# The Weekly Bottom Line

July 20, 2018

## Highlights of the Week

### United States

- Economic data was a mixed bag this week: retail sales were a bright spot, but housing starts unexpectedly plunged in June.
- Trade developments continued to make headlines, with Donald Trump announcing he was prepared to extend duties on $500bn of imports from China – roughly the value of all China's imports into the U.S.
- In his testimony to Congress, Fed Chair Powell offered an upbeat view of the U.S. economy, and noted that the risks posed by trade protectionism would not push them off course on further rate hikes.

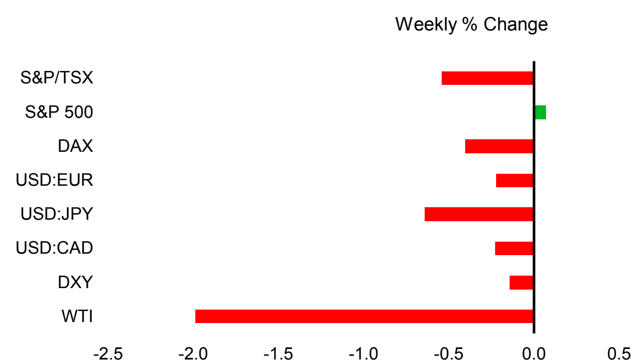
### Canada

- It was a good week for Canadian data releases, with positive surprises in retail, manufacturing, and housing, affirming last week's upbeat tone set by the Bank of Canada.
- Existing home sales were particularly positive, and, taken together with last week's housing starts, support the view that the housing market is gradually stabilizing following the implementation of B-20 guidelines.
- The U.S. announced that it will probe tariffs on uranium imports, increasing already-heightened global trade uncertainty risks.

| THIS WEEK IN THE MARKETS | Current* | Week Ago | 52-Week High | 52-Week Low |
|---|---|---|---|---|
| **Stock Market Indexes** | | | | |
| S&P 500 | 2805 | 2801 | 2873 | 2426 |
| S&P/TSX Comp. | 16478 | 16561 | 16567 | 14952 |
| DAX | 12507 | 12541 | 13560 | 11787 |
| FTSE 100 | 7664 | 7662 | 7877 | 6889 |
| Nikkei | 22698 | 22597 | 24124 | 19275 |
| **Fixed Income Yields** | | | | |
| U.S. 10-yr Treasury | 2.87 | 2.83 | 3.11 | 2.04 |
| Canada 10-yr Bond | 2.17 | 2.13 | 2.52 | 1.84 |
| Germany 10-yr Bund | 0.36 | 0.34 | 0.77 | 0.26 |
| UK 10-yr Gilt | 1.23 | 1.27 | 1.65 | 0.97 |
| Japan 10-yr Bond | 0.04 | 0.04 | 0.10 | -0.01 |
| **Foreign Exchange Cross Rates** | | | | |
| C$ (USD per CAD) | 0.76 | 0.76 | 0.83 | 0.75 |
| Euro (USD per EUR) | 1.17 | 1.17 | 1.25 | 1.15 |
| Pound (USD per GBP) | 1.31 | 1.32 | 1.43 | 1.28 |
| Yen (JPY per USD) | 111.7 | 112.4 | 114.2 | 104.7 |
| **Commodity Spot Prices**** | | | | |
| Crude Oil ($US/bbl) | 69.7 | 71.0 | 74.2 | 45.6 |
| Natural Gas ($US/MMBtu) | 2.72 | 2.86 | 7.13 | 2.52 |
| Copper ($US/met. tonne) | 6039.5 | 6216.8 | 7330.5 | 5925.3 |
| Gold ($US/troy oz.) | 1229.7 | 1241.5 | 1358.5 | 1222.9 |

*as of 10:15 am on Friday. **Oil-WTI, Cushing, Nat. Gas-Henry Hub, LA (Thursday close price), Copper-LME Grade A, Gold-London Gold Bullion; Source: Bloomberg.

