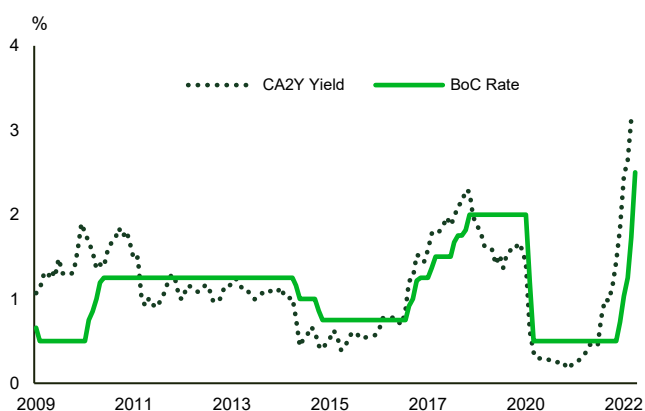
The Bank of Canada (BoC) made global headlines this week as it delivered on a super upsized rate hike of 1% (Chart 1). Though we are running out of superlatives to describe the magnitude of the BoC's actions, expectations are for more to come as inflation is poised to continue to run at elevated levels. Financial market participants are expecting 1% to 1.25% in additional rate hikes over this year.

BoC Cuts Growth, Upgrades Inflation

In the BoC's accompanying Monetary Policy Statement there were a number of nuggets the revealed insight into the Bank's thinking. The first is the change in their growth forecast. The Bank stated that economic growth will slow from 3.5% this year to 1.75% in 2023, as global economic momentum decelerates on the back of higher global interest rates and high inflation.

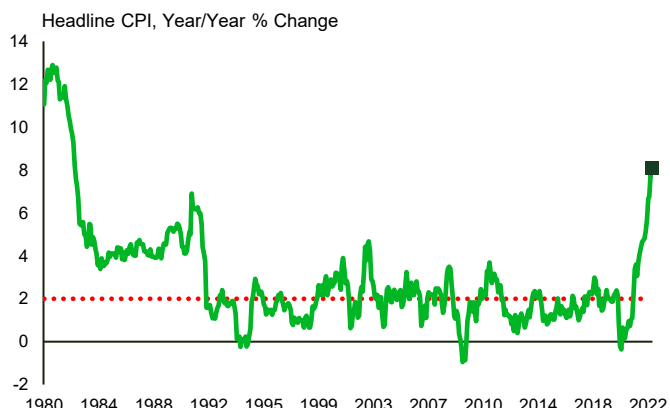
On inflation, the BoC's new forecast shows that it believes CPI will remain around 8% over the coming months and decelerate to only 7.5% by the end of this year, reaching 3.2% by the end of 2023. That means the central bank doesn't think it will be able to bring inflation down to the target band (1%-3%) within its 12-18 month monetary policy window. Given the recent Business Outlook Survey and Canadian Survey of Consumer Expectations, which showed an unmooring of inflation expectations over the forecast horizon, the Bank of Canada's forecast of higher inflation for longer hits the spot.

Chart 1: BoC Hikes 1%, Signals More to Come



Source: BoC, TD Economics.

Chart 2: Canadian Inflation Set to Rise



Note: The dark square is our June CPI forecast. Source: StatCan, TD Economics.

We also got data on Canadian existing home sales and home prices on Friday. Following the recent trend, sales declined another 5.6% month-over-month (m/m). Combined with the 4.1% m/m rise in new listings, the sales-to-listings ratio continued to fall further into balanced territory (51.7%). This caused the average Canadian home price to drop another 4.3% m/m, pushing the peak-to-trough decline to a whopping -14% since February.

Looking Ahead to Next Week

All eyes will be on Wednesday's CPI release next week. With inflation already at 7.7% year-on-year, expectations are for a +8% reading on the headline number (Chart 2). We are looking to see further increases in price pressures on food and fuel, which have been the main drivers of inflation over the last few months. Any surprise to the upside on inflation will likely cause markets to price even more hikes by the BoC. Recent re-pricing has caused the Canada 2-year to continue to rise, while the Canada 10-year has remained stable just above 3%. This has pushed the 10-year/2-year yield spread (a popular signal of recession) even deeper into negative territory. Though the BoC is still forecasting a soft landing, where it raises rates without causing recession, markets are preparing for a bumpy ride.

