

The Weekly Bottom Line

March 17, 2023

Highlights

- Following the collapse of SVB and Signature Bank, policymakers were quick to put together a rescue package over the weekend to allay depositor fears and reassure financial markets.
- Despite recent market jitters, economic data out this week including CPI, retail sales, and housing starts all suggest more tightening is still required to cool demand and return price stability.

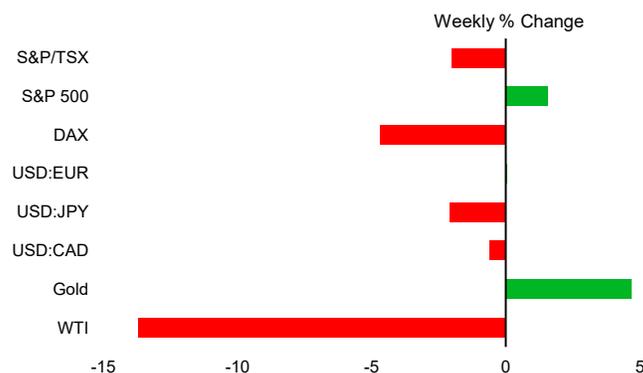
Financial

- A classic run on banks rippled through the financial system, but the regional banks' equity underperformance reflects the idiosyncratic nature of this episode.
- Risk sentiment tightens financial conditions and feeds through to the real economy if it remains unresolved for a period of time. At this early juncture, it may not deter the Fed from raising interest rates on March 22nd, but can certainly put the May meeting on ice if pressures persist.

This Week in the Markets				
	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	3960	3862	4632	3577
S&P/TSX Comp.	19539	19775	22087	18206
DAX	14816	15428	15654	11976
FTSE 100	7353	7748	8014	6826
Nikkei	27334	28144	29223	25717
Fixed Income Yields				
U.S. 10-yr Treasury	3.45	3.70	4.24	2.15
Canada 10-yr Bond	2.83	2.99	3.68	2.18
Germany 10-yr Bund	2.16	2.51	2.75	0.37
UK 10-yr Gilt	3.28	3.64	4.51	1.50
Japan 10-yr Bond	0.29	0.41	0.53	0.17
Foreign Exchange Cross Rates				
C\$ (USD per CAD)	0.73	0.72	0.80	0.72
Euro (USD per EUR)	1.06	1.06	1.12	0.96
Pound (USD per GBP)	1.21	1.20	1.33	1.07
Yen (JPY per USD)	132.2	135.0	150.2	118.6
Commodity Spot Prices**				
Crude Oil (\$US/bbl)	68.6	76.7	122.1	67.6
Natural Gas (\$US/MMBtu)	2.45	2.37	9.84	2.05
Copper (\$US/met. tonne)	8508.8	8847.0	10451.8	7160.0
Gold (\$US/troy oz.)	1947.9	1868.3	1978.9	1622.4

*As of 10:07 AM on Friday. **Oil-WTI, Cushing, Nat. Gas-Henry Hub, LA (Thursday close price).
Copper-LME Grade A. Gold-London Gold Bullion. Source: Bloomberg.

Bank Failures Renew Recession Fears, Pushing Oil Lower



Note: Data as of 11:20 AM ET, Friday, March 17, 2023.
Source: Bloomberg, TD Economics.

Global Official Policy Rate Targets	
Central Banks	Current Target
Federal Reserve (Fed Funds Rate)	4.50 - 4.75%
Bank of Canada (Overnight Rate)	4.50%
European Central Bank (Refi Rate)	3.50%
Bank of England (Repo Rate)	4.00%
Bank of Japan (Overnight Rate)	-0.10%

Source: Bloomberg.

