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GLOBAL ECONOMICS

DAILY POINTS

January 24, 2024 @ 8:30 EST

Contributors

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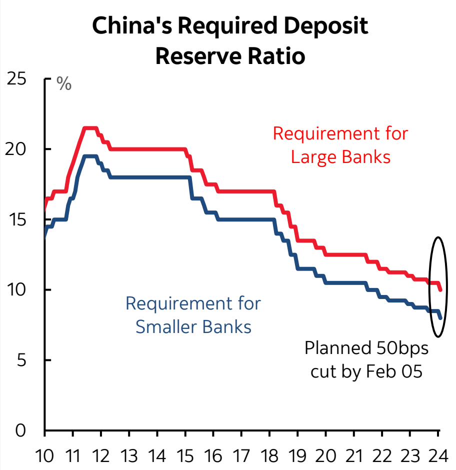
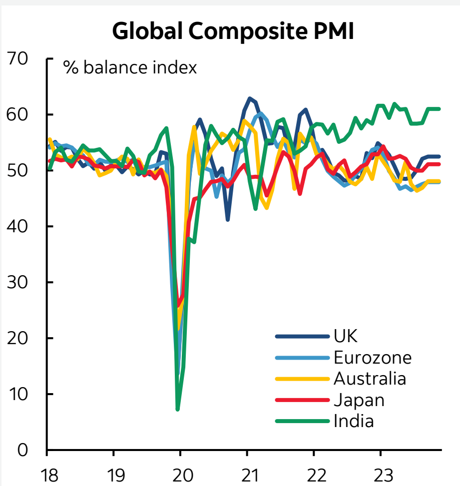
Chart 1



Sources: Scotiabank Economics, PBoC.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

On Deck for Wednesday, January 24							
Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	01-24	07:00	MBA Mortgage Applications (w/w)	Jan 19	--	--	10.4
CA	01-24	09:45	BoC Interest Rate Announcement (%)	Jan 24	5.0	5.0	5.0

KEY POINTS:

- **Risk-on sentiment aided by China stimulus**
- **Bank of Canada to hold while it may lean against nearer term cuts…**
- **…as everyone tells the same story on when cuts will commence…**
- **…that ignores still high inflation risk…**
- **….while relying upon the BoC's awful inflation forecasting track record**
- **Watch for potential BoC QT hints**
- **Canada appears on track for further fiscal expansion**
- **China cuts RRR again, but needs willing borrowers**
- **Cheap Chinese equities rallied for now, with Trump ahead**
- **Global PMIs favour Asia-Pacific countries over Europe**
- **Kiwi rates sell off as inflation details indicate ongoing domestic price pressures**
- **Trump merely beat himself**

Positive risk sentiment is driving equities higher across all main N.A. and European benchmarks after Chinese equities rallied on hastily arranged stimulus measures. The authorities appear to be scrambling as investors turn up their noses at cheap valuations perhaps partly due to US political risk; the Hang Seng's trailing and forward p/e ratios all sit between 5–8 times with a 4.4% dividend yield. US Ts are bull flattening a touch as EGBs rally by 2–4bps across countries and maturities. Gilts and Asia-Pacific benchmarks are cheaper partly on Chinese stimulus but also on NZ CPI details. The dollar is broadly softer amid the risk-on sentiment.

Scroll back to yesterday's posts for BoC expectations and the Global Week Ahead. I'll repeat them in the morning note, but not here in the chat. Canada fiscal content is offered below.

Xi Jinping was spotted trying to push on a string and screaming 'why won't this work?!!' His central bank cut the required reserve ratio by another 50bps in a somewhat unusually timed move. Cutting the RRR again technically frees up more capital for lending as long as there are willing borrowers. It helped equities for now but follow through will require a sustained acceleration of lending and not just the usual seasonal spurt around the coming Lunar New Year. It might also require some rather spirited optimism toward the mess that a Trump victory could represent to global including Chinese trade. China has been reducing RRRs for years as the economy has struggled against structural challenges (chart 1).

