THE WEEKLY BOTTOM LINE

TD Economics

HIGHLIGHTS OF THE WEEK

July 22, 2016

United States

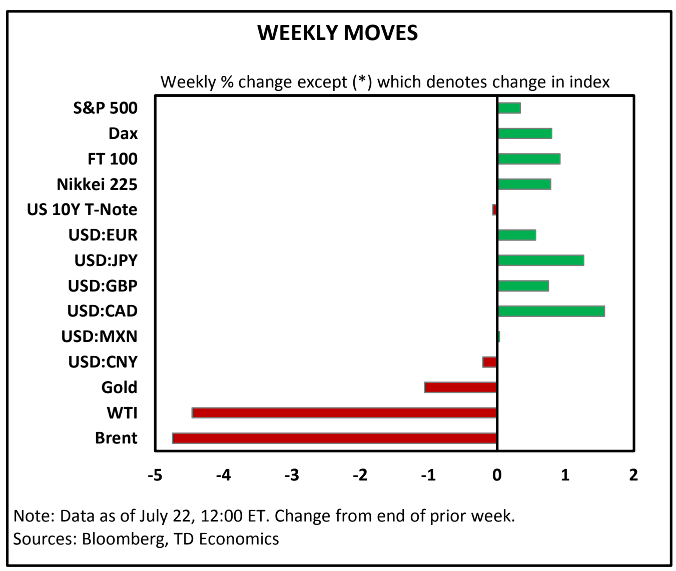
- Market sentiment continued to improve this week as worries over Turkish contagion waned, while markets remained resilient in the face of Brexit while counting on central bank stimulus in the coming weeks.
- Advance PMIs suggest that the U.K. economy is contracting in July, but the activity in the Eurozone has held up better than expected thus far.
- U.S. data continues to prove constructive with two housing reports this week painting a picture of a continuing housing market recovery. Alongside low initial jobless claims, the data suggests the domestic economy remains resilient and may be able to handle a rate hike. Should domestic data continue to come in robust and financial markets remain calm, we expect the Fed may raise rates as early as December.

Canada

- Data releases this week continued to point to a weak economic, but stable inflation backdrop in Canada, with the Canadian economy firing on just one engine – housing.
- Retail spending rose 0.2% in May, putting consumer spending on track for a modest 1.5% annualized gain as households are holding back from ramping up spending even with sharply rising housing wealth.
- Consumer prices rose 1.5% year-over-year in June, with the Bank of Canada's core measure holding steady at 2.1% y/y. Even then, housing related goods and services accounted for much of the inflation gains in the month.

THIS WEEK IN THE MARKETS	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	2,172	2,162	2,173	1,829
S&P/TSX Comp.	14,587	14,482	14,587	11,843
DAX	10,147	10,067	11,636	8,753
FTSE 100	6,730	6,669	6,752	5,537
Nikkei	16,627	16,498	20,809	14,952
Fixed Income Yields				
U.S. 10-yr Treasury	1.55	1.55	2.34	1.36
Canada 10-yr Bond	1.08	1.08	1.72	0.96
Germany 10-yr Bund	-0.03	0.01	0.80	-0.19
UK 10-yr Gilt	0.80	0.83	2.05	0.74
Japan 10-yr Bond	-0.22	-0.23	0.43	-0.28
Foreign Exchange Cross Rates				
C$ (USD per CAD)	0.76	0.77	0.80	0.69
Euro (USD per EUR)	1.10	1.10	1.16	1.06
Pound (USD per GBP)	1.31	1.32	1.58	1.29
Yen (JPY per USD)	106.2	104.9	125.1	100.5
Commodity Spot Prices*				
Crude Oil ($US/bbl)	43.3	46.0	51.2	26.2
Natural Gas ($US/MMBtu)	2.70	2.67	2.93	1.49
Copper ($US/met. tonne)	4966.5	4900.5	5416.5	4327.5
Gold ($US/troy oz.)	1323.4	1337.5	1366.4	1051.1

*as of 1:00 pm 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	Current Target
Federal Reserve (Fed Funds Rate)	0.25 - 0.5%
Bank of Canada (Overnight Rate)	0.50%
European Central Bank (Refi Rate)	0.00%
Bank of England (Repo Rate)	0.50%
Bank of Japan (Overnight Rate)	-0.10%

