The Weekly Bottom Line

August 11, 2017

Highlights of the Week

United States

- Markets this week have been largely driven by corporate earnings and political events, with tensions on the Korean Peninsula escalating to the point where markets can no longer ignore them.
- Inflation strengthened in the Eurozone, with prices growing by 0.13% in July and the year-over-year measure accelerating to 1.2% with strength particularly apparent in Germany and Spain.
- U.S. inflation surprised to the downside once again, with prices growing by 0.1% in July – or half the expected pace. Despite the soft CPI print and PPI figures, we expect inflation will strengthen somewhat in the coming months.

Canada

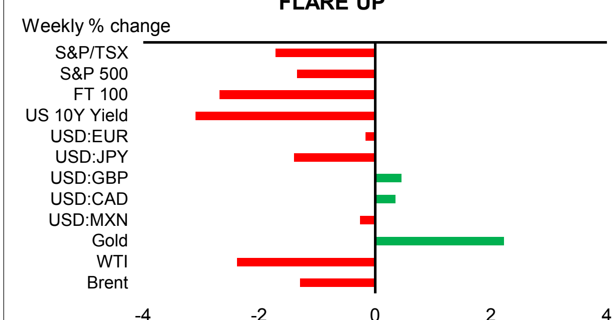
- Canadian markets fell late in the week alongside their global counterparts as geopolitical tensions ratcheted up on the back of heated U.S.-North Korean rhetoric. Domestically, housing starts remained on an upward trend in July, but current headwinds suggest a slowing pace as the year progresses.
- NAFTA renegotiations are set to begin this Wednesday. While some areas, such as dispute resolution, are likely to prove challenging, several opportunities exist for improving and modernizing the agreement.
- The timing of Mexican presidential elections argue for a relatively short negotiating process. Trade negotiations are never simple affairs, but using TPP as a template for services trade liberalization may help accelerate the process.

THIS WEEK IN THE MARKETS

	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	2442	2477	2481	2085
S&P/TSX Comp.	15074	15258	15922	14349
DAX	12024	12298	12889	10259
FTSE 100	7329	7512	7548	6666
Nikkei	19730	19952	20230	16252
Fixed Income Yields				
U.S. 10-yr Treasury	2.20	2.26	2.63	1.51
Canada 10-yr Bond	1.86	1.92	2.06	0.95
Germany 10-yr Bund	0.39	0.47	0.60	-0.15
UK 10-yr Gilt	1.06	1.18	1.52	0.52
Japan 10-yr Bond	0.06	0.07	0.12	-0.10
Foreign Exchange Cross Rates				
C$ (USD per CAD)	0.79	0.79	0.80	0.73
Euro (USD per EUR)	1.18	1.18	1.19	1.04
Pound (USD per GBP)	1.30	1.30	1.34	1.20
Yen (JPY per USD)	109.1	110.7	118.2	99.9
Commodity Spot Prices**				
Crude Oil ($US/bbl)	48.4	49.6	54.1	42.3
Natural Gas ($US/MMBtu)	2.87	2.76	3.76	2.03
Copper ($US/met. tonne)	6393.8	6347.8	6451.5	4595.0
Gold ($US/troy oz.)	1287.8	1258.8	1352.2	1128.4

*as of 10:00 am on Friday **Oil-WTI, Cushing, Nat. Gas-Henry Hub, LA (Thursday close price), Copper-LME Grade A, Gold-London Gold Bullion; Source: Bloomberg.

MOST GLOBAL MARKETS DOWN AS TENSIONS FLARE UP



Note: Data as of August 11, 11:50 AM ET.
Sources: Bloomberg, TD Economics

GLOBAL OFFICIAL POLICY RATE TARGETS

	Current Target
Federal Reserve (Fed Funds Rate)	1.00 - 1.25%
Bank of Canada (Overnight Rate)	0.75%
European Central Bank (Refi Rate)	0.00%
Bank of England (Repo Rate)	0.25%
Bank of Japan (Overnight Rate)	-0.10%

Source: Central Banks.

