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1. Weekly Markets Changes

[May 31, 2019]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
16,037.49 -192.55 -1.19%	2,752.06 -74.00 -2.62%	24,815.04 -770.65 -3.01%	7,453.15 -183.86 -2.41%	\$0.7393 -0.44c -0.59%	\$1,305.58 +20.65 +1.61%	\$53.50 -5.13 -8.75%

2. Say goodbye to Dow 25,000: Mexico tariffs spook Wall Street

[May 31, 2019] The Tariff Man, as President Donald Trump has called himself, set off another wave of selling on Wall Street, with the Dow tumbling below 25,000 to four-month lows on Friday.

Trump's threat to impose escalating tariffs on Mexico, one of America's largest and most important trading partners, amplified fears about slowing economic growth.

The Dow declined 355 points, or 1.4%, capping its sixth straight losing week. That's the longest slump since June 2011. It's also the first time the Dow has closed below 25,000 since late January.

The S&P 500 fell 1.4% and the Nasdaq lost 1.5%.

"This is just the latest worry to put on the fire for investors," Ryan Detrick, senior market strategist at LPL Financial, wrote in a note to clients. "The big question at the end of the day though is can we really fight two trade wars at the same time?"

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The Dow and S&P 500 declined nearly 7% apiece in May, their first losing months since December. The Nasdaq tumbled 8% on the month, its worst May since 2010.

Trump's vow on Thursday evening to impose tariffs on Mexico, one of America's largest trading partners, only exacerbate investor worries about how trade tensions will disrupt business and slow global economic growth. Wall Street was already growing concerned about the escalating trade battle with China.

The United States imported \$346 billion of goods from Mexico last year, including everything from auto parts and avocados to beer and televisions.

Major corporations already found themselves caught in the crosshairs of the outburst of tensions with Mexico.

Levi Strauss tumbled 7%, reflecting concerns about the fact that up to a fifth of the company's jeans and clothes sold in the United States are manufactured in Mexico and China. Constellation Brands, which owns Corona and Modelo Especial, plunged nearly 6%.

Automakers, which rely on Mexico as a vital part of their supply chain, fell sharply. Fiat Chrysler lost 6%, while General Motors declined 4% and Ford lost 2%. Parts suppliers including Lear and Delphi Technologies also stumbled.

'Alarming' decision

Trump said the United States will impose a 5% tariff on all Mexican imports starting on June 10 as a punishment for illegal immigrants crossing the Mexican border into the United States. The White House indicated the tariff would increase by increments of 5 percentage points each month until it reaches 25% in October.

Some analysts expressed concern that Trump is imposing tariffs in response to immigration problems, not economic or trade ones.

"Tariffs can be thrown around as an economic bomb for anything now," Peter Boockvar, chief investment officer at Bleakley Advisory Group, wrote in a note to clients. "Global growth rates will only continue to suffer."

Kristina Hooper, chief global market strategist at Invesco, called it an "alarming" decision by the US administration to open up a "new and unexpected frontier" by using tariffs as a "weapon" beyond just trade policy. "Markets don't like surprises and this is a big surprise," Hooper wrote in a note.

Worse, there were signs that the crackdown on Mexico may not be part of a broader economic strategy on behalf of the Trump administration.

In fact, Robert Lighthizer, Trump's top trade official, joined Treasury Secretary Steven Mnuchin in opposing the tariffs on Mexico, sources told CNN.

Peso, Mexican stocks plunge

The tariffs on Mexico will be "highly disruptive," Goldman Sachs analyst Alec Phillips wrote in a note to investors Friday. The bank warned the new trade tensions could hurt the ability to enact a new North American trade deal to replace NAFTA.

Investors exited Mexican assets in response to the news.

The iShares MSCI Mexico ETF tumbled almost 4%. The Mexican peso plunged 2.5% against the US dollar. That sharp currency move should help boost Mexican exports by making goods cheaper for overseas buyers.

Many US companies — including Ford and Walmart rely on the country as a central part of their supply chains.

The country is also a regional manufacturing hub for Japanese, South Korean and German automakers that assemble cars in Mexico and ship many of them to the United States. Shares in Mazda and plunged more than 7%, while losses for Toyota, Honda, Nissan and Volkswagen reached 3% or more.

Investors flock to bonds, gold

Signs of worry abounded on Wall Street.

The CNN Business Fear & Greed Index of market sentiment ticked into "extreme fear" territory on Friday, compared with "greed" a month ago.

Cash poured into ultra-safe government bonds, driving the 10-year Treasury yield below 2.13% for the first time since September 2017. Just a month ago the 10-year yield was sitting at 2.5%.

