Scotiabank

GLOBAL ECONOMICS

DAILY POINTS

February 22, 2024 @ 7:50 EST

Contributors

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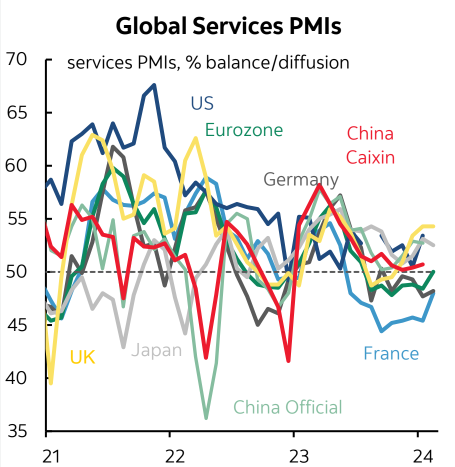
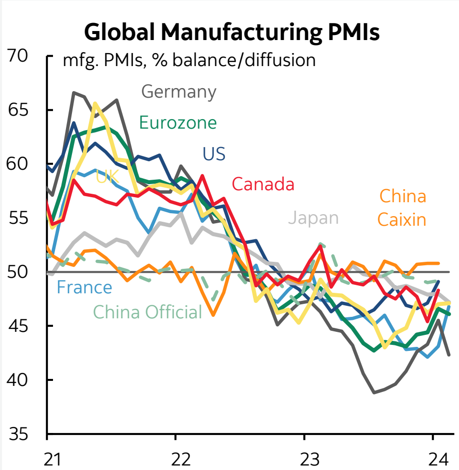
Chart 1



Sources: Scotiabank Economics, Markit, Bloomberg, ISM.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

On Deck for Thursday, February 22

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	02-22	08:30	Retail Sales (m/m)	Dec	0.8	0.8	-0.2
CA	02-22	08:30	Retail Sales ex. Autos (m/m)	Dec	--	0.7	-0.5
US	02-22	08:30	Initial Jobless Claims (000s)	Feb 17	220	216.0	212.0
US	02-22	08:30	Continuing Claims (000s)	Feb 10	1880	1884.0	1895.0
US	02-22	10:00	Existing Home Sales (mn a.r.)	Jan	4.1	4.0	3.8
US	02-22	10:00	Existing Home Sales (m/m)	Jan	8.5	4.9	-1.1
US	02-22	10:00	Fed's Jefferson to Give Speech, Q&A				
US	02-22	14:00	Fed's Harker Speaks on Economic Outlook				
US	02-22	17:00	Fed's Cook Speaks at Macrofinance Conference				
US	02-22	17:00	Fed's Kashkari Participates in Panel Discussion on Outlook				
US	02-22	19:35	Fed's Waller Speaks on Economic Outlook				

KEY POINTS:

- **Risk-on sentiment driven by earnings and data**
- **PMIs improve across most major markets...**
- **...including a signalled end to the UK's technical recession**
- **Canadian retail sales: watch December details and revisions, January guidance**
- **Where does it say that the BoC's mandate applies to just 75% of the basket??**
- **B.C. to kick off Canada's budget season with more spending, bigger deficit**
- **US: Fed-speak, light data**
- **Mexico's economy ended 2023 better than feared**
- **BoK, Central Bank of Turkey both held**

Data and Nvidia earnings are driving positive risk sentiment. After initial volatility, markets decided Nvidia's earnings and guidance were enough to drive what is so far a 14% rise to a market cap of about US$1.7 trillion with a weight of over 4% on the S&P. S&P futures are up by 1.2% so far and therefore the rest of the rally is driven by broader sentiment including the effects of improved PMIs across most regions. European stocks are also up by as little as 0.2% in London to as much as 1.3% in Germany. The dollar is broadly softer as higher beta crosses gain. Sovereign bonds yields are mostly a touch cheaper toward the front-ends in the US and across EGBs as Canadas are flat and gilts outperform in a modest bull steepener. Gilts may be benefiting from an FT piece that flagged that Winterflood Securities will allow individual investors to buy gilts in the primary market through retail platforms.

