THE WEEKLY BOTTOM LINE

TD Economics

HIGHLIGHTS OF THE WEEK

June 24, 2016

United States

- Markets were on tenterhooks all week in anticipation of the British referendum, with anxiety turning to panic overnight as Britain, in a historic vote, decided to leave the European Union (EU).
- Central banks announced readiness to deal with any fallout related to potential liquidity shortages, helping stem near-term pressures in global markets but longer-term implications of the vote are far from certain. Still, there is little doubt that the economic implications are a net-negative and could be far reaching.
- In her semiannual testimony to Congress mid-week, Chair Yellen noted the potential for "significant economic repercussions" of such an outcome that could "usher in a period of uncertainty," and negatively affect U.S. economic activity, with the Fed likely to monitor global developments closely.
- Given the implications for slower U.S. growth and lower inflation, on account of the fallout, we expect the Fed will stay pat through the rest of the year.

Canada

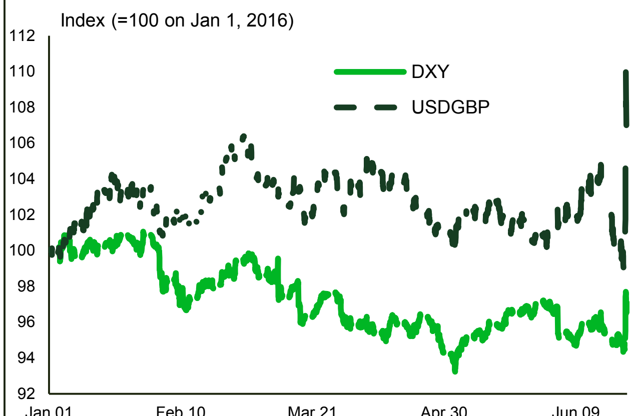
- Canadian financial markets are feeling the effects of the UK vote to "Leave" the EU. The Canadian dollar, oil and the TSX all fell on Friday morning.
- The Canadian economy will be affected primarily through confidence channels and financial linkages, with growth likely to be slightly weaker than previously forecast. The vote also means the UK will not be a part of the CETA agreement Canada signed with the EU.
- Canada's finance ministers also agreed to significant enhancements to the CPP, aimed at addressing a shortfall in savings among middle income earners. The impact is likely to be felt in reduced compensation over time, rather than lower employment.

THIS WEEK IN THE MARKETS

	Current*	Week Ago	52-Week High	52-Week Low
Stock Market Indexes				
S&P 500	2,058	2,071	2,128	1,829
S&P/TSX Comp.	13,867	13,902	14,898	11,843
DAX	9,623	9,631	11,736	8,753
FTSE 100	6,175	6,021	6,808	5,537
Nikkei	14,952	15,600	20,842	14,952
Fixed Income Yields				
U.S. 10-yr Treasury	1.58	1.61	2.47	1.57
Canada 10-yr Bond	1.18	1.12	1.87	1.00
Germany 10-yr Bund	-0.06	0.02	0.92	-0.06
UK 10-yr Gilt	1.10	1.14	2.19	1.10
Japan 10-yr Bond	-0.17	-0.15	0.53	-0.19
Foreign Exchange Cross Rates				
C$ (USD per CAD)	0.77	0.78	0.81	0.69
Euro (USD per EUR)	1.11	1.13	1.16	1.06
Pound (USD per GBP)	1.38	1.44	1.58	1.38
Yen (JPY per USD)	102.4	104.2	125.1	102.4
Commodity Spot Prices**				
Crude Oil ($US/bbl)	46.7	48.0	59.6	26.2
Natural Gas ($US/MMBtu)	2.68	2.58	2.95	1.49
Copper ($US/met. tonne)	4776.5	4541.5	5784.0	4327.5
Gold ($US/troy oz.)	1314.5	1299.0	1314.5	1051.1

*as of 9:55 am on Friday **Oil-WTI, Cushing, Nat. Gas-Henry Hub, LA (Thursday close price), Copper-LME Grade A, Gold-London Gold Bullion; Source: Bloomberg.

