

## The Weekly Bottom Line

August 12, 2022

### Highlights

#### United States

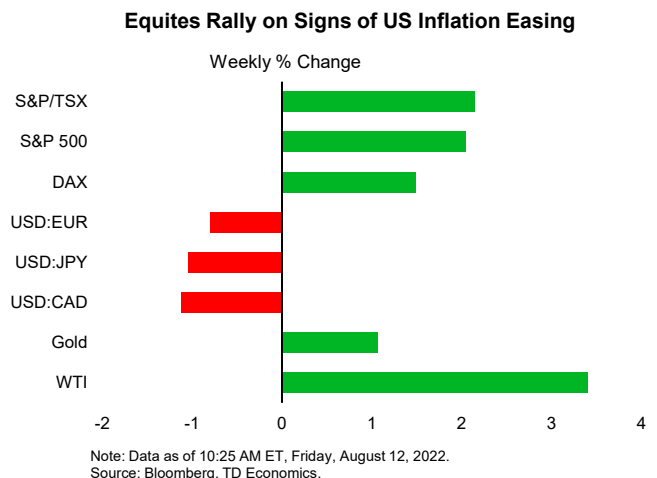
- The U.S. Senate passed a climate, healthcare, and tax bill known as the Inflation Reduction Act of 2022 earlier this week. The legislation is now off to the House of Representatives for a final vote later today where it is expected to pass.
- July CPI came in weaker than expected, with the headline measure flat on the month and core “only” increasing by 0.3% month-over-month.
- While the deceleration in inflation comes as welcome news to policymakers, Fed officials have reiterated that more tightening will be required to achieve price growth stability of 2%.

#### Canada

- A thin Canadian economic data calendar resulted in a lot of eyes looking south of the border in hopes of getting a preview of what is to come next week.
- The main focus next week will be on Canadian CPI, which is expected to show further deceleration on the back of falling energy prices.
- We will also be watching housing sales and price data, which is set to show another drop in overall real estate activity and a further leg down in prices.

This Week in the Markets				
	Current*	Week Ago	52-Week High	52-Week Low
<b>Stock Market Indexes</b>				
S&P 500	4230	4145	4797	3667
S&P/TSX Comp.	20055	19620	22087	18329
DAX	13775	13574	16272	12401
FTSE 100	7498	7440	7672	6904
Nikkei	28547	28176	30670	24718
<b>Fixed Income Yields</b>				
U.S. 10-yr Treasury	2.85	2.83	3.47	1.24
Canada 10-yr Bond	2.78	2.74	3.62	1.13
Germany 10-yr Bund	0.99	0.96	1.77	-0.50
UK 10-yr Gilt	2.11	2.05	2.65	0.52
Japan 10-yr Bond	0.19	0.17	0.26	0.01
<b>Foreign Exchange Cross Rates</b>				
C\$ (USD per CAD)	0.78	0.77	0.81	0.76
Euro (USD per EUR)	1.02	1.02	1.19	1.00
Pound (USD per GBP)	1.21	1.21	1.39	1.18
Yen (JPY per USD)	133.7	135.0	139.0	109.2
<b>Commodity Spot Prices**</b>				
Crude Oil (\$US/bbl)	93.2	89.0	123.7	62.3
Natural Gas (\$US/MMBtu)	8.52	8.16	9.45	3.34
Copper (\$US/met. tonne)	8165.5	7862.5	11299.5	7160.0
Gold (\$US/troy oz.)	1792.5	1775.5	2050.8	1696.6

\*As of 10:59 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	
Central Banks	Current Target
Federal Reserve (Fed Funds Rate)	2.25 - 2.50%
Bank of Canada (Overnight Rate)	2.50%
European Central Bank (Refi Rate)	0.50%
Bank of England (Repo Rate)	1.75%
Bank of Japan (Overnight Rate)	-0.10%

Source: Bloomberg.