Purchasing managers indices improved across most major markets and are shown in charts 1 and 2.

- Eurozone: The composite PMI increased by a full point to 48.9 which still remains in contraction at a sub-50 reading. The improvement was entirely due to services that climbed 1.6 points to 50 while manufacturing slipped a half point to 46.1.
- UK: The composite PMI edged up a bit to 53.3 from 52.9 and hence signals a return to growth in Q1 after two back-to-back contractions in GDP. The composite PMI has risen from contractionary readings up to October and steadily climbed since then.
- Australia: Here too, the composite PMI edged up 2.8 points to 51.8 and was entirely led by services (52.8 from 49.1) as manufacturing fell back into contraction (47.7, 50.1 prior).
- Japan: Here is the one exception. The composite PMI fell 1.2 points to 50.3 as both services (52.5, 53.1 prior) and manufacturing (50.3, 51.5 prior) retreated.

- India's composite PMI was little changed but still signals quite solid growth. The composite landed at 61.5 (61.2 prior) as both services and manufacturing edged a little higher.

The US will update its S&P PMIs later this morning (9:45amET). They are not the Fed's preferred gauges because they track global operations as opposed to the ISM measures that track domestic operations in keeping with the Fed's primary focus upon the domestic economy.

The Bank of Korea held its base rate at 3.5% as universally expected. One board member advocated nearer term easing and that was seized upon by markets that drove a slightly richer front-end. Governor Rhee Chang-yong nevertheless argued against nearer-term easing over 2024H1.

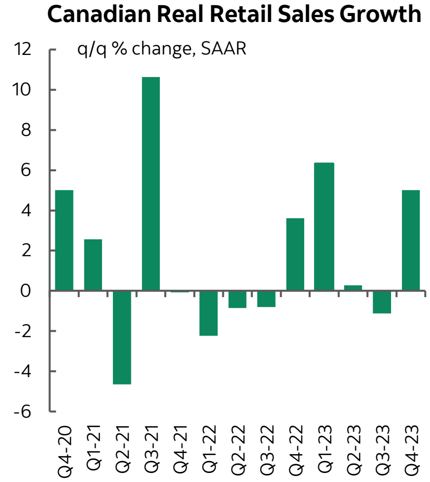
The Central Bank of Turkey left its one-week repo rate unchanged at 45% as widely expected under yet another new Governor. The bias points to a protracted hold with ongoing hike risk that is data dependent upon inflation.

Mexico's December reading for the economic activity index was better than feared at –0.05% m/m (-0.4% consensus). Bi-weekly core CPI was a touch softer than expected at 0.2% w/w (0.3% consensus). Q4 GDP was left unchanged at the original estiamte of 0.1% q/q 0.1% q/q SA nonannualized.

There will be three things to watch into the N.A. session:

1. Canadian retail sales (8:30amET): A strong December flash estimate of +0.8% m/m for nominal sales is subject to revision, but the fresh info will be the January flash. We know auto sales were sharply higher in January, but will that be enough to carry the January headline? Recall that consumers powered a sharp gain of 5% q/q SAAR in Canadian retail sales volumes during Q4 (chart 3).

Chart 3



Sources: Scotiabank Economics, Statistics Canada.

2. BC Budget: The veil will lift at 4:10pmET as BC fires the opening shot on Canada's government budget season. Finance Minister Katrine Conroy has already guided that there will be more spending and a bigger budget deficit to help with the cost of living. That's been what I have expected as a general theme for Budget season in Canada as more government spending continues to fight the Bank of Canada's efforts to control inflation. Spending is expected to focus upon housing assistance and support for small businesses as CEBA loans expire.

3. Five Fed speakers will fight over the microphone today. There will also be light US data beyond the PMIs including existing home sales during January (10amET) and weekly initial jobless claims (8:30amET). Fed speakers will include Jefferson (10amET), Harker (2pmET), Cook (5pmET), Kashkari (5pmET) and Waller (7:35pmET).

THE BANK OF CANADA CAN'T EXCLUDE SHELTER FROM ITS MANDATE

A persistent point of debate in Canada is whether the Bank of Canada should be pivoting toward cutting by reprofiling the CPI basket to exclude shelter costs because ex-shelter, current inflation is otherwise relatively tame. Here are reasons I see that as profoundly bad advice.

