

The Weekly Bottom Line

January 5, 2024

Highlights

United States

- Minutes from the December FOMC meeting confirmed that monetary policy was “likely at or near its peak” for this tightening cycle, but showed no meaningful discussion on rate cuts.
- The U.S. economy added a better-than-expected 216k jobs in December, but downward revisions to the prior two months kept a cooling trend intact. The unemployment rate held steady at 3.7%, while wage growth accelerated slightly.
- The ISM surveys overall signaled softness. Manufacturing remained in contractionary territory in December, albeit slightly less negative, while activity in the services sector slowed but remained in expansionary territory.

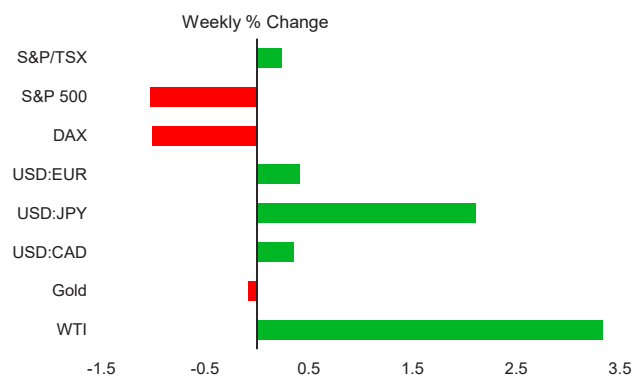
Canada

- As the Canadian economy continues to gear down, the focus turns to when the Bank of Canada (BoC) will cut interest rates. Our view of a 25 basis-point cut at the BoC’s April rate setting date currently aligns with market expectations.
- Getting inflation back to the Bank of Canada’s 2% target remains the key consideration. We expect inflation to durably get below 3% in 2024 with a return to 2% in 2025.
- Canada’s job market is continuing to find its balance as job growth stalled in December. Meanwhile, preliminary housing market data showed surprising strength to end the year.

This Week in the Markets				
	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	4711	4770	4783	3808
S&P/TSX Comp.	20997	20958	21016	18737
DAX	16633	16752	16794	14436
FTSE 100	7700	7733	8014	7257
Nikkei	33377	33464	33753	25821
Fixed Income Yields				
U.S. 10-yr Treasury	3.97	3.88	4.99	3.31
Canada 10-yr Bond	3.21	3.11	4.24	2.72
Germany 10-yr Bund	2.14	2.02	2.97	1.90
UK 10-yr Gilt	3.75	3.54	4.75	3.01
Japan 10-yr Bond	0.61	0.61	0.96	0.25
Foreign Exchange Cross Rates				
C\$ (USD per CAD)	0.75	0.76	0.76	0.72
Euro (USD per EUR)	1.10	1.10	1.12	1.05
Pound (USD per GBP)	1.28	1.27	1.31	1.18
Yen (JPY per USD)	144.2	141.0	151.7	127.9
Commodity Spot Prices**				
Crude Oil (\$US/bbl)	73.8	71.7	93.7	66.7
Natural Gas (\$US/MMBtu)	2.83	2.58	3.77	1.77
Copper (\$US/met. tonne)	8367.8	8463.9	9330.8	7823.8
Gold (\$US/troy oz.)	2058.7	2063.0	2077.5	1811.0

*As of 10:20 AM on Friday. **Oil-WTI, Cushing, Nat. Gas-Henry Hub, LA (Thursday close price), Copper-LME Grade A, Gold-London Gold Bullion. Source: Bloomberg.

Risk Assets Retreat As Rate Cut Expectations are Scaled Back



Note: Data as of 10:10 AM ET, Friday, January 5, 2024.
Source: Bloomberg, TD Economics.

Global Official Policy Rate Targets	
Central Banks	Current Target
Federal Reserve (Fed Funds Rate)	5.25 - 5.50%
Bank of Canada (Overnight Rate)	5.00%
European Central Bank (Refi Rate)	4.50%
Bank of England (Repo Rate)	5.25%
Bank of Japan (Overnight Rate)	-0.10%

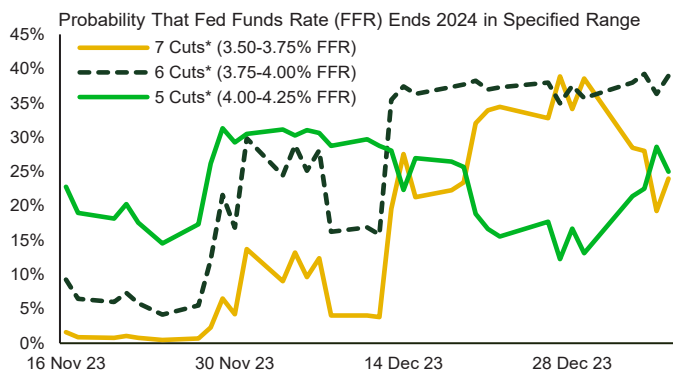
Source: Bloomberg.