Speaking of which, Trump was victorious over a female version of himself who would pardon him. Apparently, they want the original fake, not a fake of a fake, as Haley failed to convince folks that she was that different. He's on track for a November rematch against Biden. Biden's slips have been well known for a while. Now Trump's recent quotes raise further issues of mental competency. Search for them, it's worth the entertainment; not just his usual brand of remarks, but downright garbled nonsense. This one has been among the recent gems:

> "Which is incapable of solvin' even the sollest…smallest problem. The simplest of problems we can no longer solve. We are an institute in a powerful death penalty. We will put this on." Huh???!

Meanwhile in Canada it seems apparent that the Feds are on track for more spending in a coming Winter budget that will continue to fight the BoC's efforts. PM Trudeau assailed a business lobby group's demand for spending cuts given the Federal government will once again blow through fiscal goals by saying his government has to be there to support people. Never mind that excessive fiscal pump priming for years has driven inflation and borrowing costs higher than would have otherwise been the case and with regressive effects that harm lower- and middle-income households. Further, the NDP's caucus retreat has them doubling down on demands for pharmacare legislation by March 1st as per the extension they agreed upon with the Libs late last year and that would add more spending while also demanding further housing measures while threatening to withdraw support for the minority government if they don't get their wishes. More spending driving more inflation and further complicating the BoC's efforts to control inflation has been part of my narrative against market pricing for the BoC's moves for a long while.

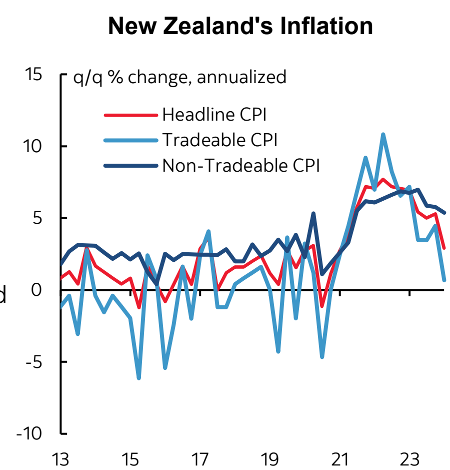
A slew of global purchasing managers for the current month can be briefly summarized by noting they favoured Asia-Pacific countries over Europe (chart 2):

- Eurozone: the composite PMI held steady at 47.9 (47.6 prior) with little change in the manufacturing and services PMIs, all of which remain in contraction.
- UK: the composite PMI was little changed at 52.5 (52.1 prior). As manufacturing jumped by 1.1 points to 47.3 and the more dominant services sector posted a small increase to 53.8 (53.4 prior). By these measures, the UK economy is expanding which stands in contrast to GDP figures.
- Japan: The composite PMI increased 1.1 points to 51.1 due to a 1.2 points jump in services (52.7) as manufacturing remained in contraction (48).
- Australia: The composite PMI increased 1.2 points to 48.1 and remains in contraction with the improvement driven mainly by services.
- India: The composite PMI put in the best showing of the whole lot of them by increased 2.5points to 61 thanks to gains in both services and manufacturing.

The US S&P PMIs arrive at 9:45amET and can have an impact upon markets but are not the measures more closely monitored by Fed-watchers. The S&P measures track global operations of US firms versus the ISM measures that monitor domestic activity.

Kiwi inflation details motivated an increase in New Zealand's yields of 4–5bps across the curve and lowered rate cut pricing in nearer term contracts by a few basis points. The headline reading landed on the screws at 0.5% q/q SA nonannualized which is the softest reading since 2020Q4 following a string of much larger gains. The rub lies in the fact that this was primarily due to commodity prices as reflected in a soft tradeable CPI reading of -0.2% q/q SA. Nontradeable CPI was up by 1.1% q/q SA which is in keeping with the trend of relatively large gains over the 2021–23 period and is more closely tied to the domestic economy. See chart 3.

Chart 3



Sources: Scotiabank Economics, Stats NZ.

BANK OF CANADA

The main focus for many of us will clearly be the BoC. See my Global Week Ahead **here** for a fuller preview. As a reminder, note the different times and as flagged when they announced the changes to communications on December 15th. The statement, MPR and the text of Governor Macklem's opening remarks for his press conference all arrive at 9:45amET and then the press conference held by Governor Macklem and SDG Rogers occurs at 10:30amET.