- First, ignoring shelter is another manifestation of the exclusion principle that led to bad advice to the Bank of Canada throughout the pandemic. That approach started with a prior about what the central bank should be doing (hiking less, or in the current context, cutting soon) and then defined the CPI basket in a selective way in order to achieve such an outcome. Talk about data manipulation to suit the narrative! That's how the central bank got caught flat-footed by reacting too late because it misread too many of the inflation warning signs and then we got saddled with high inflation and bigger hikes than we would have otherwise needed. The camp that says remove shelter from the basket now to merit cuts risks doing the exact same mistake.

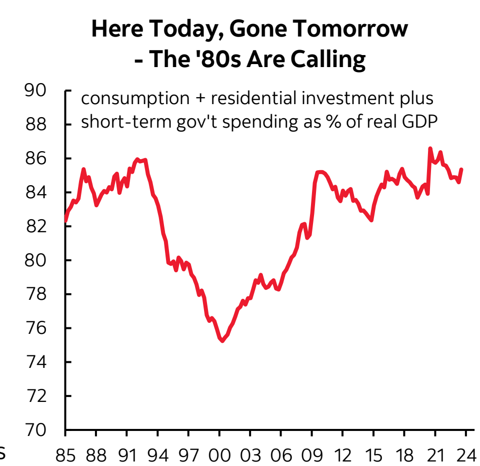
- Second, the BoC's mandate is to achieve 2% inflation over medium-term. It is not 2% inflation over the medium-term *excluding a quarter of the basket*! That quarter of the basket is about what you get when shelter's 28% weight is reduced by removing mortgage interest cost's weight of under 4%. To ignore shelter, the BoC would be derelict in its duty to deliver upon its mandate and that would be a disturbing sign to markets. Ignoring a quarter of the basket is metaphorically akin to ignoring the elephant that's standing on your head.

- Third, I think shelter cost inflation is going to be persistent and ignoring its weight could result in never being able to durably achieve 2% inflation.
- Fourth, I think shelter cost inflation is associated with other types of inflation through activities that are complementary to housing. Anyone who has bought a new or existing home knows this because they've had to buy a new roof or windows or backyard deck or landscaping or furnace or that shiny new car to go in the driveway of the new digs. Ignoring shelter in CPI and the risks to its outlook can be tantamount to ignoring too many other components of the basket.
- Fifth, context matters. When former Governor Poloz cut in 2015 and was dovish afterward, he could do so without fussing over the fact that he inflamed housing markets because inflation was low, inflation expectations were on target, and inflation risk was also low. It was a different world. Macklem doesn't face the same conditions as Poloz did. We've had a very recent soft patch in underlying inflation and need a lot more evidence to avoid easing prematurely and lighting it up again. Expectations are still at or above the upper end of the 1–3% inflation target range. Inflation drivers and inflation risk are still much alive.
- Sixth, the view that one can exclude shelter assumes there are no such other drivers of inflation risk that are still out there. Yes there are. The list includes soaring real wages, tumbling productivity, excessive immigration, housing shortfalls, ongoing fiscal pump priming, pressured global supply chains, only slight excess supply conditions, etc etc. It's not just about backward looking and volatile recent inflation data!
- Seventh, there is an argument to be made that excessively low rates over Poloz's period raised the weight on current spending as a share of GDP to today's eye watering levels (chart 4). That made Canada an economy that spends it all on here-today-gone-tomorrow current consumption which magnified longer run inflation risk with proportionately less spent on investment and hence upon improving productivity. A strict focus upon inflation targeting can have its downsides over time. Consumption plus residential investment plus short-term government spending (excluding their capital budgets) equals an astounding 85% of GDP. That's ten points higher than in 2000 and back to late 1980s levels. Who cares? I'll quote a former BoC Governor:

  > "Shorter-run biases in economic policy stack the deck in favour of inflation. So while accommodating and encouraging inflation is all too easy, limited and reducing inflation is not." —John Crow, Governor of the Bank of Canada, 1987–1994.