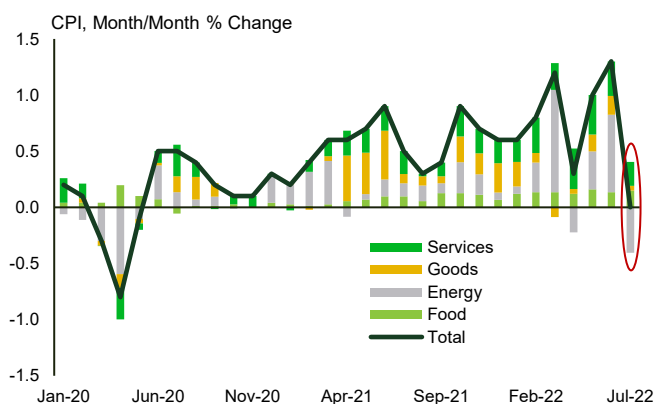
# U.S. - Inflation Was the Word of the Week

It was a week full of surprises, with inflation being the key theme. Chief among them was the U.S. Senate quickly moving to pass the Inflation Reduction Act of 2022 (IRA). It now heads to the House of Representatives later today for a final vote, where it's expected to pass. The reconciliation bill is a significantly scaled back version of the far more ambitious Build Back Better Act, though it still incorporates many of the key climate related initiatives that were included in the previous bill.

In terms of broad strokes, the IRA aims to spend roughly \$430B on climate and healthcare initiatives over the next decade and is estimated to more than offset those expenditures with \$740B of proposed revenue. Over 85% of the appropriated expenditures will be directed towards climate related initiatives and will be dispersed mainly through grants and loans. Of those investments, perhaps most noteworthy is the \$80B in new rebates allocated to eligible households for electric vehicles (EVs) and to help decarbonize residential buildings. The additional funding for EVs not only maintains the existing \$7,500 rebate but also introduces a new tax credit of up \$4,000 for both used and new EVs, with the latter applying only to those vehicles made in North America.

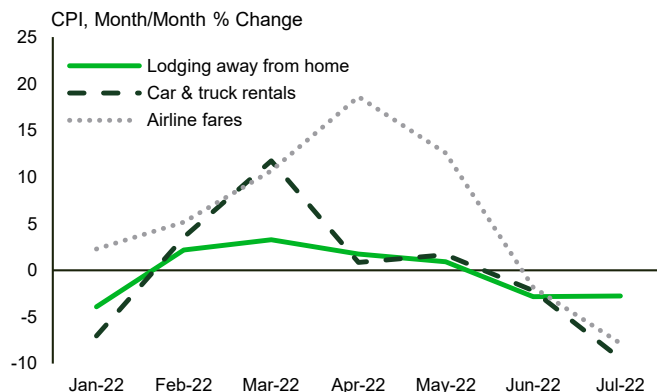
On the healthcare side, the IRA will put a cap of \$2,000 on out-of-pocket prescription drug costs for individuals on Medicare. It also aims to bring down the cost of the most expensive drugs by allowing the government to negotiate the price of a subset of those drugs covered by Medicare, though this won't start until 2026.

**Chart 1: Headline Inflation Cools in July**



Source: Bureau of Labor Statistics, TD Economics.

**Chart 2: Prices Ease Across Travel Related "Reopening" Categories in July**



Source: Bureau of Labor Statistics, TD Economics.

All of this will be paid for through a new 15% minimum corporate tax imposed on corporations earning more than \$1B, enhancements to the IRS audit and review process, and taxing share buybacks. The fact that the deficit will be reduced over the next decade is what is being used to justify the "inflation reduction" element of the bill. However, the total deficit reduction is only estimated to be \$400B (or 1.6% of GDP), and will be spread over the next decade – suggesting the impact to growth and inflation will likely be negligible.

Turning to the other surprise this week, July CPI data (finally!) came in weaker than expected. The headline index was flat on the month, while core prices "only" rose by 0.3% m/m (Chart 1). Indeed, the recent pullback in energy prices subtracted from the headline measure, though accelerating food prices provided a partial offset. Looking to the core measure, there were a few encouraging tidbits. Core services grew by 0.4% m/m – down from the 0.7% m/m reported in June. A lot of the pullback was the result of a softening in travel-related categories, such as airfares, car rentals, and lodging away from home (Chart 2). Other green shoots emerged on the goods side, as prices across most categories decelerated, while used vehicle prices, apparel, and education goods all declined.

This will be welcome news to FOMC officials, but as San Francisco Fed president Mary Daly said on Wednesday "it's still too early to declare victory". Daly reiterated her support to dial back on the pace of rate hikes in September but didn't rule out another 75bps move should the turn in inflation prove to be fleeting.

