Scotiabank.

GLOBAL ECONOMICS

DAILY POINTS

July 10, 2024 @ *7:40 EST*

Contributors

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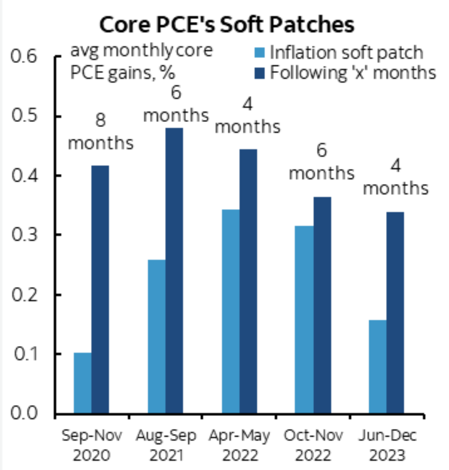
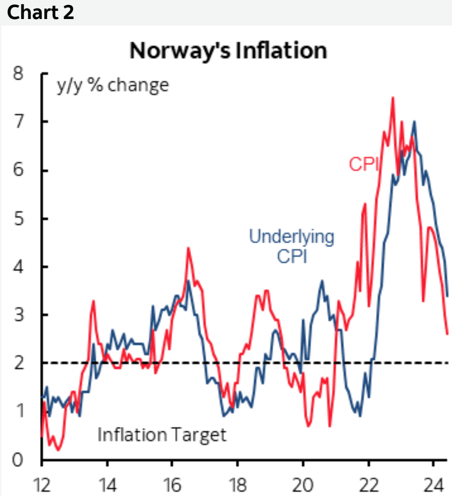
Chart 1



Sources: Scotiabank Economics, BLS.

Chart 2



Sources: Scotiabank Economics, Statistics Norway.

On Deck for Wednesday, July 10

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	07-10	07:00	MBA Mortgage Applications (w/w)	Jul 05	--	--	-2.6
US	07-10	08:30	Initial Jobless Claims (000s)	Jul 06	235	235.0	238.0
US	07-10	08:30	Continuing Claims (000s)	Jun 29	1845	1864.0	1858.0
US	07-10	10:00	Wholesale Inventories (m/m)	May F	--	0.6	0.6
US	07-10	10:00	Fed's Powell Testifies to House Financial Services				
US	07-10	14:30	Fed's Goolsbee, Bowman Give Opening Remarks at Childcare Event				
US	07-10	19:30	Fed's Cook Speaks on Global Inflation, Monetary Policy				

KEY POINTS:

- **Bonds and equities are rallying the day before US CPI**
- **What Powell should fear the most**
- **Powell round 2 to be no more exciting than round 1**
- **Powell's post-CPI comments on Monday may be the bigger risk**
- **Kiwi dollar underperforms, rates outperform on dovish RBNZ signals**
- **NOK depreciates, rates rally after softer than expected CPI**
- **China's core CPI inflation rate held steady**
- **Hands off home equity, Ottawa!**

There are no major calendar-based major macro risks to consider ahead of tomorrow's US CPI. The kiwi and Norwegian currencies and rates curves are the biggest movers on dovish signals that had markets adjusting central bank cut expectations.

What Powell Should Fear the Most

If you think Powell round 1 was dull, just wait until the version before the House financial services committee today (10amET). We'll hear for the umpteenth time that Powell likes the nascent evidence of cooling inflation but wants more data and that labour market pressures are becoming more balanced. The same opening statement will be delivered.

Chart 1 shows what he fears and justifiably so. It shows average m/m core PCE inflation during soft patches since the pandemic unfolded and then what happened over ensuing months. Five soft patches for core PCE inflation all gave way to renewed acceleration each and every time during the pandemic era including earlier this year. The soft patches have been of varying lengths as have the periods of renewed acceleration. The FOMC cannot overreact to just one soft core PCE print in May. Or even two if tomorrow's core CPI reading hints at a soft core PCE reading later in the month despite potential upside pressures.

The US will test appetite for 10s this afternoon after Powell is done.

Powell's Post-CPI Comments on Monday May be More Useful

Powell's appearance on Monday may be more insightful than his bland testimony yesterday and today. He delivers a post-CPI interview with David Rubinstein at the Economic Club of Washington at noon on Monday. Depending on what happens to CPI, if Powell wants to tee anything up for the 31st then this is his last scheduled chance to do so before the Committee goes into blackout on the 20th. I doubt very much that July is an option versus requiring more evidence and coming back in September, but it's a risk.