Gold, which tends to rise when investors are scared, gained 1% and climbed above the \$1,300 level.

The VIX volatility index climbed 9%, though it remains well below the levels reached in December.

US oil prices plunged 5.5% to a three-month low of \$53.50 a barrel, reflecting fear about the economic impact of the tariffs on China and Mexico. Halliburton, Occidental Petroleum and Hess each fell 3% or more. Crude tumbled 16% in May, snapping a four-month winning streak.

Global growth concerns

Beyond the trade front, investors were also unnerved by weak economic numbers overseas.

Activity in China's vast factory industry fell to a three-month low in May. New orders declined, likely reflecting pressure from the trade war.

In Germany, retail sales unexpectedly declined. That sent the German 10-year bond yield plunging deeper into negative territory to a record low.

"We don't want to lose the German consumer," Boockvar wrote. "The domestic side is what's kept their economy out of recession."

Longest weekly losing streak since 2011

The broadside against Mexico comes at a delicate time in global financial markets.

US stocks have slumped and bond yields have plunged in part because of worries about the escalating trade war between the United States and China. Investors fear the tit-for-tat tariffs — and threats of non-tariff retaliation — will slow economic growth, dent consumer confidence and derail business investment.

"This latest round of tariffs will create economic uncertainty, and economic uncertainty creates wealth destruction," said Jack P. McIntyre, portfolio manager for global fixed income strategies at Legg Mason affiliate Brandywine Global.

3. Canadian economy grew by 0.4% in Q1

[May 31, 2019] Canada's economy expanded at an annualized pace of just 0.4% in the first three months of the year, giving the country its weakest back-to-back quarters of growth since 2015.

The real gross domestic product reading for the first quarter followed a revised growth number of just 0.3% in the previous quarter, Statistics Canada said Friday in a new report.

It was the slowest two-quarter stretch of growth since an oil-price plunge caused the economy to shrink over the first half of 2015.

Economists had expected growth at an annualized rate of 0.7% for the first quarter, according to Thomson Reuters Eikon.

The Statistics Canada report said downward pressure on first-quarter growth was driven by weakness in net trade as imports increased 1.9% and export volumes dropped 1% for their first quarterly decrease since 2017.

Canada also saw a substantial contraction of 9.5% in its exports of farm and fishing products as well as a 2.8% drop in crude-oil shipments.

On the positive side, the agency said overall economic growth was boosted by the highest quarterly level of household spending in two years, following broad-based increases that included strength in auto purchases and audio-visual equipment.

The economy also saw an 8.7% increase in business investments on equipment and machinery—the biggest jolt in 23 years. The surge was fuelled in part by significant investments in aircraft and other transportation equipment, the report said.

Looking ahead, the report's month-to-month reading for March—the final month of the first quarter—suggested the second quarter could be off to a

stronger start. March posted a 0.5% increase compared to a 0.2% contraction in February.

The first-quarter reading Friday was slightly higher than the Bank of Canada's prediction of 0.3%.

On Thursday, Carolyn Wilkins, the central bank's senior deputy governor, said the recent economic slowdown was temporary. She said growth has already been accelerating in the second quarter—which the Bank of Canada has predicted will post 1.3% growth.

From there, Wilkins said Canada's economic expansion should pick up its pace throughout the rest of 2019.

Even with the expected domestic improvement, she underlined risks to the outlook. She warned the highly uncertain international trade environment—including the ongoing U.S.-China trade war—poses a threat for Canada.

Wilkins also listed trade disruptions such as Beijing's new restrictions on some Canadian agricultural products. A diplomatic conflict has intensified in recent months, leading China to reject shipments of some key Canadian goods, including canola.

The central bank is also monitoring the possibility of a trade feud between the U.S. and the European Union. U.S. President Donald Trump has threatened to apply tariffs on autos from the EU.

4. The reason why the Fed could be pressured to raise rates

[May 31, 2019] The tariff-induced market meltdown is increasing the probability that the Federal Reserve could cut interest rates later this year.

But what if the central bank goes in a different direction? There's an argument that the Fed's hands are tied and that it might need to actually hike rates if consumer prices creep higher.

The Fed may not just be facing the risk of recession. It needs to watch out for another threat: a troublesome economic trend known as stagflation, which is when sluggish growth and inflation happen simultaneously. That's what happened in the 1970s, when oil prices surged at the same time the broader economy was slumping.

"It's entirely possible the Fed could have to raise rates," said Michael DePalma, managing director of fixed income with MacKay Shields, a firm that runs the High Yield bond ETF.

"What's tricky is that inflation is a process. It doesn't turn on a dime. It has to work its way through," DePalma added. "If you do get inflation it can seriously hamper the Fed's ability to cut rates if the economy slows."