U.S. – Rate Cut Expectations Ease Slightly at the Start of 2024

After a festive December where a sharp pullback in long-term yields sent risk assets higher, markets have gotten off to a much more sober start in 2024. Investors have seemingly adjusted their New Year’s resolutions, resulting in more moderate expectations for interest rate cuts this year. Cuts totaling 150 basis points by the end of 2024 remains the dominant scenario. The probability for more aggressive policy loosening (i.e., 7 cuts) has fallen sharply, while the probability of slightly less aggressive loosening (i.e., 5 cuts) has increased (Chart 1). In line with these developments, the 10-year Treasury yield has recouped some of the lost ground, rising from 3.8% at the end of December to near 4% recently, and equity markets have pared back year-end gains, with the S&P 500 down 1.6% from its recent peak.

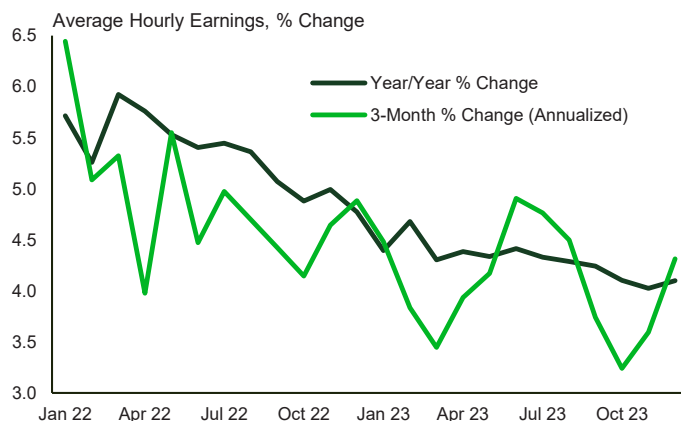
The minutes from the December FOMC meeting contributed to the softening in expectations for interest rate cuts this week. After the Fed signaled that the policy rate would head lower in 2024, there was an anticipation that rate cut talk may have featured heavily at the last meeting. Committee participants confirmed that the policy rate was “likely at or near its peak for this tightening cycle”, given the reduction in inflation in 2023 and “growing signs of demand and supply coming into better balance in product and labor markets”. But, meaningful debate on rate cuts was missing. Instead, the discussion was somewhat more balanced, touching on both the risks of maintaining rates in a restrictive position for too long and the risks of prematurely easing policy. Participants noted that their outlooks were associated with an “unusually elevated” degree of uncertainty and stressed the importance of maintaining a data-dependent approach to setting monetary policy.

Chart 1: Markets Pare Back Aggressive U.S. Interest Rate Cut Outlook for 2024



*Cuts of 25 basis points. As at 10:45 AM on Jan 5th.
Source: CME Group, TD Economics.

Chart 2: U.S. Wage Growth Picked Up in December



Source: Bureau of Labor Statistics, TD Economics.

Speaking of data, this morning’s payrolls report showed that hiring unexpectedly accelerated in December, with the U.S. economy adding 216 thousand jobs (see [commentary](#)). However, a downward revision of 71 thousand jobs to the prior two months limits some of the enthusiasm of this upward surprise. On a three-month moving average basis, hiring is still trending lower, which suggests that restrictive monetary policy continues to work as intended, cooling labor demand. Nonetheless, other aspects of the report still play in favor of showing some caution on easing monetary policy. The unemployment rate held steady at 3.7%. With the labor market still tight, wage growth gained some ground in December (Chart 2). A recent pullback in the job ‘quits’ rate – a leading indicator of labor costs – suggests that wage growth is nonetheless poised to cool ahead.

Other data reports were a mixed bag. Consumers increased vehicle purchases in December (up 3.2% to 15.8 million annualized), although this appears to be partially related to the return of year-end discounts (see [here](#)). Meanwhile, the ISM indexes signaled softness. There was a slowdown in the expansion of the services side of the economy, and the manufacturing sector remained in contraction for the 14th month in row in December, albeit slightly less so on the month.

All factors considered, a loosening in monetary policy is coming, but we anticipate the Fed will show a bit more caution, with the first rate cut not likely to come until the second half of the year.