POUND FALLS SHARPLY ON BREXIT



Source: Bloomberg, TD Economics

GLOBAL OFFICIAL POLICY RATE TARGETS	Current Target
Federal Reserve (Fed Funds Rate)	0.25 - 0.5%
Bank of Canada (Overnight Rate)	0.50%
European Central Bank (Refi Rate)	0.00%
Bank of England (Repo Rate)	0.50%
Bank of Japan (Overnight Rate)	-0.10%

Source: Central Banks.

U.S. – KEEP CALM AND TRADE ON… AS BRITAIN LEAVES THE EU

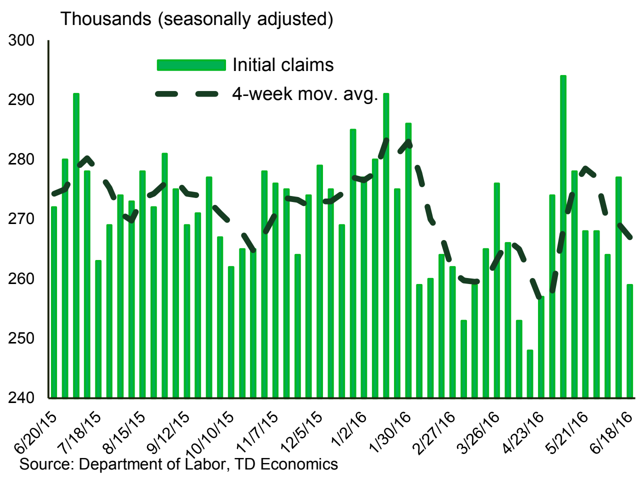
Markets were on tenterhooks all week in anticipation of the UK referendum. Anxiety turned to panic overnight as Britons, in a historic vote, decided to leave the EU. Despite the very close polls ahead of the vote investors increasingly positioned themselves for a status-quo result. In fact, sentiment was decidedly risk-on right through until voting booths closed at 10pm GMT. But, as results started to trickle in, doubts surfaced, with the BBC finally calling the vote for the "leave" camp at 4:45am London time. The final tally was 51.9% to 48.1% with 1,269,501 more votes cast in favor of divorcing the UK from the EU. Turnout was high, at 72.2%, but fell shy of that level in London, Scotland, and Northern Ireland – all bastions of the "remain" camp.

The pound fell as much as 12% versus the dollar as the outcome became clear. Gold and volatility surged while equities and the safest of bond yields slumped, before some retracement this morning. At this point, central banks have announced their readiness to deal with any near-term fallout related to potential liquidity shortages, with the Federal Reserve noting it is prepared to provide dollar liquidity through existing swap lines with major central banks. The concerted central bank move should help stem near-term pressures in global markets. But, longer-term implications of the vote are far from precise given the rapid and substantial repricing in global markets, the ensuing volatility, and uncertainty of the political response on both sides of the channel.

Despite the unknowns, there is little doubt that the economic implications are a net-negative and could be far reaching. The uncertainty and lack of access to the common market will almost surely decimate business investment in the UK and probably stifle trade with the EU (and potentially others) – something that's not likely to be fully offset by the slumping sterling. The expected downturn will likely necessitate a monetary policy response from the Bank of England, which is most likely to cut rates at its meeting in August despite the expected uptick in inflation owing to the sharp currency depreciation. At the same time, while the EU may benefit from the exodus of capital from the UK into the region, it too will likely suffer from reduced trade ties and uncertainty, which could also drag on economic growth, delaying the region's recovery even further.

While the economic impacts of Brexit will undoubtedly be most pronounced across the pond, the U.S. will not be immune to the fallout. In her semiannual testimony to Congress mid-week, Chair Yellen noted the potential for

U.S. LABOR MARKET CONTINUES TO IMPROVE



Source: Department of Labor, TD Economics

"significant economic repercussions" of such an outcome that could "usher in a period of uncertainty." While the Chair didn't believe such an outcome would trigger a recession in the U.S., she was forthright in saying that Fed officials "just don't really know what will happen," but will monitor developments closely, particularly as far as they relate to "domestic economic activity, labor markets, and inflation."

On the domestic front, Chair Yellen's testimony warned against focusing too much on a single data point and reinforced the view that despite the weak May employment report, the labor market continues to improve. This view was supported by this week's initial jobless claims data, which fell down to 259 thousand. The Chair largely stuck to the script of accelerating U.S. growth, and indicated that wage growth is strengthening – corroborating a finding from our recent paper. Ultimately, rising wages and incomes should keep America's economy supported through resilient consumption and the housing recovery – a view reinforced by this week's data on existing home sales which rose to an eight-year high of 5.53 million.