Even at that it's not totally clear that Powell would limit himself to commenting on Monday. They have found other ways to get the message out within blackout ahead of FOMC decisions in the past when they have felt a strong need to shift. The main risks in that sense would be PCE on the 26th and maybe Q2 GDP and Q2 core PCE on the 25th.

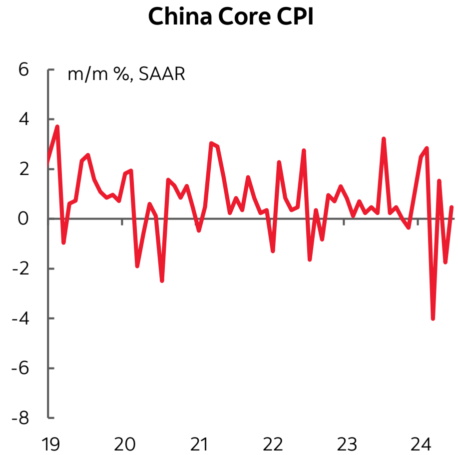
The RBNZ is Paving the Way for a Pivot

The RBNZ held its official cash rate unchanged at 5.5% as universally expected. It also sounded somewhat more dovish than markets expected which drove the NZ$ weaker and a 13bps decline in 2-year bond yields in a bull steepener move. Pricing for the August 14th meeting doubled to 14bps of a quarter point cut and just over a full cut is priced for the October meeting.

The statement flagged "more evidence of excess productivity capacity emerging" aka net excess supply, that they are "confident that inflation will return to within its 1–3 percent target range over the second half of 2024," and that "monetary policy is feeding through to domestic demand more strongly than expected."

The RBNZ's next forecasts with explicit forward guidance will be delivered at the August meeting. The RBNZ's prior explicit forward guidance back in May indicated that easing wasn't likely until well into 2025 and so at risk is a wholesale revision to their explicit forward guidance. Q2 CPI on July 16th will be watched carefully, especially the non tradeable component that is more aligned with domestic drivers of inflation.

Chart 3



Sources: Scotiabank Economics, China National Bureau of Statistics.

Markets Increase Pricing for a Year-end Cut by Norges Bank

NOK is competing with the NZ$ for the softest cross to the USD this morning as its own rates curve is also outperforming other global benchmarks in the wake of a softer than expected CPI reading (chart 2). Norway's rates curve rallied by about 8–10bps across maturities. Markets added 10bps to pricing for a cut by the December meeting that now stands at about 15bps. CPI in June was up 0.2% m/m (0.6% consensus) with underlying inflation up by 0.2% (0.4% consensus).

Low Chinese Core CPI Inflation Held Steady

China's CPI inflation rate slightly missed expectations at 0.2% y/y (0.4% consensus, 0.3% prior). Core inflation, however, was unchanged at 0.6% y/y and has been reasonably stable over the past four months. Core inflation in m/m terms ran similarly to the y/y rate at 0.5% m/m at a seasonally adjusted and annualized rate (chart 3). Deflation this is not, at least in terms of how most economists would define it as an economy-wide declines in a wide set of prices that is expected to persist to the point to which it alters behaviour by encouraging mass deferral of purchases and investment into future periods of expected cheaper prices. That's the 1930s scenario across western economies. China faces a plethora of risks, both structural and cyclical, but it also has an untapped well of policy options should genuine deflation risk surface.

Beware Ottawa Installing an ATM On Your Home!

Be nervous. And vocal. Ever since the Trudeau government started to require that Canadians report home sales on their income tax returns it has been feared that one purpose to doing so is to create the tax infrastructure to take it the next step and start taxing capital gains on principal residences. To date, they have not been taxed. The unwise move to increase the capital gains inclusion rate for assets other than the principal residence in this year's Budget was an added warning shot. It snuck up on an unprepared lobby group that was put into reaction mode but this time there should be very strongly organized opposition.

A further sign that the spendthrift Trudeau administration wants to tax your home came the other day as flagged in good articles like **this** one. The Prime Minister is keeping company with far left interest groups who want your home for their own purposes.

This idea of taxing capital gains on principal residences surfaced a few years ago in the context of trying to shock price expectations when house prices were rapidly rising. Apply taxes and wipe out the FOMO component of housing demand as one way of addressing affordability.