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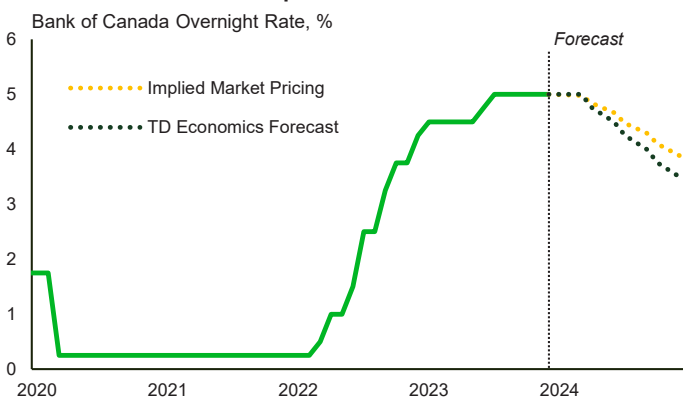
Canada – The Year of the Cut

The new year is less than one week old, but the theme that will govern the next 12 months is firmly in place. After the most aggressive interest rate hiking campaign in over 40 years, the Bank of Canada's (BoC) focus is now shifting towards rate cuts. The burning questions are when the first cut will occur and how many cuts will be delivered. Markets had ended the year preparing for a loosening in conditions, with equities up over 10% from late-October and both Canadian and U.S. yields sliding almost 100 basis points (bps) from their fourth-quarter peaks.

The BoC will meet eight times in 2024 with their first policy decision on January 24th. For the last six months, the Bank has held the overnight policy rate at 5.00% as it continues to assess the incoming data. Markets are pricing the first rate cut to occur at the BoC's April meeting (Chart 1), in line with [our forecast](#). We expect measured 25 bp cuts to occur over the remaining meetings, bringing the end-point to 3.50%, slightly lower than market expectations of 3.75%. Still, this rate is notably tighter than pre-pandemic levels.

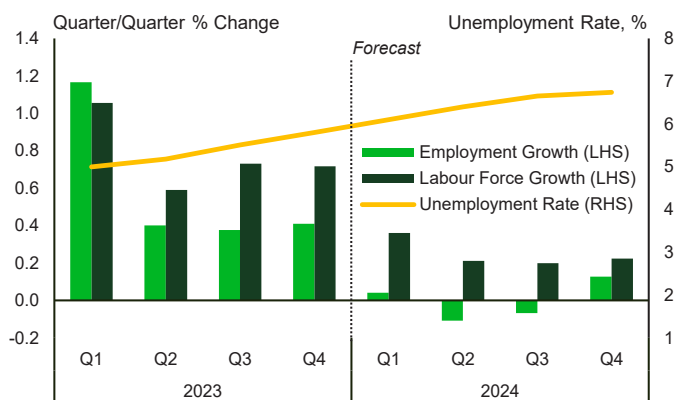
Make no mistake, the effects of the cumulative 475 bps of interest rate hikes are taking hold. Consumers are reeling in their spending, and growth is evolving in a manner consistent with inflation inching closer to the BoC's 2% target. But the job is not done yet, as inflation remains elevated and wage growth is still running hot. Thus, we sit at a critical crossroads between prematurely cutting rates and potentially reigniting inflation, or keeping conditions too tight, causing more economic pain than necessary.

Chart 1: At Least 100 Basis Points of Rate Cuts Expected in 2024



Source: Bloomberg, TD Economics.

Chart 2: Canadian Unemployment Rate to Move Higher as Employment Growth Slows



Source: Statistics Canada, TD Economics.

Recall that Canadian inflation printed on the hotter side in [November](#), with headline and core measures above 3%. The next inflation release, due out on January 17th could see inflation accelerate on the back of base-effects that saw weak inflation a year-ago. However, inflation is trending in the right direction, and we forecast it will durably break below the 3% level in 2024.

On the data front, Canadian employment was flat in December while the unemployment rate held steady at 5.8%. We are seeing signs that the job market is gradually losing momentum, but further cooling is needed to give the Bank of Canada comfort to pull the trigger on rate cuts. Over the year, we expect labour force growth to continue outpacing employment gains, pulling the unemployment rate higher from current levels (Chart 2). Meanwhile, job vacancies are declining across the country, although it is not occurring evenly [across provinces](#), and wages remain elevated in the in 4-5% range.

Preliminary housing market data for the month of December pointed to strong sales activity and declining listings, tightening conditions in major markets. The greater-than-expected drop in yields, and subsequently mortgage rates, in the fourth quarter partially explains this uptick in activity. The BoC will be watching the housing market as seasonally strong spring homebuying will fall directly in line with the expected timing of interest rate easing.

