

The Weekly Bottom Line

May 31, 2019

Highlights of the Week

United States

- U.S.-China trade tensions continued to dominate headlines as both countries dig in for another round of negotiations under more strained circumstances. U.S. tariffs against Mexico appear to also be in the works.
- As trade tensions flare, investors have run for cover, driving up bond prices and sending the yield curve into inversion territory.
- U.S. Q1 growth was revised marginally lower (3.1% vs. 3.2%), and Q2 is projected to be lower still (below 2%). Inflation however managed to edge marginally higher with core PCE at 1.6% year-on-year in April.

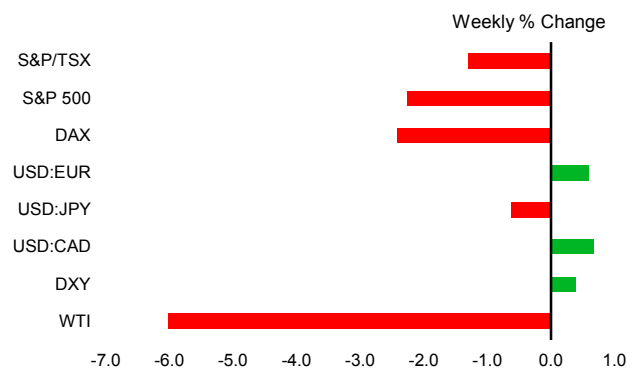
Canada

- Trade-related risk-off sentiment weighed on Canadian financial markets this week, with the S&P/TSX Composite down more than 1% and WTI oil prices falling more than 5%.
- Statistics Canada's GDP release confirmed that the Canadian economy hit a soft patch in Q1, with GDP up a modest 0.4% (annualized). Nevertheless, details of the report point to improving momentum heading into Q2.
- The Bank of Canada kept its overnight rate on hold at 1.75%, as expected, with its communication offering a relatively constructive tone on the back of improving domestic data, but weighing the latter against elevated global trade uncertainty.

This Week in the Markets				
	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	2764	2826	2946	2351
S&P/TSX Comp.	16026	16230	16669	13780
DAX	11727	12011	13107	10382
FTSE 100	7165	7278	7777	6585
Nikkei	20601	21117	24271	19156
Fixed Income Yields				
U.S. 10-yr Treasury	2.18	2.32	3.24	2.18
Canada 10-yr Bond	1.51	1.61	2.60	1.51
Germany 10-yr Bund	-0.20	-0.12	0.57	-0.20
UK 10-yr Gilt	0.89	0.96	1.73	0.89
Japan 10-yr Bond	-0.09	-0.07	0.16	-0.09
Foreign Exchange Cross Rates				
C\$ (USD per CAD)	0.74	0.74	0.78	0.73
Euro (USD per EUR)	1.11	1.12	1.18	1.11
Pound (USD per GBP)	1.26	1.27	1.34	1.25
Yen (JPY per USD)	108.7	109.3	114.5	107.7
Commodity Spot Prices**				
Crude Oil (\$US/bbl)	54.8	58.4	76.4	42.3
Natural Gas (\$US/MMBtu)	2.66	2.60	4.80	2.52
Copper (\$US/met. tonne)	5822.0	5932.0	7330.5	5713.8
Gold (\$US/troy oz.)	1300.6	1284.8	1341.0	1174.2

*As of 11:19 AM on Friday. **Oil-WTI, Cushing, Nat. Gas-Henry Hub, LA (Thursday close price). Copper-LME Grade A. Gold-London Gold Bullion. Source: Bloomberg.

Equity, Oil Markets Fall as Trade Tensions Ratchet Up



Note: Data as of 11:32 AM ET, Friday, May 31, 2019.
Source: Bloomberg, TD Economics

Global Official Policy Rate Targets	
	Current Target
Federal Reserve (Fed Funds Rate)	2.25 - 2.50%
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. - Trade Tensions Still in the Spotlight