TRUMP'S COMMENTS HURT GREENBACK




Note: Data as of 10:20 AM ET, Friday July 20, 2018
Sources: Bloomberg, TD Economics

| GLOBAL OFFICIAL POLICY RATE TARGETS | Current Target |
|---|---|
| Federal Reserve (Fed Funds Rate) | 1.75 - 2.00% |
| Bank of Canada (Overnight Rate) | 1.50% |
| European Central Bank (Refi Rate) | 0.00% |
| Bank of England (Repo Rate) | 0.50% |
| Bank of Japan (Overnight Rate) | -0.10% |

Source: Central Banks.

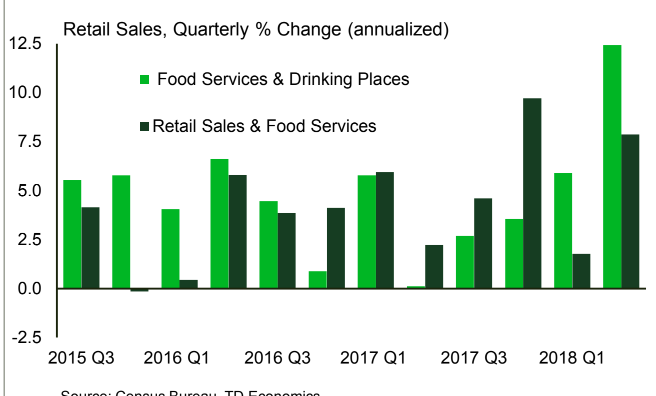
# U.S. - Happy-Go-Lucky Fed Presses On With Rate Hikes

Economic data was a mixed bag this week. While May's retail sales were a bright spot, housing starts unexpectedly plunged in June. Trade policy developments also remained top of investors' minds: Angela Merkel spoke strongly against tariffs, while Donald Trump ramped up his protectionist rhetoric, saying he was prepared to extend duties on the full $500bn of imports from China. He also criticized the Fed's interest rate hikes, and the strong U.S. dollar – leading to  modest greenback selloff.

While the threat of further trade tariffs continues to pose a substantial downside risk to U.S. and global growth, for the time being the U.S. economy is moving full steam ahead. In June, retail spending rose by a robust 0.5%, on top of a substantial upgrade to May's data, as consumers continued to hit stores and restaurants in masses. One of the categories that saw strong growth was spending on restaurants and eating out (+1.5% m/m), accelerating to 8% y/y – the fastest pace since August 2015. The pickup in spending in this largely-discretionary category is a testament to strong momentum in consumer spending. Indeed, for the second quarter as a whole, nominal retail sales were up nearly 8% annualized (versus 1.8% in Q1) (Chart 1), suggesting that even adjusting for inflation, second quarter consumer spending is set to come in above 3% (annualized) in next week's GDP release.

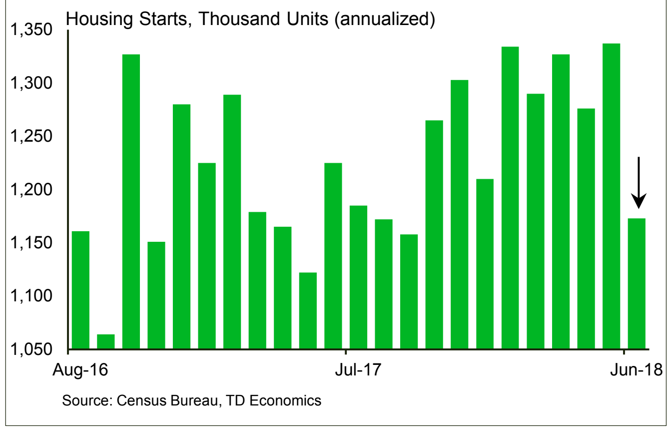
The upbeat view of the domestic economy was further echoed by Fed Chair Powell this week. In his semi-annual testimony to Congress he noted the strong labor market, rising after-tax incomes, and healthy growth in business investment. He also praised progress on the inflation front, and somewhat downplayed the risk stemming from trade protectionism noting that "the risks to the outlook were roughly balanced". He concluded, that "the FOMC believes that, for now, the best way forward is to keep gradually raising the federal funds rate." In other words, current trade risks are not enough to derail the Fed from hiking rates on a quarterly basis.

