TD Economics

The Weekly Bottom Line

August 2, 2019

Highlights of the Week

United States

- Financial markets plunged after mixed messaging by the Federal Reserve, and later a 10% tariff on all remaining imported Chinese goods was announced to take effect in September.
- The Federal Reserve cut its policy rate by 25 basis points this week, but markets were unhappy with the lack of commitment to cut more if necessary.
- Slowing global economic growth and past tariff actions suggest that another cut is likely in September. However, escalating trade tensions may require even lower interest rates to help cushion the fallout.

Canada

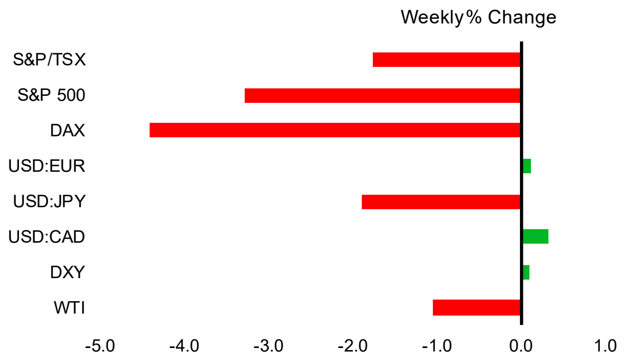
- May GDP data revealed a third straight month of solid output growth, sending our second quarter tracking to 3% (annualized). June trade data confirmed that much of this strength will come from net exports.
- The solid second quarter is most likely to be followed by a trend-like pace of expansion. Net trade ended the quarter on a softer note, and the announcement of new U.S.-China tariffs brought trade conflict uncertainty back to a boil.

This Week in the Markets

	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	2926	3026	3026	2351
S&P/TSX Comp.	16262	16531	16669	13780
DAX	11872	12420	12676	10382
FTSE 100	7407	7549	7777	6585
Nikkei	21087	21658	24271	19156
Fixed Income Yields				
U.S. 10-yr Treasury	1.86	2.07	3.24	1.86
Canada 10-yr Bond	1.37	1.47	2.60	1.37
Germany 10-yr Bund	-0.50	-0.38	0.57	-0.50
UK 10-yr Gilt	0.55	0.69	1.73	0.55
Japan 10-yr Bond	-0.16	-0.15	0.16	-0.17
Foreign Exchange Cross Rates				
C$ (USD per CAD)	0.76	0.76	0.78	0.73
Euro (USD per EUR)	1.11	1.11	1.18	1.11
Pound (USD per GBP)	1.21	1.24	1.33	1.21
Yen (JPY per USD)	106.6	108.7	114.5	106.6
Commodity Spot Prices**				
Crude Oil ($US/bbl)	55.4	56.2	76.4	42.3
Natural Gas ($US/MMBtu)	2.36	2.26	4.80	2.22
Copper ($US/met. tonne)	5875.0	5941.0	6555.5	5713.8
Gold ($US/troy oz.)	1446.2	1418.8	1446.2	1174.2

*As of 12:02 PM on Friday. **Oil-WTI, Cushing, Nat. Gas-Henry Hub, LA (Thursday close price). Copper-LME Grade A. Gold-London Gold Bullion. Source: Bloomberg.

New China Tariffs Send Markets Lower



Note: Data as of 12:52 PM ET, Friday, August 02, 2019.
Source: Bloomberg, TD Economics

Global Official Policy Rate Targets

	Current Target
Federal Reserve (Fed Funds Rate)	2.00 - 2.25%
Bank of Canada (Overnight Rate)	1.75%
European Central Bank (Refi Rate)	0.00%
Bank of England (Repo Rate)	0.75%
Bank of Japan (Overnight Rate)	-0.10%

Source: Central Banks.