James Orlando, CFA, Director | 416-413-3180

Recent Key Economic Indicators: Jul 8, 11 - 15, 2022					
Release Date	Economic Indicator/Event	Data for Period	Units	Current	Prior
United States					
Jul 12	NFIB Small Business Optimism	Jun	Index	89.5	93.1
Jul 13	Consumer Price Index Ex Food and Energy	Jun	M/M % Chg.	0.7	0.6
Jul 13	Consumer Price Index Ex Food and Energy	Jun	Y/Y % Chg.	5.9	6.0
Jul 13	Consumer Price Index	Jun	M/M % Chg.	1.3	1.0
Jul 13	Consumer Price Index	Jun	Y/Y % Chg.	9.1	8.6
Jul 14	Initial Jobless Claims	Jul 9	Thsd	244.0	235.0
Jul 14	PPI Ex Food and Energy	Jun	M/M % Chg.	0.4	0.6
Jul 14	PPI Final Demand	Jun	M/M % Chg.	1.1	0.9
Jul 15	Empire Manufacturing	Jul	Index	11.1	-1.2
Jul 15	Retail Sales Advance	Jun	M/M % Chg.	1.0	-0.1
Jul 15	Retail Sales Ex Auto and Gas	Jun	M/M % Chg.	0.7	-0.1
Jul 15	Capacity Utilization	Jun	%	80.0	80.3
Jul 15	Industrial Production	Jun	M/M % Chg.	-0.2	0.0
Jul 15	Manufacturing (SIC) Production	Jun	M/M % Chg.	-0.5	-0.5
Jul 15	Business Inventories	May	M/M % Chg.	1.4	1.3
Canada					
Jul 13	Bank of Canada Rate Decision	Jul 13	%	2.50	1.50
Jul 14	Manufacturing Sales	May	M/M % Chg.	-2.0	2.6
Jul 15	Wholesale Trade Sales	May	M/M % Chg.	2.0	-0.5
Jul 15	Existing Home Sales	Jun	M/M % Chg.	-4.8	-8.6
International					
Jul 8	CH Consumer Price Index	Jun	Y/Y % Chg.	2.5	2.1
Jul 13	UK Monthly Gross Domestic Product (3M/3M)	May	M/M % Chg.	0.4	0.3
Jul 14	CH Gross Domestic Product	2Q	Y/Y % Chg.	1.2	4.8
Jul 14	CH Retail Sales	Jun	Y/Y % Chg.	0.3	-6.7
Jul 14	CH Surveyed Jobless Rate	Jun	%	5.7	5.9

Source: Bloomberg, TD Economics.

Upcoming Economic Releases and Events: Jul 18 - 22, 2022						
Release Date	Time*	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
United States						
Jul 18	10:00	NAHB Housing Market Index	Jul	Index	66.0	67.0
Jul 19	8:30	Building Permits	Jun	Thsd	1680.0	1695.0
Jul 19	8:30	Housing Starts	Jun	Thsd	1595.0	1549.0
Jul 20	10:00	Existing Home Sales	Jun	Mlns	5.40	5.41
Jul 21	8:30	Initial Jobless Claims	Jul 16	Thsd	240.0	244.0
Jul 22	9:45	S&P Global US Composite PMI	Jul	Index	-	52.3
Jul 22	9:45	S&P Global US Manufacturing PMI	Jul	Index	51.5	52.7
Jul 22	9:45	S&P Global US Services PMI	Jul	Index	52.5	52.7
Canada						
Jul 18	8:15	Housing Starts	Jun	Thsd	-	287.3
Jul 20	8:30	Consumer Price Index	Jun	Y/Y % Chg.	-	7.7
Jul 20	8:30	Consumer Price Index NSA	Jun	M/M % Chg.	-	1.4
Jul 20	8:30	Industrial Product Price	Jun	M/M % Chg.	-	1.7
Jul 22	8:30	Retail Sales	May	M/M % Chg.	-	0.9
Jul 22	8:30	Retail Sales Ex Auto	May	M/M % Chg.	-	1.3
International						
Jul 19	2:00	UK ILO Unemployment Rate 3 Months	May	%	3.8	3.8
Jul 19	5:00	EZ Consumer Price Index	Jun	Y/Y % Chg.	8.6	8.1
Jul 20	2:00	UK Consumer Price Index	Jun	Y/Y % Chg.	9.3	9.1
Jul 21	8:15	EZ ECB Main Refinancing Rate	Jul 21	%	0.25	0.00
Jul 21	19:30	JN Natl Consumer Price Index	Jun	Y/Y % Chg.	2.4	2.5
Jul 21	20:30	JN Jibun Bank Japan PMI Manufacturing	Jul	Index	-	52.7
Jul 22	2:00	UK Retail Sales Ex Auto Fuel	Jun	Y/Y % Chg.	-6.1	-5.7
Jul 20 - 21		JN BOJ Policy Balance Rate	Jul 21	%	-0.10	-0.10

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

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