THE WEEKLY BOTTOM LINE

TD Economics

March 17, 2017

HIGHLIGHTS OF THE WEEK

United States

- The Fed carried out its well-telegraphed rate hike this week. Despite the Fed's hawkish messaging in advance of the decision, its expectations for rate increases were unchanged, leading bond yields to dip.
- The Fed edged up its economic forecast for 2018, as did TD Economics in our latest forecast, released this week.
- Overseas, one populist threat to the Eurozone was vanquished this week as the populist right-wing party lost the Dutch election. However, the UK is days away from triggering the two-year Brexit negotiation process with the EU, so the risk of euro-driven market volatility remains.

Canada

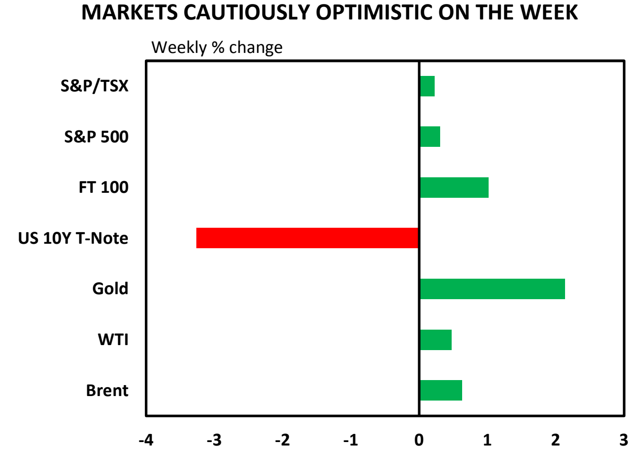
- Economic growth in Canada continues to surpass expectations. With recent data on manufacturing sales, growth in the first quarter appears likely to surpass our recent forecast of 2.6% (annualized). This would mark the third straight quarter that growth came in above 2.5%.
- The Canadian housing market is the gift that keeps on giving. The further prices and sales appear to move from fundamentals, the bigger the risk of a correction. The downside risk is greatest in the Greater Toronto Area where prices are up 24% year-on-year.
- To deal with housing, the Bank of Canada prefers macro-prudential tools to the blunt instrument of interest rate policy. With scant inflation, the central bank is likely to remain on hold through 2018. While further upside surprises to growth could pull rate hikes forward, a sharper turn negative in housing could just as easily push rate hikes even further into the future.

THIS WEEK IN THE MARKETS

	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	2,380	2,373	2,396	2,001
S&P/TSX Comp.	15,549	15,507	15,922	13,266
DAX	12,082	11,963	12,083	9,269
FTSE 100	7,420	7,343	7,420	5,924
Nikkei	19,522	19,605	19,634	14,952
Fixed Income Yields				
U.S. 10-yr Treasury	2.50	2.57	2.63	1.36
Canada 10-yr Bond	1.76	1.81	1.87	0.95
Germany 10-yr Bund	0.44	0.49	0.49	-0.19
UK 10-yr Gilt	1.23	1.23	1.66	0.52
Japan 10-yr Bond	0.08	0.09	0.12	-0.29
Foreign Exchange Cross Rates				
C$ (USD per CAD)	0.75	0.74	0.80	0.74
Euro (USD per EUR)	1.07	1.07	1.15	1.04
Pound (USD per GBP)	1.24	1.22	1.49	1.20
Yen (JPY per USD)	112.8	114.8	118.2	99.9
Commodity Spot Prices*				
Crude Oil ($US/bbl)	49.2	48.5	54.1	35.7
Natural Gas ($US/MMBtu)	2.87	2.66	3.20	1.74
Copper ($US/met. tonne)	5890.3	5716.3	6103.5	4495.8
Gold ($US/troy oz.)	1229.2	1204.7	1366.4	1128.4

*as of 11:05 am on Friday **Oil-WTI, Cushing, Nat. Gas-Henry Hub, LA (Thursday close price), Copper-LME Grade A, Gold-London Gold Bullion; Source: Bloomberg.

MARKETS CAUTIOUSLY OPTIMISTIC ON THE WEEK



Note: Data as of Mar. 17, 11:45 AM ET.
Sources: Bloomberg, TD Economics

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.