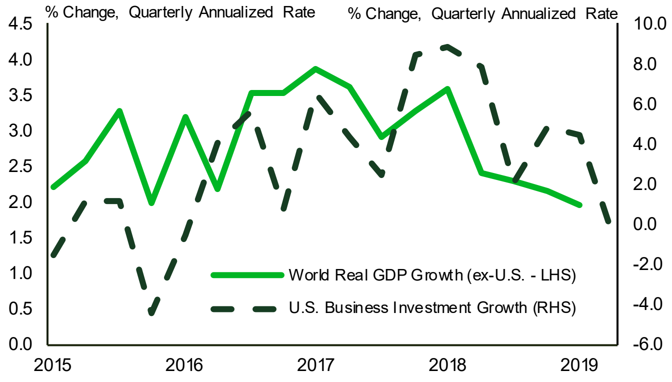
U.S. - The Fed is Not Done Cutting Rates

Events this week caused a lot more turmoil than usual for financial markets in mid-summer. Global financial markets reacted quickly and negatively to mixed messaging by Federal Reserve Chair Jerome Powell. The very next day, a tweet by U.S. President Trump called for a 10 % tariff on the remaining $300bn in untariffed Chinese imported goods beginning September 1st. Any goodwill from the Federal Reserve was quickly thrown into reverse. Global equity and commodity markets sold off with investors seeking the safety of government bonds. The tweet came after talks broke down during a brief meeting between trade representatives from the U.S. and China.

Tackling these two events separately, financial markets wanted more clarity on the Fed's commitment to further rate cuts. First off, many were puzzled as to why rates were cut at all given the solid performance of the U.S. economy. The data this week confirmed that global developments had yet to take a significant toll on domestic economic activity. July payrolls came in as expected, with 164k jobs created, and wage growth firmed up slightly to 3.2% y/y. What's more, consumer spending for June expanded at a healthy pace, and core inflation registered a slight improvement. Lastly, although motor vehicle sales slowed to a 16.9 million annual pace in July, this remains in line with expectations for 2019 as a whole.

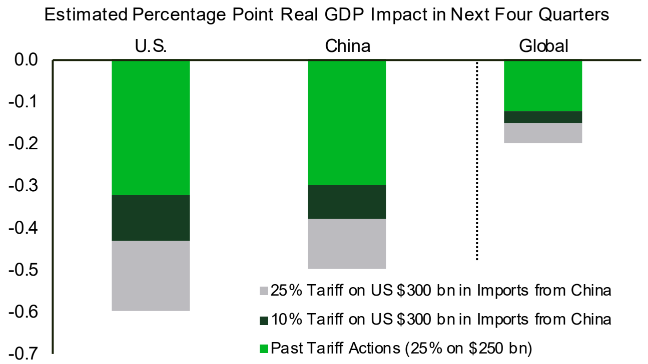
The reason why the Fed is cutting is simple. The data reflects past performance, and forward-looking surveys offer a slightly less favorable outlook. For example, July's ISM manufacturing survey again edged down and is close to tipping into contraction. Moreover, growth in world GDP is strongly correlated with domestic business investment with a short lag (Chart 1). As a result, the half-point decline in global growth since last year has weighed on business investment enough to shave about a tenth of a point off U.S. growth.

Chart 1: U.S. Business Investment Growth Strongly Tied to Global Growth



Source: FRB Dallas, BEA, TD Economics

Chart 2: Threatened Tariffs to Take Another Bite out of U.S. and Global Economic Growth



Source: TD Economics

This week's 25 basis-point cut should help to offset the impact of a slowing global economy on domestic growth, but it's likely not enough to insure against the fallout from past tariff actions. A follow-up rate cut in September should help alleviate some of the pain. However, recent steps by the U.S. administration to place tariffs on the remaining Chinese imported products is likely to now take a deeper bite out of economic activity (Chart 2). This last tranche of goods tilts more heavily towards consumer products and could eventually result in higher consumer prices than previous tariff actions. Furthermore, China is likely to retaliate by taking further actions to impede U.S. business activity in the country. It may also choose to let its exchange rate depreciate beyond US $7, an important psychological threshold that could send tremors through global financial markets.

With no end in sight for trade tensions, any larger-than-anticipated negative impact on consumer spending, confidence and business investment would likely call for even lower interest rates to help support U.S. economic growth.