The Chair declined to weigh in on when the Fed will next raise rates warning instead, perhaps ominously, that risks abound. In light of the negative implications from a surging greenback and financial volatility on U.S. trade and financial services industry, coupled with the downward pressure on inflation from the former, we expect the Fed will remain on the sidelines through the remainder of the year, and potentially well into 2017 given the downside risks that have surfaced.

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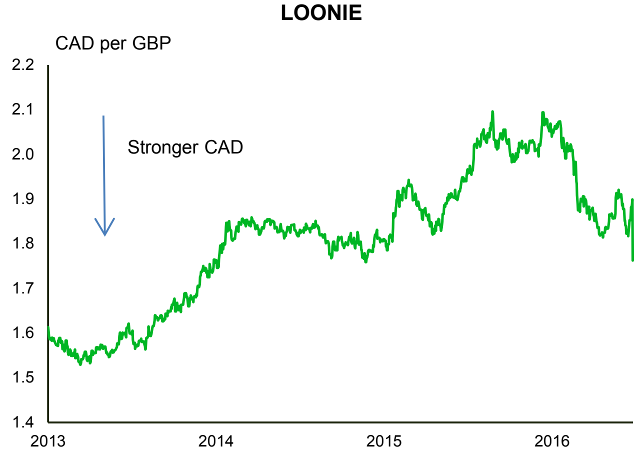
CANADA – NOT IMMUNE FROM BREXIT'S IMPACT

Britons voted to "leave" the European Union on Thursday, and the fallout on financial markets was immediate. Markets are in flight-to-safety mode, so the Canadian dollar, oil prices and the TSX are all down somewhat. The biggest impact has been on the British pound, which has taken it on the chin – down to a 30-year low at the time of writing. Consequently, the Canadian dollar is near a two-year high versus the pound (see Chart 1).

For a complete analysis of the impact of the leave vote, please see TD Economics' new report "And Now for Something Completely Different: UK Votes to Leave the EU". The biggest economic impacts will be felt in the UK, but Canada is not immune. The Canadian economy is linked to the UK in a variety of ways. The direct trade linkages are relatively small. Canada sent 3% of its goods exports to the UK in 2015, however, that is still our third largest export market behind the U.S. and China. The UK carries a larger weight in services trade, where two-way trade in services amounts to 5.5% of the total. And when it comes to foreign direct investment, 9% of Canadian FDI is UK-bound. Both Canada and the U.S. have material financial exposure to the UK (see Chart 2). The vote also throws uncertainty on the Comprehensive Economic Trade agreement (CETA) negotiated between Canada and the EU, and scheduled to take effect in 2017. It would no longer encompass UK-Canada trade after the UK leaves the EU.

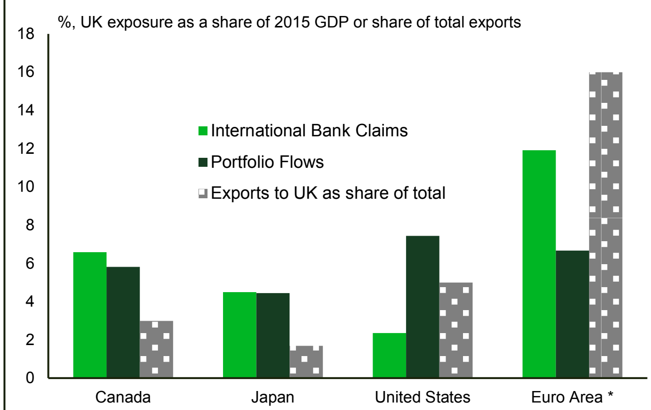
Canada's economy will feel the effects of the UK vote most quickly through financial and confidence channels. So far market reaction has been relatively orderly, apart from the sharp drop in the pound. It is still early days, but should financial conditions deteriorate, the economic outlook for the global economy, and Canada in turn, are at risk for a downgrade A deterioration in stock market wealth and greater economic uncertainty are generally negative for economic growth.

