THE WEEKLY BOTTOM LINE

TD Economics

HIGHLIGHTS OF THE WEEK

June 2, 2017

United States

- The U.S. job machine slowed in May (+138k jobs) as the unemployment fell to a sixteen year low of 4.3%. A pullback in the participation rate contributed to the fall in the unemployment rate.
- The Federal Reserve's preferred measure of price growth slowed in April to 1.7% (from 1.9%), while the core measure fell to 1.5% (from 1.6%).
- Weak inflation will probably not forestall a rate hike in June, but continued weakness could be enough to delay further rate hikes. Just as much as job growth, this is an important metric to watch for guidance on future Fed action.

Canada

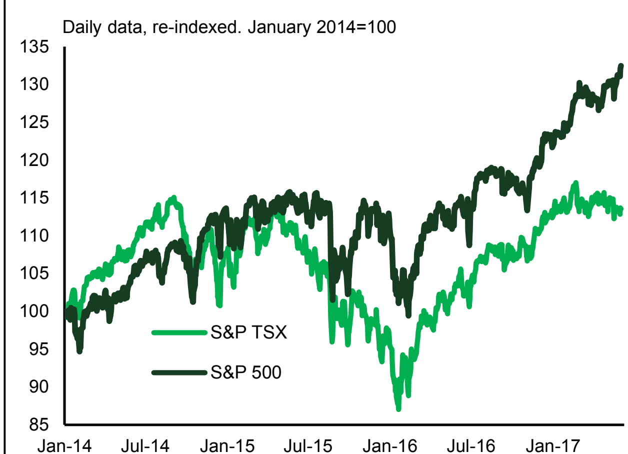
- Canadian real GDP rose 3.7% annualized in Q1, while nominal GDP rose 8.3%, marking the best three-quarter streak in almost seven years.
- The household sector has contributed most to growth, due in large part to a hot housing market. Still, exports appear to be gaining momentum heading into the second quarter of the year.
- Preliminary data showed policy-induced soft market conditions in the GTA and GVA extended into May, bringing the durability of Canada's growth prospects into question.
- Low interest rates will likely continue to support consumption amid a cool down in activity in Canada's largest housing markets, providing upside potential to our 2017 growth forecast. Higher interest rates in 2018 should bring about a cooling in consumption and real estate.

THIS WEEK IN THE MARKETS

	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	2,430	2,416	2,430	2,001
S&P/TSX Comp.	15,435	15,417	15,922	13,690
DAX	12,803	12,602	12,807	9,269
FTSE 100	7,549	7,548	7,549	5,924
Nikkei	20,177	19,687	20,177	14,952
Fixed Income Yields				
U.S. 10-yr Treasury	2.16	2.25	2.63	1.36
Canada 10-yr Bond	1.40	1.45	1.87	0.95
Germany 10-yr Bund	0.28	0.33	0.49	-0.19
UK 10-yr Gilt	1.04	1.01	1.52	0.52
Japan 10-yr Bond	0.06	0.04	0.12	-0.29
Foreign Exchange Cross Rates				
C$ (USD per CAD)	0.74	0.74	0.79	0.73
Euro (USD per EUR)	1.13	1.12	1.14	1.04
Pound (USD per GBP)	1.29	1.28	1.49	1.20
Yen (JPY per USD)	110.5	111.3	118.2	99.9
Commodity Spot Prices*				
Crude Oil ($US/bbl)	47.4	49.8	54.1	39.5
Natural Gas ($US/MMBtu)	2.93	3.10	3.76	2.03
Copper ($US/met. tonne)	5675.0	5638.0	6103.5	4495.8
Gold ($US/troy oz.)	1275.6	1266.9	1366.4	1128.4

*as of 10:25 am on Friday **Oil-WTI, Cushing, Nat. Gas-Henry Hub, LA (Thursday close price), Copper-LME Grade A, Gold-London Gold Bullion; Source: Bloomberg.

NORTH AMERICAN STOCK MARKETS



Data to 12:15 PM, Friday, June 2, 2017. Source: WSJ / Bloomberg

GLOBAL OFFICIAL POLICY RATE TARGETS

	Current Target
Federal Reserve (Fed Funds Rate)	0.75 - 1%
Bank of Canada (Overnight Rate)	0.50%
European Central Bank (Refi Rate)	0.00%
Bank of England (Repo Rate)	0.25%
Bank of Japan (Overnight Rate)	-0.10%

Source: Central Banks.