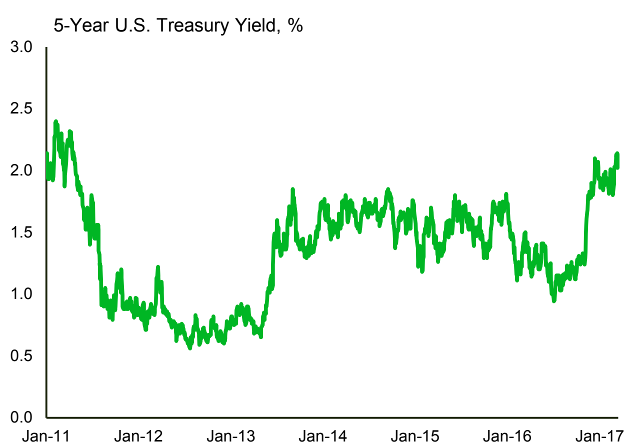
U.S. – THE FED TAKES ANOTHER STEP ON THE RATE HIKE TIGHTROPE

Markets were cautiously optimistic this week as the Fed carried out its well-telegraphed rate hike, and one populist threat to the euro zone was vanquished in the Dutch election. The Fed hiked the funds rate 25 basis points, to a range between 0.75% and 1.0%. Bonds rallied in the wake of the decision, since the hawkish rhetoric leading up to the decision was not born out in a more aggressive pace of rate hikes in the Fed's "dot" plot. The Fed continues to expect to raise rates three times in total in 2017, unchanged from its December forecast. Even with a dip downwards in yields this week, the 5-Year Treasury yield remains close to a six-year high(see Chart).

During the press conference, Yellen characterized the economy as "progressing nicely", and that the Fed views three hikes per year as a "gradual" pace in the current environment. While the median interest rate projection remained unchanged, the number of dots at the median rose (from six to nine). The Fed's economic projections told a similar story, edging up by 0.1 percentage point its outlook for core inflation in 2017 and its outlook for economic growth in 2018. In other words, FOMC members are a bit more confident, but no more hawkish, than they were in December.

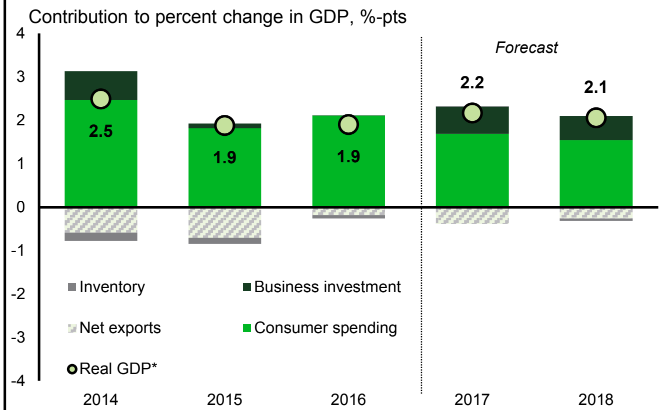
The Fed was not alone in nudging up its forecast. In our latest economic forecast released this week, we also bumped up our forecast for growth in 2018. The upgrade is largely owing to a more optimistic forecast for domestic demand, and business investment in particular. Measures of business sentiment have largely held on to their post-election jumps, and we expect that optimism will translate into increased spending over the next two years. Particularly now that the weakness in corporate profits appears to have turned around, and the worst is over in the oil patch.

CHART 1: U.S. YIELDS BREAKING OUT



Source: FRB, TD Economics

CHART 2: BUSINESS INVESTMENT TO TAKE GROWTH UP A NOTCH



*Real GDP growth is Q4/Q4
Source: Bureau of Economic Analysis, forecast by TD Economics as at March 2017.

As always, there are upside and downside risks to the outlook. The most notable upside risk stems from fiscal policy. We continue to believe it is too early to include any potential boost from the kinds of tax cuts or infrastructure spending that was promised during the campaign. As evidenced by the current debate on healthcare reform, it is going to take time for Republican members of Congress and the White House to reach an acceptable compromise on these key policy priorities. Therefore, we expect any fiscal boost to be a factor in the 2018 outlook and beyond, not this year.