**CHART 1: CONSUMERS RAMP UP SPENDING IN Q2**




Source: Census Bureau, TD Economics

**CHART 2: HOME BUILDING TAKES A BREATHER IN JUNE**




Source: Census Bureau, TD Economics

The U.S. economy continues to be red-hot, but this pace of expansion will be hard to sustain going forward as it starts to bump against capacity constraints, particularly on the labor front. Higher material prices, wages and shortages of labor in some sectors featured prominently in the latest Beige Book.

The construction industry is one sector facing these headwinds, with prices of lumber and steel rising precipitously following the tariffs. While homebuilders' optimism remains quite high, housing starts fell by 12.3% m/m in June – the largest decline since November 2011. (Chart 2). The bulk of the pullback was seen on the multifamily side (-20% m/m), with more moderate decline in single-family starts (- 9.1%). The large decline on the multifamily side could be reflective of the changing housing market dynamics, with demand rotating away from rental units. Next week's release of both new and existing home sales should shed more light on the health of the housing market, particularly on the demand side.

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# Canada - Positive Data Releases Point to a Solid Q2

This was a good week for Canadian data, with releases on manufacturing, retail, and existing home sales, as well as consumer price inflation all surprising on the upside.

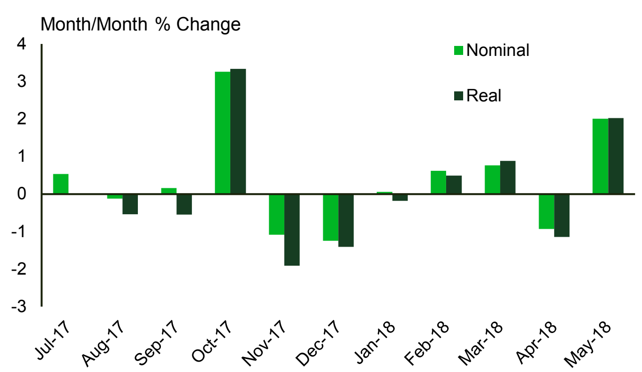
Existing home sales kicked off the release schedule, moving up 4.1% in June, with the relatively broad-based increase erasing much of the losses in the previous month. Taken together with last week's housing starts release, this confirms expectations of a stabilizing housing market following the implementation of B-20 guidelines.

Manufacturing sales also showed a broad-based rebound of 1.4% in May, offsetting April's disappointing performance. Even more encouraging, retail sales growth came in at 2.0% for May, significantly exceeding expectations and suggesting healthy wage gains are making their way into household spending. With retail and manufacturing sales recently subjected to one-off factors (weather, temporary refinery outages), this paints a reassuringly healthy picture of their underlying trend this quarter.

Finally, CPI came in slightly above expectations as headline inflation accelerated to 2.5% (year-on-year) from 2.3% in May – the fastest pace since early 2012. The average of the Bank of Canada's core measures, meanwhile, remained at its 2.0% target. The CPI-Common core measure held steady at 1.9%, while the other two core measures edged up to 2.0% (from 1.9% previously).