U.S. – THE FED'S CONUNDRUM: LOW UNEMPLOYMENT, SLOW INFLATION

The Federal Reserve has a conundrum. Its dual mandate is for maximum employment and price stability. On the latter, inflation has remained stubbornly below its 2% target. In April, the Fed's preferred core inflation measure slowed to 1.5% from a recent peak of 1.8% in February.

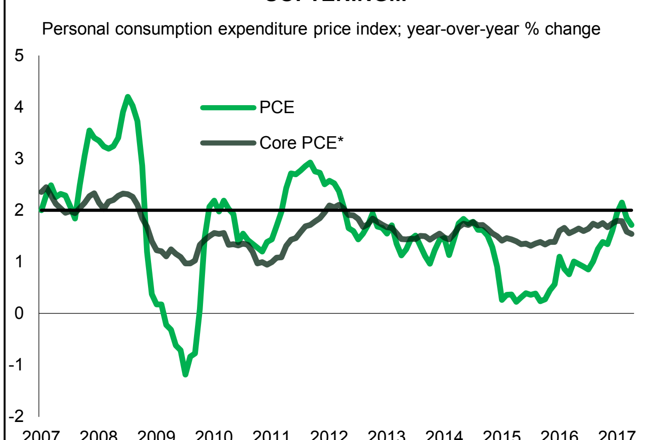
On the former however, it's becoming harder and harder to argue that the American economy is not nearing full employment. In May, the unemployment rate ticked down to 4.3% – its lowest level in sixteen years. Broader measures of unemployment, such as the U6 (which adds marginally attached workers and involuntary part-timers to the tally) also fell to 8.4% - its lowest level in nearly a decade.

In theory, a tightening labor market should be putting upward pressure on inflation. But, as noted by Federal Reserve Governor Brainard in a speech this week, even while the unemployment rate has fallen over five percentage points since the end of the recession, inflation has moved little. Headline consumer price growth has ebbed and flowed with energy prices, but core price measures have maintained a modest rate of change, notably under 2%.

There are a few ways to square this circle. The first, as referenced by Brainard, is that well-anchored inflation expectations have reduced the impact of economic slack on inflation. In economics jargon, the slope of the Phillips curve, may still be negative (inflation rises as unemployment falls), but it has flattened.

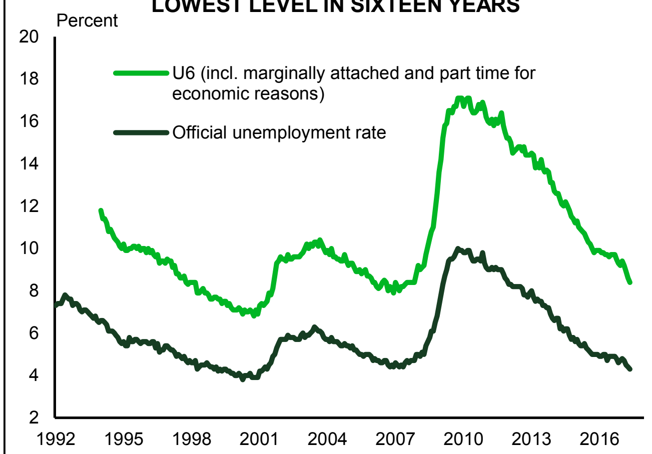
A second explanation is that even as unemployment has fallen, so has the theoretical unemployment rate associated with full employment. On this front, the median projection for the long-term unemployment rate among FOMC members has moved consistently downward. Given the recent moves in unemployment and inflation, there is a good chance that it will do so again in June. There is a good argument that an aging population puts downward pressure on the natural rate of unemployment. One can see this dynamic in Japan where the measured unemployment rate is at an all-time low, yet the economy continues to be plagued by deflation.

CHART 1: CONSUMER PRICE GROWTH SOFTENING...



*Excluding food and energy. Source Bureau of Economic Analysis.

CHART 2: ...AS UNEMPLOYMENT RATE HITS LOWEST LEVEL IN SIXTEEN YEARS



Source: Bureau of Labor Statistics.

A third explanation is that the unemployment rate is no longer an accurate measure of labor market slack. While the more inclusive measures have also been falling, the still-limited rebound in core-age participation rates suggests more slack may exist. Alongside a potentially lower natural unemployment rate, this larger "shadow" gap could be diluting the inflationary impact of the tightening labor market.