TD Economics Key Financial Forecasts													
	Current Rate 3/17/23	2022				2023				2024			
		Q1	Q2	Q3	Q4	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Fed Funds Target Rate	4.75	0.50	1.75	3.25	4.50	5.00	5.25	5.25	5.25	4.75	4.25	3.75	3.25
2-yr Govt. Bond Yield	4.05	2.28	2.92	4.22	4.41	4.30	4.40	4.05	3.70	3.40	3.10	2.85	2.70
10-yr Govt. Bond Yield	3.45	2.32	2.98	3.83	3.88	3.60	3.75	3.65	3.50	3.40	3.25	3.15	3.05
30-yr Govt. Bond Yield	3.62	2.44	3.14	3.79	3.97	3.75	3.90	3.85	3.80	3.70	3.55	3.45	3.35

Forecast by TD Economics as of March 2023; all forecasts are end-of-period. Source: Bloomberg, Federal Reserve Board, TD Economics.

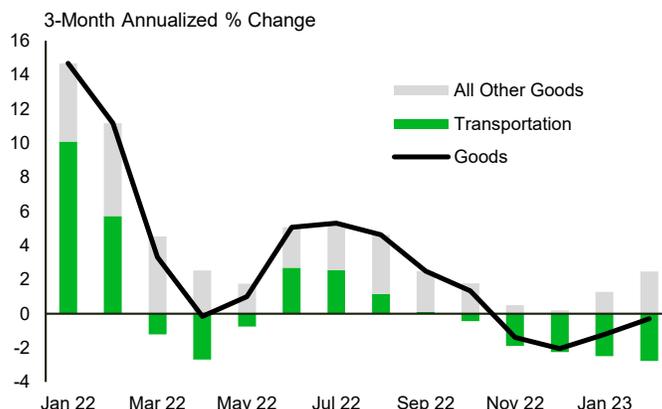
Lifelines Extended, But Uncertainty Remains

Can policymaker’s walk while chewing gum? We’ll soon find out. The Federal Reserve’s attempt at reining in multidecade inflation without causing a recession was always thought to be a lofty goal. However, last week’s failure of both SVB and Signature Bank followed by the subsequent deposit run at First Republic has added a new layer of complexity.

In an effort to allay depositor fears and reassure financial markets, the FDIC, Federal Reserve, and U.S. Treasury implemented a rescue plan over the weekend. Deposit insurance for all deposits over \$250k was extended, while a Bank Term Funding Program was also established, allowing all depository institutions to borrow at the Fed at a low rate using standard collateral. Moreover, the collateral could be valued at par rather than “marked to market” as is the case with other Fed liquidity facilities. Not only will this increase the amount of capital that troubled banks can access, but it will also prevent institutions from having to sell assets at significant losses, which should help to shore up confidence and stem the tide on further deposit outflows.

While sound in theory, investors remained skeptical that the risk remained contained to just a handful of regional banks. And this skepticism was only reinforced when news came that Credit Suisse may also be experiencing similar liquidity issues. Market sentiment soured mid-week but was quick to recover following news that First Republic had secured a rescue package and that the Swiss Central Bank would provide a liquidity backstop for Credit Suisse. After a volatile week, the S&P 500 finished 2% higher, while the 10-year yield fell

Chart 2: Recent Declines in Goods Prices Concentrated in Transportation

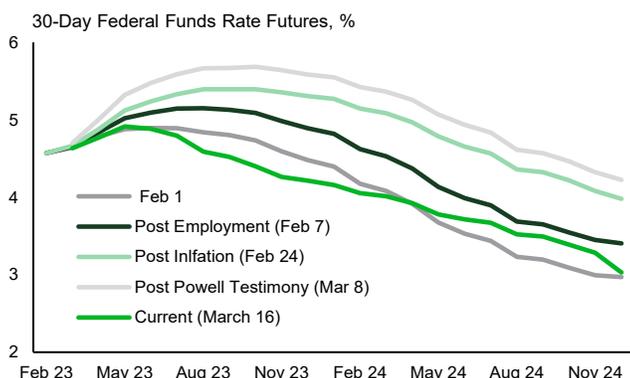


Source: Bureau of Labor Statistics, TD Economics.