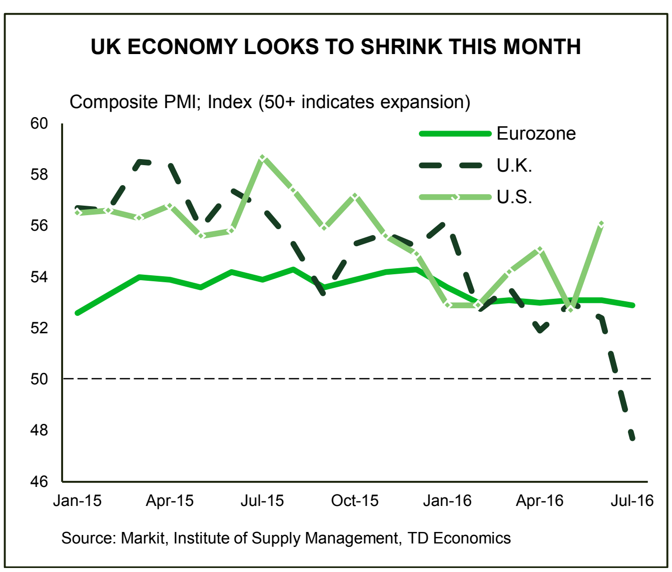
Source: Central Banks.

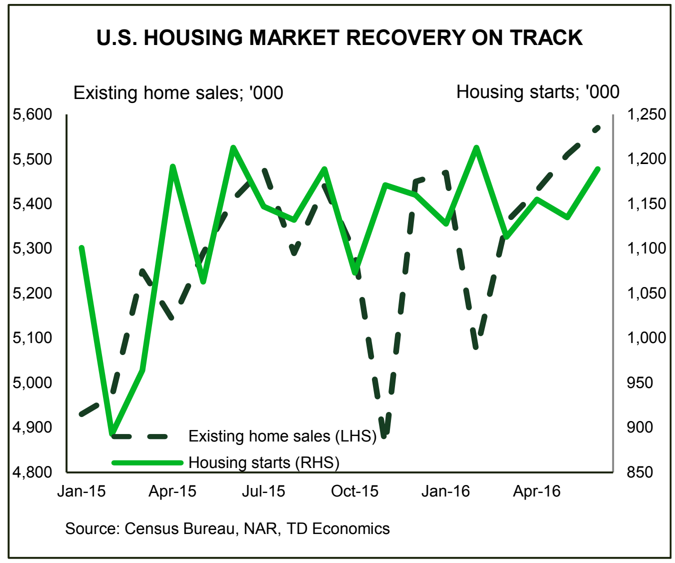
U.S. – ECB STANDS PAT FOR NOW, AS FED LOOKS TO TIGHTEN

Investor sentiment continued to improve through most of the week, driving risk assets higher. U.S. equity benchmarks posted several consecutive record daily highs and have risen nearly 10% from their post-Brexit referendum trough. Global equities, which remain some 6% off their mid-2015 peaks, have also been on a tear. The gains are partly related to a relatively strong earnings season, particularly in the U.S., where second quarter profits came in stronger than expected. Sentiment has been further buoyed by relatively firm commodity prices, as oil inventories at major U.S. hubs are beginning to exhibit modest declines. Markets have also been supported by a reduction in global financial market volatility and expectations of further central bank easing.

Risk sentiment has been helped by diminished fears of contagion related to Turkey's coup attempt last weekend. While investors dumped local assets alongside the imposition of emergency rule by the country's President this week, hitting the lira, broader contagion to other EMs has been, thus far, largely absent.

Brexit's immediate fallout also appears to be limited to the British economy. The UK economy appears to be headed for a recession, and may have already begun to contract, with advance PMIs for both the manufacturing and services sectors slumping to contractionary territory in July according to advance readings. Poor retail sales and home price declines for June pose further downside risk, suggesting that the weakness was already present prior to the June 23rd vote. As it stands, the current data only increases the onus on the Bank of England to act, with easing measures expected to be announced during its August meeting round.





Encouragingly, the Eurozone economy appears to be thus far taking Brexit in stride, with advance results of purchasing managers' surveys suggesting a slight deceleration in manufacturing, while the pace of services activity remained largely unchanged. Both results exceeded market views that expected a more discernable slowdown. This sentiment was echoed by ECB President Draghi, who viewed financial markets as exhibiting "encouraging resilience" to Brexit. Still, while he stressed it was "too early to assess" the exact impact of Brexit on the Eurozone economy, he opened the door for additional stimulus come September, suggesting that the ECB has provided "enough evidence" of the availability of additional tools.