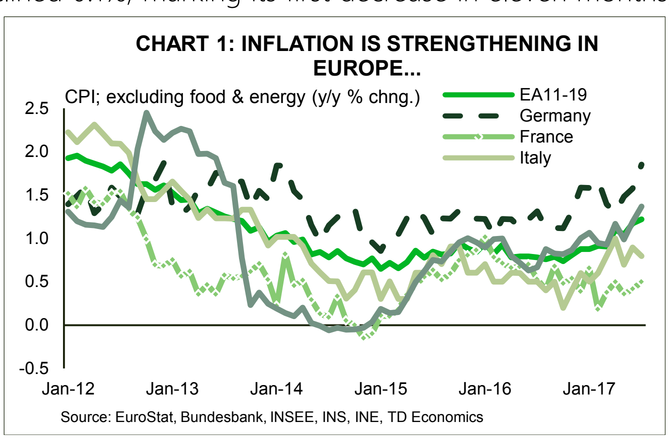
U.S. - Inflation Strengthens in Eurozone, But Stays Soft in U.S.

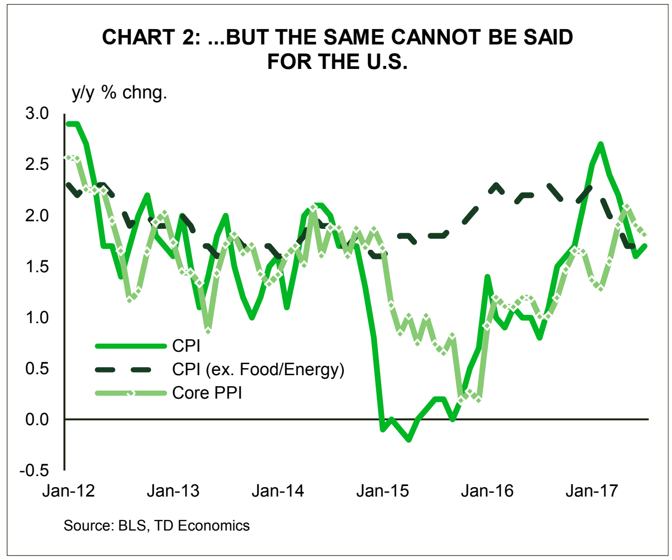
Markets have this week been driven largely by political events and corporate results. Second quarter earnings continued to impress, boosting sentiment and stock valuations. Oil prices also helped, with the WTI benchmark rising above $50 on Thursday morning, helped along by rising global tensions and a drawdown in US inventories

Escalating tensions really begun to weigh on markets on Thursday afternoon with stock indices having the worst day in three months. Volatility sprung to life, with the VIX rising to 17. The tensions have so far boosted the flow of money into safe-haven assets, such as G7 government bonds. At the same time, risk assets exposed to the peninsula, such as the Kospi, Shenzen, and Nikkei equity indices fell on the week. While we don't expect situation on the Korean Peninsula to result in armed conflict, it could lead to weaker economic performance as consumers and businesses in the region pare back spending.

As far as economic data, this week was all about inflation. The story was relatively good in Europe, with several economies seeing robust readings. Core CPI in Germany and Spain rose by 0.4% and 0.3% (m/m) in July – the fastest monthly pace of several years. Price gains in France and Italy were less apparent, and averaged 0.13% for the Eurozone as a whole. Still, inflation in year-on-year terms accelerated to a four-year high of 1.2%, with these readings likely to provide further comfort for ECB officials to begin considering paring back on bond buying.

Inflation was far less robust in the U.S. with the producer price index (PPI) report on Thursday as well as its consumer cousin a day later, underwhelming. Total PPI declined 0.1%, marking its first decrease in eleven months,





while the core measure pulled back by just as much in July, with the year-on-year measures decelerating by 0.3 percentage points to 1.9% and 1.8%, respectively. The consumer price index (CPI) also missed expectations, increasing by half of the 0.2% m/m gain that was expected.

The figures will not reassure Fed officials who have been looking for the data to turn after months of weaker than expected readings. While some of the past weakness has been transitory, the continued softness suggests that more permanent factors may be at play. As such, the Fed is likely to downgrade its inflation projections at its September meeting. They may also delay the timing for when inflation will finally reach its 2% target, but most will likely remain of the view that such an outcome will occur over the medium-term horizon.

