

## The Weekly Bottom Line

June 10, 2022

### Highlights

#### United States

- U.S. CPI came in above expectations, with the headline reading reaching a new 40-year high. Core inflation also surprised with a broad-based acceleration.
- The U.S. trade deficit narrowed in April with both lower U.S. imports and rising exports contributing. We expect further narrowing will add to GDP growth in the second quarter.
- Meanwhile, consumer credit made bad headlines this week, but as long as household income stays on the rise, credit growth should remain sustainable.

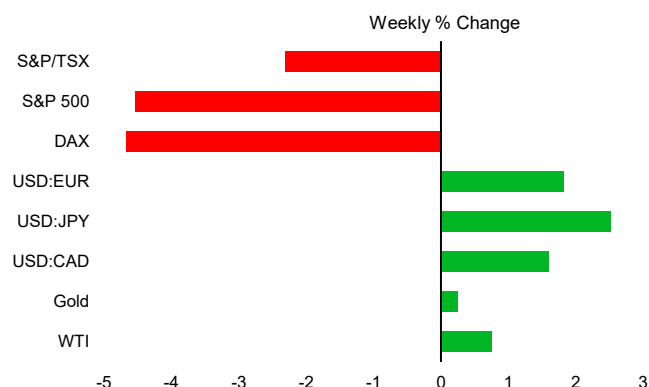
#### Canada

- The Bank of Canada Financial System Review (FSR) report reaffirmed that financial institutions remain resilient, but that vulnerabilities related to high household debt and elevated home prices have increased during the pandemic.
- In the press conference that followed the FSR release, Governor Macklem struck a decisively hawkish tone on inflation and interest rates, leaving the door open on the outsized 75 basis points hike in July.
- The labour market added 40k new jobs and the unemployment rate declined by 0.1 percentage points to 5.1% in May. Wage growth continued to accelerate amid competition for workers in a drum tight labour market.

This Week in the Markets				
	Current*	Week Ago	52-Week High	52-Week Low
<b>Stock Market Indexes</b>				
S&P 500	3924	4109	4797	3901
S&P/TSX Comp.	20311	20791	22087	19699
DAX	13784	14460	16272	12832
FTSE 100	7312	7533	7672	6844
Nikkei	27824	27762	30670	24718
<b>Fixed Income Yields</b>				
U.S. 10-yr Treasury	3.13	2.93	3.13	1.17
Canada 10-yr Bond	3.27	3.06	3.27	1.12
Germany 10-yr Bund	1.47	1.27	1.47	-0.50
UK 10-yr Gilt	2.39	2.16	2.39	0.51
Japan 10-yr Bond	0.25	0.23	0.25	0.01
<b>Foreign Exchange Cross Rates</b>				
C\$ (USD per CAD)	0.78	0.79	0.83	0.77
Euro (USD per EUR)	1.05	1.07	1.22	1.04
Pound (USD per GBP)	1.23	1.25	1.42	1.22
Yen (JPY per USD)	134.2	130.9	134.4	109.0
<b>Commodity Spot Prices**</b>				
Crude Oil (\$US/bbl)	121.6	118.9	123.7	62.3
Natural Gas (\$US/MMBtu)	8.18	8.33	9.45	3.11
Copper (\$US/met. tonne)	9620.1	9498.5	11299.5	8894.0
Gold (\$US/troy oz.)	1855.9	1851.2	2050.8	1726.4

\*As of 10:55 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 Markets Fall on Inflation, Oil Moves Higher



Note: Data as of 10:52 AM ET, Friday, June 10, 2022. Source: Bloomberg, TD Economics.

Global Official Policy Rate Targets	
Central Banks	Current Target
Federal Reserve (Fed Funds Rate)	0.75 - 1.00%
Bank of Canada (Overnight Rate)	1.50%
European Central Bank (Refi Rate)	0.00%
Bank of England (Repo Rate)	1.00%
Bank of Japan (Overnight Rate)	-0.10%

Source: Bloomberg.

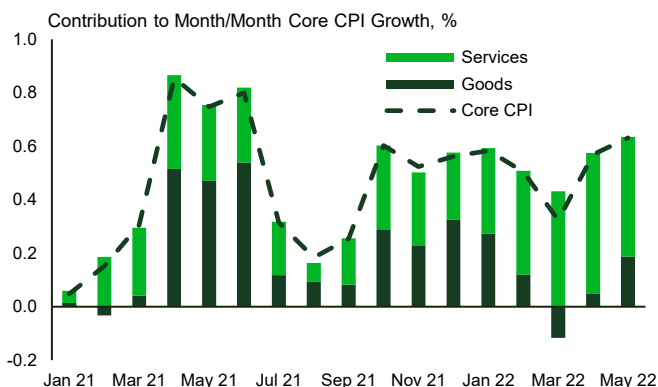
# U.S. - The Good, the Bad and the Ugly

Market anticipation built through the week for Friday’s CPI data release. Inflation came in above expectations and markets reacted by ratcheting up their expectations for rate hikes. Financial markets have now priced in three consecutive 50 basis-point hikes, starting with next Wednesday’s FOMC decision. The 10-Year Treasury yield jumped seven basis points on the news, finishing the week 18 basis points higher at 3.11% (at the time of writing). Equity markets’ timid attempts to regain their footing early in the week came crashing down Friday, as Thursday’s sell-off intensified.

