![Scotiabank]

December 15, 2020 @ 18:*25 EST*

KEY POINTS:

- **Risk assets bid as safe havens retreat**
- **BoC's Macklem sounded cautiously optimistic…**
- **…but is he too concerned about CAD…**
- **...and not enough about housing?**
- **FOMC expectations & what would be possible surprises**
- **PMIs on tap: Eurozone, UK, Japan…**
- **…after Australia's jumped higher**
- **US retail sales likely to reflect a weak start to holiday shopping**
- **UK & Canadian CPI on tap**
- **US stimulus meetings to continue**

TODAY'S NORTH AMERICAN MARKETS

Risk assets held onto a decent bid as safe havens stumbled during the North American session. Canadian markets paid relatively little heed to BoC Governor Macklem's speech which is probably just a-o-k by him, but his comments on CAD struck a bit of a nerve (see below).

- Equities were up by over 1% in the US and about ¾% in Toronto. European markets ended as mixed as they started.
- Gilts underperformed all other sovereign curves as longer-end yields backed up by 5–6bps. US Treasury and Canadian yields rose by 1–2bps toward the longer end. EGBs were generally little changed except for spread narrowing over bunds by Italian and non-core markets.
- Oil posted a slick 1% gain on average across WTI and Brent.
- The USD weakened again today with leading crosses including the Mexican peso and sterling.

BoC Governor Macklem's speech (here) and press conference didn't really shake up CAD or short-term rates trading, but it's worth highlighting what I thought were the main takeaways while also emphasizing some curious remarks about the currency.

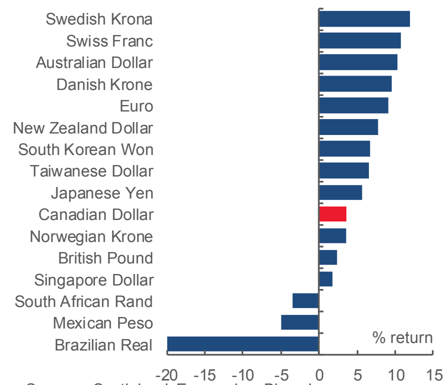
- he's fading near-term downside by looking through to later upside when vaccines become more widely available. His remarks on near-term growth risks indicated they view Q4 GDP growth as likely being stronger than they figured back in the October MPR given a stronger start to the quarter, while a potential Q1 setback is likely to be much less significant than the Q2 retrenchment;
- he didn't elaborate on rate cut options other than to say "if" they need to do more, then they have tools available but negative rates are not among them. That conditionality dismisses near-term risk;
- The concerns he expressed toward CAD were somewhat puzzling.

CONTACTS

Derek Holt, VP & Head of Capital Markets Economics
416.863.7707
Scotiabank Economics
derek.holt@scotiabank.com

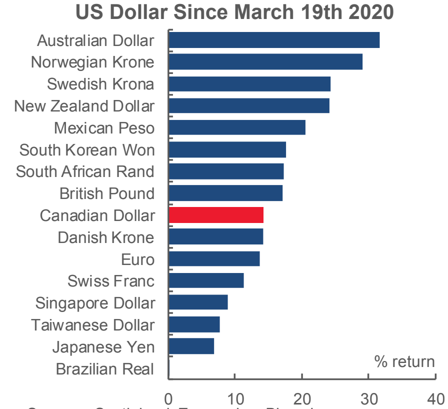
Evan Andrade, Economic Analyst
416.862.3080
Scotiabank Economics
evan.andrade@scotiabank.com

Chart 1 **Major Currencies Against the US Dollar Since December 17th 2019**



Sources: Scotiabank Economics, Bloomberg.

Chart 2 **Major Currencies Against the US Dollar Since March 19th 2020**



Sources: Scotiabank Economics, Bloomberg.

Chart 3 **Major Currencies Against the US Dollar Since October 30th 2020**

Sources: Scotiabank Economics, Bloomberg.

- I thought he was too sanguine toward housing risks.

The most succinct indication of the overall tone of the speech was provided early on. This wasn't a downbeat sounding Governor out to spit in anybody's holiday 'nog. He's a nice guy, so he wanted a cheerful message going into a rough stretch for Canadians. If anything, the broad tone of his remarks leaned a bit more toward the optimistic side. Here's one passage to consider:

> "Because we all need to lift our spirits as we head into the holiday season, I want to end the year with some cautious optimism. My message is that exports and business investment could bounce back from this recession more quickly than they did after the global financial crisis. But for this to happen, we all have some work to do."

Another notable quote to this effect was delivered during the press conference:

> "I have to say I've been very impressed by the resilience of the Canadian economy."

That doesn't sound to me like a Governor preparing to enter the new year with some token half cut.