Retailers are raising prices

Make no mistake: Tariffs imposed on China and Mexico should lead to higher prices at US retailers and car dealerships.

Costco chief financial officer Richard Galanti was pretty blunt when asked about the impact of the trade war on the company's earnings conference call Thursday evening.

"At the end of the day, prices will go up on things," Galanti said.

Keep in mind that Costco is a retail powerhouse that has the financial wherewithal to absorb the hit from higher costs better than many other chains. It's also a company that prides itself on offering bargains. So if Costco might have to raise prices, expect just about every other retailer, large and small, to do the same.

Lewis Alexander, chief US economist at Nomura, said in a report that he's expecting a "pronounced impact on auto prices and some electronics" because of tariffs. He argues that food prices could go up, too.

"Higher tariffs on imports from Mexico and China could provide an opportunity for price-setters to raise prices, which could make long-term inflation expectations unstable," Alexander added. "In that case, shocks induced by tariffs might have a long-lasting impact on inflation."

Inflation risk is 'underappreciated'

A lot of people are also too quick to dismiss inflation as a concern, said Alejandra Grindal, senior international economist with Ned Davis Research. She noted that in addition to the possibility of higher consumer prices from tariffs, the healthy job market in the United States has led to higher wages. A continued rise in the size of workers' paychecks will add to inflation pressures. "I'm not saying the Fed will definitely raise rates. But it's a risk that's underappreciated since tariffs and higher wages could lead to a spike in inflation," Grindal said.

Still, unless the pendulum swings dramatically toward a recession or a substantial pickup in inflation, the Fed may have no choice but to sit tight and wait to see how the trade war ultimately pans out.

"It's hard to see stagflation coming, but you could see consumer prices accelerate at the same time the economy slows down," said Brian Nick, chief investment strategist with Nuveen. "That's why I don't think the Fed steps in either way."

The Fed also has to worry more about a prolonged economic slump because of tariffs than the risk of higher prices, said Mona Mahajan, US investment strategist and portfolio manager with Allianz Global Investors.

"The case for cutting rates has escalated. There is substantial downside for the US economy," Mahajan said, adding that the Fed may be willing to let inflation overshoot a bit in order to avoid a sharp economic slowdown. Either way, the Fed is in a bind right now. There are no easy answers about what it should do next.

5. Obsolete bills to lose legal tender status

[May 31, 2019] The federal government is planning to eliminate "legal tender" status for certain obsolete bank notes — including the \$1, \$2, \$25, \$500 and \$1,000 bills — that are no longer being produced.

The change means these notes won't be acceptable for use in transactions after Jan. 1, 2021, although they will be redeemable at face value at financial institutions.

The issue of \$1 and \$2 bills ended in 1989 and 1996, respectively, after these bills were replaced with coins.

The \$25 and \$500 bills were discontinued shortly after they were issued in 1935, and the \$1,000 note was scrapped in 2000.

"Most Canadians will not be affected because the bank notes targeted by this announcement have not been produced in decades and are rarely used in transactions," the Bank of Canada states.

The central bank indicates that it supports the move, "which helps ensure that the bank notes used by Canadians are current, in good condition, easy to use and difficult to counterfeit."

6. BoC's Wilkins calls trade war escalation a 'major preoccupation'

[May 30, 2019] A top Bank of Canada official says the economy is caught in the middle of the U.S.-China trade war— and that further escalation of global trade conflicts remain a "major preoccupation" for its policy-makers.

In prepared remarks of her speech Thursday in Calgary, senior deputy governor Carolyn Wilkins said the deepening dispute between Canada's top trading partners was a main point of discussion ahead of the bank's decision this week to leave its interest rate unchanged.

Governor Stephen Poloz, who maintained the bank's trend-setting rate at 1.75% Wednesday, appeared to be in no hurry to make a move, even as he underlined the improved economy.

In explaining the decision, Wilkins said the Bank of Canada sees growing evidence that the domestic economy has been strengthening since its sharp

slowdown over the winter. She said it's largely on track to pick up its pace over the second half of 2019.

International conditions, however, pose a threat to a Canadian rebound, Wilkins said.

"China and the United States have escalated their dispute, and Canada has been caught in the crossfire," said Wilkins' speech to the Calgary Chamber of Commerce.

She also listed other disruptions such as China's new restrictions on some Canadian agricultural products, which she noted have had direct effects on farmers. A diplomatic conflict has intensified in recent months, leading China to reject shipments of some Canadian goods, including canola and pork.

"If some of these disputes were to be resolved, that would provide a welcome boost to the Canadian and global economies," Wilkins said.