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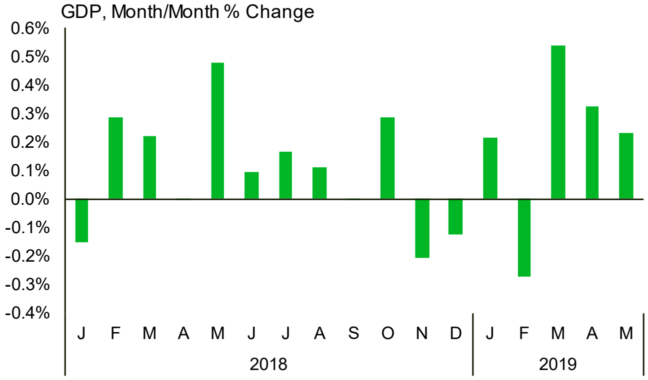
Canada - Second Half Risks Rising

Global markets had more than a few trigger points this week. Mid-week, all eyes were on the U.S. Federal Reserve, where Chair Powell delivered a rate cut together with a statement that struck a decidedly neutral tone (see commentary). This drove some market gyrations, but the main event was yet to come. On Thursday, President Trump announced via Twitter that the U.S. would impose a 10% tariff on the remaining $300 billion of imports from China that had previously been left untouched. Markets sold off on the news and were still in the red at the time of writing.

These external developments left a dour mark on what was otherwise a fairly constructive week for the Canadian economy. Wednesday saw May GDP came in above market expectations, with a 0.2% month-on-month gain reported. Combined with solid, upwardly revised activity in the prior months, the May data contributed to the best three-month string of GDP reports since mid-2017 (see commentary). Some of the gains, notably in real estate activity and manufacturing were likely one-offs as these sectors shook off earlier impediments. Still, the overall strength of the past few months has pleasantly surprised and sent our tracking for second quarter growth to 3% annualized – a fair bit above the Bank of Canada's July forecast of 2.3%.

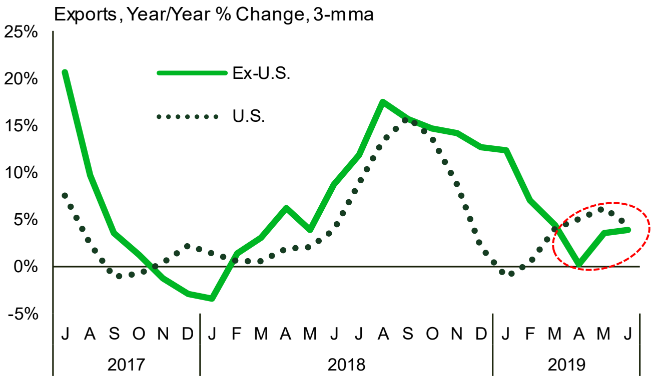
The other part of the story was the June international trade data. Volatility was the name of the game, with aircraft shipments giving up part of their outsized gain in the prior month (see commentary). Even so, goods exports surged for the quarter as a whole, rising roughly 15% annualized (Chart 2). Imports, conversely, were down somewhat – not the strongest sign for the health of domestic demand, but possibly related to elevated inventory levels.

Chart 1: May Continued a String of Solid GDP Growth



Source: Statistics Canada, TD Economics

Chart 2: A Solid Second Quarter for Exports



Source: Statistics Canada, TD Economics

The softer end to the quarter in the trade data suggests that the recent string of one-off lifts to activity is fading. This suggests a more trend-like pace of expansion is likely to prevail over the latter half of 2019. And the theme of downside skew in the risks facing the Canadian economy is not going anywhere. As we were reminded by President Trump, trade uncertainty is still with us. Even though we are no longer in the cross-hairs, Canada is still likely to experience some collateral damage. Our past research has shown that there is little overlap between what Canadians produce and what the U.S. imports from China, limiting near-term opportunities to gain market share. At the same time, confidence effects can be significant, and global supply chains are bound to be impacted by the further thickening of borders.

Perhaps most importantly, markets are becoming increasingly concerned about global growth prospects and the demand for major commodities, with clearly negative impacts on Canada. The benchmark U.S. crude oil contract, for example, dropped roughly $3 per barrel in the wake of President Trump's announcement. All of this is to say that while domestic conditions are healthy at present, still more external speedbumps are forming on the road ahead. Buckle your seatbelts.