Like the Fed, we also expect a gradual pace of rate hikes this year. Downside risks to the forecast have not entirely vanished. Concerns stemming from political uncertainty in Europe did clear one hurdle this week with the Dutch election result. But, France's Presidential elections loom (on April 23rd and May 7), and the UK is on the cusp of triggering two years of Brexit negotiations with the EU. The potential for euro-driven market volatility to disturb markets' current placid optimism is real. And on this side of the pond, the risk that the Trump administration moves from rhetoric to real protectionist measures on trade also looms.

Taking a step back to the here and now, the U.S. economy is doing well. The Fed must now walk a tightrope balancing the need to remove monetary stimulus against the risk of taking rates too high, which would dampen domestic growth too much or trigger risks abroad.

Leslie Preston, Senior Economist 416-983-7053

CANADA – LET THE GOOD TIMES ROLL

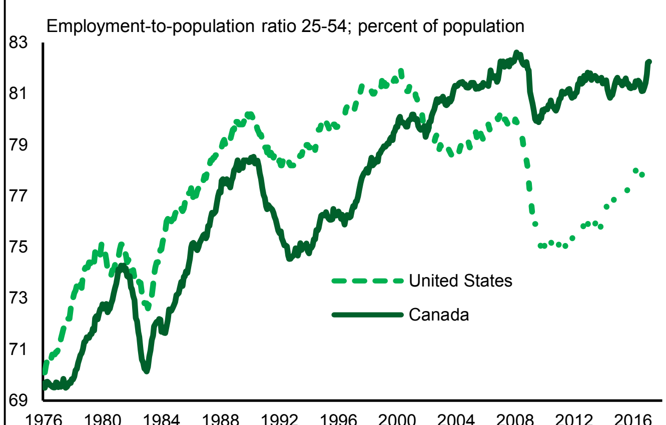
Economic growth in Canada continues to surpass expectations. With recent data on manufacturing sales, growth in the first quarter of this year appears likely to surpass our recent forecast of 2.6% (annualized). This would mark the third quarter that growth came in above the mid-2% mark.

The strong economic performance has been echoed in robust job creation, falling unemployment and rebounding labor force participation. In February, the unemployment rate fell to 6.6% (from 6.8%), while the employment-to-population ratio of prime working-age people (those between 25 and 54) rose to its highest level since the 2008 recession (Chart 1). Even the seeming turn toward part-time employment that characterized 2016, appears to be reversing. Full-time job creation over the past three months is running at the fastest rate in over seven years.

The rebound in growth is explained in large part by the recovery in the oil patch, where the turn-up in energy prices has helped. Our recently published forecast expects the oil and gas sector to lead economic growth over the next year. Following close behind is the construction sector, benefiting from the energy rebound as well as residential real estate activity that continues to push full-steam ahead.

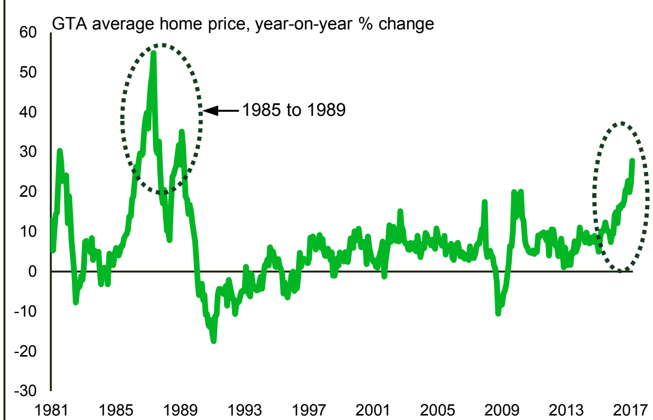
And here in lies the rub. The housing market has been the gift that keeps on giving, but there are legitimate worries about how long this can be sustained. The further prices and sales appear to move away from fundamentals, the more pronounced the risk of a correction (Chart 2). The downside risk is greatest in the Greater Toronto Area where prices are up 24% year-on-year, amidst low inventories. One need not go out on a limb to say this appears excessive. Even with strong population growth, sales relative to population have pushed above historic levels.