A fourth explanation is that even while the U.S. labor market is tightening, a consistent and possibly expanding level of global economic slack is keeping downward pressure on inflation. With the Federal Reserve more responsive to domestic than global conditions, rate hikes to-date have put upward pressure on the dollar and helped to import global disinflation into America.

Putting it all together, the improvement in the labor market may provide the impetus for the Federal Reserve to continue to raise interest rates, especially if productivity remains weak and it is satisfied that wage growth is moving higher. Still, it cannot ignore the inflation side of its mandate. Continued underperformance on the inflation front will strengthen the case for patience and likely lead the Federal Reserve to slow the pace of rate hikes.

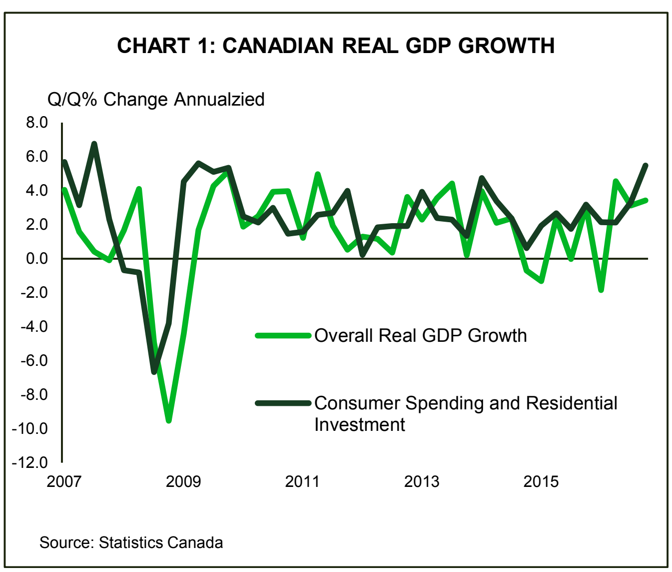
James Marple, Senior Economist 416-982-2557

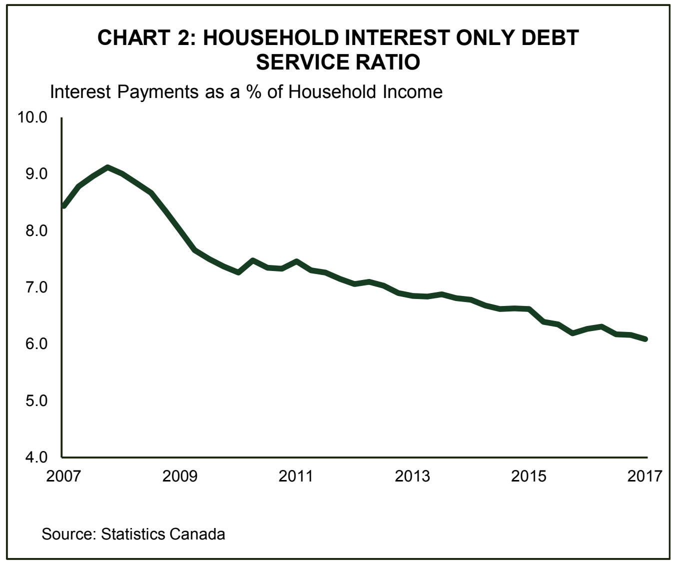
CANADA – ALL ABOUT THE HOME PRICE

Low oil prices have led to a softening in Canadian economic growth, but they didn't hold it down. National accounts data for the first quarter was released this week, and what a quarter is was. Real GDP grew by 3.7% q/q annualized with the economy now on the best three-quarter growth streak since 2010. Canadian nominal GDP surged 8.3%, building off the strength in real activity and a 14% rise in oil prices, for its best quarterly performance since 2010.

Despite exports still struggling to gain momentum, the economy has benefitted from strength in the household sector, particularly real estate, to drive growth. The combination of real residential investment and spending on housing related items (utilities, furnishing and equipment) rose by almost 11% in the first quarter contributing to about three-quarters of economic growth. Consumers have also been spending on just about everything at a healthy rate, supported by a positive wealth impact stemming from a $21,000 appreciation in average home prices over the quarter.