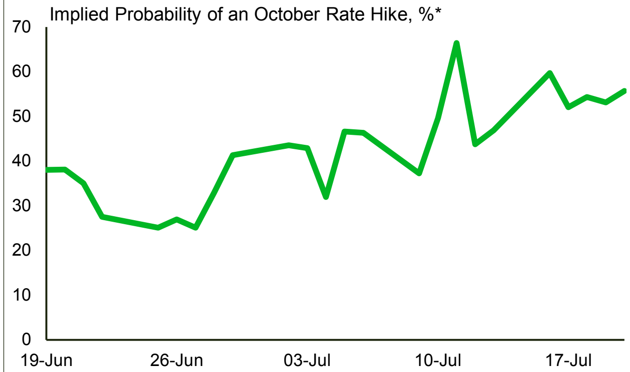
All told, the data this week paint a positive picture of Canadian economic growth, and support the notion

**CHART 1: RETAIL SALES SHOW HEALTHY VOLUME INCREASES IN MAY**




Source: Statistics Canada, TD Economics

**CHART 2: PROBABILITY OF OCTOBER RATE HIKE EDGING UP BUT NOT DEFINITIVELY (YET)**




*As of 10:30 am on July 20, 2018. Source: Bloomberg, TD Economics

that activity is bouncing back from its soft performance early in the year. Indeed, with the releases this week, we anticipate real GDP growth to advance at a solid 2.9% in the second quarter, in line with the Bank of Canada's recently-updated forecast.

The case for cautiousness on further rate hikes continues to lie in the risk management framework of Governor Poloz. As long as the threat of a further escalation of trade wars looms on the horizon, we expect the Bank to keep the pace of hikes very gradual.

Accentuating lingering trade uncertainties was an announcement from the United States Commerce Department this week, of a probe into uranium imports using the same national security lens used to justify tariffs on steel and aluminum. With the potentially impacted value of goods at 0.2% of the country's total merchandise goods exports, its magnitude comes in at less than those already imposed on steel and aluminum, and much less than the more worrying auto tariff investigations. If implemented, however, their effects would be more regionally concentrated.

Looking at OIS-implied probability of rate hikes confirms the absence of a pre-determined path for rate hikes. The odds of an October hike are still divided at the 55% mark (as of 10:30 am this morning), moving up only modestly following the releases this week.

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| RECENT KEY ECONOMIC INDICATORS: JULY 16-20, 2018 | | | | | | |
|---|---|---|---|---|---|---|
| Release Date | | Economic Indicator/Event | Data for Period | Units | Current | Prior |
| **United States** | | | | | | |
| Jul 16 | | Empire Manufacturing | Jul | Index | 22.6 | 25.0 |
| Jul 16 | | Retail Sales Advance | Jun | M/M % Chg. | 0.5 | 1.3 |
| Jul 16 | | Retail Sales Ex Auto and Gas | Jun | M/M % Chg. | 0.3 | 1.3 |
| Jul 16 | | Business Inventories | May | Thsd | 0.4 | 0.3 |
| Jul 17 | | Capacity Utilization | Jun | % | 78.0 | 77.7 |
| Jul 17 | | Manufacturing (SIC) Production | Jun | M/M % Chg. | 0.8 | -1.0 |
| Jul 17 | | Industrial Production | Jun | M/M % Chg. | 0.6 | -0.5 |
| Jul 17 | | NAHB Housing Market Index | Jul | Index | 68.0 | 68.0 |
| Jul 18 | | Housing Starts | Jun | Thsd | 1173.0 | 1337.0 |
| Jul 18 | | Building Permits | Jun | Thsd | 1273.0 | 1301.0 |
| Jul 19 | | Initial Jobless Claims | Jul | Thsd | 207.0 | 215.0 |
| **Canada** | | | | | | |
| Jul 17 | | Manufacturing Sales | May | M/M % Chg. | 1.4 | -1.1 |
| Jul 20 | | Consumer Price Index Core- Trim | Jun | Y/Y % Chg. | 2.0 | 1.9 |
| Jul 20 | | Consumer Price Index Core- Median | Jun | Y/Y % Chg. | 2.0 | 2.0 |
| Jul 20 | | Consumer Price Index Core- Common | Jun | Y/Y % Chg. | 1.9 | 1.9 |
| Jul 20 | | Consumer Price Index | Jun | Y/Y % Chg. | 2.5 | 2.2 |
| Jul 20 | | Consumer Price Index NSA | Jun | M/M % Chg. | 0.1 | 0.1 |
| Jul 20 | | Retail Sales Ex Auto | May | M/M % Chg. | 1.4 | 0.2 |
| Jul 20 | | Retail Sales | May | M/M % Chg. | 2.0 | -0.9 |
| **International** | | | | | | |
| Jul 15 | CH | Gross Domestic Product | 2Q | Y/Y % Chg. | 6.7 | 6.8 |
| Jul 17 | UK | ILO Unemployment Rate 3Mths | May | % | 4.2 | 4.2 |
| Jul 18 | UK | Consumer Price Index | Jun | Y/Y % Chg. | 2.4 | 2.4 |
| Jul 18 | EZ | Consumer Price Index | Jun | Y/Y % Chg. | 2.0 | 2.0 |
| Jul 19 | JN | Natl Consumer Price Index | Jun | Y/Y % Chg. | 0.7 | 0.7 |