"But if the disputes were to worsen and become long lasting, the outlook would be quite different..."

"Obviously, this remains a major preoccupation for us."

If the trade environment deteriorates further, economic demand will fall and companies will be forced to wrestle with supply-chain disruptions, she said.

Wilkins did note that Canada's trade picture has seen positives, such as the U.S. move to drop steel and aluminum tariffs. Their removal is expected to improve the chances of the updated North American free trade agreement being ratified.

On Wednesday, the bank reported that recent economic indicators for Canada have been unexpectedly robust.

The central bank said data has shown the oil sector is beginning to recover, the national housing market is stabilizing and job growth remains strong. The numbers, it added, also point to growth in consumer spending, exports and business investment.

The Bank of Canada said the current interest-rate level was "appropriate." Moving forward, it said the governing council will pay close attention to developments in household spending, oil markets and global trade.

The Bank of Canada has been cautious with the interest rate due to the accumulation of high levels of household debt, which has built up after years of very low borrowing costs.

Many experts expect the central bank to leave its key interest rate untouched until at least late in the year and perhaps longer. Some have predicted a rate cut will come before the next increase.

7. Life expectancy growth stalls: StatsCan

[May 30, 2019] Life expectancy at birth has stopped rising for the first time in more than 40 years, according to new data from Statistics Canada.

From 2016 to 2017, StatsCan reports, life expectancy at birth did not increase for males or females.

From the mid-1990s to 2012, life expectancy increased by an average 0.2 years annually. Since then, it has slowed to a 0.1-year annual increase.

The stall in life expectancy improvement in 2017 is “largely attributable to the opioid crisis,” StatsCan says.

The Government of Canada agency points to “accidental drug overdoses among young adult men” as the primary cause, noting that the trend is particularly evident in British Columbia.

While more Canadians are dying young, older Canadians are still living longer, the report indicates.

In 2017, life expectancy for 65-year old Canadians rose by 0.1 years. A 65-year-old female could expect to live to 87.1, and the average male would reach 84.3 years, StatsCan notes.

“Although older men are living longer, the increase in deaths among young men almost completely offset these gains,” StatsCan says. “A similar pattern occurred among women, although to a lesser extent.”

The rise in overdoses is offsetting fewer and later deaths from cancer and heart disease, it says.

8. BoC holds rate, says numbers reinforcing view that slowdown was temporary

[May 29, 2019] The Bank of Canada is holding its key interest rate steady, and its senior officials insist there’s more proof an economic pickup has followed the abrupt winter deceleration.

The central bank, as widely expected, kept its trend-setting rate at 1.75% Wednesday—and governor Stephen Poloz appeared to be in no hurry to make a move, even as he pointed to economic improvements.

The bank said in a statement that there’s “accumulating evidence” the economy has been re-emerging in the second quarter of this year following a period when economic growth nearly came to a halt.

“Overall, recent data have reinforced governing council’s view that the slowdown in late 2018 and early 2019 was temporary,” the bank said.

Several recent economic indicators have been unexpectedly robust. Canada will receive another important piece of information Friday with the release of its economic growth report for the first quarter.

The central bank said data has shown the oil sector is beginning to recover, the national housing market is stabilizing and job growth remains strong. The numbers, it added, also point to growth in consumer spending, exports and business investment.

However, the economy also faces expanding trade risks, the bank said, following the escalation of international conflicts and Chinese restrictions on Canadian goods that are already having a direct impact on exports.

A diplomatic dispute that has festered for several months has led China to block some shipments of canola, pork and other products from Canada.

On trade, the bank noted that the removal of steel and aluminum tariffs as well as encouraging signs the updated North American free trade agreement is moving closer to ratification will be positives for Canadian exports and investment.

Policy-makers are also paying close attention to the high levels of debt weighing on Canadian households.

Taking these factors into consideration, the Bank of Canada said the current policy level is “appropriate.”

“Governing council will remain data dependent and especially attentive to developments in household spending, oil markets and the global trade environment,” the statement said.

Many economists expect the central bank to leave its key interest rate untouched until at least late in the year and perhaps longer. Some have predicted a rate cut will come before the next increase.

The next rate decision is scheduled for July 10, when the bank will also release its updated economic forecasts in its quarterly monetary policy report.

Last month, the weaker economic data led Poloz to set aside talk of rate increases.

The sudden down shift over the winter—caused mostly by a drop in oil prices—forced the central bank to cut its 2019 growth forecast. The reduction came after the economy ran at close to full tilt for most of 2017 and 2018—a stretch that saw Poloz hike the interest rate five times.

Have a nice and fruitful week!

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