But, while most major central banks are getting ready to prime the pumps later this summer, the Federal Reserve finds itself once again in the lone camp contemplating tightening policy. Data has remained quite resilient in recent weeks, with the blockbuster June employment report alongside strong retail spending dispelling the notion of a sharp slowdown in the U.S. economy. This week, reports on new home construction and existing home sales further reinforced the view of domestic strength, while jobless claims suggest strong job growth is continuing amidst global volatility. As a result, futures markets, which had previously completely priced out any expectation of a rate hike this year now assign even odds to such an outcome by December. Should data continue to prove constructive and markets to remain calm, the Fed may just be able to squeeze in a rate hike before the end of this year.

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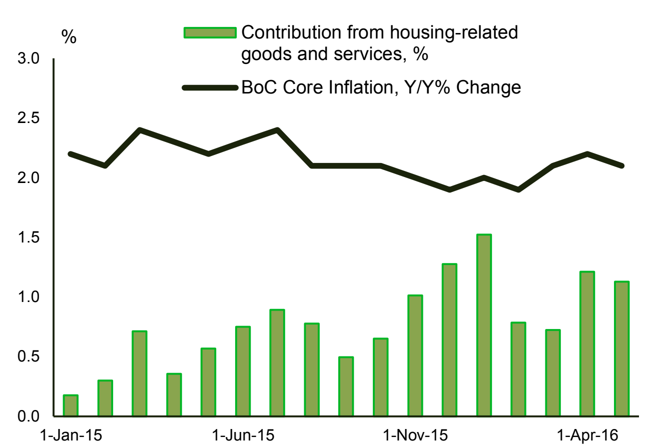
CANADA – HOUSING AGAINST THE REST

Data releases this week continued to point to a weak economic, but stable inflation backdrop in Canada. The Canadian economy likely contracted yet again in the second quarter of this year, a third decline in the last six quarters, mostly tied to the temporary oil production disruptions due to the wildfires in May. Nonetheless, even stripping away the impact of the fires, the Canadian economy is firing on just one engine – housing.

Housing activity has been growing substantially faster than the overall economy, with ratios of residential sales and investment to GDP reaching record levels in the first quarter. Typically, this level of housing activity feeds into stronger consumer spending, particularly on housing-related items, as households furnish, renovate or capitalize on new-found housing wealth. But, this week's release of retail sales suggests that this does not seem to be happening. Despite a 0.2% rise in nominal retail spending in May, real (inflation-adjusted) retail sales are tracking a modest decline in the second quarter, putting overall consumer spending (including non-retail services spending) on track for a mild gain of 1.5% annualized – the smallest increase since early 2015 when the economy was in recession. The silver lining is that households are seemingly reluctant to add significantly to their already-high debt loads.

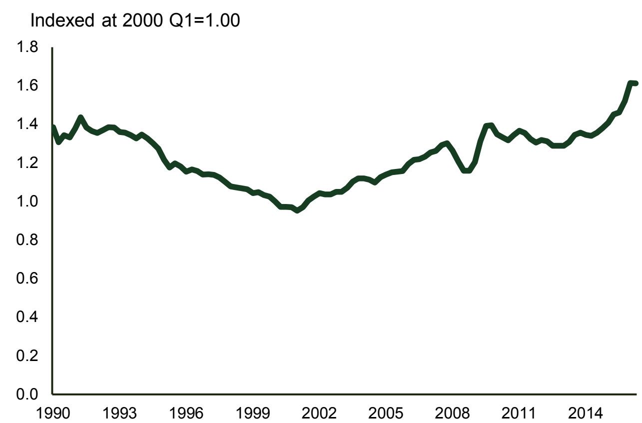
The dichotomy between housing and the rest of the economy was even apparent in the Canadian consumer price report. While headline inflation was running at just 1.5% (y/y) due to falling energy prices, the Bank of Canada's core inflation remained steady at 2.1%. But, digging deeper, most of the subcomponents growing faster than 2.0% are tied to renting, owning or maintaining a home. The biggest price increases have been in electricity bills, which rose at 7% year-over-year in June.