CHART 1: MORE CORE-AGED PEOPLE ARE WORKING IN CANADA



Source: Statistics Canada, Bureau of Labor Statistics,

CHART 2: UP, UP AND AWAY FOR TORONTO HOME PRICES



Source: CREA, TD Economics.

The vulnerability to housing correction is the main source of downside risk to the Canadian economy. Periods of such rapid appreciation are generally followed by corrections. However, in the near-term, without a major catalyst, the housing market appears likely to keep on chugging. Higher mortgage rates and tighter regulations have so far appeared to have little effect on the market, and further increases may also be taken in stride given their likely gradual pace.

All of this brings into question how the Bank of Canada should respond. In terms of housing, the Bank has been consistent that it prefers macro-prudential tools to the blunt instrument of the overnight rate. Instead the Bank's policy will be guided with reference to the outlook for inflation. And, apart from rebounding energy prices, inflation pressures appear scant. The average of the Bank of Canada's trio of core inflation measures is sitting at 1.6% – well shy of target.

At the same time, the Bank has expressed increasing concern for external risks. Given this sensitivity and its desire to support a rotation toward exports, which relies on a competitive exchange rate, we expect the Bank of Canada to remain on hold through the this year and well into 2018. While further upside surprises to economic growth could pull this forward, a sharper correction in the housing market could just as easily push rate hikes even further into the future.

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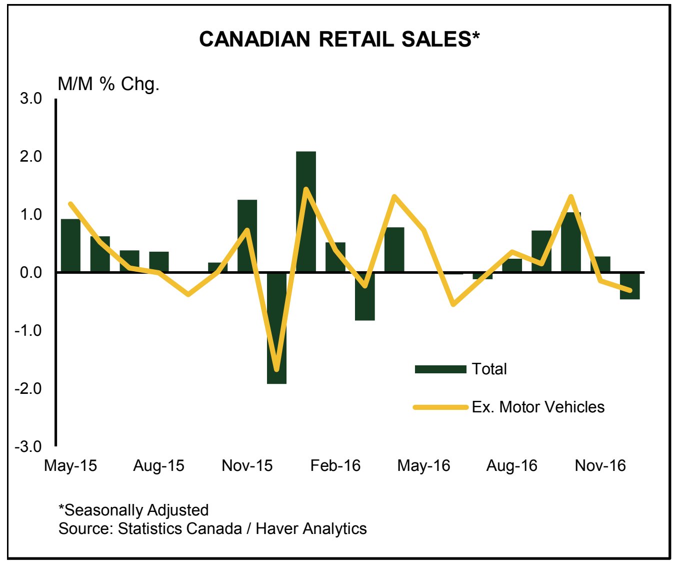
CANADA: UPCOMING KEY ECONOMIC RELEASES

Retail Sales - January*

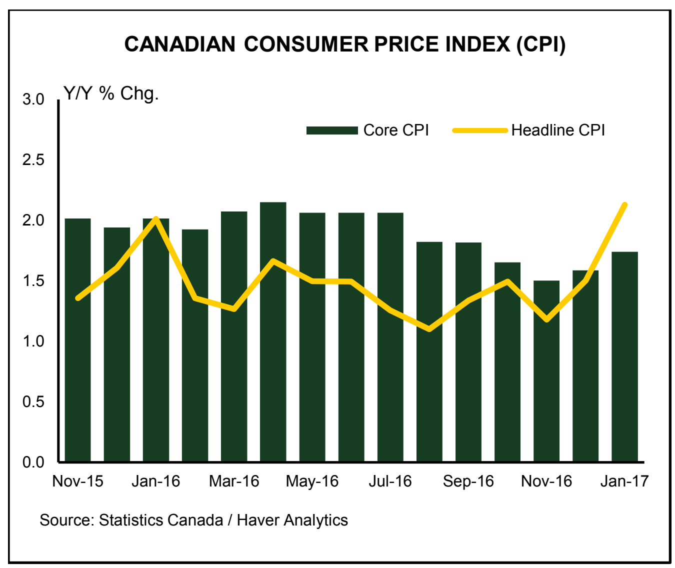
Release Date: March 21, 2017
December Result: -0.5% m/m, ex-auto: -0.3% m/m
TD Forecast: 0.9% m/m, ex-auto: 1.0% m/m
Consensus: N/A