Source: Bloomberg, TD Economics.

| UPCOMING ECONOMIC RELEASES AND EVENTS: JULY 23-27, 2018 | | | | | | | |
|---|---|---|---|---|---|---|---|
| Release Date | Time* | | Economic Indicator/Event | Data for Period | Units | Consensus Forecast | Last Period |
| | | | **United States** | | | | |
| Jul 23 | 10:00 | | Existing Home Sales | Jun | Mlns | 5.4 | 5.4 |
| Jul 24 | 9:45 | | Markit US Services PMI | Jul | Index | - | 56.5 |
| Jul 24 | 9:45 | | Markit US Manufacturing PMI | Jul | Index | - | 55.4 |
| Jul 25 | 10:00 | | New Home Sales | Jun | Thsd | 670.0 | 689.0 |
| Jul 26 | 8:30 | | Advance Goods Trade Balance | Jun | Blns | - | -64.8 |
| Jul 26 | 8:30 | | Initial Jobless Claims | Jul 21 | Thsd | - | 207.0 |
| Jul 26 | 8:30 | | Retail Inventories | Jun | M/M % Chg. | - | 0.4 |
| Jul 26 | 8:30 | | Durable Goods Orders | Jun | M/M % Chg. | 2.7 | -0.4 |
| Jul 26 | 8:30 | | Durables Ex Transportation | Jun | M/M % Chg. | 0.3 | 0.0 |
| Jul 26 | 8:30 | | Cap Goods Orders Nondef Ex Air | Jun | M/M % Chg. | - | 0.3 |
| Jul 27 | 8:30 | | Gross Domestic Product Annualized | 2Q | Q/Q % Chg. | 4.0 | 2.0 |
| Jul 27 | 8:30 | | Personal Consumption | 2Q | Q/Q % Chg. | - | 0.9 |
| Jul 27 | 8:30 | | Core Personal Consumption Expenditure | 2Q | Q/Q % Chg. | - | 2.3 |
| | | | **Canada** | | | | |
| Jul 23 | 8:30 | | Wholesale Trade Sales | May | M/M % Chg. | - | 0.1 |
| Jul 26 | 8:30 | | CFIB Business Barometer | Jul | Index | - | 62.2 |
| | | | **International** | | | | |
| Jul 23 | 20:30 | JN | Nikkei Japan PMI Mfg | Jul | Index | - | 53.0 |
| Jul 24 | 4:00 | EZ | Markit Eurozone Manufacturing PMI | Jul | Index | - | 54.9 |
| Jul 24 | 4:00 | EZ | Markit Eurozone Services PMI | Jul | Index | - | 55.2 |
| Jul 24 | 4:00 | EZ | Markit Eurozone Composite PMI | Jul | Index | - | 54.9 |

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

## Disclaimer