The strong dependence on the household sector throws into question the durability of Canada's economic performance, particularly in light of an ongoing policy-induced adjustment in housing activity in both BC and Ontario. Indeed, the pace of spending is likely to moderate going forward, but the consumer is expected to continue to carry the economy for just a little longer. For one, while the BC housing market adjusted during much of last year, provincial growth still notched up very strong growth of 3.7% last year. This offers some consolation that a cool down in housing won't derail Canada's economic prospects. Even as existing home sales adjust to more normal levels, housing starts are still elevated due to the lagged impact of double-digit home price growth, which is expected to continue to prop construction activity through the remainder of the year.





Meanwhile, low interest rates should continue to help support the consumer. While household debt (5.2% y/y in Q1) continues outpace personal income (+4.1% y/y in Q1) and households are arguably carrying too much debt, the cost of borrowing is still low. Households are paying down their principal at a faster rate than has historically been the case and the interest portion of monthly debt payments hit a new record low in the first quarter of the year, both in absolute terms and as a share of income.

There is some hope on the export front too. This week's export data indicated that real exports rose 0.8% in April atop an already strong 1.3% gain in March, telegraphing a strong start to second quarter net-trade. However, the momentum in exports over the last two months has mainly been an energy story, with more than two-thirds of the yearly Canadian export growth stemming from energy products.

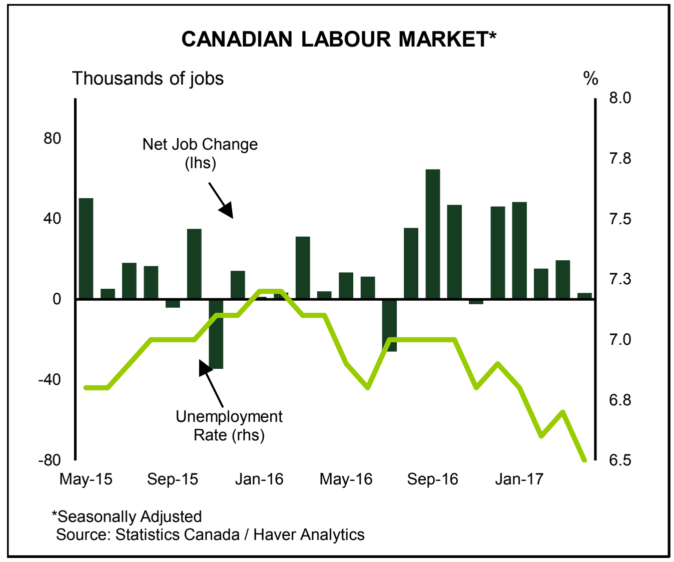
Overall, even as Canada's largest housing markets come back to earth, the consumer will likely keep on chugging along, suggesting some upside to our economic forecast for this year. But, with the economy on a stronger footing, the Bank of Canada is expected to start raising rates as early as spring 2018, putting downward pressure on consumer spending and residential investment. The plan is that, by then, exports and business investment will have started to pick up.

Diana Petramala, Economist, 416-982-6420

CANADA: UPCOMING KEY ECONOMIC RELEASES

Canadian Employment - May*

Release Date: June 9, 2017
April Result: 3.2k, unemployment rate 6.5%
TD Forecast: 20k, unemployment rate 6.6%
Consensus: 11.3k, unemployment rate 6.6%



We forecast employment growth to advance at a 20k pace in May, marking a marginal pickup from the 3k recorded increase in April. We look for modest gains in the private services and manufacturing industry groups. Services jobs are coming off two relatively weak months while surveys have pointed to a resurgence in factory hiring. The breakdown between full- and part-time employment is uncertain this month, as the pullback in full-time jobs suggests some rebound whereas the long string of gains in prior months may give way to further correction in May. If anything, part-time jobs are more likely to see net gains in May. Note that the construction strike in Quebec in late May should have no impact on the survey as workers affected by labour disputes are still deemed as employed in the LFS.

The unemployment rate will draw attention following its 0.2pp descent to 6.5%, which reflected an unfavourable 0.4pp plunge in labor force participation. The April drop however mainly reflected a correction in prime-age participation, which climbed to a historical high of 87.3% in March. Hence the April figures draw limited concern over participation, and some stabilization or pickup in labour force growth in May should drive the unemployment rate slightly higher to 6.6%.

On wages, we see scope for a moderate pickup in average hourly earnings among permanent employees partly on a base effect. Recall that earnings growth slowed to a subpar 0.5% y/y in April, though the recent deceleration is in stark contrast to the SEPH wage series, which continued to average above a 2% pace through March. Over the course of this year, the material declines in economic slack over the past three quarters should help drive LFS wages higher.