No policy rate change is expected. No balance sheet changes are likely but there may be hints at how such changes are afoot. Expect less confidence in near-term progress on the inflation front and more pushback against nearer term easing.

Since it's a full MPR, we'll get a full forecast update that they'll have to live with until April. I expect a mildly more hawkish tone. Q4 growth might be a little better than they've been assuming, but recall that you don't ease on first signs that tighter monetary policy is among the factors that are damaging growth since that's the whole point of the exercise! Headline inflation is a tick lower than the October MPR's forecast for 2023Q4, but they are likely to be concerned that their preferred core measures have reaccelerated over the past couple of readings while inflation risk has pivoted higher again (chart 4).

On balance, I expect them to continue to guide they expect inflation to be on 2% next year and that they won't wait until that point to begin easing. Who cares. The BoC always says that and is almost always wrong. The general equilibrium models they use are hardwired to achieve balance within about a 2-year period of time and they are trying to jawbone inflation expectations lower. If you want to know what your priced views on the BoC are derived from, then have a look at chart 5 and think again. Every shop's house view is saying the same thing, cut mid-year, 6–12 or maybe 18 months ahead of achieving 2% while gullibly accepting the BoC's word for when that will happen.

Macklem knows this track record even as he puts on a brave face publicly. That's why I also expect Macklem to say they will be highly data dependent along the path between now and then to see if data is going their way and to reemphasize the same key measures they are monitoring.

Key will be any tweaks to inflation forecasts and output gap dynamics. In their last forecast in October they said they expected 2% inflation in 2025, ending the year at 2.1% Q4/Q4. How they adjust this—if at all—could be key by way of signalling when and by how much they may ease starting in advance.

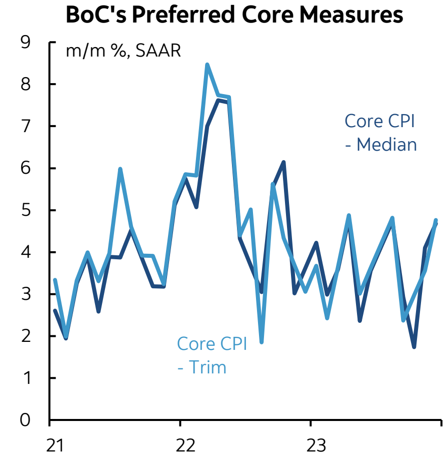
Statement changes:

- Will they adjust "The slowdown in the economy is reducing inflationary pressures in a broadening range of goods and services prices." There is a case for softening this given the reacceleration.
- I expect them to retain the sentence that says they remain "prepared to raise the policy rate further if needed." The reason is one-part a fundamentals argument, another part market management.
- I expect an unchanged reference to what they are continuing to monitor, namely how "Governing Council wants to see further and sustained easing in core inflation, and continues to focus on the balance between demand and supply in the economy, inflation expectations, wage growth and corporate pricing behaviour."
- They are unlikely to announce any QT changes today. The BoC tends to prefer setting up expectations for balance sheet changes in advance with focused communications. Expect questioning in the presser and watch for risk of QT commentary that may indicate they are considering changes especially ahead of the large maturity in April. In my view, they need to address the root cause which is an overly aggressive pace of winding down settlement balances and I would expect a speech in the nearer term.

While markets have sharply lowered cut pricing by mostly eliminating March and reducing April from nearly a half point priced cut to under 20bps, I still think paying those contracts is prudent. I also don't yet like a cut by mid-year which is what everyone is saying in a deeply crowded consensus. I remain much more concerned about persistent underlying inflationary pressures while inflation risk is pivoting higher.

