

## The Weekly Bottom Line

September 16, 2022

### Highlights

#### United States

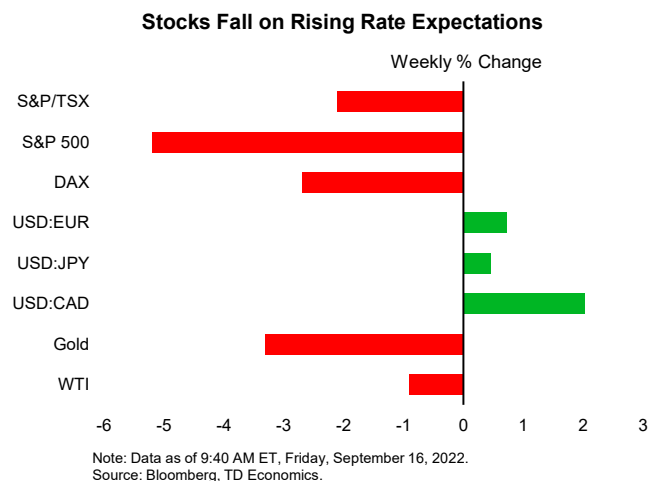
- CPI inflation surprised to the upside in August, rising 0.1% m/m. The core measure also recorded a sizeable 0.6% m/m gain, as both goods and service categories accelerated on the month.
- Financial markets have now fully priced a 75-basis point hike from the Fed next week and are anticipating the Fed funds rate reaches 4% by year-end.
- A tentative agreement between U.S. rail companies and the unions representing rail workers was reached on Thursday, avoiding what could have been another crippling blow to U.S. supply chains.

#### Canada

- A volatile week for financial markets saw steep equity market declines on the back of rising odds of another super-sized rate hike by the Bank of Canada.
- Rising yields reflect expectations that next week's Canadian CPI data will show that core measures of inflation will remain at uncomfortably high levels.
- The impact of higher rates is still being felt in the Canadian housing market, where sales have dropped again, while prices sent mixed messages.

This Week in the Markets				
	Current*	Week Ago	52-Week High	52-Week Low
<b>Stock Market Indexes</b>				
S&P 500	3901	4067	4797	3667
S&P/TSX Comp.	19560	19773	22087	18329
DAX	12735	13088	16272	12401
FTSE 100	7254	7351	7672	6904
Nikkei	27568	28215	30500	24718
<b>Fixed Income Yields</b>				
U.S. 10-yr Treasury	3.47	3.31	3.47	1.30
Canada 10-yr Bond	3.18	3.13	3.62	1.21
Germany 10-yr Bund	1.78	1.70	1.78	-0.39
UK 10-yr Gilt	3.16	3.10	3.17	0.70
Japan 10-yr Bond	0.26	0.25	0.26	0.04
<b>Foreign Exchange Cross Rates</b>				
C\$ (USD per CAD)	0.75	0.77	0.81	0.75
Euro (USD per EUR)	1.00	1.00	1.18	0.99
Pound (USD per GBP)	1.14	1.16	1.38	1.14
Yen (JPY per USD)	143.2	142.5	144.6	109.2
<b>Commodity Spot Prices**</b>				
Crude Oil (\$US/bbl)	85.0	86.8	123.7	65.6
Natural Gas (\$US/MMBtu)	8.60	8.25	9.84	3.33
Copper (\$US/met. tonne)	7848.8	7924.0	11299.5	7160.0
Gold (\$US/troy oz.)	1660.3	1716.8	2050.8	1660.3

\*As of 9:40 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)	3.25%
European Central Bank (Refi Rate)	1.25%
Bank of England (Repo Rate)	1.75%
Bank of Japan (Overnight Rate)	-0.10%

Source: Bloomberg.

# U.S. - Full Steam Ahead for the FOMC

Hopes that the Federal Reserve can still engineer a soft landing were tested again this week. Consumer Price Index (CPI) data for August showed inflation was far hotter than expected, leading to a sharp repricing of market expectations on the future path of rate hikes. Following the release, market participants were quick to fully price a 75-basis point move from the Federal Reserve next week, and now expect the Fed funds rate to reach 4% by year-end. The pull forward in rate hike expectations triggered a sharp sell-off in U.S. equities, with the S&P 500 suffering its worst day of the year – falling by over 4%. Equities dipped a bit further through the remainder of the week and are down 5.5% at the time of writing.