CHART 1: CANADIAN INFLATION



Source: Statistics Canada. Estimate by TD Economics

CHART 2: INDEX OF EXISTING HOME PRICES TO NOMINAL GDP



Source: Statistics Canada, CREA, estimated by TD Economics

With the overall economy on a soft footing, foreign investment is likely boosting housing, both indirectly and directly. Indirectly, foreign investment in Canadian bonds has helped keep interest rates low. Amidst political and economic uncertainty across several global economies, Canada has garnered safe-haven status. The release of foreign investment statistics this week showed that foreign interest in Canadian bonds hit a high point in May of this year. Coincidently, the 5-year government bond yield hit record low levels in mid-June, following the UK's vote to leave the European Union. Non-residents have also been parking unprecedented levels of cash in Canadian bank accounts since early 2014. Some of this cash is likely making its way into Canadian housing, giving direct support to the sector. The more-than 60% increase in residential home sales in Toronto and Vancouver has largely followed trends in foreign direct investment in Canada.

The economic data in Canada have been mediocre at best of late, especially stripping away housing activity. Research is increasingly showing that in an environment of soft economic conditions, macro prudential rules are a better tool to cool housing and debt growth than raising interest rates. As such, we continue to expect the Bank of Canada to remain on hold straight through to 2018, with the figurative "housing-risk" ball passed to the Department of Finance or the banking regulator.

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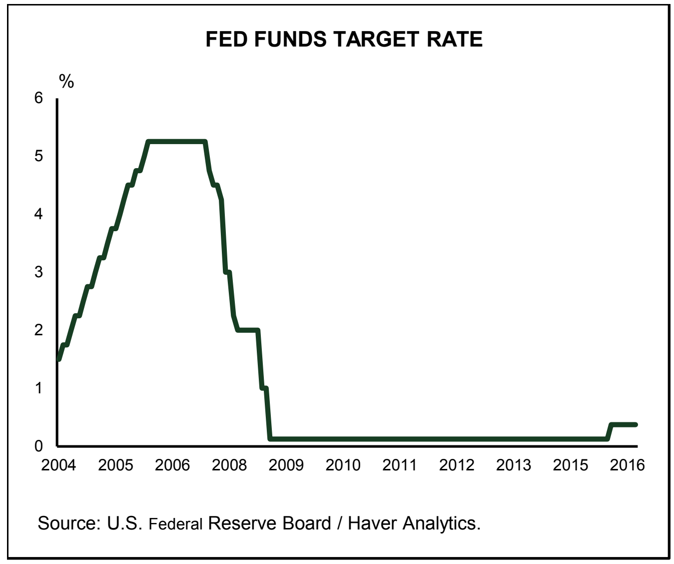
U.S.: UPCOMING KEY ECONOMIC RELEASES

U.S. FOMC Rate Decision*

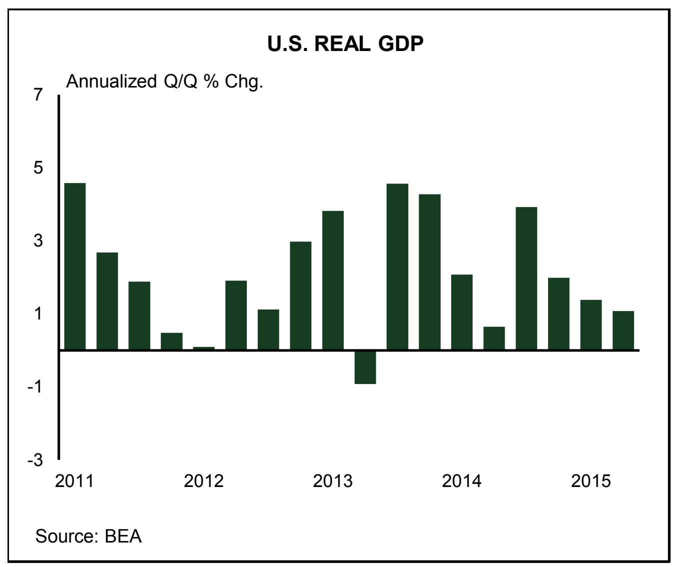
Release Date: July 27, 2016
June Result: 0.25% to 0.50%
TD Forecast: 0.25% to 0.50%
Consensus: 0.25% to 0.50%



The market volatility that immediately followed the UK Referendum has more or less subsided and with measures of financial conditions reaching new heights, one conduit of contagion to the US economy has been contained. For the Federal Reserve, this is a step in the right direction and significantly reduces the chance that the nascent normalization in policy is scrapped in favor of additional accommodation. However, the more durable aftermath of the Brexit vote—a hit to global confidence and business investment—remains unknown. And while the tone of economic data in the United States has improved over the last month or so, there is little to suggest that the Fed has fallen behind the curve. Underlying inflation remains reasonably contained and expectations of future inflation point to an emergent stabilization just above new cyclical lows. This backdrop affords the Fed the ability to sound a little more confident in the economy while at the same time remaining patient in appreciation of a risk management approach to the conduct of monetary policy. Without updated economic projections and a press conference, it will fall exclusively to the post meeting statement to convey this message.