CHART 1: POUND WEAKER AGAINST THE LOONIE



Source: TD Economics, Bloomberg as of 12:00 pm.

CHART 2: CANADA AND U.S. HAVE MATERIAL FINANCIAL EXPOSURE TO THE UK



Source: Source: IMF, BIS, Haver Analytics, TD Economics.
Banking claims are year-end, investment assets as of June 2015. *Euro Area includes: Germany, France, Italy, Spain.

That said, central bank and government responses to quell market panic are crucial to the ultimate path of economic growth. To that end, the G7 Finance Ministers and Central Bank Governors released a statement expressing confidence in the resiliency of the UK economy and financial sector, and that they have "taken steps to ensure adequate liquidity and to support the functioning of markets. We stand ready to use the established liquidity instruments to that end."

The historic vote in the UK overshadowed the enhancements to the Canada Pension Plan (CPP) announced earlier this week. The enhancements will see the income replacement rate rise from 25% to 33% and the earnings maximum increased. The changes will be phased in over seven years, starting in 2019, and go some way to address a savings gap among middle-income earners, particularly for those not covered by a workplace pension plan. In terms of economic impact, employees will now cost one percentage point more (plus four additional percentage points on earnings above the current maximum). The most likely result will be via offsetting changes to wages and benefits, rather than reduced employment.

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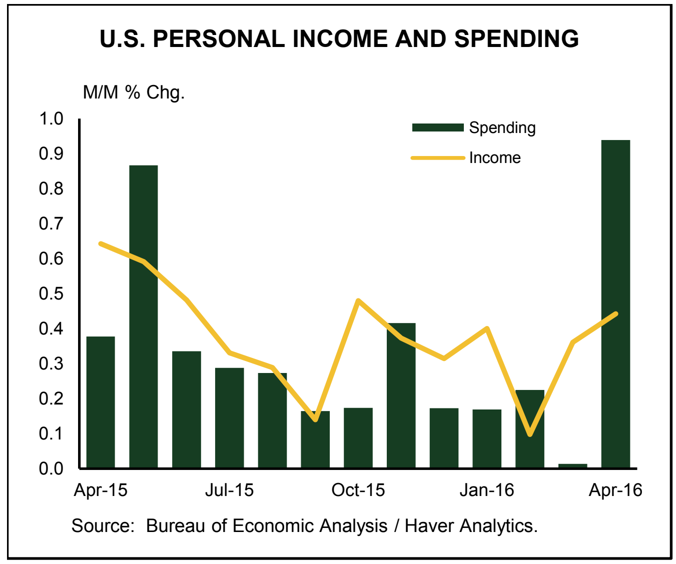
U.S.: UPCOMING KEY ECONOMIC RELEASES

U.S. Personal Income & Spending - May*

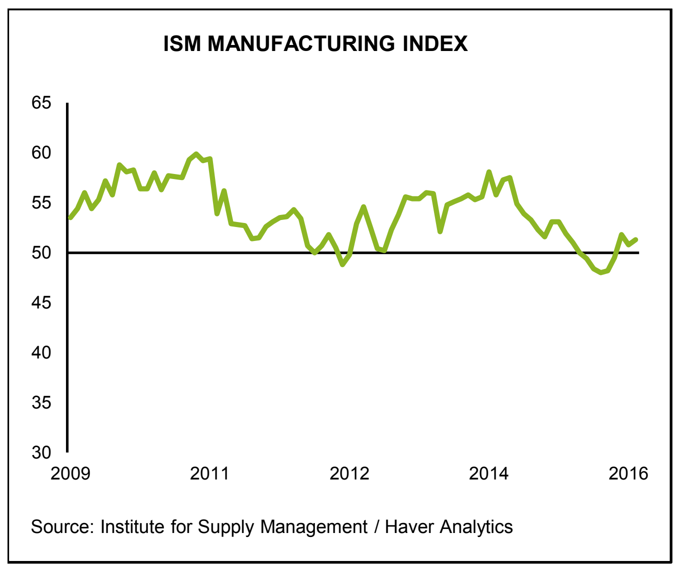
Release Date: June 29, 2016
April Result: Income 0.4% m/m; spending 1.0% m/m
TD Forecast: Income 0.2% m/m; spending 2.0% m/m
Consensus: Income 0.3% m/m; spending 0.3% m/m