In terms of the actual CPI figures, headline inflation rose 0.1% month-on-month (m/m), a few ticks above the consensus forecast. More worrying, was the 0.6% m/m increase in core inflation – a sharp acceleration from July’s 0.3% m/m gain. While some persistence in price growth across service categories such as shelter and healthcare was expected, the August data showed far more breadth and strength across nearly all goods and service categories.

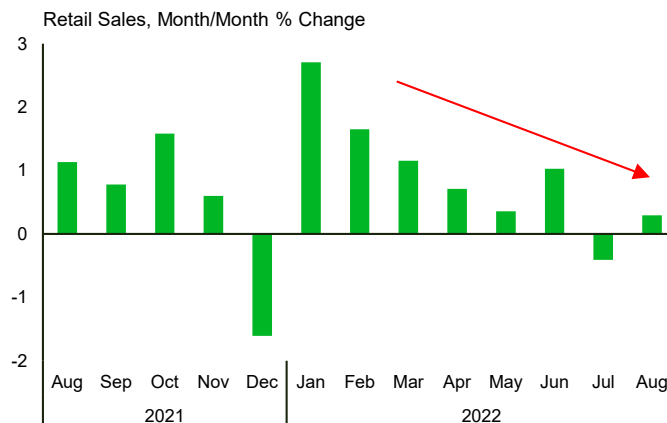
While we’re hesitant to put too much stock in one month of data, the re-acceleration in goods prices is somewhat concerning. Despite demand for consumer goods cooling more recently, goods inflation has shown considerable staying power. This was reaffirmed later in the week where August retail sales data showed only a modest gain of 0.3% m/m (Chart 1). The control group of sales was even weaker, recording a flat reading on the month.

**Chart 1: Inventory-to-Sales Ratio Across Department Stores Elevated**



Source: Census Bureau, TD Economics.

**Chart 2: Retail Sales Remain Weak in August**



Source: Census Bureau, TD Economics.

The continued gains in goods prices are even more perplexing when we consider the fact that not only is demand weakening, but inventory levels are also starting to look toppish. Inventory-to-sales ratios across department stores are now well above pre-pandemic levels – suggesting we should be seeing some disinflationary pressure (Chart 2). Other oddities are also starting to emerge across used vehicle prices. The Manheim Used Vehicle Price Index – a measure that captures dealer purchase prices – has fallen by over 10% this year, yet the CPI measure of used vehicle prices has declined by only 1.5%. This suggests that lower costs are not being passed onto consumers, and retailers are instead maintaining wider margins. Over the near-term, this is not necessarily problematic. But if left unchecked, it can start to sow the seeds of more engrained inflationary pressures. Fortunately, that hasn’t happened yet. According to data released by the New York Federal Reserve, both one-and-three-year inflation expectations have continued to move lower, with August readings falling to 5.8% (from 6.2%) and 2.8% (from 3.2%), respectively.

One piece of good news emerged this week, with a tentative agreement reached between U.S. rail companies and the unions representing the rail workers. The labor deal averts what would have been another crippling blow to U.S. supply chains, and almost certainly lead to more near-term pressures on inflation. FOMC officials will likely breathe a sigh of relief, as the focus can remain squarely on what will still be a challenging task; threading the needle of lowering inflation while trying to avoid a recession.

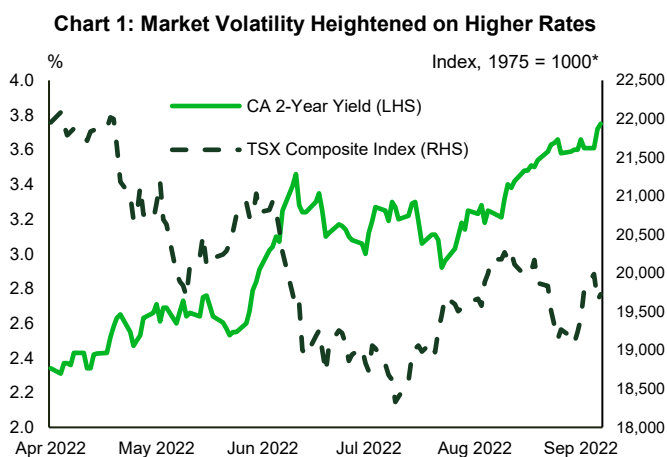
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# Canada – Yields Jump on Higher BoC Bets

It was a volatile week for financial markets, with the risk-off move causing the TSX to drop approximately 2%, while the S&P 500 declined nearly 5%. Clearly the U.S. CPI data release, which showed an uptick in core inflation, raised expectations that Canadian CPI will show a similar move next week. This raised market pricing that the Bank of Canada (BoC) will have to hike its policy rate even more than previously expected, lifting the Canada 2-year yield by a whopping 25 basis points – to a 15 year high of 3.87% (Chart 1).