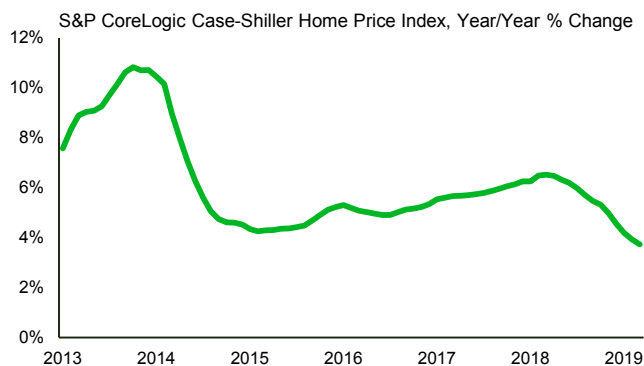
U.S.-China trade negotiations hit a major speedbump earlier in the month and there is now a higher probability that talks could face protracted delays. President Trump stated that the U.S. is “not ready to make a deal”, though he still believes the two nations will ultimately reach an agreement.

In other trade news, just as the U.S. and Mexico took steps this week to ratify the USMCA, President Trump threatened to impose a 5% tariff on all Mexican imports starting July 10th. The President wants Mexico to do more to deter illegal migration from Central America. These tariffs, alongside prolonged Chinese negotiations, complicate trade relations even further. The heightened bout of uncertainty is likely to dent already shaky business confidence.

China has responded to U.S. rhetoric with both direct and indirect threats. The country suggested that they too may influence global supply chains through their dominance of “rare earth” exports – a group of 17 minerals used in the production of most modern electronic devices. A ban on exports to the U.S. could disrupt production and affect prices of many products ranging from smartphones to satellites. There are also indications that China may have once again halted purchases of U.S. soybeans after previously resuming purchases as a sign of goodwill during negotiations.

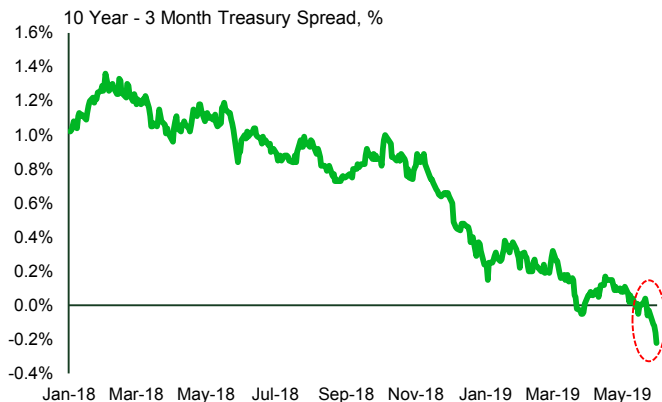
Meanwhile, on the domestic data front, home price appreciation continues to moderate. Data for March showed that home prices grew 3.7% year-on-year, lower than the 3.9%

Chart 1: Home Price Growth Records Twelfth Consecutive Month of Deceleration



Source: S&P Dow Jones Indices LLC, TD Economics

Chart 2: Growth Fears Cause Yield Curve Inversion



Source: Bloomberg, TD Economics. Last data point: 11:23 AM ET, May 31, 2019.

recorded in February (Chart 1). Price growth has been decelerating since April last year, suggesting that even with lower mortgage rates and rising wages, past price growth may have stretched affordability for many potential buyers.

First quarter real GDP growth was revised to 3.1% annualized, relative to 3.2% previously. The slight downgrade reflected lower business and residential investment. Weak performance in these two categories is expected to continue, weighing on growth in Q2 and resulting in a sub 2% outturn. Personal spending in April was also soft at 0.3% month-on-month, even as incomes rose more than expected, coming in at 0.5%. April’s outturn, however, followed strong growth in March, suggesting that personal spending will be a key driver of Q2 growth, even as other components such as investment look to drag on activity.

With concerns of lower growth and heightened trade tensions, investors pushed the yield on 10-yr Treasury notes to the lowest close since September 2017 this week. This caused the yield curve to invert as it dipped below the three-month note (Chart 2). While inversions tend to precede recessions, the phenomenon would need to be sustained and observed among other maturities before the indicator signals an imminent risk and materially affect decisions at the Fed. All said, the reignited trade tensions have skewed the risks to both U.S. and global growth further to the downside – a development which will no doubt receive close monitoring by central bank officials.