25bps landing at 3.45%. Investors also significantly recalibrated expectations on the future path of the fed funds rate, with a 25bps hike at next week’s announcement only 75% priced and rate cuts again priced for later this year (Chart 1).

Only time will tell if this sharp repricing is overdone, but at the moment, the Fed appears stuck between a rock and a hard place. It is clear that the rapid adjustment in interest rates over the past year has pinched a nerve within a sub-segment of the banking sector. But on the other hand, the recent flow of economic data suggests more tightening is still required to cool the economy and return price stability. This was evident in February’s reading of CPI, where core inflation accelerated on the month – rising by 0.5% m/m – pushing the 3-month annualized change to a four-month high of 5.2%. Considerable breadth was seen across the cyclical component of services, which is closely tied to discretionary spending. And while goods prices were flat on the month, that was largely due to another sizeable decline in used vehicle prices, offsetting an acceleration across most other goods categories (Chart 2). Outside of inflation, retail sales (-0.4% m/m) softened in February but that was only after an outsized gain in January, while housing starts ended a 5-month slide and surged 10% m/m to 1.45M. The data is definitely telling the FOMC to hike, but the financial stability concerns also cannot be ignored. Provided risks remain contained, we expect the Fed to push ahead with another 25bps hike next week.

Chart 1: Fed Funds Futures Have Narrowed Since the Collapse of SVB & Signature Bank



Source: Bloomberg, TD Economics.

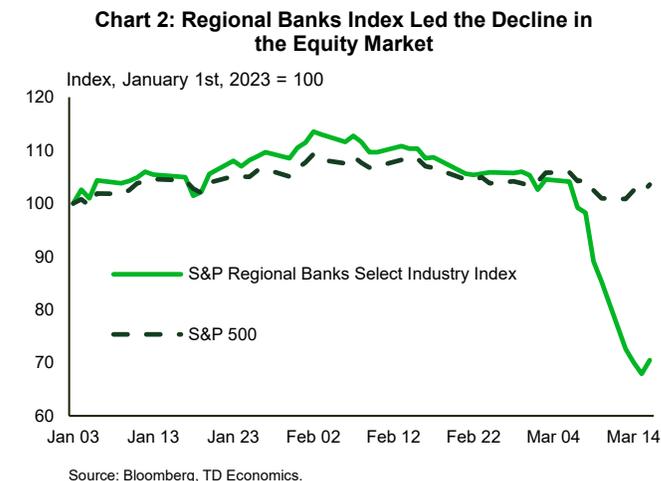
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Financial - Some Banks Fail, but It's Not a Free Fall

The Federal Reserve was blind sighted by an evolving risk that was right under its nose. While it tightened monetary policy at an unprecedented pace, deposit growth within commercial banks plummeted at an historic pace (Chart 1). Some of this movement reflected the outcome of quantitative tightening and some reflected a shift in depositor preferences into higher yielding products. Predicting this shift was actually well within forecast models, offering little element of surprise. Predicting individual behaviors and market confidence, however, is another story.

Unless you've been completely cut off from every form of communication, by now it's well known that the sudden failure of Silicon Valley Bank was more than a classic "run on a bank". The aggressive rate hike cycle pressured the market value of the bank's financial assets, even though these were deemed high quality and liquid. Meanwhile, a concentration of a large amount of uninsured deposits from start-up companies left the bank exposed to a sudden shift in confidence. Once the financial market participants witnessed a mass deposit exit and a swift bank failure, it opened the door to lurking risks within other institutions. The fear of the known unknown kicked in.