- Finally, inflation expectations and changed behaviour as indicated by wage setting exercises are driven by overall inflation. Consumers don't differentiate between different sources of inflation and instead look at broad cost of living pressures. Ignoring a major driver of those cost of living pressures risks being out of touch with how expectations are formed and how behaviour changes in ways that threaten the BoC's ability to deliver upon its inflation mandate.

Chart 4



Sources: Scotiabank Economics, Statistics Canada.

So in all, I find that this proposition that inflation targeting should cross out the shelter component is just the latest iteration of the bias that has resurfaced throughout the pandemic to ignore this, ignore that, can't control this, can't control that—and before you know it we've got runaway inflation and fundamental changes in behaviour (eg. wage settlements, poor productivity).

Last, think about the extension of the policy advice for a minute. Ignoring shelter as the justification to ease in potentially premature fashion could reignite broader inflationary pressures especially if done straight into the peak Spring housing market and through another round of what I'm sure will be expansionary government budgets.

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.	4.69	4.67	4.58	4.32	4.31	4.22	4.33	4.32	4.23	4.49	4.48	4.41
CANADA	4.20	4.19	4.25	3.62	3.62	3.63	3.54	3.55	3.54	3.42	3.43	3.41
GERMANY	2.89	2.85	2.76	2.44	2.43	2.33	2.45	2.45	2.36	2.58	2.59	2.53
JAPAN	0.17	0.16	0.14	0.37	0.36	0.34	0.72	0.73	0.73	1.73	1.73	1.81
U.K.	4.60	4.63	4.58	4.14	4.14	4.06	4.11	4.10	4.05	4.63	4.64	4.60
	Spreads vs. U.S. (bps):											
CANADA	-49	-48	-32	-70	-68	-58	-79	-77	-69	-107	-105	-100
GERMANY	-180	-181	-182	-188	-188	-188	-188	-187	-187	-191	-189	-188
JAPAN	-452	-451	-444	-395	-395	-387	-361	-359	-350	-276	-275	-260
U.K.	-9	-3	0	-18	-16	-15	-22	-22	-18	14	16	19

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	21172	-45.1	-0.2	2.9	1.2	4.8
Dow 30	38612	48.4	0.1	0.9	1.6	16.8
S&P 500	4982	6.3	0.1	0.6	2.7	24.8
Nasdaq	15581	-49.9	-0.3	-0.5	1.4	35.4
DAX	17380	261.9	1.5	2.0	4.2	12.9
FTSE	7676	13.7	0.2	1.0	2.5	-3.2
Nikkei	39099	836.5	2.2	2.5	7.1	44.3
Hang Seng	16743	239.9	1.5	5.0	9.0	-17.7
CAC	7904	91.5	1.2	2.1	6.6	8.3
Commodities	Level		% change:			
WTI Crude	77.80	-0.11	-0.1	1.5	3.5	5.2
Natural Gas	1.73	-0.04	-2.5	7.4	-28.6	-20.5
Gold	2028.49	2.50	0.1	1.2	0.3	11.1
Silver	23.08	0.02	0.1	4.5	1.2	6.0
CRB Index	274.01	3.25	1.2	0.4	2.6	3.0
Currencies	Level		% change:			
USDCAD	1.3472	-0.0034	-0.3	0.1	-0.1	-0.6
EURUSD	1.0846	0.0027	0.2	0.7	-0.3	2.3
USDJPY	150.38	0.0800	0.1	0.3	1.5	11.5
AUDUSD	0.6571	0.0020	0.3	0.7	0.0	-3.4
GBPUSD	1.2671	0.0033	0.3	0.6	-0.3	5.2
USDCHF	0.8789	-0.0007	-0.1	-0.1	1.1	-5.6

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	**Mar 06, 2024**
US - Fed	**Mar 20, 2024**
England - BoE	**Mar 21, 2024**
Euro zone - ECB	**Mar 07, 2024**
Japan - BoJ	**Mar 19, 2024**
Mexico - Banxico	**Mar 21, 2024**
Australia - RBA	**Mar 18, 2024**
New Zealand - RBNZ	**Feb 27, 2024**