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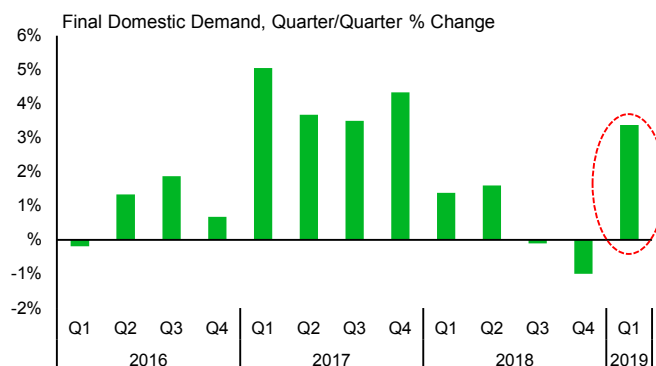
Canada - A Soft Q1 with a Dose of Optimism

Lingering trade tensions between the U.S. and China continued to weigh on sentiment this week, impacting both global and Canadian markets. The S&P/TSX Composite followed its global peers lower, dropping more than 1% at the time of writing, whereas (WTI) oil slumped more than 5% on the heels of the aforementioned trade worries and elevated inventories in the U.S. The U.S. threat to impose a 5% tariff on imported Mexican goods dampened sentiment further.

On the data front, Statistics Canada's GDP release was the highlight of the week. Real GDP grew at 0.4% (annualized) in the first quarter, in line with our tracking and closely in line with the Bank of Canada's 0.3% forecast. As expected, exports were the culprit (Chart 1), with the 4.1% drop in Q1 subtracting a full 1.3 pts from GDP, and with net trade exerting an even larger drag due to a strong rebound in imports (+7.7%). Meanwhile, housing continued to be a weak spot, with residential investment falling for a fifth consecutive quarter. Most of the weakness in these two categories was pre-written. Indeed, exports experienced a broad-based decline in February that was led by a sharp slump in oil shipments, whereas data on home resales and residential construction continued to disappoint, with signs of stabilization starting to appear only recently.

Still, the weak GDP headline masked some encouraging details. Most important amongst these was a strong, 3.4% rebound in final domestic demand (Chart 2), led by household spending (+3.5%). A stronger-than-expected

Chart 2: Final Domestic Demand Rebounds in Q1



Source: Statistics Canada, TD Economics

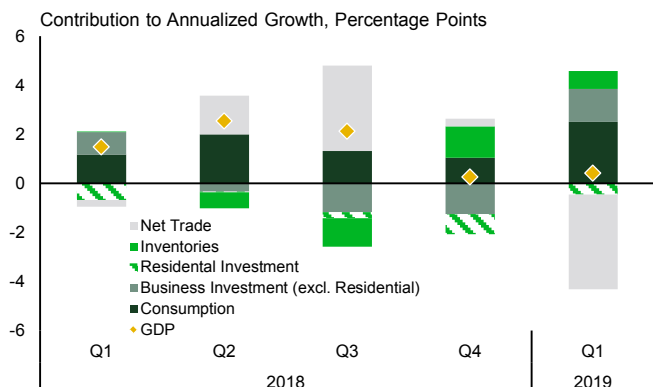
labour market performance partially explains this, with the healthy trend in job gains further confirmed by this week's payrolls data. At the other end of the spectrum, a long-awaited pick up in business investment was another bright spot, ending a streak of serial disappointments that casted doubt on any potential rotation in economic growth to this category. Wrapping up the data release, a healthy 0.5% print in March's monthly GDP, which was relatively broad-based across the industries, adds credence to the expectation of improving momentum heading into Q2.

On a separate, yet related note, the Bank of Canada kept its overnight interest rate on hold at 1.75% this week. In its release and the subsequent speech by Senior Deputy Governor Wilkins, the central bank maintained a constructive tone, highlighting some green shoots in the economy, including improving household spending and strong labour markets, while emphasizing that the current level of interest rates is appropriate given the macroeconomic backdrop.

Looking ahead, we expect the Bank of Canada to remain on the sidelines. Recent data has been pointing to improving momentum, but the outlook remains clouded with uncertainty. For instance, one fly in the ointment in today's report is an inventory build, which together with that in Q4, will likely result in a drag on GDP growth going forward. More importantly, escalating trade tensions are likely the biggest headwind heading into the second half of the year, a risk highlighted by the Bank of Canada this week.