Marc Ercolao, Economist

Recent Key Economic Indicators: Dec 25, 2023 - Jan 05, 2024					
Release Date	Economic Indicator/Event	Data for Period	Units	Current	Prior
United States					
Dec 26	S&P CoreLogic CS 20-City NSA	Oct	Y/Y % Chg.	4.9	3.9
Dec 26	S&P CoreLogic CS US HPI NSA	Oct	Y/Y % Chg.	4.8	4.0
Dec 28	Advance Goods Trade Balance	Nov	Blns	-90.3	-89.6
Dec 28	Initial Jobless Claims	Dec 23	Thsd	218.0	206.0
Jan 02	S&P Global US Manufacturing PMI	Dec	Index	47.9	48.2
Jan 03	ISM Manufacturing	Dec	Index	47.4	46.7
Jan 03	Wards Total Vehicle Sales	Dec	Mlns	15.8	15.3
Jan 04	ADP Employment Change	Dec	Thsd	164.0	101.0
Jan 04	Initial Jobless Claims	Dec 30	Thsd	202.0	220.0
Jan 04	S&P Global US Composite PMI	Dec	Index	50.9	51.0
Jan 04	S&P Global US Services PMI	Dec	Index	51.4	51.3
Jan 05	Change in Nonfarm Payrolls	Dec	Thsd	216.0	173.0
Jan 05	Unemployment Rate	Dec	%	3.7	3.7
Jan 05	Average Hourly Earnings	Dec	M/M % Chg.	0.4	0.4
Jan 05	Factory Orders	Nov	M/M % Chg.	2.6	-3.4
Jan 05	Factory Orders Ex Trans	Nov	M/M % Chg.	0.1	-1.3
Jan 05	ISM Services Index	Dec	Index	50.6	52.7
Jan 05	Durable Goods Orders	Nov	M/M % Chg.	5.4	5.4
Jan 05	Cap Goods Orders Nondef Ex Air	Nov	M/M % Chg.	0.8	0.8
Canada					
Dec 28	CFIB Business Barometer	Dec	Index	47.0	45.4
Jan 02	S&P Global Canada Manufacturing PMI	Dec	Index	45.4	47.7
Jan 05	Net Change in Employment	Dec	Thsd	0.1	24.9
Jan 05	Unemployment Rate	Dec	%	5.8	5.8
International					
Dec 25	JN Jobless Rate	Nov	%	2.5	2.5
Dec 27	JN Retail Sales	Nov	Y/Y % Chg.	5.3	4.1
Dec 30	CH Manufacturing PMI	Dec	Index	49.0	49.4
Jan 01	CH Caixin China PMI Mfg	Dec	Index	50.8	50.7
Jan 03	JN Jibun Bank Japan PMI Mfg	Dec	Index	47.9	47.7

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


Upcoming Economic Releases and Events: Jan 08 - 12, 2024

Release Date	Time*	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
United States						
Jan 08	12:30	<i>Fed's Bostic Speaks on the Economic Outlook</i>				
Jan 09	6:00	NFIB Small Business Optimism	Dec	Index	90.8	90.6
Jan 09	8:30	Trade Balance	Nov	Blns	-64.80	-64.30
Jan 10	10:00	Wholesale Trade Sales	Nov	M/M % Chg.	-	-1.3
Jan 10	15:15	<i>Fed's Williams Gives Speech on 2024 Economic Outlook</i>				
Jan 11	8:30	Consumer Price Index	Dec	M/M % Chg.	0.2	0.1
Jan 11	8:30	Consumer Price Index Ex Food and Energy	Dec	M/M % Chg.	0.2	0.3
Jan 11	8:30	Consumer Price Index	Dec	Y/Y % Chg.	3.2	3.1
Jan 11	8:30	Consumer Price Index Ex Food and Energy	Dec	Y/Y % Chg.	3.8	4.0
Jan 11	8:30	Initial Jobless Claims	Jan 06	Thsd	213.0	202.0
Jan 12	8:30	PPI Final Demand	Dec	M/M % Chg.	0.1	0.0
Jan 12	8:30	PPI Ex Food and Energy	Dec	M/M % Chg.	0.2	0.0
Jan 12	10:00	<i>Fed's Kashkari Speaks at Regional Economic Conditions Conference</i>				
Canada						
Jan 09	8:30	Int'l Merchandise Trade	Nov	Blns	1.80	2.97
International						
Jan 08	5:00	EZ Retail Sales	Nov	Y/Y % Chg.	-1.3	-1.2
Jan 08	18:30	JN Tokyo Consumer Price Index	Dec	Y/Y % Chg.	2.5	2.7
Jan 09	5:00	EZ Unemployment Rate	Nov	%	6.5	6.5
Jan 11	20:30	CH Consumer Price Index	Dec	Y/Y % Chg.	-0.4	-0.5
Jan 12	2:00	UK Monthly Gross Domestic Product	Nov	Q/Q % Chg.	-0.1	0.0

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

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