There are reasons to be hopeful. This week's NFIB survey offered some reassurance, with the share of firms raising selling prices rising to 8% - the highest share since mid-2014. There was also an increase in the share expecting to raise prices from 19% to 23%. At the same time, labor market progress continues at a resilient pace.. With unemployment at 4.3%, wages growing at 2.5% y/y, and the trade-weighted dollar down 8% from its peak in December, inflation is likely to turn higher in the months ahead. This should allow the Fed to continue its plans to normalize its balance sheet and perhaps sneak in one rate hike before the year is out.

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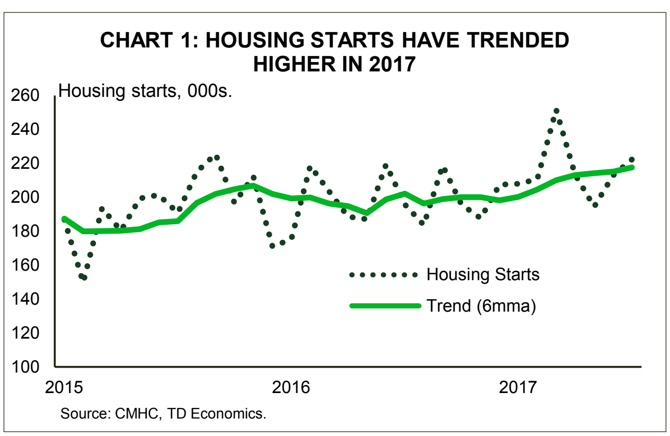
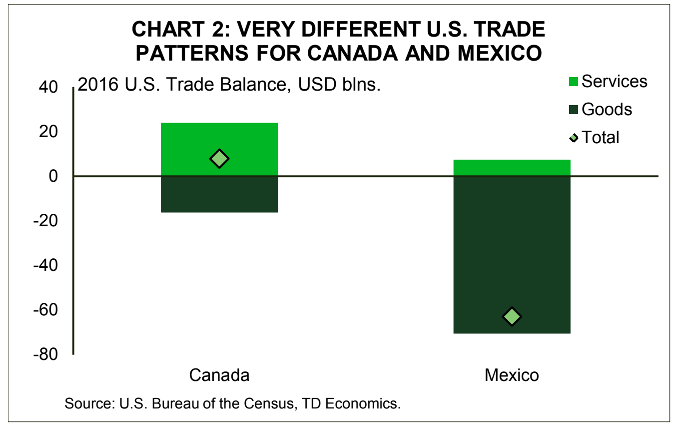
Canada - NAFTA Negotiation Process Begins Anew

Canadian markets started the shortened trading week with something of a yawn, as markets largely moved sideways until Thursday, as heated rhetoric from President Trump and Kim Jong Un took the S&P/TSX index, crude oil, and the loonie lower. The loonie recovered somewhat by mid-morning Friday assisted by soft US inflation data, but remained below US79 cents.

On the domestic front, the only major economic release was July housing starts, which came in ahead of market expectations at 222k units (at annual rates). The healthy climb, driven by multifamily units, led to a seventh straight monthly gain in the trend measure (Chart 1). In light of modest household formation rates and a number of headwinds to housing markets (rising borrowing costs, macro-prudential measures), it is likely that starts will begin to trend lower as the year progresses and multi-family projects pre-sold in prior years make their way through the start phase and into construction.

Much attention has rightly been given to the heated U.S.-North Korean rhetoric, but thankfully this has so far remained a war of words only. Where rhetoric has turned to action is on the trade front, with the first of seven planned rounds of NAFTA negotiations set to commence this Wednesday, August 16th. From a purely "Trumpian", zero-sum point of view, Canada likely has a favourable starting point vis-à-vis Mexico. While we run a surplus in goods with the U.S., once the significant trade in services is taken into account, Canada actually runs a small deficit overall (Chart 2). Not so for Mexico, where a larger goods surplus and smaller services deficit resulted in a roughly US$60 billion surplus in 2016.