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Chart 1: Net Trade and Residential Investment Weigh on Q1 GDP



Source: Statistics Canada, TD Economics

U.S.: Upcoming Key Economic Releases

U.S. ISM Manufacturing Index - May*

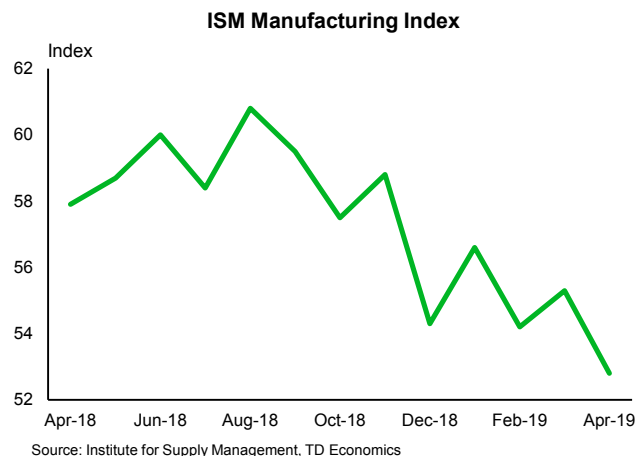
Release Date: June 3, 2019

Previous: 52.8

TD Forecast: 52.5

Consensus: 53.0

We look for a modest monthly decline in the manufacturing ISM index as we expect trade-related headwinds to remain a major obstacle for recovery in the short-term. The average of the ISM-adjusted regional surveys failed to improve in May and remained unchanged at 53.5, with declines in three out of the six published surveys we track. Based on regional data, a decline in inventories is likely to be a major drag for the index. Moreover, a recent spate of weak growth in core durable goods orders, a downside surprise in the Markit PMI survey, and another below-50 China manufacturing PMI print also boost the odds for a downside surprise in May, in our view.



U.S. Employment - May*

Release Date: June 7, 2019

Previous: 263k, unemployment rate: 3.6%

TD Forecast: 190k, unemployment rate: 3.6%

Consensus: 185k, unemployment rate: 3.6%

We look for payrolls to trend lower to 190k in May, following an eye-popping 263k print in the previous month. In particular, we expect job creation in the manufacturing sector to remain subdued, staying in the single-digit range for a fourth consecutive month. Likewise, we anticipate a mean-reversion in employment in the services sector following the 200k+ print in April. We do flag risks to the upside on the back of a larger-than-expected recovery in employment in the retail sector after three notable declines in Feb-April. All in, the household survey should show the unemployment rate remained steady at 3.6%, while wages are expected to rise 0.2% m/m. The latter should bring the



annual print down a tenth to 3.1%. However, if the monthly growth rate were to round up to a “soft” 0.3% advance, that would keep wage growth unchanged at 3.2% y/y.

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

Canada: Upcoming Key Economic Releases

Canadian International Trade - April*

Release Date: June 6, 2019

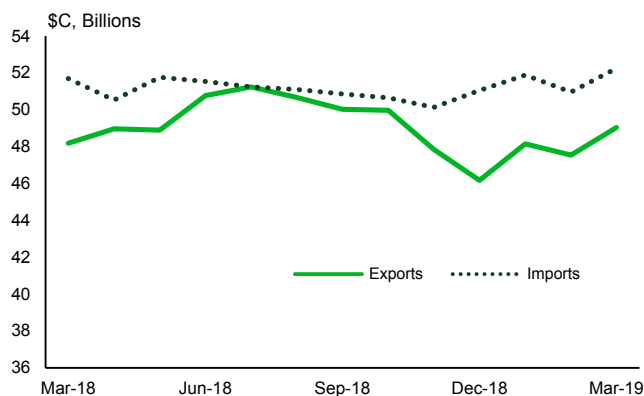
Previous: -\$3.2bn

TD Forecast: -\$2.9bn

Consensus: -\$2.8bn

TD looks for the international trade deficit to narrow modestly to \$2.9bn in April on a combination of weaker import activity and stronger energy exports, partially offset by a pullback in non-energy exports. Motor vehicles are the primary culprit to the latter after a major automaker idled production for two weeks in April, and a sharp drop in preliminary US imports suggests a significant impact on auto exports. Energy products will provide a key offset on higher prices alongside further recovery in crude export volumes which bottomed in February. On the other side of

Canadian International Merchandise Trade



Source: Statistics Canada, TD Economics

the ledger, imports should pare gains after the 2.5% increase in March, led by a pullback in aircraft imports.