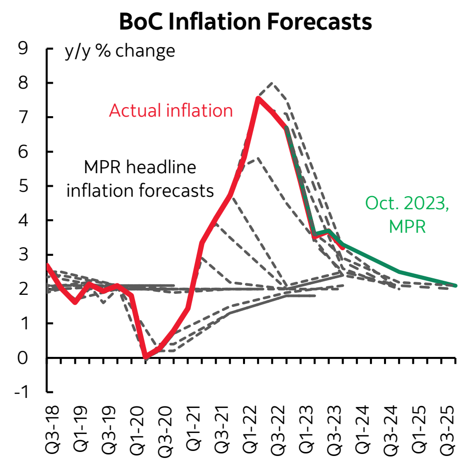
On that note, I continue to believe that inflation risk is higher in Canada than the US and the BoC should take its time and be patient even as the Fed eventually begins cutting. Here's the partial list: ripping wages with collective bargaining efforts cementing years of wage gains 2–3 times the BoC's inflation rate and more (chart 6); inflation expectations that remain at or above the upper end of the BoC's 1–3% target range; tumbling labour productivity; rampantly excessive immigration on a thoroughly mismanaged file that begs a pre–election cabinet shuffle; tight housing and auto inventories; ongoing fiscal stimulus that will very likely increase further at the federal and provincial levels of government;

Chart 4



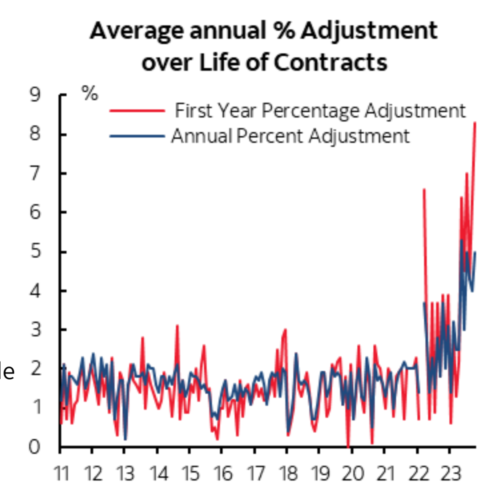
Sources: Scotiabank Economics, Statistics Canada.

Chart 5



Sources: Scotiabank Economics, BoC, Haver.

Chart 6



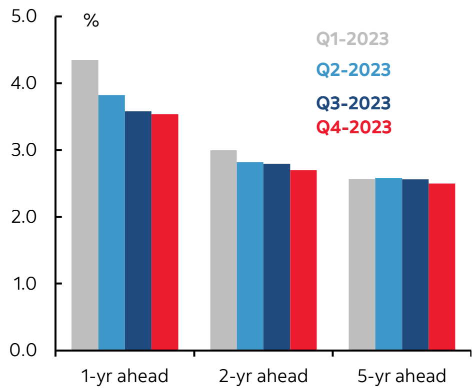
Sources: Scotiabank Economics, Statistics Canada.

renewed global supply chain pressures as indicated by soaring shipping costs. Output gaps are one thing in terms of drivers of inflation, but the Governor applauds the move toward gradual balance and excess supply too loudly as the foundation for the BoC's inflation forecasts.

Today's inflation remains a different animal than in the past. With inflation expectations proving to be stubbornly high amid evidence of changed behaviour through wage settlements and moribund productivity, I fear the BoC remains behind the curve. If it doesn't do what is necessary to control inflation because of the heat it is taking, then inflation will persist as a pernicious, insidious, regressive tax on those who can least afford to pay it right into October 2025. Biden's polling is weak partly because Bidenomics failed the promise of improving conditions for his base by driving up inflation and borrowing costs while he is mismanaging immigration. Trudeaunomics should take some lessons from this but appears to be doubling down.

Chart 7

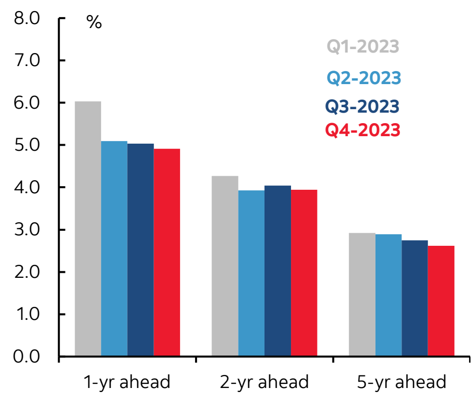
Canadian Businesses' Inflation Expectations Remain High



Sources: Scotiabank Economics, Bank of Canada.