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Canada: Upcoming Key Economic Releases

Canadian Employment - July*

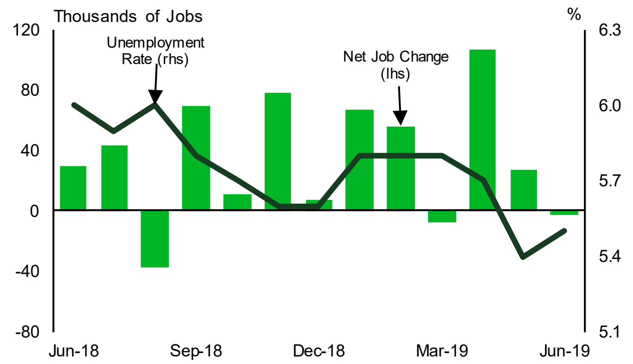
Release Date: August 9, 2019

Previous: -2k, unemployment rate: 5.5%,

TD Forecast: 10k, unemployment rate: 5.5%,

Consensus: N/A

Canadian Labour Market*



*Seasonally Adjusted
Source: Statistics Canada, TD Economics

TD Securities looks for the Canadian economy to add 10k jobs in July in a further moderation from the robust performance observed in 2018Q4/2019Q1. The goods-producing sector should provide the main engine for job growth following the loss of 30k positions in June; while manufacturing firms may be hesitant to add back workers given ongoing trade tensions, the recent strength of residential construction suggests last month's 7.5k decline should be short-lived. Elsewhere we look for details to show a rebound in part-time employment, which has seen a 26k decline since May, alongside an unchanged 5.5% unemployment rate. Wage growth should get more attention than usual owing to the recent surge in SEPH earnings for May, which left both measures of monthly wage growth over 3% y/y. Base-effects will provide a tailwind to wage growth for permanent workers as AHE fell by 0.3% in July 2018, however we expect this to be partially offset by mean reversion after the largest one-month increase since 2004, leaving wages up 3.8% y/y.

Canadian Housing Starts - July*

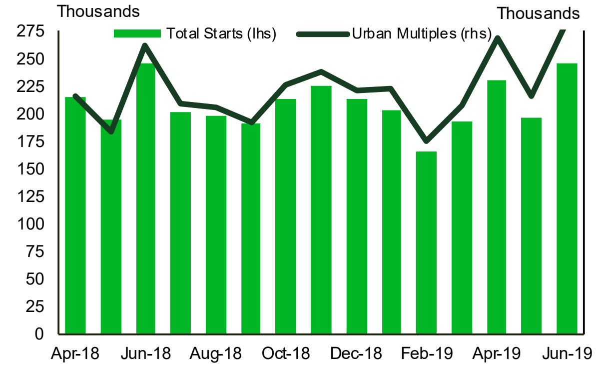
Release Date: August 9, 2019

Previous: 246k

TD Forecast: 220k

Consensus: N/A

Canadian Housing Starts



Source: CMHC, TD Economics

Housing starts are expected to slow to a 220k pace in July, down from 246k, on a pullback in multi-family housing starts from record levels observed in June when developers broke ground on 185k units. Single family starts are also susceptible to some giveback after rising 30% from the February lows since we have yet to see any significant pickup in permit issuance. On a regional basis, we look for a broad-based slowdown given a heatwave across Eastern Canada and mean reversion in the West; housing starts for BC were 10% higher in June than any other month on record, while a 40% m/m increase saw Alberta housing starts hit their highest level since mid-2018. While our forecast implies a 10% m/m decline, it would still leave starts above the six-month trend, underscoring the recent strength of residential investment in Canada.

*Forecast by Rates and FX Strategy Group. For further information, contact TDRates&FXCommoditiesResearch@tdsecurities.com