Indeed, “ugly” seems like an appropriate epithet for May’s [CPI print](#). Energy prices pushed the headline print to a new 40-year high. Since May, the nationwide average retail gasoline price has continued to rise and is likely to reach \$5 per gallon in the coming days. This will keep the headline reading elevated in June. Food prices also continued to accelerate, adding to the headline print.

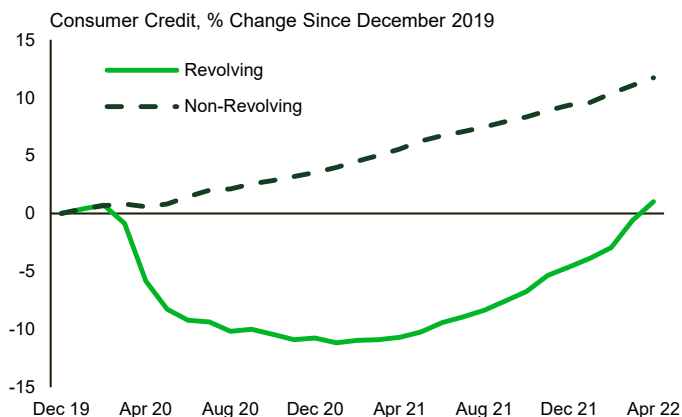
Excluding energy and food, May’s month-on-month core inflation matched the April’s reading. What came as a surprise was an acceleration in core goods inflation. In turn, core services inflation, which tends to be stickier and less volatile, decelerated only slightly remaining above last year’s average (Chart 1). This suggest that core inflation – the main yardstick for monetary policy– is not coming down to a level the Fed would like it to be at any time soon. What’s needed is a further easing in demand, particularly for goods, to lower price pressures. Since some retailers are starting to discount their merchandise

**Chart 1: Prices Paid for Services Continue to Dominate Core Inflation**



Source: Bureau of Labor Statistics, TD Economics.

**Chart 2: Revolving Credit Has Just Recovered From COVID**



Source: Federal Reserve Board, TD Economics.

in the wake of excessive inventories, we expect pressures there to ease in the coming months.

Some good news came from trade data. The U.S. trade deficit narrowed in April to \$87.1 billion from a record of \$107.7 billion in March. Over the past two years demand for imported goods outweighed the value of American exports, contributing to a significant wedge in the trade balance, but this week’s report delivered a snapback, providing some evidence of declining demand for imported items. Meanwhile, exports of goods and services expanded. Trade data is quite volatile and it’s possible to see it zag after the current zig, but we think the recent report portends a reversal of the two-year trend, and we will see the gap narrowing further, adding to GDP growth in the second quarter.

Meanwhile, consumer credit made bad headlines this week as it expanded by \$38.1 billion in April after an already sizeable increase in March. This increase suggests that consumers are relying more on credit for their purchases, which could become a burden should they face trouble repaying this debt. Zooming in on details, however, much of this growth was due to an acceleration in revolving credit, which has only just recovered to its prepandemic level(Chart 2). This coincides with a normalization in spending on discretionary services, such as in-person entertainment and travel, which are usually financed by revolving credit, such as credit cards. As long as household income stays on the rise, credit growth should remain sustainable.

Maria Solovieva, CFA, Economist | 416-380-1195

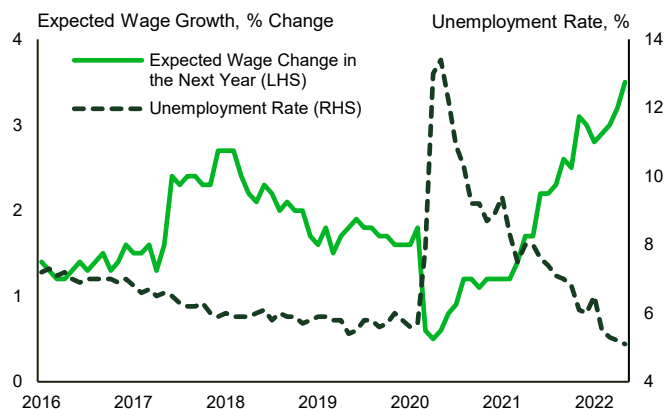
# Canada - The Rising Stakes of Rising Rates

May's jobs data and The Bank of Canada Financial System Review (FSR) made for an eventful week in Canada. Thursday's FSR report offered an update on key risks to Canada's financial system. While maintaining that financial institutions remain resilient, the Bank sounded more concerned about elevated household debt and home prices, stating that those vulnerabilities have worsened. In particular, many Canadians have taken out mortgages which are large relative to their income during the pandemic, often by taking advantage of ultra-low variable rates (Chart 1). These borrowers are more vulnerable to higher interest rates, an income shock or a house price correction.

