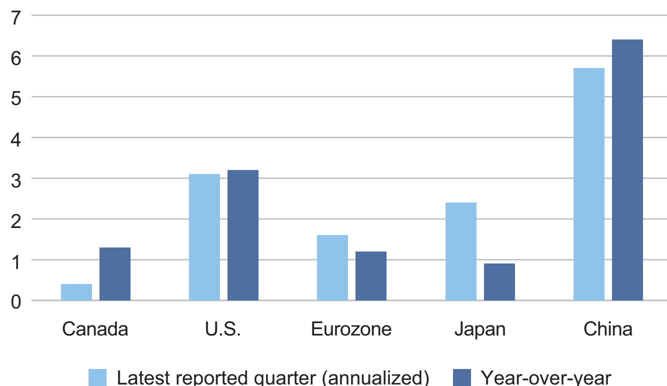
The trend of moderating global growth and subdued (but positive) inflation in the developed world took a back seat to developments in the U.S. trade war that led to a further decline in interest rates across global yield curves. In the meantime, risk assets such as equities and corporate bonds performed well following a strong first quarter.

Real GDP Growth (%)



Source: Bloomberg

The world's focus returned to the U.S. trade war amid rising concerns over a downturn in business investment driven by uncertainty over how long the trade war will persist and to what extent tensions could slow already subdued economic growth. Higher tariffs levied by the U.S. on China in May were the catalyst for increased concern.

This uncertainty has been the main driver of expectations that the Fed will embark on an easing cycle beginning in July. However, the case for the U.S. Federal Reserve (Fed) to lower borrowing costs is not entirely clear cut. While U.S. real GDP growth has moderated following a boost from the corporate tax cut tailwinds last year, on an annualized basis it should still exceed the 2% average over the past decade. Additionally, the annual rate of core inflation is approximately at the 2% target, the U.S. unemployment rate sits at its lowest level in a half century, and consumer spending continues to rise.

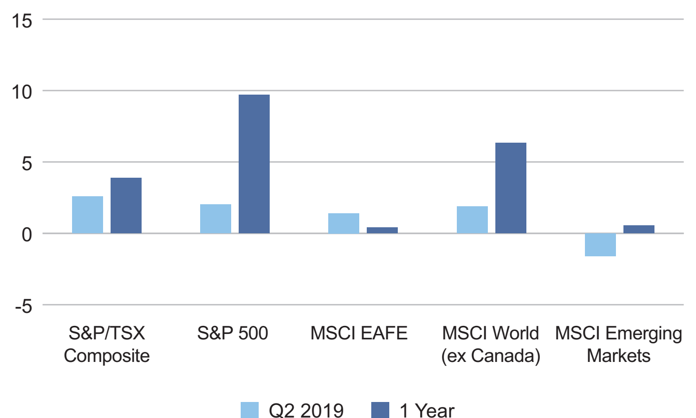
Reducing interest rates at this point would be more of an insurance policy tool – reminiscent of moves by the Fed in 1995 and 1999 – used to tide over a period of economic uncertainty rather than in response to a looming downturn. While the market is pricing in an interest rate cut by the Fed at the next committee meeting in July, the wisdom in doing so is questionable. A rate cut would put the Fed in an unenviable light – appearing to be led by the market as well as succumbing to the pressure tactics of President Donald Trump.

We are now in the longest period of expansion that the U.S. has experienced since 1854. Despite the buffer that the Fed has built by raising rates 200 basis points over the last three years, the bank rate is still historically low and, if lowered prematurely, would not be as effective a tool in providing the needed economic boost should the expansion truly be in jeopardy. Lastly, the futures market that is currently pricing in four rate cuts over the next 12 months is also pricing in rate hikes as early as 2021 – implying that any slowdown is expected to be relatively short.

While it is true the U.S. market is not the global market, we look at the U.S. market first because global capital is interconnected and the last two major corrections emanated from events within the U.S. The uncertain trade environment can be credited with slowing economic growth in Europe, the U.K., Japan and emerging economies, notably China. Growth in emerging market economies, while still vastly greater than that in the developed world, is expected to slow to 4%, the lowest level in four years, amid expectations that growth in China will decelerate to 6.2% from 6.6%.