Regardless of the starting point, negotiations are likely to see a number of sticking points. Both Canada and Mexico have already indicated their strong desire to see Chapter 19 dispute resolution (via independent arbitration) remain in the agreement. Potential changes to rules-of-origin requirements may also prove challenging, particularly if the U.S. pushes for an American content rule. Some areas that the U.S. has indicated it may focus on, such as agricultural products and the *de minimus* threshold for online purchases would likely benefit Canadian consumers, but face significant opposition from entrenched interest groups.

The service side of the agreement may prove to be both more important, and perhaps easier to come to agreement on. More important as the original NAFTA text, which was written before widespread internet access, is not reflective of modern, internet-enabled ways of doing business or the importance of intellectual property. Easier as all three countries can use the draft Trans-Pacific Partnership trade agreement as a starting point for negotiations. This is likely particularly important for the Mexican delegation, which will want to reach an agreement by February of next year – Presidential elections mean that after that point, an agreement can't be signed until January of 2019.

Ultimately, as in all negotiations, no party is likely to be completely happy with all outcomes. Nevertheless, the discussions are an important opportunity to expand and improve what has been an important component of Canadian prosperity over the past 23 years.

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U.S.: Upcoming Key Economic Releases

U.S. Retail Sales - July*

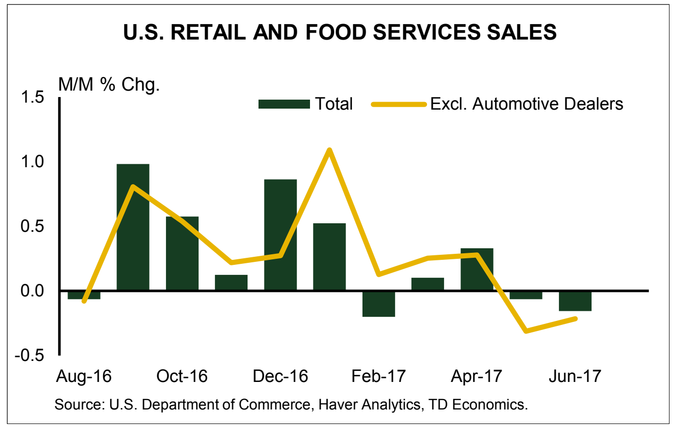
Release Date: August 15, 2017

Previous Result: -0.2%, ex-auto -0.2%

TD Forecast: 0.4%, ex-auto 0.4%

Consensus: 0.4%, ex-auto 0.4%

We expect retail sales to rebound 0.4% in July, led by a strong 0.5% increase in the control group (excluding autos, gasoline station, food services and building material sales). The prior two monthly readings have been soft, particularly for the control group, suggesting scope for a solid bounce back in July. Gasoline station and motor vehicle sales are not expected to move the needle on headline sales, consistent with little change observed in seasonally-adjusted gasoline prices and light weight vehicle sales. If realized, our projections would mark a solid start to the third quarter and would be consistent with real PCE growth of at least 2.5%, if not better.