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

RECENT KEY ECONOMIC INDICATORS: MAY 29 - JUNE 2, 2017

Release Date		Economic Indicator/Event	Data for Period	Units	Current	Prior	
United States							
May 30		Personal Consumption Expenditure Core	Apr	Y/Y % Chg.	1.5	1.6	
May 30		Personal Consumption Expenditure Deflator	Apr	Y/Y % Chg.	1.7	1.9	R▼
May 30		Real Personal Spending	Apr	M/M % Chg.	0.2	0.5	R▲
May 30		Personal Income	Apr	M/M % Chg.	0.4	0.2	
May 30		S&P CoreLogic US Home Price Index NSA	Mar	Y/Y % Chg.	5.8	5.7	R▼
May 30		Conf. Board Consumer Confidence	May	Index	117.9	119.4	R▼
May 31		Pending Home Sales	Apr	M/M % Chg.	-1.3	-0.9	R▼
Jun 01		Initial Jobless Claims	May 27	Thsd	248.0	235.0	R▲
Jun 01		ISM Manufacturing	May	Index	54.9	54.8	
Jun 01		Wards Total Vehicle Sales	May	Mlns	16.58	16.81	
Jun 02		Change in Nonfarm Payrolls	May	Thsd	138.0	174.0	R▼
Jun 02		Trade Balance	Apr	USD, Blns	-47.6	-45.3	R▼
Jun 02		Unemployment Rate	May	%	4.3	4.4	
Jun 02		Average Hourly Earnings	May	M/M % Chg.	0.2	0.2	R▼
Canada							
May 30		Current Account Balance	Q1	CAD, Blns	-14.1	-11.7	R▲
May 30		Industrial Product Price	Apr	M/M % Chg.	0.6	0.8	
May 31		Gross Domestic Product	Mar	M/M % Chg.	0.5	0.0	
May 31		Quarterly Gross Domestic Product Annualized	Q1	Y/Y % Chg.	3.7	2.7	R▲
Jun 01		Markit Canada Manufacturing PMI	May	Index	55.1	55.9	
Jun 02		Int'l Merchandise Trade	Apr	M/M % Chg.	-0.4	-0.9	R▼
Jun 02		Labor Productivity	Q1	Q/Q % Chg.	1.4	0.4	
International							
May 29	JN	Jobless Rate	Apr	%	2.8	2.8	
May 29	JN	Retail Trade	Apr	Y/Y % Chg.	3.2	2.1	
May 30	CH	Manufacturing PMI	May	Index	51.2	51.2	
May 31	EZ	Consumer Price Index Core	May A	Y/Y % Chg.	0.9	1.2	
May 31	EZ	Unemployment Rate	Apr	%	9.3	9.4	R▼
May 31	IN	Gross Domestic Product	Q1	Y/Y % Chg.	6.1	7.0	
Jun 01	UK	Markit UK PMI Manufacturing SA	May	Index	56.7	57.3	
Jun 01	BZ	Gross Domestic Product	Q1	Y/Y % Chg.	-0.4	-2.5	

Source: Bloomberg, TD Economics.

UPCOMING ECONOMIC RELEASES AND EVENTS: JUNE 5-9, 2017

Release Date	Time*		Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
United States							
Jun 05	10:00		Factory Orders	Apr	M/M % Chg.	0.2	0.5
Jun 05	10:00		Factory Orders Ex Trans	Apr	M/M % Chg.	-	-0.3
Jun 05	10:00		ISM Non-Manf. Composite	May	Index	57.0	57.5
Jun 08	8:30		Initial Jobless Claims	Jun 03	Thsd	-	248.0
Jun 09	10:00		Wholesale Trade Sales	Apr	M/M % Chg.	-	0.0
Canada							
Jun 06	10:00		Ivey Purchasing Managers Index SA	May	Index	-	62.4
Jun 08	8:15		Housing Starts	May	Thsd	-	213.1
Jun 08	10:30		*Bank of Canada Releases Financial System Review*				
Jun 09	8:30		Capacity Utilization Rate	1Q	Q/Q % Chg.	-	82.2
Jun 09	8:30		Net Change in Employment	May	Thsd	-	3.2
Jun 09	8:30		Unemployment Rate	May	%	6.6	6.5
International							
Jun 06	5:00	EZ	Retail Sales	Apr	Y/Y % Chg.	-	2.3
Jun 08	21:30	CH	Consumer Price Index	May	Y/Y % Chg.	1.4	1.2

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