However, that fear has largely been contained, at least at this juncture. The pressure on equity markets was not economy wide. A concentration within the banking sector was further narrowed to the regional banks' sub-sector. In the period between March 8th and March 15th, the S&P's Regional Banks Sub-Industry Index lost more than 30% of its value while the S&P 500 index declined

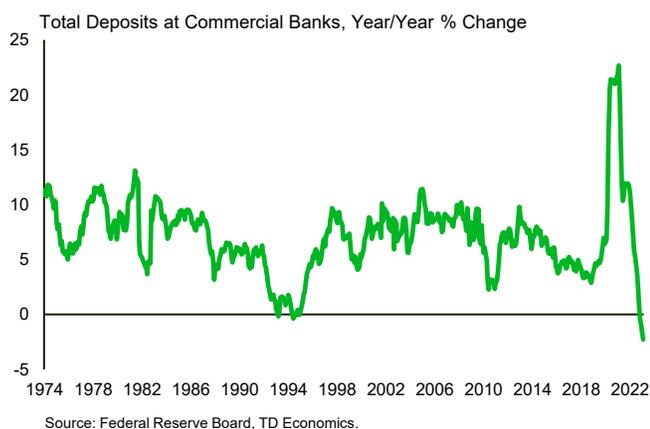


by 2.5%, half of which was due to the pressure on the banking sector (Chart 2). While large, the magnitude of change is not unprecedented. During the Global Financial Crisis – the poster child of the banking sector crisis – the index lost almost 80% of its value (albeit, in a period of six months), while its maximum daily loss was 1.5 times greater than the current episode.

The relative containment of the crisis doesn't negate the seriousness of the situation. Look no further than within expectations for the fed funds rate. In a matter of ten days, the futures market turned upside down, shifting its pricing from a 50-basis point hike in March and a 5.75% terminal rate, to 25-basis point hike and a terminal rate 85 basis points lower. On March 13th, the two-year yield collapsed by 57 basis points to 4.03% – the largest decline since the Black Monday market crash of 1987. This initially pushed the U.S. dollar down 2% relative to other currencies. But, the greenback reclaimed its strength as a safe-haven currency as soon as the confidence shock drifted over the Atlantic. As the biggest shareholder of Credit Suisse declared no interest in upping its funding commitment to the already-beleaguered institution, the greenback finished 1.5% below March 8th level.

In both cases, the respective regulators and the central bank stepped in to provide a liquidity backstop, having learned from the past that the first order of business is to stabilize financial market shocks that have the potential to seize up the system if left unchecked. The second order of business will be to ensure guard rails are in place to limit a future episode. This usually comes in the form

Chart 1: Commercial Banks Deposit Growth Plummeted at a Historic Pace





of more oversight. Market chatter has already settled on one possible change for U.S. mid-and-small sized banks to lower the banks' asset threshold at which stricter capital and liquidity rules start to apply from \$250 to \$100 billion. Another proposal being bantered about is to put more rigor into the stress test that assesses valuation of banks capital during a hypothetical macroeconomic recession scenario.

From an economic perspective, any permanency in tighter

financial conditions among mid- and smaller-sized banks that flows through to tighter credit standards will impact loan demand and the real economy. The irony is that this feedback loop might help the Fed tap down domestic demand and contain inflationary pressures, as long as pressure on financial conditions remain 'controlled'. Up until now, the U.S. economy was described as stronger-for-longer, with consumers and job demand completely defying the odds. Time will tell.