Nominal consumer spending is expected to begin 2017 on a solid note, with retail sales forecast to advance by 1.0% m/m in January. Gasoline stations should provide a heavy tailwind to retail sales as a whole, as rising wholesale gas prices are exacerbated by newly implemented carbon pricing plans in Ontario and Alberta. Demand for building materials and home furnishings should be supported by the continued increase in residential construction and homes sales while we also see scope for a broader pickup in core spending following the weak holiday shopping season and strong pace of job growth throughout the fourth quarter. Motor vehicle sales are likely to post a healthy gain in line with industry estimates, but could still act as a modest drag given the strength of the ex-auto series. Real retail sales, however, should come in significantly weaker than the nominal print due to the sharp rise in consumer prices (mostly attributable to energy), which will conflate with the poor handoff from December to hold down real consumer spending to the low 2% range in Q1.

Consumer Price Index - February*

Release Date: March 24, 2017
January Result: 0.9% m/m nsa, 2.1% y/y
TD Forecast: 0.2% m/m nsa, 2.1% y/y
Consensus: N/A



After registering a substantial positive surprise in January and jumping slightly above the mid-point of the Bank of Canada's inflation target, February headline CPI inflation is expected to remain unchanged at 2.1% y/y, reflecting a moderate price increase of 0.2% m/m. While energy prices are expected to fall in February, they are forecasted to register another double-digit y/y increase. We also anticipate higher shelter prices due to tightness in the Canadian housing market. Meanwhile food prices are expected to remain weak on a y/y basis, mostly because of a strong base effect and intense competition at grocery stores. Because the recent strength in headline CPI was largely driven by special factors (a jump in energy prices and the carbon levy in Alberta), we expect the core metrics of inflation (CPI common, trimmed mean and median) to edge slightly higher to average 1.7% from 1.6% in January as the amount of slack in the economy gradually shrinks.

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

RECENT KEY ECONOMIC INDICATORS: MARCH 13-17, 2017

Release Date		Economic Indicator/Event	Data for Period	Units	Current	Prior	
		United States					
Mar 14		NFIB Small Business Optimism	Feb	Index	105.3	105.9	
Mar 14		Producer Price Index Ex Food and Energy	Feb	M/M % Chg.	0.3	0.4	
Mar 14		Producer Price Index Final Demand	Feb	M/M % Chg.	0.3	0.6	
Mar 15		Empire Manufacturing	Mar	Index	16.4	18.7	
Mar 15		Consumer Price Index	Feb	M/M % Chg.	0.1	0.6	
Mar 15		Consumer Price Index Ex Food and Energy	Feb	M/M % Chg.	0.2	0.3	
Mar 15		Consumer Price Index	Feb	Y/Y % Chg.	2.7	2.5	
Mar 15		Consumer Price Index Ex Food and Energy	Feb	Y/Y % Chg.	2.2	2.3	
Mar 15		Real Avg Hourly Earning	Feb	Y/Y % Chg.	0.0	0.0	
Mar 15		Retail Sales Advance	Feb	M/M % Chg.	0.1	0.6	R▲
Mar 15		Retail Sales Ex Auto and Gas	Feb	M/M % Chg.	0.2	1.1	R▲
Mar 15		NAHB Housing Market Index	Mar	Index	71.0	65.0	
Mar 15		Business Inventories	Jan	M/M % Chg.	0.3	0.4	
Mar 15		FOMC Rate Decision (Upper Bound)	Mar 15	%	1.0	0.75	
Mar 16		Housing Starts	Feb	Thsd	1288.0	1251	R▲
Mar 16		Building Permits	Feb	Thsd	1213.0	1293	
Mar 16		Initial Jobless Claims	Mar 11	Thsd	241.0	243.0	
Mar 17		Industrial Production	Feb	M/M % Chg.	0.0	-0.1	R▲
Mar 17		Manufacturing (SIC) Production	Feb	M/M % Chg.	0.5	0.5	
		Canada					
Mar 14		Teranet/National Bank House Price Index	Feb	Y/Y % Chg.	13.4	13.0	
Mar 15		Existing Home Sales	Feb	M/M % Chg.	5.2	-1.3	
Mar 17		Manufacturing Sales	Jan	M/M % Chg.	0.6	2.1	
		International					
Mar 13	CH	Retail Sales YTD	Feb	Y/Y % Chg.	9.5	10.4	
Mar 15	UK	Unemployment Rate	Jan	%	4.7	4.8	
Mar 15	EC	Employment	4Q	Y/Y % Chg.	1.1	1.2	
Mar 16	EC	Consumer Price Index	Feb	M/M % Chg.	0.4	-	
Mar 16	UK	Bank of England Bank Rate	Mar 16	%	0.25	0.25	
Mar 16	JN	Bank of Japan Policy Balance Rate	Mar 16	%	-0.1	-0.1	