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

Canada: Upcoming Key Economic Releases

Canadian Manufacturing Sales - June*

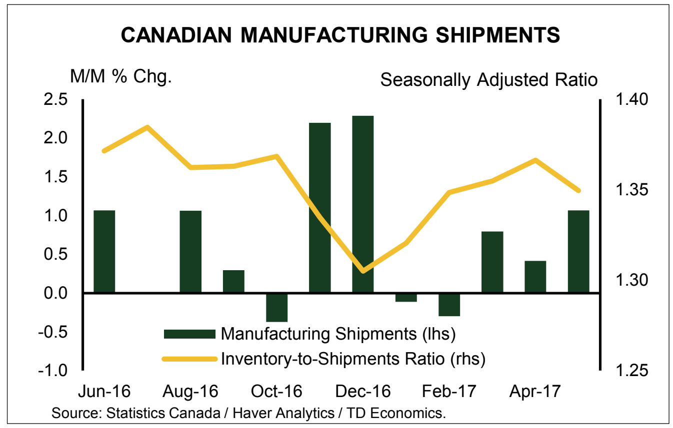
Release Date: August 17, 2017

Previous Result: 1.1% m/m

TD Forecast: -1.2% m/m

Consensus: -1.0% m/m

Manufacturing sales are forecast to decline by 1.2% m/m in June, though weaker factory prices should allow volumes to outperform the nominal print. Energy products and motor vehicles should act as the primary drivers of the pullback, with the former expected to post a large decline due to softer crude prices, which bottomed towards the end of June, though export volumes edged lower as well. Motor vehicle exports also fell in June, which coincides with a pullback in domestic production and further evidence that the market for US auto sales has plateaued. Aerospace shipments should provide some offset but we still expect transportation to make a negative contribution on net. Elsewhere, we look for a fairly broad decline as manufacturers adjust to the rising Canadian dollar, a headwind which will grow stronger in Q3. While our forecast would represent the largest drop since early 2016, it would still leave Q2 nominal shipments up almost 5% on an annualized quarterly basis.



Source: Statistics Canada / Haver Analytics / TD Economics.

Canadian Consumer Price Index - July*

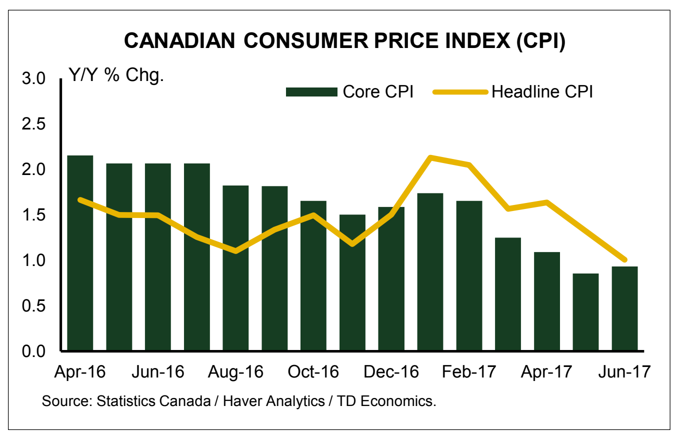
Release Date: August 18, 2017

Previous Result: -0.1% m/m, 1.0% y/y

TD Forecast: -0.1% m/m, 1.1% y/y

Consensus: 0.1% m/m, 1.3% y/y

We look for July headline inflation to inch higher to 1.1% y/y from 1.0% y/y in June, reflecting a 0.1% decline in prices on the month. We expect energy prices on balance to decline on the month, led by lower gasoline prices, but this impact should be neutral on a year-ago basis. Further gains in food prices are likely, in line with the past increases in agricultural prices though currency appreciation poses a downside risk in the months ahead. Other sources of strength in July include shelter costs on the back of the acceleration in new housing prices and rising mortgage rates. Though we believe underlying measures of inflation are bottoming, we proceed with caution in the near-term and continue to see risks skewed to the downside due to lagged effects of economic slack, renewed currency appreciation and other sources of transitory weakness. The three core metrics of inflation (CPI common, trimmed mean and median) averaged 1.40% y/y in June and will likely once again drive the market reaction, with some stabilization or pickup to the benefit of rate hike expectations.



Source: Statistics Canada / Haver Analytics / TD Economics.

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RECENT KEY ECONOMIC INDICATORS: AUGUST 7-11, 2017						
Release Date		Economic Indicator/Event	Data for Period	Units	Current	Prior
United States						
Aug 08		NFIB Small Business Optimism	Jul	Index	105.2	103.6
Aug 09		Unit Labor Costs	2Q P	Q/Q % Chg.	0.6	5.4
Aug 09		Wholesale Trade Sales	Jun	M/M % Chg.	0.7	-0.1
Aug 10		Initial Jobless Claims	Aug 05	Thsd	244.0	241.0
Aug 10		Producer Price Index Final Demand	Jul	M/M % Chg.	-0.1	0.1
Aug 10		Producer Price Index Ex Food and Energy	Jul	M/M % Chg.	-0.1	0.1
Aug 11		Consumer Price Index	Jul	M/M % Chg.	0.1	0.0
Aug 11		Consumer Price Index Ex Food and Energy	Jul	M/M % Chg.	0.1	0.1
Aug 11		Consumer Price Index	Jul	Y/Y % Chg.	1.7	1.6
Aug 11		Consumer Price Index Ex Food and Energy	Jul	Y/Y % Chg.	1.7	1.7
Canada						
Aug 08		Housing Starts	Jul	Thsd	222.3	212.9
International						
Aug 08	CH	Consumer Price Index	Jul	Y/Y % Chg.	1.4	1.5
Aug 10	UK	NIESR Gross Domestic Product Estimate	Jul	Y/Y % Chg.	0.2	0.3

Source: Bloomberg, TD Economics.