Recent Key Economic Indicators: Jul 29 - Aug 2, 2019

Release Date		Economic Indicator/Event	Data for Period	Units	Current	Prior
		United States				
Jul 30		Personal Income	Jun	M/M % Chg.	0.4	0.4
Jul 30		Real Personal Spending	Jun	M/M % Chg.	0.2	0.3
Jul 30		Personal Consumption Expenditure Deflator	Jun	Y/Y % Chg.	1.4	1.4
Jul 30		Personal Consumption Expenditure Core Deflator	Jun	Y/Y % Chg.	1.6	1.5
Jul 30		Pending Home Sales	Jun	M/M % Chg.	2.8	1.1
Jul 30		Conf. Board Consumer Confidence	Jul	Index	135.7	124.3
Jul 31		ADP Employment Change	Jul	Thsd	156.0	112.0
Jul 31		Employment Cost Index	2Q	Q/Q % Chg.	0.6	0.7
Jul 31		FOMC Rate Decision (Upper Bound)	Jul 31	%	2.25	2.50
Aug 01		Initial Jobless Claims	Jul 27	Thsd	215.0	207.0
Aug 01		Markit US Manufacturing PMI	Jul	Index	50.4	50.0
Aug 01		ISM Employment	Jul	Index	51.7	54.5
Aug 01		ISM Manufacturing	Jul	Index	51.2	51.7
Aug 01		Wards Total Vehicle Sales	Jul	Mlns	16.8	17.3
Aug 02		Trade Balance	Jun	USD, Blns	55.2	-55.3
Aug 02		Change in Nonfarm Payrolls	Jul	Thsd	164.0	193.0
Aug 02		Average Hourly Earnings	Jul	M/M % Chg.	0.3	0.3
Aug 02		Unemployment Rate	Jul	%	3.7	3.7
Aug 02		Factory Orders Ex Trans	Jun	M/M % Chg.	0.1	0.0
Aug 02		Factory Orders	Jun	M/M % Chg.	0.6	-1.3
		Canada				
Jul 31		Industrial Product Price	Jun	M/M % Chg.	-1.4	-0.1
Jul 31		Gross Domestic Product	May	M/M % Chg.	0.2	0.3
Aug 01		Markit Canada Manufacturing PMI	Jul	Index	50.2	49.2
Aug 02		Int'l Merchandise Trade	Jun	CAD, Blns	0.1	0.6
		International				
Jul 29	JN	Jobless Rate	Jun	%	2.3	2.4
Jul 29	JN	Industrial Production	Jun	Y/Y % Chg.	-4.1	-2.1
Jul 29	JN	BOJ Policy Balance Rate	Jul 30	%	-0.10	-0.10
Jul 30	CH	Manufacturing PMI	Jul	Index	49.7	49.4
Jul 31	EZ	Unemployment Rate	Jun	%	7.5	7.6
Jul 31	EZ	Gross Domestic Product	2Q	Y/Y % Chg.	1.1	1.2
Jul 31	EZ	Consumer Price Index Core	Jul	Y/Y % Chg.	0.9	1.1
Jul 31	MX	Gross Domestic Product, NSA	2Q	Y/Y % Chg.	-0.7	1.2
Aug 01	EZ	Markit Eurozone Manufacturing PMI	Jul	Index	46.5	46.4
Aug 01	UK	Markit UK PMI Manufacturing	Jul	Index	48.0	48.0
Aug 01	UK	Bank of England Bank Rate	Aug 01	%	0.75	0.75
Aug 02	EZ	Retail Sales	Jun	Y/Y % Chg.	2.6	1.0

Source: Bloomberg, TD Economics.

Upcoming Economic Releases and Events: Aug 5 - 9, 2019

Release Date	Time*		Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
United States							
Aug 05	9:45		Markit US Services PMI	Jul	Index	-	52.2
Aug 05	10:00		ISM Non-Manufacturing Index	Jul	Index	55.5	55.1
Aug 08	8:30		Initial Jobless Claims	Aug 03	Thsd	-	215
Aug 08	10:00		Wholesale Trade Sales	Jun	M/M % Chg.	-	0.1
Aug 09	8:30		Producer Price Index Ex Food and Energy	Jul	M/M % Chg.	0.2	0.3
Aug 09	8:30		Producer Price Index Final Demand	Jul	M/M % Chg.	0.2	0.1
Canada							
Aug 09	8:15		Housing Starts	Jul	Thsd	-	245.7
Aug 09	8:30		Hourly Wage Rate Permanent Employees	Jul	Y/Y % Chg.	-	3.6
Aug 09	8:30		Net Change in Employment	Jul	Thsd	-	-2.2
Aug 09	8:30		Unemployment Rate	Jul	%	-	5.5
International							
Aug 05	4:00	EZ	Markit Eurozone Composite PMI	Jul	Index	-	51.5
Aug 05	4:00	EZ	Markit Eurozone Services PMI	Jul	Index	53.3	53.3
Aug 08	21:30	CH	Consumer Price Index	Jul	Y/Y % Chg.	2.7	2.7
Aug 09	4:30	UK	Gross Domestic Product	2Q	Y/Y % Chg.	1.4	1.8
Aug 09	4:30	UK	Industrial Production	Jun	Y/Y % Chg.	-0.1	0.9
Aug 09	4:30	UK	Manufacturing Production	Jun	Y/Y % Chg.	-1.0	0.0

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

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