Canadian Employment - May*

Release Date: June 7, 2019

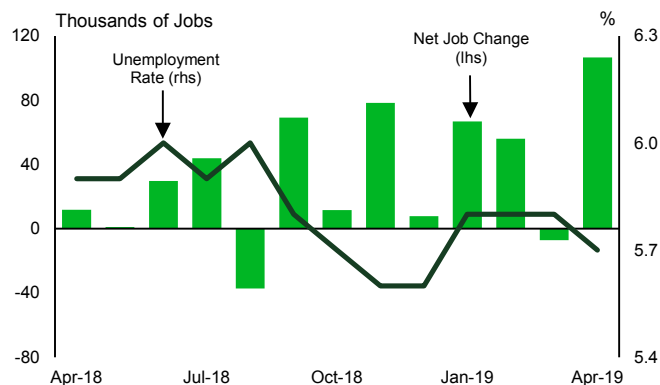
Previous: 106k, unemployment rate: 5.7%

TD Forecast: -5k, unemployment rate: 5.8%

Consensus: -5k, unemployment rate: 5.7%

TD looks for the labour market to disappoint in May with employment falling by 5k which should push the unemployment rate to 5.8%, while wages should soften to 2.5% y/y on a sizeable base-effect from May 2018. We have previously argued that recent labour market strength is unwarranted by the economic backdrop and last month's blockbuster print has not changed our view. While we acknowledge that the volatility of the LFS makes it difficult to accurately predict the timing of any pullback, we view the risks as disproportionately skewed towards a soft print and think our forecast could prove conservative should such a pullback occur. Previous examples have shown much larger giveback after periods of strength; for example, net employment fell by over 60k in January 2018 after job growth was

Canadian Labour Market*



*Seasonally Adjusted
Source: Statistics Canada, TD Economics

reported at 140k over 2017Q4. Any giveback should be led by the goods-producing sector, with manufacturing in the spotlight after adding 10k jobs over March/April as PMIs dipped into contractionary territory. However, segments of the service-producing sector also appear vulnerable with wholesale/retail trade employment rising by 4.8% (annualized) over the last six months.

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

Recent Key Economic Indicators: May 27 - 31, 2019						
Release Date	Economic Indicator/Event	Data for Period	Units	Current	Prior	
United States						
May 28	S&P CoreLogic CS US HPI NSA	Mar	Y/Y % Chg.	3.7	3.9	
May 28	Conf. Board Consumer Confidence	May	Index	206.2	129.2	
May 30	Gross Domestic Product Annualized	1Q	Q/Q % Chg.	3.1	3.2	
May 30	Personal Consumption	1Q	Q/Q % Chg.	1.3	1.2	
May 30	Core Personal Consumption Expenditure	1Q	Q/Q % Chg.	1.0	1.3	
May 30	Initial Jobless Claims	May 25	Thsd	215.0	212.0	
May 30	Advance Goods Trade Balance	Apr	Blns	-72.1	-71.9	
May 30	Retail Inventories	Apr	M/M % Chg.	0.5	-0.3	
May 30	House Price Purchase Index	1Q	Q/Q % Chg.	1.1	1.2	
May 30	Pending Home Sales	Apr	M/M % Chg.	-1.5	3.9	
May 31	Personal Income	Apr	M/M % Chg.	0.5	0.1	
May 31	Real Personal Spending	Apr	M/M % Chg.	0.0	0.9	
May 31	Personal Consumption Expenditure Deflator	Apr	Y/Y % Chg.	1.5	1.4	
May 31	Personal Consumption Expenditure Core Deflator	Apr	M/M % Chg.	0.2	1.0	
May 31	Personal Consumption Expenditure Core Deflator	Apr	Y/Y % Chg.	1.6	1.5	
Canada						
May 29	Bank of Canada Rate Decision	May 29	%	1.75	1.75	
May 30	CFIB Business Barometer	May	Index	59.7	56.7	
May 30	Current Account Balance	1Q	Blns	-17.35	-16.62	
May 31	Quarterly Gross Domestic Product Annualized	1Q	Q/Q % Chg.	0.4	0.3	
May 31	Industrial Product Price	Apr	M/M % Chg.	0.8	1.3	
May 31	Gross Domestic Product	Mar	Y/Y % Chg.	1.4	1.1	
May 31	Gross Domestic Product	Mar	M/M % Chg.	0.5	-0.2	
International						
May 30	BZ Gross Domestic Product	1Q	Y/Y % Chg.	0.5	1.1	
May 30	JN Retail Sales	Apr	Y/Y % Chg.	0.5	1.0	
May 31	IN Gross Domestic Product	1Q	Y/Y % Chg.	5.8	6.6	

Source: Bloomberg, TD Economics.