UPCOMING ECONOMIC RELEASES AND EVENTS: AUGUST 14-18, 2017						
Release Date	Time*	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
United States						
Aug 15	8:30	Import Price Index ex Petroleum	Jul	M/M % Chg.	-	0.1
Aug 15	8:30	Export Price Index	Jul	M/M % Chg.	-	-0.2
Aug 15	8:30	Export Price Index	Jul	Y/Y % Chg.	-	0.6
Aug 15	8:30	Empire Manufacturing	Aug	Y/Y % Chg.	10.0	9.8
Aug 15	8:30	Retail Sales Advance	Jul	M/M % Chg.	0.4	-0.2
Aug 15	8:30	Retail Sales Ex Auto and Gas	Jul	M/M % Chg.	0.4	-0.1
Aug 15	10:00	NAHB Housing Market Index	Aug	Index	-	64.0
Aug 15	10:00	Business Inventories	Jun	M/M % Chg.	0.4	0.3
Aug 16	8:30	Housing Starts	Jul	Thsd	1225.0	1215.0
Aug 16	8:30	Building Permits	Jul	Thsd	1420.0	1275.0
Aug 16	14:00	*FOMC Meeting Minutes*	Jul 26			
Aug 17	8:30	Initial Jobless Claims	Aug 12	Thsd	-	244.0
Aug 17	9:15	Manufacturing (SIC) Production	Jul	Y/Y % Chg.	0.2	0.2
Aug 17	9:15	Capacity Utilization	Jul	Y/Y % Chg.	76.8	76.6
Aug 17	9:15	Industrial Production	Jul	M/M % Chg.	0.3	0.4
Aug 17	13:00	*Fed's Kaplan Speaks in Lubbock, Texas*				
Aug 18	10:15	*Fed's Kaplan Speaks in Dallas*				
Canada						
Aug 14	8:00	*Canada Foreign Minister gives speech on Nafta in Ottawa*				
Aug 14	8:30	Teranet/National Bank HPI	Jul	Y/Y % Chg.	-	14.2
Aug 14	10:00	*Foreign Minister Freeland testifies about Nafta*				
Aug 15	9:00	Existing Home Sales	Jul	M/M % Chg.	-	-6.7
Aug 17	8:30	Manufacturing Sales	Jun	M/M % Chg.	-1.0	1.1
Aug 18	8:30	Consumer Price Index NSA	Jul	M/M % Chg.	0.1	-0.1
Aug 18	8:30	Consumer Price Index	Jul	Y/Y % Chg.	1.3	1.0
Aug 18	8:30	Core-Common Consumer Price Index	Jul	Y/Y % Chg.	-	1.4
Aug 18	8:30	Core -Trim Consumer Price Index	Jul	Y/Y % Chg.	-	1.2
Aug 18	8:30	Core-Median Consumer Price Index	Jul	Y/Y % Chg.	-	1.6
International						
Aug 15	4:30	UK Consumer Price Index	Jul	Y/Y % Chg.	2.7	2.6
Aug 16	5:00	EZ Gross Domestic Product SA	2Q P	Q/Q % Chg.	-	0.6
Aug 16	4:30	UK ILO Unemployment Rate 3Mths	Jun	%	4.5	4.5
Aug 16	5:00	EZ Gross Domestic Product SA	2Q P	Y/Y % Chg.	-	2.1
Aug 17	4:30	UK Retail Sales Ex Auto Fuel	Jul	M/M % Chg.	1.1	3.0
Aug 17	4:30	UK Retail Sales Inc Auto Fuel	Jul	M/M % Chg.	1.3	2.9
Aug 17	5:00	EZ Consumer Price Index	Jul	M/M % Chg.	-	0.0

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

Disclaimer