Personal spending momentum is expected to drift markedly lower in May, rising at a more sustainable 0.2% m/m pace following the outsized 1.0% m/m surge the month before. Despite the sharp downshift in personal consumption expenditures growth, the overall tone of this report should be constructive, suggesting that the rebound in US household spending is being sustained. Real spending activity, however, should be relatively tepid, eking out a meager 0.1% m/m advance. Nevertheless, PCE remains on track to rise at a very healthy 3.0% or better pace, providing a key underpinning for GDP growth this quarter. The outlook for spending remains quite favorable, given the supportive backdrop from low energy prices, gains in disposable income and the recovery in household confidence. Personal incomes should also rise by a decent 0.2% m/m. On the inflation front, the core PCE deflator should advance at a 0.2% m/m pace, though the annual pace of core PCE inflation should remain unchanged at 1.6% y/y.

U.S. ISM Manufacturing Index - June*

Release Date: July 1, 2016
May Result: 51.3
TD Forecast: 51.7
Consensus: 51.4



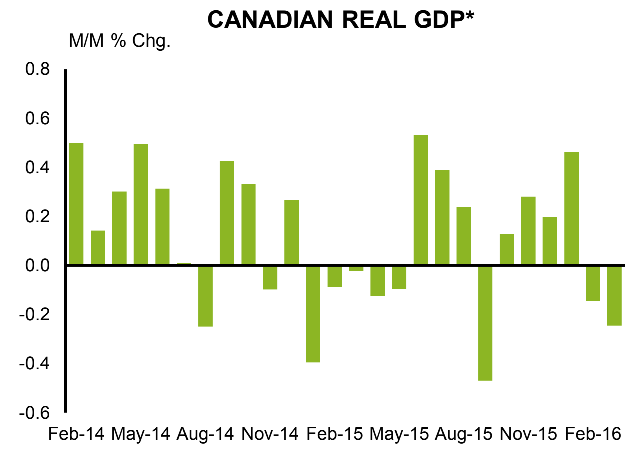
The US manufacturing sector performance has been uneven in recent months. However, a more encouraging picture is beginning to emerge among the various regional manufacturing sector PMIs, pointing to a further pickup in positive momentum in the sector. In June, TD expects the ISM manufacturing sector index to tick modestly higher, rising to 51.7 from 51.3. This will mark a further bounce in manufacturing sector momentum, building on the uptick in April. The improvement in the index should come from gains in the key forward-looking indicators such as new orders and production, suggesting further upside momentum for manufacturing sector activity going forward. The overall outlook for the manufacturing sector remains quite favorable, as the combination of the improving domestic backdrop, rising energy prices and the diminishing impact from the strong dollar provide a more favorable underpinning for the sector going forward.

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

CANADA: UPCOMING KEY ECONOMIC RELEASES

Canadian Real GDP - April*

Release Date: June 30, 2016
March Result: -0.2% m/m
TD Forecast: 0.1% m/m
Consensus: 0.1% m/m



*Real GDP at basic prices in 2007 chained dollars
Source: Statistics Canada / Haver Analytics

Industry-level real GDP is forecast to have increased by 0.1% m/m in April. The details of the report will likely show a bounce in manufacturing output and continued momentum in real estate activity. A more muted performance is expected from wholesale and retail sales, which lines up with the activity data released earlier this month. The wildcard in the report will be the energy sector, which took a large bite out of the March report. On this front, both energy export and import volumes fell and rig count data showed an additional decline through April. There were also reports of maintenance-related shutdowns that could weigh on output and related activity. This print will give a very early indication of what promises to be a very challenging Q2 for the Canadian economy. Already hampered by a poor handoff from Q1—though March could be revised higher when measured to two decimal places—the April data is expected to provide only a partial offset ahead of the disruption caused by the wildfires in Northern Alberta. Collectively these factors will leave annualized growth contracting by between 0.8% and 1.0%. While a recovery is expected over the second half of the year, the magnitude will be determined by developments in the global economy.