Chart 8

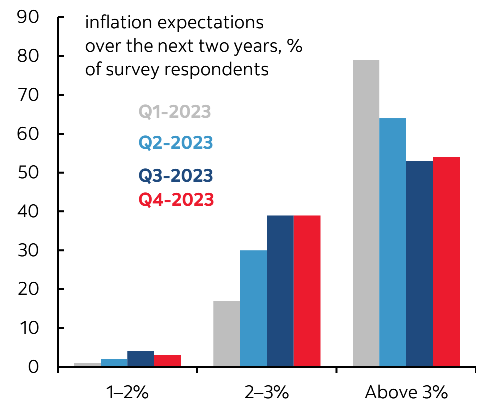
Canadian Consumers Inflation Expectations



Sources: Scotiabank Economics, Bank of Canada.

Chart 9

Canadian Businesses Expect Inflation to Surpass BoC's Target



Sources: Scotiabank Economics, Bank of Canada.

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.	4.31	4.37	4.36	4.01	4.04	4.03	4.10	4.13	4.10	4.33	4.36	4.31
CANADA	4.01	4.04	4.04	3.49	3.53	3.51	3.44	3.47	3.44	3.38	3.41	3.36
GERMANY	2.69	2.71	2.70	2.24	2.27	2.24	2.33	2.35	2.32	2.52	2.54	2.47
JAPAN	0.07	0.04	0.03	0.32	0.27	0.21	0.72	0.67	0.62	1.80	1.76	1.62
U.K.	4.39	4.38	4.38	3.94	3.93	3.91	3.99	3.99	3.99	4.59	4.58	4.64
	Spreads vs. U.S. (bps):											
CANADA	-29	-33	-32	-52	-51	-52	-66	-66	-66	-95	-95	-95
GERMANY	-161	-166	-166	-176	-177	-179	-177	-178	-179	-182	-183	-184
JAPAN	-423	-433	-434	-369	-377	-382	-338	-346	-349	-254	-260	-269
U.K.	8	0	2	-6	-11	-12	-11	-14	-12	25	22	33

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	21035	110.3	0.5	0.4	0.7	2.0
Dow 30	37905	-96.4	-0.3	1.5	1.4	12.4
S&P 500	4865	14.2	0.3	2.1	2.3	21.1
Nasdaq	15426	65.6	0.4	3.2	2.9	36.1
DAX	16866	238.9	1.4	2.6	1.0	11.7
FTSE	7513	27.5	0.4	0.9	-2.4	-3.1
Nikkei	36226	-291.1	-0.8	2.1	8.9	32.2
Hang Seng	15900	545.9	3.6	4.1	-2.7	-27.9
CAC	7452	64.4	0.9	1.8	-1.5	5.7
Commodities	Level		% change:			
WTI Crude	74.69	0.32	0.4	2.9	1.5	-6.8
Natural Gas	2.50	0.05	2.1	-12.8	-4.1	-23.2
Gold	2036.05	6.77	0.3	1.5	-0.8	5.1
Silver	22.26	0.06	0.3	-3.4	-9.0	-6.0
CRB Index	268.20	1.25	0.5	2.0	0.6	-3.5
Currencies	Level		% change:			
USDCAD	1.3445	-0.0017	-0.1	-0.5	1.4	0.6
EURUSD	1.0911	0.0057	0.5	0.3	-0.9	0.2
USDJPY	146.98	-1.3700	-0.9	-0.8	3.3	12.9
AUDUSD	0.6613	0.0033	0.5	0.9	-2.7	-6.1
GBPUSD	1.2754	0.0067	0.5	0.6	0.5	3.4
USDCHF	0.8621	-0.0081	-0.9	-0.3	0.9	-6.6

Central Banks	
Current Rate	
Canada - BoC	5.00
US - Fed	5.50
England - BoE	5.25
Euro zone - ECB	4.50
Japan - BoJ	-0.10
Mexico - Banxico	11.25
Australia - RBA	4.35
New Zealand - RBNZ	5.50
Next Meeting Date	
Canada - BoC	Jan 24, 2024
US - Fed	Jan 31, 2024
England - BoE	Feb 01, 2024
Euro zone - ECB	Jan 25, 2024
Japan - BoJ	Mar 19, 2024
Mexico - Banxico	Feb 08, 2024
Australia - RBA	Feb 05, 2024
New Zealand - RBNZ	Feb 27, 2024