BoC Governor Macklem and Senior Deputy Governor Rogers's comments at the press conference accompanying the report's release made headlines. Macklem struck a decisively hawkish tone stating that they are "not going to sleep easy until Canadians can stop worrying about inflation" and that "the likelihood that the rate will need to go to the top of the 2-3% range or possibly somewhat above it ... has increased."

The governor also stated that the economy was overheating. Indeed, May's jobs report supported the notion that the Canadian economy is operating beyond full employment (Chart 2). Canada saw a net gain of 40k jobs, record low unemployment and rising wages in May's labour force survey. While rising employment and wages are helping to ease the drag of inflation on household finances, they

**Chart 2: Tight Labour Market Pushing Wages Higher**



Source: CFIB, Statistics Canada, TD Economics.

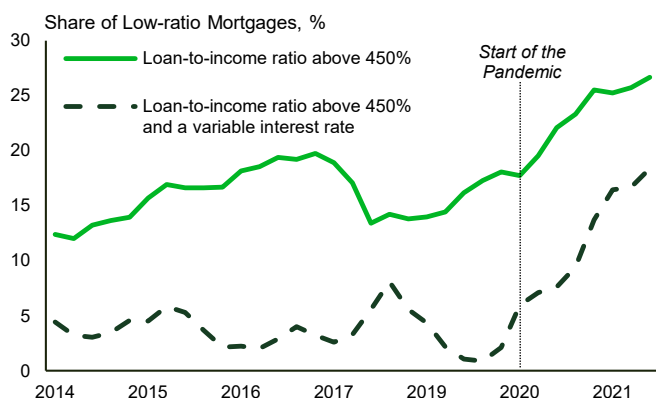
are also adding more fire to domestic demand, complicating the job for the BoC. As a result, the jobs report further adds to the speculation of even higher interest rates, with short-term bond yields moving higher today.

The Bank is working hard to convince consumers and businesses that it will be able rein in inflation before higher inflation expectations become firmly entrenched. But, keeping inflation expectations anchored might not be easy while gasoline prices set new records (up a few cents from last week and 56% from a year ago) and food prices remain elevated. According to the survey conducted by Statistics Canada, Canadians are feeling higher food and energy costs acutely: 43% answered that food was the area where they were most affected by rising prices in the last six months, while 32% said it was transportation.

All in all, this week's developments suggest that the BoC is leaving the door open for an outsized 75 basis point hike in July, particularly if the incoming data shows that inflation and inflation expectations continue to drift higher. However, while the Bank might be eager to stomp out inflation, two years of ultra-low interest rates have allowed vulnerabilities to build up. As a result, reining in inflation while at the same time achieving a soft landing now becomes a "delicate" act.

Ksenia Bushmeneva, Economist | 416-308-7392

**Chart 1: The Share of Highly Indebted Mortgage Borrowers Increased During the Pandemic**



Source: Regulatory filings of Canadian banks, Bank of Canada, TD Economics.

Recent Key Economic Indicators: Jun 6 - 10, 2022					
Release Date	Economic Indicator/Event	Data for Period	Units	Current	Prior
<b>United States</b>					
Jun 7	Trade Balance	Apr	Blns	-87.1	-109.8
Jun 8	Wholesale Trade Sales	Apr	M/M % Chg.	0.7	1.8
Jun 9	Initial Jobless Claims	Jun 4	Thsd	229.0	202.0
Jun 10	Consumer Price Index	May	M/M % Chg.	1.0	0.3
Jun 10	Consumer Price Index	May	Y/Y % Chg.	8.6	8.3
Jun 10	Consumer Price Index Ex Food and Energy	May	M/M % Chg.	0.6	0.6
Jun 10	Consumer Price Index Ex Food and Energy	May	Y/Y % Chg.	6.0	6.2
<b>Canada</b>					
Jun 7	International Merchandise Trade	Apr	Blns	1.5	2.3
Jun 10	Net Change in Employment	May	Thsd	39.8	15.3
Jun 10	Unemployment Rate	May	%	5.1	5.2
<b>International</b>					
Jun 7	JN Gross Domestic Product Annualized SA	1Q	Q/Q % Chg.	-0.5	-1.0
Jun 8	EZ Employment	1Q	Y/Y % Chg.	2.9	2.6
Jun 8	EZ Gross Domestic Product SA	1Q	Y/Y % Chg.	5.4	5.1
Jun 9	EZ ECB Main Refinancing Rate	Jun 9	%	0.00	0.00
Jun 9	CH Consumer Price Index	May	Y/Y % Chg.	2.1	2.1

Source: Bloomberg, TD Economics.