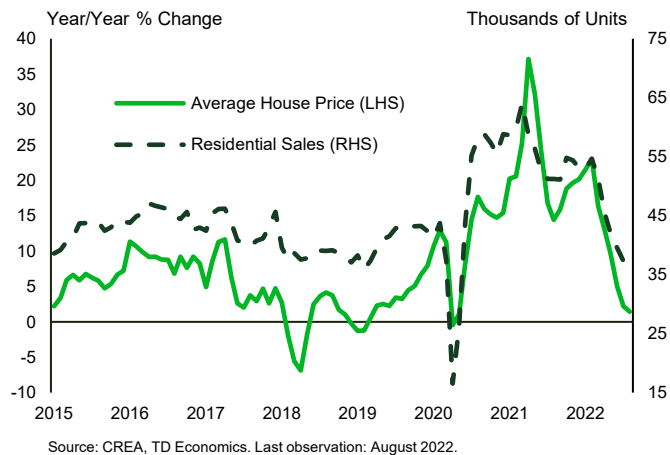
It is our [view](#) that the BoC will need to raise rates to a very restrictive level of 4% to decisively break this high inflation cycle. Though it will take time for interest rates to work through the economy, the BoC is closely watching the incoming data. This means that there will be a lot of eyes on next week's Canadian CPI release. With gas prices having fallen in August on slowing global growth fears, we expect to see further deceleration in the headline CPI print. This is good news, but the BoC will be more interested in the core inflation numbers, which strip out volatile items like food and energy.

If the U.S. CPI data are any indication, we will likely see the impact of high food and fuel prices having spilled into to other inflation components. One area where this is likely to show up is in the rise of services inflation. This is an important category, as services inflation tends to be much more 'sticky' than the goods inflation that led this



\*Index measured in CAD. Source: BoC, WSJ, TD Economics.

**Chart 2: Housing Sales and Prices Weaken**



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

cycle. This means that even if goods (food and fuel) prices ease on global demand fears, rising services prices could keep [inflation uncomfortably high](#) for much longer than the BoC would like.

Though inflation will be impacted by higher rates with a lag, the same cannot be said for Canadian real estate. New data on housing this week showed existing homes sales dropped another 1% in August (Chart 2). That brings the level of housing market activity down an astonishing 17% below pre-pandemic levels. The sales decline was apparent in every province, save Ontario, which benefitted from a surprising flurry of transactions in Toronto. This bounce in the higher priced Toronto market helped push the national average home price up nearly 2% on the month. Though it may look encouraging, we believe this improvement in average home prices is only temporary.

In fact, the more 'like-for-like' MLS home price index, which removes some of the compositional effects of the Toronto market, showed another notable decline of 1.6% in August. This weakness more closely mirrors the current market dynamics, where total sales have continued to slide. Given our view that the BoC will continue to hike rates through this year, we are expecting further declines in housing prices, with average home prices dropping by around 20% on a quarterly peak-to-trough basis.