Source: Bloomberg, TD Economics.

UPCOMING ECONOMIC RELEASES AND EVENTS: MARCH 20-24, 2017

Release Date	Time*		Economic Indicator/Event	Data for Period	Units	Consensus Forecast	Last Period
			United States				
Mar 20	8:30		*Fed's Evans Speaks on Fox Business News*				
Mar 20	13:10		*Fed's Evans Speaks on Economy and Policy in New York*				
Mar 21	6:00		*Fed's Dudley Speaks at BoE Event on Bank Ethics in London*				
Mar 21	8:30		Current Account Balance	4Q	USD, Blns	-128.2	-113.0
Mar 21	12:00		*Fed's George Speaks in Washington, D.C.*				
Mar 21	18:00		*Fed's Mester Speaks at University of Richmond*				
Mar 21	21:45		*Fed's Rosengren Speaks in Bali, Indonesia*				
Mar 22	10:00		Existing Home Sales	Feb	Mlns	5.58	5.69
Mar 23	8:00		*Fed's Yellen Speaks at Community Development Conference*				
Mar 23	8:30		Initial Jobless Claims	Mar 18	Thsd	240.0	241.0
Mar 23	10:00		New Home Sales	Feb	Thsd	565.0	555.0
Mar 23	12:30		*Fed's Kashkari Speaks on U.S. Education Outcomes in D.C.*				
Mar 23	19:00		*Dallas Fed's Kaplan Speaks on Economy in Chicago*				
Mar 24	8:00		*Fed's Evans Speaks at Community Development Event*				
Mar 24	8:05		*Fed's Bullard Speaks in Memphis*				
Mar 24	8:30		*Fed's Williams Speaks at the Brookings Institution's Spring Conference*				
Mar 24	8:30		Durable Goods Orders	Feb P	M/M % Chg.	1.0	2.0
Mar 24	8:30		Durables Ex Transportation	Feb P	M/M % Chg.	0.5	0.0
Mar 24	8:30		Cap Goods Orders Nondef Ex Air	Feb P	M/M % Chg.	0.6	-0.1
Mar 24	9:45		Markit US Manufacturing PMI	Mar P	Index	54.8	54.2
			Canada				
Mar 20	8:30		Wholesale Trade Sales	Jan	M/M % Chg.	-	0.7
Mar 21	8:30		Retail Sales Ex Auto	Jan	M/M % Chg.	-	-0.3
Mar 21	8:30		Retail Sales	Jan	M/M % Chg.	-	-0.5
Mar 22	11:00		Speech				
Mar 24	8:30		Consumer Price Index Core- Trim YoY%	Feb	Y/Y % Chg.	-	1.7
Mar 24	8:30		Consumer Price Index Core- Median YoY%	Feb	Y/Y % Chg.	-	1.9
Mar 24	8:30		Consumer Price Index Core- Common YoY%	Feb	Y/Y % Chg.	-	1.3
Mar 24	8:30		Consumer Price Index	Feb	Y/Y % Chg.	-	2.1
Mar 24	8:30		Consumer Price Index NSA	Feb	M/M % Chg.	-	0.9
			International				
Mar 21	5:30	UK	Consumer Price Index	Feb	Y/Y % Chg.	2.1	1.8
Mar 23	5:30	UK	Retail Sales	Feb	Y/Y % Chg.	2.6	1.5
Mar 23	20:30	JN	Nikkei Japan PMI Manufacturing	Mar P	Index	-	53.3
Mar 24	5:00	EC	Markit Eurozone Manufacturing PMI	Mar P	Index	55.3	55.4

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