On CAD, the Governor said several things in his speech and the press conference

> "More recently, the Canadian dollar has been appreciating, largely reflecting a broad-based depreciation of the US dollar. This is hurting the competitiveness of Canadian exporters in our largest market."
>
> "The Canadian dollar has been appreciating, and for the most part that appreciation doesn't reflect made-in-Canada factors. It largely reflects a broad-based depreciation of the US dollar."
>
> The C$ has been "relatively stable" against other currencies.
>
> "We don't target the dollar, we don't have an objective for the Canadian dollar, it's set in the markets."
>
> "It's on our radar screen."

While I appreciated the broad tone of his speech, **I found the concerns expressed toward CAD to be puzzling quite frankly.** Charts 1–3 show the appreciation in multiple major currencies to the USD over different periods of time. Compared to a year-ago, CAD has barely budged while underperforming multiple other stronger crosses against the USD which is notable since currency moves that are sustained and carry longer lagging effects should be the focus. Compared to CAD's weakest point last March, it's rise since then has only at best made it a middle of the pack performer against the USD. Ditto when the starting point is instead the end of October to reflect the more recent period of appreciation. The first point is therefore that **CAD's appreciation has been unspectacular compared to multiple other major currencies** and not just the USD and especially over the smoothed period of the past year.

The second point questions why this would seriously bother the BoC. If CAD's rise along with many others currencies over the past nine months reflects an improvement in risk appetite that sparked less demand for safe havens like the USD, yen and Swiss franc that have all underperformed, then shouldn't that be viewed as an encouraging development by way of confidence in the macro backdrop? In other words, it's the market saying we're repricing your currency because we think the global growth outlook has improved and along with it demand for your products. Put another way, would the BoC prefer to go back to the world where USDCAD stood at 1.45 instead of today's 1.27??

Further, even if CAD is a concern to the BoC, it can't really do a whole lot about it anyway. My advice? Don't walk into a room of FX traders and start waving a BB gun at them.

The Governor's remarks on CAD's effects, however, need to be taken in the full context where he spoke of upside and downside risks to exports. In fact, on balance, he sounded pretty optimistic that trade and investment could lead the way:

> "Nevertheless, there is room for cautious optimism that international trade will recover more quickly from the pandemic than it did from the global financial crisis, and Canadian businesses need to be ready. Since the initial shutdowns last spring, trade has bounced back faster than many economists had predicted. Recent international surveys suggest

executives expect trade to be strong in 2021. And the news of effective new vaccines puts a more certain timeline on the resurgence of global demand."

An added area where I'm not sure I agree with the Governor related to his remarks on housing. Macklem stated that "we're not seeing the kind of frothy housing markets we saw in 2016." See this morning's note for more on this topic. This is a record year for existing home sales, while resale months' supply sits at an all-time low and building price pressures are among the upward sources of pressure on Canadian inflation given the way CPI captures housing.

OVERNIGHT MARKETS

A wave of global releases covering purchasing managers' indices and UK inflation on the eve of the next day's Bank of England meeting will pose somewhat more elevated macro data risk through the overnight session.

November UK CPI will be released at 2amET. Inflation isn't expected to change from the 0.7% y/y reading from October. We expect inflation to end 2020 around 0.8% y/y with considerable uncertainty around the outlook in 2021. The tariffs and quotas brought on by failing to negotiate a deal before January 1st, 2021 will likely put upward pressure on prices next year.

The preliminary December Markit PMIs for France (3:15amET), Germany (3:30am ET), and the Eurozone (4am ET) will be released over the early morning. Re-imposed restrictions in the Eurozone to combat rising cases over Q4 should continue to hinder growth. A positive or negative surprise to the PMIs will heavily inform eurozone growth forecasts for the final quarter of the year and how the year is transitioning into the 2021.

The preliminary December UK PMIs will be released at 4:30am ET. The Oxford stringency index showed a loosening of restrictions at the beginning of the month which could lift the composite measure out of contractionary territory. Overall the new targeted measures to combat the second wave have had far less of an impact on economic activity relative to the first wave's measures.

Japan will also release PMIs for December at 7:30pmET. If Australia is any indication of what to expect across Asia-Pacific markets, then that country's release of its PMIs after North American markets closed was encouraging. The composite Australian PMI climbed by 2.1 points in December to 57.0 which is getting back toward the pandemic-era peak in July when it hit 57.8.

TOMORROW'S NORTH AMERICAN MARKETS

The main event will clearly be the FOMC communications toward afternoon but ongoing stimulus meetings between US Treasury Secretary Mnuchin, Pelosi, McConnell et al might offer competing risk.

Material data risk will include US retail sales for November (8:30amET) that are expected to record a softer pace of gains reflecting a decline in auto sales but also a fairly tepid start to the holiday shopping season. The US Markit PMIs for December will complete the suite of global PMI being updated this week (9:45amET).