James Orlando, Director & Senior Economist

Recent Key Economic Indicators: Sept 12 - 16, 2022					
Release Date	Economic Indicator/Event	Data for Period	Units	Current	Prior
<b>United States</b>					
Sep 13	NFIB Small Business Optimism	Aug	Index	91.8	89.9
Sep 13	Consumer Price Index	Aug	M/M % Chg.	-0.1	0.0
Sep 13	Consumer Price Index	Aug	Y/Y % Chg.	8.3	8.5
Sep 13	Consumer Price Index Ex Food and Energy	Aug	M/M % Chg.	0.6	0.3
Sep 13	Consumer Price Index Ex Food and Energy	Aug	Y/Y % Chg.	6.3	5.9
Sep 14	PPI Ex Food and Energy	Aug	M/M % Chg.	0.4	0.3
Sep 14	PPI Final Demand	Aug	M/M % Chg.	-0.1	-0.4
Sep 15	Empire Manufacturing	Sep	Index	-1.5	-31.3
Sep 15	Initial Jobless Claims	Sep 10	Thsd	213.0	218.0
Sep 15	Retail Sales Advance	Aug	M/M % Chg.	0.3	-0.4
Sep 15	Retail Sales Ex Auto and Gas	Aug	M/M % Chg.	0.3	0.3
Sep 15	Capacity Utilization	Aug	%	80.0	80.2
Sep 15	Industrial Production	Aug	M/M % Chg.	-0.2	0.5
Sep 15	Manufacturing (SIC) Production	Aug	M/M % Chg.	0.1	0.6
Sep 15	Business Inventories	Jul	M/M % Chg.	0.6	1.4
<b>Canada</b>					
Sep 14	Manufacturing Sales	Jul	M/M % Chg.	-0.9	-0.1
Sep 15	Existing Home Sales	Aug	M/M % Chg.	-1.0	-5.3
Sep 16	Housing Starts	Aug	Thsd	267.4	275.2
Sep 16	Wholesale Trade Sales	Jul	M/M % Chg.	-0.6	0.1
<b>International</b>					
Sep 12	UK Monthly Gross Domestic Product	Jul	Q/Q % Chg.	0.0	-0.1
Sep 13	UK ILO Unemployment Rate 3Mths	Jul	Q/Q % Chg.	3.6	3.8
Sep 14	UK Consumer Price Index	Aug	Y/Y % Chg.	9.9	10.1
Sep 15	CH Retail Sales	Aug	Y/Y % Chg.	5.4	2.7
Sep 15	CH Surveyed Jobless Rate	Aug	%	5.3	5.4
Sep 16	UK Retail Sales Ex Auto Fuel	Aug	Y/Y % Chg.	-5.0	-3.1
Sep 16	EZ Consumer Price Index	Aug	Y/Y % Chg.	9.1	9.1

Source: Bloomberg, TD Economics.

Upcoming Economic Releases and Events: Sept 19 - 23, 2022						
Release Date	Time*	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
<b>United States</b>						
Sep 19	10:00	NAHB Housing Market Index	Sep	Index	48.0	49.0
Sep 20	8:30	Building Permits	Aug	Thsd	1610.0	1685.0
Sep 20	8:30	Housing Starts	Aug	Thsd	1459.0	1446.0
Sep 21	10:00	Existing Home Sales	Aug	Mlns	4.70	4.81
Sep 21	14:00	FOMC Rate Decision (Upper Bound)	Sep 21	%	3.25	2.50
Sep 21	14:00	Interest on Reserve Balances Rate	Sep 22	%	3.2	2.40
Sep 21	14:30	<i>Fed Chair Holds Press Conference Following FOMC Meeting</i>				
Sep 22	8:30	Initial Jobless Claims	Sep 17	Thsd	220.0	213.0
Sep 23	9:45	S&P Global US Composite PMI	Sep	Index	-	44.6
Sep 23	9:45	S&P Global US Manufacturing PMI	Sep	Index	51.3	51.5
Sep 23	9:45	S&P Global US Services PMI	Sep	Index	45.3	43.7
Sep 23	14:00	<i>Powell Gives Opening Remarks at Fed Listens Event</i>				
<b>Canada</b>						
Sep 19	8:30	Industrial Product Price	Aug	M/M % Chg.	-	-2.1
Sep 20	8:30	Consumer Price Index NSA	Aug	M/M % Chg.	-0.1	0.1
Sep 20	8:30	Consumer Price Index	Aug	Y/Y % Chg.	7.2	7.6
Sep 20	15:45	<i>BoC's Deputy Governor, Paul Beaudry, Gives Speech on Pandemic Macroeconomics</i>				
Sep 23	8:30	Retail Sales Ex Auto	Jul	M/M % Chg.	-1.1	0.8
Sep 23	8:30	Retail Sales	Jul	M/M % Chg.	-2.0	1.1
<b>International</b>						
Sep 19	19:30	JN National Consumer Price Index	Aug	Y/Y % Chg.	2.9	2.6
Sep 22	7:00	UK Bank of England Bank Rate	Sep 22	%	2.25	1.75
Sept 21 - 22		JN BOJ Policy Balance Rate	Sep 22	%	-	-0.10

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

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