One *TRILLION* Dollars!

Douglas Porter, CFA, Chief Economist • douglas.porter@bmo.com • 416-359-4887

In a chock-a-block week of economic news, events, and earnings—and yet strangely precious little net move in most markets—the $1 trillion figure rose above the din. In fact, that big round number arguably was the centre-piece of every major economic storyline this week. Here are six of the biggest:

1) As you may have heard, **Apple** rather famously became the first listed company to grip the $1 trillion market-cap handle, with Amazon and Alphabet in hot pursuit (giving a whole new meaning to AAA rating). But while that impressive feat hogged the headlines, perhaps the more pertinent story was the broader strength in U.S. Q2 earnings (well above 20% y/y), and the growing divide with much of the rest of the world (barely above 5% y/y in other developed markets). This wedge partly reflects the impact of U.S. corporate tax relief. But it also **partly reflects the growing divide in underlying economic growth between the U.S. and the rest of the industrialized world.** This week saw more Q2 GDP releases; and, contrary to the U.S. pick-up (to a 2.8% y/y clip), the trend is to slower growth. Prime example: Euro area GDP cooled to a 1.4% a.r. last quarter, shaving the annual gain to 2.1%. Next week's report on Japan is expected to show GDP growth running at less than 1% y/y. Even Canada, which knocked down a hearty 0.5% gain in May and is on track for a 3.3% advance for all of Q2, will see its y/y pace decelerate to around 2.0% (due to even stronger gains a year ago).

2) One of the main reasons that equities barely benefitted from the solid earnings is **gnawing trade war concerns**. After a tantalizing hint of a reprieve, the U.S. quickly reverted to the Bad Cop routine, threatening a painful 25% tariff on $200 billion of imports from China. By week's end, China in turn warned of tariffs up to 25% on $60 billion of U.S. imports, triggering yet another blast of rhetoric from the U.S. side. Not helping matters was the U.S. trade release on Friday—overshadowed by the largely on-consensus employment report—which showed the deficit on goods and services gapping up to $46.3 billion in June, and nudging up to $33.5 billion on goods trade with China alone. The ongoing tensions sent the yuan skidding further to a 14-month low, until the PBoC stepped in late in the week with a 20% reserve requirement on foreign exchange forwards, halting the slide. The currency is still down more than 8% from its April high. The $1 trillion figure involved here? **China's holdings of U.S. Treasuries** stand at a cool $1.176 trillion, and may prove to be the ultimate hammer in a true trade war.

3) Treasuries also went on a small ride to nowhere this week, with **10-year yields** temporarily punching above the 3% level, before receding back to about where they started (2.96%). Yields were given a push last week on speculation that the Bank of Japan was preparing to back off slightly on its ultra-loose policy, but instead they only tweaked policy at this week's meeting. Undaunted, yields still forged higher on news that the U.S. Treasury will ramp up H2 borrowing in order to fund **the groaning budget deficit**—which is headed for the $1 trillion mark next year (up from "only" $750 billion in the past 12 months). Yields backed off on Friday amid

the non-threatening jobs data (wages steady at 2.7% y/y) and the gathering storm clouds around trade. Notably, Canadian yields held on to increases of 4-5 bps across the curve on the week due to the strong GDP report, surprisingly robust trade results spurring upward growth revisions, and even some chatter of a September rate hike (we're sticking with October).

4) One of the reasons we would stay a tad cautious on the next BoC rate hike is the **ongoing uncertainty around NAFTA**. While Governor Poloz has been extraordinarily clear that policy will be dictated by economic facts and not lurid headlines, it would seem extremely risky to be rushing rate hikes in the face of very real trade threats. This week saw some classic good news/bad news on the NAFTA front, with all reports suggesting a deal on auto content is achingly close. That's the good news. The bad news is that Canada is outside looking in, at this particular part of the deal. It's not entirely clear how important that exclusion really is, and may just be another part of the unusual U.S. negotiating style; moreover, many of the latest U.S. proposals on the auto front for NAFTA could actually be a mild positive for Canada. Meantime, the U.S. continues to suddenly make nice with the EU (at least in relative terms), reducing the risk of broader auto tariffs. Overall **U.S. trade flows with both the EU and with NAFTA partners** are above the $1 trillion mark, although we would note that the gap with Europe is much bigger than with Canada and Mexico combined—for those keeping score at home.

5) Another reason we would argue for some caution on BoC rate hikes is that there are growing **signs that past rate moves are starting to bite**. The 100 bp rise in overnight rates since the start of last July appears to be weighing on spending, housing, and borrowing. The early return for July home sales suggests that activity is still moderating in much of the country from the 1-2 hit of rising mortgage rates and a tighter regulatory backdrop. While Toronto bucked that trend with an 18% y/y rise in sales, this was from very low levels a year ago, and they are still down 30% from two years ago. At the same time, auto sales sagged 3.6% y/y in July and are now down 0.7% so far this year—suggesting Canadian vehicle sales are poised to report their first annual setback this year since 2009. The BoC has often suggested that they are watching with a hawk eye on how sensitive the consumer is to rate hikes. Adding it up, overall household borrowing is showing distinct signs of cooling, easing from a 5.8% clip a year ago to just below 4.1% y/y in June—matching the slowest pace since 2001. Okay, this one is a stretch, **but total household borrowing is now up almost One Trillion Canadian Dollars** this cycle (to a bit above $2 trillion).

6) Finally, a number of countries have found themselves on the receiving end of U.S. trade threats and/or sanctions recently, and their respective markets have felt the pain. The **latest target is Turkey**, which was hit with sanctions this week after not releasing a U.S. pastor (arrested after the 2016 coup attempt). Already under pressure from President Erdogan's foray into monetary policy advice, the Turkish lira was slammed some more this week. The cost of the U.S. dollar jumped almost 5% from last Friday alone to 5.08 lira; in perspective, the currency was barely above par as recently as a decade ago. It's now depreciated more than 30% in the past year alone, rivalling Argentina for the weakest significant currency in the world. As a result, Turkey has seen its **nominal GDP sag in U.S. dollar terms** from a peak five years ago of nearly $1 trillion to below $900 billion now, even with robust volume growth.

Things that may you go hmmmm: One notable feature in July payrolls was that U.S. factories added a cool 37,000 jobs, the 11th time in 12 months with a gain of at least 20,000. In the past year, U.S. manufacturing jobs are now up 327,000 or more than 2.6% y/y. That's **the largest yearly percent gain in factory payrolls since the boom year of 1984.**

There has been a lot of inflation since 1967—the year that Dr. Evil was reportedly frozen, along with Austin Powers. But, even accounting for the average 4.0% U.S. CPI inflation rate over that period of 51 years, that would still mean that prices are up "just" a bit more than 7.5 times over that stretch. In other words, **even now his One *Million* Dollar demand would be just $7.51 million in today's dollars—arguably a still laughably low figure to ransom the world**. Keeping the demand steady as a share of U.S. national income would still produce a figure a bit below $24 million in today's dollars, or less than what last night's starting pitcher for the Seattle Mariners (Felix Hernandez) makes in a year. Think bigger, Dr. Evil.