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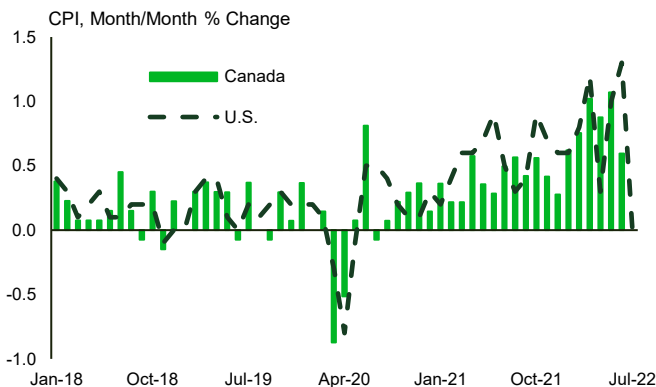
# Canada - Looking South for Signs of Hope

With an empty Canadian economic data calendar, all eyes were on what was moving south of the border. Clearly U.S. CPI was the focus with the upcoming Canada CPI release next week. Given that headline month-on-month (m/m) CPI in the U.S. showed zero price growth in July (Chart 1), sentiment jumped on hopes that central banks may not have to hike rates as much as previously thought. This caused short-term bond yields to drop and equity markets to rally over the week.

Following the U.S.'s lead, we are looking for Canadian CPI to show a second straight print of decelerating monthly price growth. This monthly trend should translate into a peak in year-on-year (y/y) inflation, with the headline number coming back below 8%. The pullback in gasoline prices will be a primary driver here, with prices having fallen approximately 20% from their peak in early June.

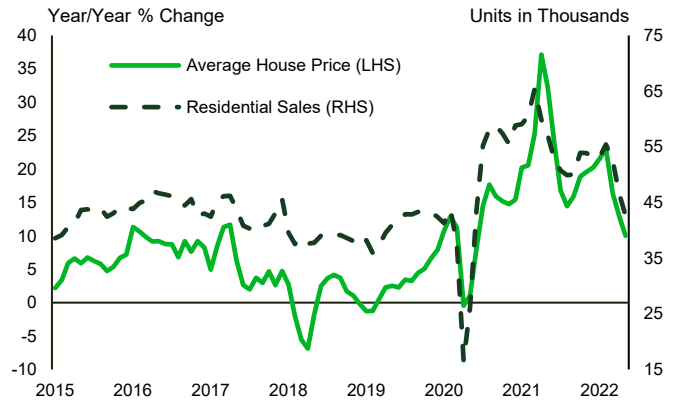
Though a near-term peak in inflation will come as welcomed news, the broadening of inflation to all areas of the economy is likely to keep the annual figures uncomfortably high through the remainder of 2022. We'll be closely watching the evolution of services inflation, which is most reflective of Canadian domestic demand, and has just started to accelerate on the back of rising wages. It is currently growing at 5.2% y/y and is unlikely to show much deceleration given the still ongoing re-opening boom.

**Chart 1: U.S. Inflation Drops, Canada Looking to Follow**



Source: StatCan, BLS, TD Economics.

**Chart 2: Housing Sales and Prices Set to Drop**



Source: CREA, TD Economics. Last observation: May 2022.

Though an improved inflation report will be welcomed news for the Bank of Canada, it is unlikely to cause policymakers to change course at its September 7th meeting. The BoC is poised to continue hiking its policy rate at a significant pace as it will need much more evidence that inflation is declining. We are looking for the policy rate to reach 3% by September, getting to 3.25% by year-end. That would bring the policy rate decisively beyond the BoC's neutral rate – the interest rate that is neither accommodative nor restrictive – assumption of 2% to 3% and into restrictive territory.

Speaking of interest rates, we will also be getting data on Canadian home sales and prices next week. We are looking for another leg down in sales activity. And with listings holding up reasonably well, this will force the sales-to-listings ratio (currently at 51.7%) even lower. This is putting even more downward pressure on home prices. Based on early readings of transaction data over July, we are expecting the peak-to-trough decline in prices since the first quarter to continue to push towards our forecast of 19%. With the BoC unlikely to pause on rate hikes until later this year, the real estate sector's fall from grace isn't done yet (Chart 2).