Upcoming Economic Releases and Events: Jun 13 - 17, 2022						
Release Date	Time*	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
<b>United States</b>						
Jun 13	14:00	<i>Fed's Brainard Discusses Community Reinvestment Act</i>				
Jun 14	6:00	NFIB Small Business Optimism	May	Index	93.0	93.2
Jun 14	8:30	PPI Ex Food and Energy	May	M/M % Chg.	0.6	0.4
Jun 14	8:30	PPI Final Demand	May	M/M % Chg.	0.8	0.5
Jun 15	8:30	Empire Manufacturing	Jun	Index	3.0	-11.6
Jun 15	8:30	Retail Sales Advance	May	M/M % Chg.	0.2	0.9
Jun 15	8:30	Retail Sales Ex Auto and Gas	May	M/M % Chg.	0.5	1.0
Jun 15	10:00	Business Inventories	Apr	M/M % Chg.	1.2	2.0
Jun 15	10:00	NAHB Housing Market Index	Jun	Index	68.0	69.0
Jun 15	14:00	FOMC Rate Decision (Upper Bound)	Jun 15	%	1.50	1.00
Jun 15	14:00	Interest on Reserve Balances Rate	Jun 16	%	-	0.9
Jun 15	14:30	<i>Fed Chair Holds Press Conference Following FOMC Meeting</i>				
Jun 16	8:30	Building Permits	May	Thsd	1790.0	1823.0
Jun 16	8:30	Housing Starts	May	Thsd	1714.0	1724.0
Jun 16	8:30	Initial Jobless Claims	Jun 11	Thsd	-	229.0
Jun 17	8:45	<i>Powell Makes Welcoming Remarks at Dollar Conference</i>				
Jun 17	9:15	Capacity Utilization	May	%	79.3	79.0
Jun 17	9:15	Industrial Production	May	M/M % Chg.	0.5	1.1
Jun 17	9:15	Manufacturing (SIC) Production	May	M/M % Chg.	0.4	0.8
<b>Canada</b>						
Jun 14	8:30	Manufacturing Sales	Apr	M/M % Chg.	-	2.5
Jun 15	8:15	Housing Starts	May	Thsd	-	267.3
Jun 15	9:00	Existing Home Sales	May	M/M % Chg.	-	-12.6
Jun 16	8:30	Wholesale Trade Sales	Apr	M/M % Chg.	-	0.3
Jun 17	8:30	Industrial Product Price	May	M/M % Chg.	-	0.8
<b>International</b>						
Jun 13	2:00	UK Monthly Gross Domestic Product (3M/3M)	Apr	M/M % Chg.	0.4	0.8
Jun 14	2:00	UK ILO Unemployment Rate 3 Months	Apr	%	3.6	3.7
Jun 14	22:00	CH Retail Sales	May	Y/Y % Chg.	-7.1	-11.1
Jun 14	22:00	CH Surveyed Jobless Rate	May	%	6.1	6.1
Jun 16	7:00	UK Bank of England Bank Rate	Jun 16	%	1.25	1.00
Jun 16-17		JN BOJ Policy Balance Rate	Jun 17	%	-	-0.10
Jun 17	2:00	UK Retail Sales Ex Auto Fuel	May	Y/Y % Chg.	-4.8	-6.1
Jun 17	5:00	EZ Consumer Price Index	May	Y/Y % Chg.	8.1	7.4

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

## Disclaimer

This report is provided by TD Economics. It is for informational and educational purposes only as of the date of writing, and may not be appropriate for other purposes. The views and opinions expressed may change at any time based on market or other conditions and may not come to pass. This material is not intended to be relied upon as investment advice or recommendations, does not constitute a solicitation to buy or sell securities and should not be considered specific legal, investment or tax advice. The report does not provide material information about the business and affairs of TD Bank Group and the members of TD Economics are not spokespersons for TD Bank Group with respect to its business and affairs. The information contained in this report has been drawn from sources believed to be reliable, but is not guaranteed to be accurate or complete. This report contains economic analysis and views, including about future economic and financial markets performance. These are based on certain assumptions and other factors, and are subject to inherent risks and uncertainties. The actual outcome may be materially different. The Toronto-Dominion Bank and its affiliates and related entities that comprise the TD Bank Group are not liable for any errors or omissions in the information, analysis or views contained in this report, or for any loss or damage suffered.