See the week ahead (here) for a full Fed preview with expectations. In summation, I expect revised qualitative asset purchase program guidance at this meeting or at least jawboning where they will go with it soon, no alteration in total Treasury and MBS purchases, unchanged maturity distribution of these purchases and the previously promised new communication tools. What would surprise me would be not only if they extended maturity horizons for purchase activity at this juncture, but also if we saw more FOMC members indicating hikes in 2022 or 2023 than the one and four members who did so respectively in the September dots pre-vaccines. It might be premature to do so now, but it's likely the direction we're going into the subsequent dot plots in my view.

For Canadian CPI (8:30amET), I went low at –0.3% m/m NSA and 0.5% y/y on a combination of a typical seasonal m/m drop in seasonally unadjusted prices, a higher than usual prior starting point with the main drivers during the prior month expected to land weaker in November, plus lower gas prices. A wildcard is represented by imputed prices due to incomplete/missing markets that will start to come back in this release due to restrictions and lock downs (and more so in the next December CPI report).

Fixed Income	Government Yield Curves (%):											
	2-YEAR			5-YEAR			10-YEAR			30-YEAR		
	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk
U.S.	0.11	0.12	0.15	0.36	0.36	0.39	0.91	0.89	0.92	1.65	1.63	1.66
CANADA	0.26	0.25	0.27	0.45	0.44	0.47	0.73	0.72	0.74	1.29	1.28	1.28
GERMANY	-0.76	-0.77	-0.77	-0.79	-0.80	-0.79	-0.61	-0.62	-0.61	-0.20	-0.21	-0.19
JAPAN	-0.12	-0.13	-0.12	-0.12	-0.12	-0.11	0.01	0.01	0.02	0.62	0.63	0.64
U.K.	-0.05	-0.09	-0.08	-0.03	-0.06	-0.04	0.26	0.22	0.26	0.83	0.76	0.80
	Spreads vs. U.S. (bps):											
CANADA	14	14	12	8	9	7	-18	-18	-18	-36	-35	-38
GERMANY	-87	-89	-93	-115	-116	-119	-152	-151	-153	-185	-184	-185
JAPAN	-24	-24	-27	-48	-48	-51	-90	-88	-90	-103	-100	-103
U.K.	-17	-21	-23	-39	-42	-43	-65	-67	-66	-82	-87	-86

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	17506	119.1	0.7	-0.8	3.7	2.6
Dow 30	30199	337.8	1.1	0.1	0.8	7.0
S&P 500	3695	47.1	1.3	-0.2	1.9	15.8
Nasdaq	12595	155.0	1.2	0.1	5.6	42.9
DAX	13363	139.7	1.1	0.6	1.7	-0.3
FTSE	6513	-18.5	-0.3	-0.7	1.4	-13.4
Nikkei	26688	-44.6	-0.2	0.8	3.0	11.4
Hang Seng	26207	-182.2	-0.7	-0.4	-0.7	-4.7
CAC	5530	2.5	0.0	-0.5	1.1	-7.7
Commodities	Level		% change:			
WTI Crude	47.62	0.00	0.0	4.6	15.2	-20.9
Natural Gas	2.67	-0.01	-0.4	9.4	-0.9	14.1
Gold	1853.37	-0.27	-0.0	0.8	-1.9	25.6
Silver	23.86	0.04	0.2	0.4	-1.6	40.9
CRB Index	163.02	0.78	0.5	3.0	6.0	-12.0
Currencies	Level		% change:			
USDCAD	1.2699	-0.0002	-0.0	-0.9	-2.9	-3.5
EURUSD	1.2153	0.0002	0.0	0.6	2.5	9.1
USDJPY	103.63	-0.0400	-0.0	-0.6	-0.9	-5.4
AUDUSD	0.7557	-0.0002	-0.0	1.5	3.2	9.8
GBPUSD	1.3441	-0.0019	-0.1	0.3	1.8	0.8
USDCHF	0.8856	-0.0001	-0.0	-0.4	-3.0	-9.9

Central Banks	
Current Rate	
Canada - BoC	0.25
US - Fed	0.25
England - BoE	0.10
Euro zone - ECB	0.00
Japan - BoJ	-0.10
Mexico - Banxico	4.25
Australia - RBA	0.10
New Zealand - RBNZ	0.25
Next Meeting Date	
Canada - BoC	Jan 20, 2021
US - Fed	Dec 16, 2020
England - BoE	Dec 17, 2020
Euro zone - ECB	Jan 21, 2021
Japan - BoJ	Dec 18, 2020
Mexico - Banxico	Dec 17, 2020
Australia - RBA	Feb 01, 2021
New Zealand - RBNZ	Feb 23, 2021