U.S. Real GDP - Q2*

Release Date: July 29, 2016
Q1 Result: 1.1% q/q
TD Forecast: 2.5% q/q
Consensus: 2.6% q/q



US economic growth is set to rebound in Q2, and TD expects GDP growth to post a respectable 2.5% q/q advance reflecting a reacceleration in underlying growth momentum from the subpar 1.1% q/q pace in Q1. The rebound in growth is expected to be driven by the resurgence in personal spending activity, which should boast a robust 4.1% q/q advance, adding 2.8ppts to topline growth. This will mark the fastest pace of gain in this indicator since Q4 2014. Net trade should also add favorably to economic activity this quarter, providing a modest 0.10ppts tailwind to GDP growth. The wildcard for this report will be the performance in private domestic investment, which TD expects to subtract a further 0.23ppts from growth owing to weaker inventory performance and a further slippage in fixed investment activity. The risks to the inventories forecast, however, are to the downside. Notwithstanding this, the overall tone of this report should be encouraging, reflecting some improvement in the underlying domestic fundamental backdrop. In the coming months, TD expects the positive momentum in overall economic activity to be sustained, though the potential fallout from the Brexit vote provides a meaningful downside risk to this favorable outlook.

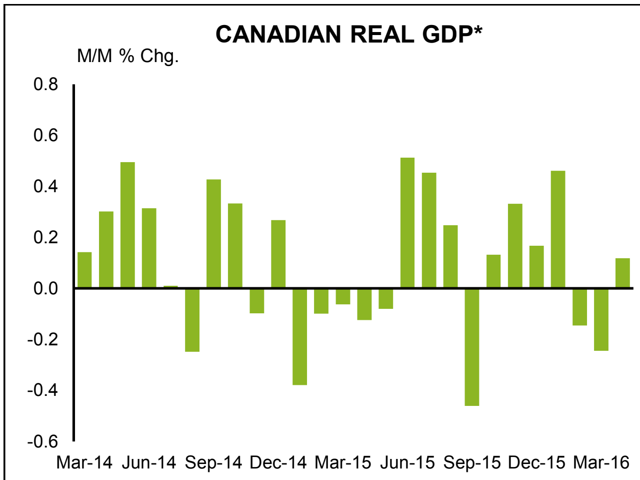
*Forecast by Rates and FX Strategy Group. For further information, contact TDRates&FXCommoditiesResearch@tdsecurities.com

CANADA: UPCOMING KEY ECONOMIC RELEASES

Canadian Real GDP - May*

Release Date: July 29, 2016
April Result: 0.1 % m/m
TD Forecast: -0.4% m/m
Consensus: -0.5% m/m

A sharp contraction in the extraction industry following the wildfires in Northern Alberta is expected to drive a 0.4% m/m drop in May industry-level real GDP. Looking beyond this sector—which is estimated to have singlehandedly cut around 0.5% from headline growth—activity data released over the course of the month painted a decidedly mixed picture of the Canadian economy. On the plus side, wholesale volumes increased by a very respectable 1.5% while activity related to the 2016 Census likely supported public administration. On the other side of the coin, manufacturing volumes were quite weak due in part to the disruption in the supply chain for autos caused by the earthquake in Japan in the prior month. Existing home sales took a step back in May while housing starts were also on the soft side. For the quarter as a whole, annualized expenditure-based real GDP is forecast to have fallen by 0.9% which is broadly in line with what the Bank of Canada had forecast in the July Monetary Policy Report (MPR).



*Real GDP at basic prices in 2007 chained dollars
Source: Statistics Canada / Haver Analytics