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Recent Key Economic Indicators: Aug 8 - 12, 2022					
Release Date	Economic Indicator/Event	Data for Period	Units	Current	Prior
<b>United States</b>					
Aug 9	NFIB Small Business Optimism	Jul	Index	89.9	89.5
Aug 9	Unit Labor Costs	2Q	Q/Q % Chg.	10.8	12.7
Aug 10	Consumer Price Index	Jul	M/M % Chg.	0.0	1.3
Aug 10	Consumer Price Index	Jul	Y/Y % Chg.	8.5	9.1
Aug 10	Consumer Price Index Ex Food and Energy	Jul	M/M % Chg.	0.3	0.7
Aug 10	Consumer Price Index Ex Food and Energy	Jul	Y/Y % Chg.	5.9	5.9
Aug 10	Wholesale Trade Sales	Jun	M/M % Chg.	1.8	0.7
Aug 11	Initial Jobless Claims	Aug 6	Thsd	262.0	248.0
Aug 11	PPI Ex Food and Energy	Jul	M/M % Chg.	0.2	0.4
Aug 11	PPI Final Demand	Jul	M/M % Chg.	-0.5	1.0
<b>International</b>					
Aug 9	CH Consumer Price Index	Jul	Y/Y % Chg.	2.7	2.5
Aug 12	UK Gross Domestic Product	2Q	Y/Y % Chg.	2.9	8.7

Source: Bloomberg, TD Economics.

Upcoming Economic Releases and Events: Aug 15 - 19, 2022						
Release Date	Time*	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
<b>United States</b>						
Aug 15	8:30	Empire Manufacturing	Aug	Index	5.0	11.1
Aug 15	10:00	NAHB Housing Market Index	Aug	Index	55.0	55.0
Aug 16	8:30	Building Permits	Jul	Thsd	1645.0	1696.0
Aug 16	8:30	Housing Starts	Jul	Thsd	1537.0	1559.0
Aug 16	9:15	Capacity Utilization	Jul	%	80.2	80.0
Aug 16	9:15	Industrial Production	Jul	M/M % Chg.	0.3	-0.2
Aug 16	9:15	Manufacturing (SIC) Production	Jul	M/M % Chg.	0.2	-0.5
Aug 17	8:30	Retail Sales Advance	Jul	M/M % Chg.	0.2	1.0
Aug 17	8:30	Retail Sales Ex Auto and Gas	Jul	M/M % Chg.	0.3	0.7
Aug 17	10:00	Business Inventories	Jun	M/M % Chg.	1.4	1.4
Aug 17	14:00	<i>FOMC Meeting Minutes</i>				
Aug 18	8:30	Initial Jobless Claims	Aug 13	Thsd	265.0	262.0
Aug 18	10:00	Existing Home Sales	Jul	Mlns	4.86	5.12
Aug 18	13:20	<i>Fed's George Speaks on Economic Outlook</i>				
Aug 18	13:45	<i>Fed's Kashkari Speaks in Q&amp;A</i>				
<b>Canada</b>						
Aug 15	8:30	Manufacturing Sales	Jun	M/M % Chg.	-	-2.0
Aug 15	8:30	Wholesale Trade Sales	Jun	M/M % Chg.	-	1.6
Aug 15	9:00	Existing Home Sales	Jul	M/M % Chg.	-	-5.6
Aug 16	8:15	Housing Starts	Jul	Thsd	-	273.8
Aug 16	8:30	Consumer Price Index	Jul	Y/Y % Chg.	-	8.1
Aug 16	8:30	Consumer Price Index NSA	Jul	M/M % Chg.	-	0.7
Aug 18	8:30	Industrial Product Price	Jul	M/M % Chg.	-	-1.1
Aug 18	8:30	Teranet/ National Bank HPI SA	Jul	M/M % Chg.	-	1.0
Aug 18	8:30	Teranet/National Bank HPI	Jul	Y/Y % Chg.	-	16.7
Aug 19	8:30	Retail Sales	Jun	M/M % Chg.	-	2.2
Aug 19	8:30	Retail Sales Ex Auto	Jun	M/M % Chg.	-	1.9
<b>International</b>						
Aug 16	2:00	UK ILO Unemployment Rate 3 Months	Jun	%	3.8	3.8
Aug 17	2:00	UK Consumer Price Index	Jul	Y/Y % Chg.	9.9	9.4
Aug 17	5:00	EZ Employment	2Q	Y/Y % Chg.	-	2.9
Aug 17	5:00	EZ Gross Domestic Product SA	2Q	Y/Y % Chg.	4.0	4.0
Aug 18	5:00	EZ Consumer Price Index	Jul	Y/Y % Chg.	8.9	8.6
Aug 18	19:30	JN Natl Consumer Price Index	Jul	Y/Y % Chg.	2.6	2.4
Aug 19	2:00	UK Retail Sales Ex Auto Fuel	Jul	Y/Y % Chg.	-2.8	-5.9

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

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