Upcoming Economic Releases and Events: June 3 - 7, 2019						
Release Date	Time*	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
United States						
Jun 03	10:00	ISM Employment	May	Index	-	52.4
Jun 03	10:00	ISM Manufacturing	May	Index	53.0	52.8
Jun 03	13:25	<i>Fed's James Bullard speaks on the U.S. economy and monetary policy in Chicago, IL</i>				
Jun 03	21:45	<i>Fed's Mary Daly speaks at Symposium on Asian Banking and Finance in Singapore</i>				
Jun 03		Wards Total Vehicle Sales	May	Mlns	16.80	16.40
Jun 04	8:30	<i>Fed's John Williams speaks at NY Fed's event in New York, NY</i>				
Jun 04	10:00	Factory Orders Ex Trans	Apr	M/M % Chg.	-	0.7
Jun 05	8:15	ADP Employment Change	May	Thsd	175.0	275.0
Jun 05	9:45	<i>Fed's Raphael Bostic speaks on housing affordability in Atlanta, GA</i>				
Jun 05	10:00	ISM Non-Manufacturing Index	May	Index	55.7	55.5
Jun 05	14:00	<i>U.S. Federal Reserve Releases Beige Book</i>				
Jun 06	8:30	Initial Jobless Claims	Jun 01	Thsd	-	215.0
Jun 06	8:30	Trade Balance	Apr	Blns	-50.50	-50.00
Jun 06	8:40	<i>Fed's Robert Kaplan speaks at Boston College's event in Boston, MA</i>				
Jun 06	12:00	Household Change in Net Worth	1Q	Blns	-	-3730.00
Jun 06	13:00	<i>Fed's John Williams speaks at Council on Foreign Relations' event in New York, NY</i>				
Jun 07	0:00	<i>Fed's Mary Daly speaks at Singapore Management University in Singapore</i>				
Jun 07	8:30	Change in Nonfarm Payrolls	May	Thsd	190.0	263.0
Jun 07	8:30	Unemployment Rate	May	%	3.6	3.6
Jun 07	8:30	Average Hourly Earnings	May	M/M % Chg.	0.3	0.2
Jun 07	10:00	Wholesale Trade Sales	Apr	M/M % Chg.	0.2	2.3
Canada						
Jun 03	8:30	MLI Leading Indicator	Apr	M/M % Chg.	-	0.2
Jun 03	9:30	Markit Canada Manufacturing PMI	May	Index	-	49.7
Jun 05	8:30	Labor Productivity	1Q	Q/Q % Chg.	-	-0.4
Jun 06	8:30	Int'l Merchandise Trade	Apr	Blns	-	-3.21
Jun 07	8:30	Capacity Utilization Rate	1Q	%	-	81.7
Jun 07	8:30	Hourly Wage Rate Permanent Employees	May	Y/Y % Chg.	-	2.6
Jun 07	8:30	Unemployment Rate	May	%	-	5.7
Jun 07	8:30	Net Change in Employment	May	Thsd	-	106.5
International						
Jun 04	5:00	EZ Consumer Price Index Estimate	May	Y/Y % Chg.	-	1.7
Jun 04	5:00	EZ Unemployment Rate	Apr	%	-	7.7
Jun 04	20:30	JN Nikkei Japan PMI Composite	May	Index	-	50.8
Jun 04	21:45	CH Caixin China PMI Composite	May	Index	-	52.7
Jun 05	4:30	UK Markit/CIPS UK Composite PMI	May	Index	-	50.9
Jun 05	5:00	EZ Retail Sales	Apr	Y/Y % Chg.	-	1.9
Jun 06	5:00	EZ Gross Domestic Product	1Q	Y/Y % Chg.	-	1.2

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

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