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

RECENT KEY ECONOMIC INDICATORS: JULY 18-22, 2016							
Release Date		Economic Indicator/Event	Data for Period	Units	Current	Prior	
United States							
Jul 18		NAHB Housing Market Index	Jul	Index	59.0	60.0	
Jul 19		Building Permits	Jun	Thsd	1153.0	1136	R▼
Jul 19		Housing Starts	Jun	Thsd	1189.0	1135	R▼
Jul 21		Initial Jobless Claims	Jul 16	Thsd	253.0	254.0	
Jul 21		Existing Home Sales	Jun	Mlns	5.6	5.5	R▼
Jul 22		Markit US Manufacturing PMI	Jul P	Index	52.9	51.3	
Canada							
Jul 21		Wholesale Trade Sales	May	M/M % Chg.	1.8	0.2	R▲
Jul 22		Retail Sales	May	M/M % Chg.	0.2	0.8	R▼
Jul 22		Retail Sales Excluding Auto	May	M/M % Chg.	0.9	1.3	
Jul 22		Consumer Price Index	Jun	M/M % Chg.	0.2	0.4	
Jul 22		Consumer Price Index	Jun	Y/Y % Chg.	1.5	1.5	
Jul 22		Consumer Price Index Core	Jun	M/M % Chg.	0.0	0.3	
Jul 22		Consumer Price Index Core	Jun	Y/Y % Chg.	2.1	2.1	
International							
Jul 19	UK	Consumer Price Index Core	Jun	Y/Y % Chg.	1.4	1.2	
Jul 20	UK	Unemployment Rate	May	%	4.9	5.0	
Jul 21	UK	Retail Sales	Jun	Y/Y % Chg.	4.3	5.7	R▼
Jul 21	EZ	ECB Main Refinancing Rate	Jul 21	%	0	0.0	
Jul 22	EZ	Markit Eurozone Manufacturing PMI	Jul P	Index	51.9	52.8	
Jul 22	UK	Markit UK PMI Manufacturing (SA)	Jul P	Index	49.1	52.1	

Source: Bloomberg, TD Economics.

UPCOMING ECONOMIC RELEASES AND EVENTS: JULY 25-29, 2016

Release Date	Time*		Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
United States							
Jul 26	9:00		S&P/Case-Shiller US Home Price Index	May	Y/Y % Chg.	-	5.0
Jul 26	9:00		S&P/Case-Shiller US Home Price Index (SA)	May	M/M % Chg.	-	0.1
Jul 26	9:45		Markit US Services PMI	Jul P	Index	52.1	51.4
Jul 26	10:00		New Home Sales	Jun	Thsd	560.0	551.0
Jul 26	10:00		Consumer Confidence Index	Jul	Index	95.8	98.0
Jul 27	8:30		Capital Goods Orders Non-defense Excl. Aircraft	Jun P	M/M % Chg.	0.2	-0.4
Jul 27	8:30		Durable Goods Orders	Jun P	M/M % Chg.	-1.1	-2.3
Jul 27	10:00		Pending Home Sales	Jun	M/M % Chg.	1.8	-3.7
Jul 27	14:00		FOMC Rate Decision	Jul 27	%	0.5	0.5
Jul 28	8:30		Initial Jobless Claims	Jul 23	Thsd	260.0	253.0
Jul 28	8:30		Advance Goods Trade Balance	Jun	USD, Blns	-61.2	-60.6
Jul 29	8:30		Gross Domestic Product (Annualized)	Q2 A	Q/Q % Chg.	2.6	1.1
Jul 29	8:30		Personal Consumption	Q2 A	Q/Q % Chg.	4.1	1.5
Jul 29	8:30		Core PCE	Q2 A	Q/Q % Chg.	1.7	2.0
Jul 29	8:30		Employment Cost Index	Q2	Q/Q % Chg.	0.6	0.6
Jul 29	9:30		*Fed's Williams Discusses Policy Toolkit in Boston*				
Jul 29	13:00		*Fed's Kaplan Speaks in Q&A in Albuquerque*				
Canada							
Jul 28			CFIB Business Barometer	Jul	Index	-	60
Jul 29	8:30		Gross Domestic Product	May	M/M % Chg.	-0.5	0.1
Jul 29	8:30		Industrial Product Price	Jun	M/M % Chg.	-	1.1
International							
Jul 27	4:30	UK	Gross Domestic Product	Q2 A	Y/Y % Chg.	2.1	2.0
Jul 28	19:30	JN	Jobless Rate	Jun	%	3.2	3.2
Jul 28	19:30	JN	Consumer Price Index	Jun	Y/Y % Chg.	-0.4	-0.4
Jul 28	19:50	JN	Retail Trade	Jun	Y/Y % Chg.	-1.3	-1.9
Jul 28		JN	BOJ Policy Rate	Jul 29	%	-	-0.1
Jul 29	5:00	EZ	Unemployment Rate	Jun	%	10.1	10.1
Jul 29	5:00	EZ	Core Consumer Price Index	Jul A	Y/Y % Chg.	0.9	0.9
Jul 29	5:00	EZ	Gross Domestic Product (SA)	Q2 A	Q/Q % Chg.	0.3	0.6

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