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

RECENT KEY ECONOMIC INDICATORS: JUNE 20-24, 2016

Release Date		Economic Indicator/Event	Data for Period	Units	Current	Prior	
United States							
Jun 22		Existing Home Sales	May	Mlns	5.5	5.4	R▼
Jun 23		Initial Jobless Claims	Jun 18	Thsd	259.0	277.0	
Jun 23		Continuing Claims	Jun 11	Thsd	2142	2162	R▲
Jun 24		Durable Goods Orders	May P	M/M % Chg.	-2.2	3.3	R▼
Jun 24		Durables Ex Transportation	May P	M/M % Chg.	-0.3	0.5	
Jun 24		Cap Goods Orders Nondef Ex Air	May P	M/M % Chg.	-0.7	-0.4	R▲
Jun 24		Cap Goods Ship Nondef Ex Air	May P	M/M % Chg.	-0.5	0.6	R▲
Canada							
Jun 22		Retail Sales	Apr	M/M % Chg.	0.9	-0.8	R▲
Jun 22		Retail Sales Ex Auto	Apr	M/M % Chg.	1.3	-0.1	R▲
International							
Jun 20	GE	Producer Price Index	May	Y/Y % Chg.	-2.7	-3.1	
Jun 23	EC	Markit Eurozone Manufacturing PMI	Jun P	Index	52.6	51.5	

Source: Bloomberg, TD Economics.

UPCOMING ECONOMIC RELEASES AND EVENTS: JUNE 27- JULY 1, 2016							
Release Date	**Time***		**Economic Indicator/Event**	**Data for Period**	**Units**	**Consensus Forecast**	**Last Period**
			United States				
Jun 27	8:30		Advance Goods Trade Balance	May	USD, Blns	-59.5	-57.5
Jun 28	8:30		Core PCE	Q1 T	Q/Q % Chg.	2.1	2.1
Jun 28	8:30		Gross Domestic Product Price Index	Q1 T	Q/Q % Chg.	0.6	0.6
Jun 28	8:30		Personal Consumption	Q1 T	Q/Q % Chg.	2.0	2
Jun 28	8:30		Gross Domestic Product Annualized	Q1 T	Q/Q % Chg.	1.0	0.8
Jun 28	10:00		Consumer Confidence Index	Jun	Index	93.1	92.6
Jun 29	8:30		PCE Core	May	M/M % Chg.	0.2	0.2
Jun 29	8:30		PCE Deflator	May	M/M % Chg.	0.2	0.3
Jun 29	8:30		Real Personal Spending	May	M/M % Chg.	-	0.6
Jun 29	8:30		Personal Spending	May	M/M % Chg.	0.3	1.0
Jun 29	8:30		Personal Income	May	M/M % Chg.	0.3	0.4
Jun 29	10:00		Pending Home Sales	May	M/M % Chg.	-1.0	5.1
Jun 30	8:30		Continuing Claims	Jun 18	Thsd	-	259.0
Jun 30	8:30		Initial Jobless Claims	Jun 25	Thsd	-	2162
Jun 30	13:30		*Fed's Bullard Speaks in London*				
Jul 01	10:00		ISM New Orders	Jun	Index	-	55.7
Jul 01	10:00		ISM Prices Paid	Jun	Index	63.8	63.5
Jul 01	10:00		ISM Manufacturing	Jun	Index	51.4	51.3
Jul 01	17:00		Domestic Vehicle Sales	Jun	Mlns	13.6	13.3
Jul 01	17:00		Total Vehicle Sales	Jun	Mlns	17.3	17.4
			Canada				
Jun 30	8:00		CFIB Business Barometer	Jun	Index	-	58.2
Jun 30	8:30		Raw Materials Price Index	May	M/M % Chg.	-	0.7
Jun 30	8:30		Industrial Product Price	May	M/M % Chg.	-	-0.5
Jun 30	8:30		Gross Domestic Product	Apr	M/M % Chg.	0.1	-0.2
			International				
Jun 29	8:00	GE	Consumer Price Index	Jun P	Y/Y % Chg.	0.4	0.1
Jun 30	2:45	FR	Producer Price Index	May	Y/Y % Chg.	-	-4.1
Jun 30	2:45	FR	Consumer Price Index	Jun P	Y/Y % Chg.	-	0.0
Jun 30	19:30	JN	National Consumer Price Index	May	Y/Y % Chg.	-0.5	-0.3
Jul 01	5:00	EC	Unemployment Rate	May	%	10.1	10.2

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