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Recent Key Economic Indicators: Mar 13 - 17, 2023					
Release Date	Economic Indicator/Event	Data for Period	Units	Current	Prior
United States					
Mar 14	NFIB Small Business Optimism	Feb	Index	90.9	90.3
Mar 14	Consumer Price Index	Feb	M/M % Chg.	0.4	0.5
Mar 14	Consumer Price Index	Feb	Y/Y % Chg.	6.0	6.4
Mar 14	Consumer Price Index Ex Food and Energy	Feb	M/M % Chg.	0.5	0.4
Mar 14	Consumer Price Index Ex Food and Energy	Feb	Y/Y % Chg.	5.5	5.6
Mar 15	Empire Manufacturing	Mar	Index	-24.6	-5.8
Mar 15	PPI Ex Food and Energy	Feb	M/M % Chg.	0.2	0.5
Mar 15	PPI Final Demand	Feb	M/M % Chg.	-0.1	0.3
Mar 15	Retail Sales Advance	Feb	M/M % Chg.	-0.4	3.2
Mar 15	Retail Sales Ex Auto and Gas	Feb	M/M % Chg.	0.0	2.8
Mar 15	Business Inventories	Jan	M/M % Chg.	-0.1	0.3
Mar 15	NAHB Housing Market Index	Mar	Index	44.0	42.0
Mar 16	Building Permits	Feb	Thsds	1524.0	1339.0
Mar 16	Housing Starts	Feb	Thsds	1450.0	1321.0
Mar 16	Initial Jobless Claims	Mar 11	Thsds	192.0	212.0
Mar 17	Capacity Utilization	Feb	%	78.0	78.0
Mar 17	Industrial Production	Feb	M/M % Chg.	0.0	0.3
Canada					
Mar 14	Manufacturing Sales	Jan	M/M % Chg.	4.1	-1.5
Mar 15	Housing Starts	Feb	Thsds	244.0	216.5
Mar 15	Existing Home Sales	Feb	M/M % Chg.	2.3	-3.0
Mar 16	Wholesale Trade Sales	Jan	M/M % Chg.	2.4	-0.8
Mar 17	Industrial Product Price	Feb	M/M % Chg.	-0.8	0.4
International					
Mar 14	UK ILO Unemployment Rate 3-Months	Jan	M/M % Chg.	3.7	3.7
Mar 14	CH Surveyed Jobless Rate	Feb	%	5.6	-
Mar 16	EZ ECB Main Refinancing Rate	Mar 16	%	3.50	3.00
Mar 17	EZ Consumer Price Index	Feb	Y/Y % Chg.	8.5	8.6

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

Upcoming Economic Releases and Events: Mar 20 - 24, 2023						
Release Date	Time*	Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
United States						
Mar 21	10:00	Existing Home Sales	Feb	Mlns	4.2	4.0
Mar 21	10:00	<i>FOMC Begins Two-Day Meeting</i>				
Mar 22	14:00	<i>FOMC Concludes Two-Day Meeting</i>				
Mar 22	14:00	FOMC Rate Decision (Upper Bound)	Jan 13	%	5.00	4.75
Mar 22	14:00	Interest on Reserve Balances Rate	Mar 23	%	4.95	4.65
Mar 22	14:30	<i>Fed Chair Holds Press Conference Following FOMC Meeting</i>				
Mar 23	8:30	Initial Jobless Claims	Mar 18	Thsds	-	192.0
Mar 23	10:00	New Home Sales	Feb	Thsds	650.0	670.0
Mar 24	8:30	Cap Goods Orders Nondef Ex Air	Feb	M/M % Chg.	0.0	0.8
Mar 24	8:30	Durable Goods Orders	Feb	M/M % Chg.	1.5	-4.5
Mar 24	9:45	S&P Global US Composite PMI	Mar	Index	-	50.1
Mar 24	9:45	S&P Global US Manufacturing PMI	Mar	Index	47.0	47.3
Mar 24	9:45	S&P Global US Services PMI	Mar	Index	50.2	50.6
Canada						
Mar 21	8:30	Consumer Price Index	Feb	Y/Y % Chg.	-	5.9
Mar 21	8:30	Consumer Price Index NSA	Feb	M/M % Chg.	-	0.5
Mar 24	8:30	Retail Sales	Jan	M/M % Chg.	-	0.5
Mar 24	8:30	Retail Sales Ex Auto	Jan	M/M % Chg.	-	-0.6
International						
Mar 22	3:00	UK Consumer Price Index	Dec	Y/Y % Chg.	9.8	10.1
Mar 23	8:00	UK Bank of England Bank Rate	Mar 23	%	4.25	4.00
Mar 23	19:30	JN National Consumer Price Index	Feb	Y/Y % Chg.	3.3	4.3
Mar 23	20:30	JN Jibun Bank Japan PMI Manufacturing	Mar	Index	-	47.7
Mar 24	3:00	UK Retail Sales Ex Auto Fuel	Feb	Y/Y % Chg.	-4.9	-5.3

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

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