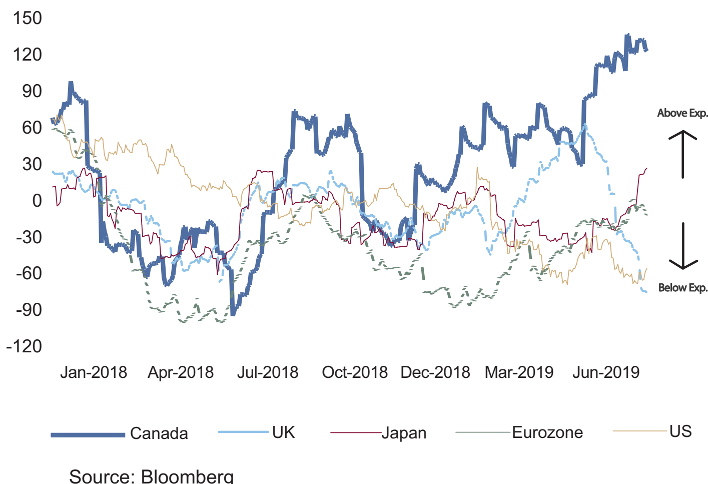
Despite trade tensions, the average unemployment rate in Europe dropped to a decade low, while U.K. consumers are providing support to their economy as wage increases outpace inflation. There are also country specific factors that will impact economic data. In U.K. politics, a new prime minister will be chosen but the options are not clear or necessarily favourable. These options include a general election, a second Brexit referendum, leaving the E.U. with a negotiated deal, or not leaving the E.U. at all. In Japan, consumer confidence tumbled to a three-year low in May as the potential increase to a controversial sales tax in October disrupted consumer expectations.

Equity Index Performance (CAD) (%)
(at June 30, 2019)



Source: TD Securities, MSCI

Economic Surprise Indices



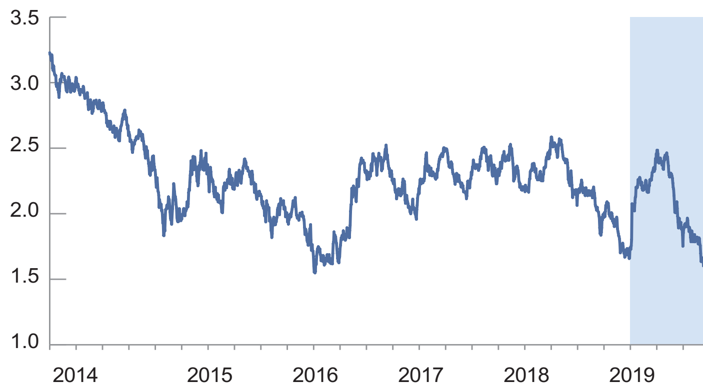
Source: Bloomberg

Canadian economic data is demonstrating some degree of resilience relative to both the sub-par output in the previous two quarters and the rest of the developed world – see the chart below. After a slow start to the year, second quarter GDP growth could approach 3% on an annualized basis, and Canadian employment is strong. Canadian inflation remains firmly in positive territory with core inflation readings sitting very close to the middle of the Bank of Canada's (BoC) target range. The bank rate is still below the rate of inflation and 75 basis points below the Fed's, so the BoC has less ammunition than the Fed to combat a true slowdown. Furthermore, given continued concern by the BoC over elevated consumer debt levels and house prices, which could be further inflamed by a rate cut, it should be apparent that the BoC should not be currently contemplating a rate cut. Despite the rebound in economic data pointing to a moderately growing economy and a positive inflationary environment, Canadian bond yields are being influenced by global developments.

As a result, during the quarter in Canada:

- Interest rates declined across the yield curve: the 2-year, 5-year, 10-year and 30-year benchmark Canada bond yields declined 8 basis points, 13 basis points, 16 basis points and 21 basis points, respectively.

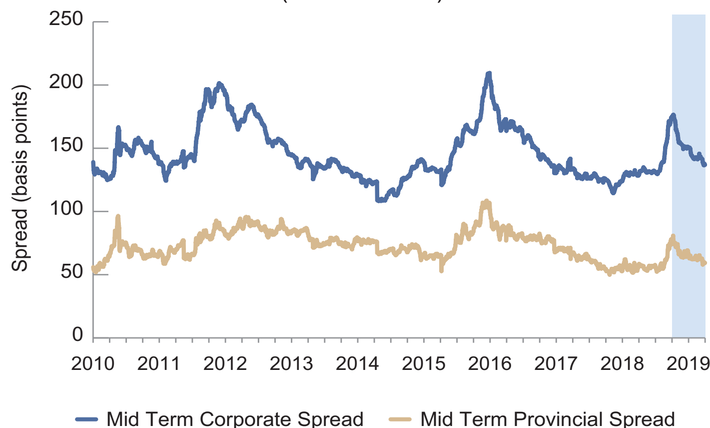
30-year Government of Canada Bond Yield (%)



Source: Bloomberg

- Canadian spread product (corporate credit, provincial credit, etc.) continued to perform strongly along with the rebound in other risk assets such as equities.

Canadian Credit Spreads
(2010 to 2019)



Source: FTSE Global Debt Capital Markets