Now it's about generational 'fairness.' Somehow the warped logic is that robbing from folks who have seen capital gains on their homes will make them more affordable for younger potential entrants. Here are some of the reasons why it would be poor policy if Ottawa essentially enacted a measure that would be akin to installing ATMs on the sides of your homes to fund its heavy spending ambitions. Note that among the themes is that both first-time buyers and folks at a more advanced stage of life could be equally hurt.

- Lenders generally assess home equity estimates of collateral when deciding whether to approve a loan or not. If government takes a portion, then maybe lenders would adjust the terms to compensate for higher risk, or perhaps they would lower the amount they are willing to lend or they may just refuse loans especially for high ratio mortgages. Yeah, that'll help first-time home buyers who are among the most likely to have relatively little to put down on a home purchase. Taxing home equity could drive regressive outcomes.

- Bond markets would likely have the same reaction to such a policy measure as lenders especially in terms of insured mortgage bonds. The market could demand a wider mortgage bond spread over Canadas to compensate for higher risk of reduced equity backing a portfolio of bonds. The potentially wider spread would influence what mortgage borrowers pay especially for the higher ratio mortgages of first-time buyers which, again, would be a regressive outcome. Ottawa's overall funding costs through its crown corporation could rise. That mortgage bond spreads are sensitive to policy shifts was clearly apparent over the past year as the Federal government went back and forth tinkering with the mortgage bond program in cavalier fashion that indicated they had no idea of what they were doing.

- Taxing capital gains on principal residences could work against increasing housing supply as the biggest challenge facing housing markets by scaring off investment capital. Talk about an own goal! More demand could be funnelled into rental accommodations and, guess what, there aren't any!

- It would be a shock to many folks' retirement plans since many rely upon their home as a retirement nest egg. Even if grandfathered, house prices would adjust and adversely affect everyone. The shock could be rather acute given the sheer number of retiring boomers in an aging population. And recall that the government chose not to grandfather the hike in the capital gains inclusion rate. To not grandfather such a tax change is exceptionally unfair to savers and investors who made decisions based upon what they understood to be the rules of the game only to see them suddenly and retroactively changed.

- Housing is already heavily taxed so let's abandon the myth that there is room for more taxes. Tens of thousands of dollars within an average home's price is accounted for in development charges, land transfer taxes, property taxes, taxes on inputs, estate settlement taxes, transactions taxes, taxes on renovations etc. If governments wish to do something useful for housing affordability, then they could consider cutting their housing levies, though incidence effects would have to be carefully considered.

- Implementation risk would be very high. The botched roll-out of the hike in the capital gains inclusion rate offered one example as the intention was announced and the muddle thinking about how to do it unfolded afterward. For instance, would people be allowed to deduct capital improvements to their homes? That would only seem fair, and yet it would massively raise compliance costs and represent an unfair shift for those who didn't necessarily track those receipts over years if not decades.

- Who is to say governments will make good use of what they take from your home equity? Installing an ATM on the side of your home would offer a blank cheque to governments absent any discipline over what they do with the funds and this government already has an addiction to spending and excessive public sector hiring. Taxing housing's capital gains would be a structural long-term policy option that would fan expectations that Ottawa is seeking longer-lived spending pledges than it currently guides.

- Then there is the issue of triple taxation extending its reach into your savings which is what the government has already done by taxing capital gains on everything other than principal residences. You pay taxes on income, on consumption and on non-sheltered savings. The last thing left is for government to steal your retirement savings and taxing home equity could be the thin edge of the wedge in that regard. What next, TFSAs? Change RRSP terms? The knock on effects to confidence in retirement savings vehicles could be damaging and out of the control of politicians' short-term words against ever possibly thinking of doing such things after setting precedents.

- The housing stock could fall into disrepair by damaging investment in upkeep if government gets a part. Think rent-controlled housing where government action ruined the market and caused high rents. Canadians finance home renos partly out of capital gains on their homes and on the expectation that renos will raise the value of their home. Dent after-tax capital gains and the incentive to invest in renos goes down.

- Reverse mortgages would be made less attractive with government taking a slice and that would hit some retirees who wish to stay in their homes. If they could still qualify, they might secure a lower financing limit as a sudden shock to their retirement lifestyles.

- Taxing home equity would do nothing to address the root causes of worsening housing affordability for younger Canadians. In my view, a key one is the focus upon redistribution rather than a productivity- and income-raising agenda. Youth unemployment is becoming a disturbing phenomenon in Canada as argued **here**. Further, the Feds routinely over-stimulate demand for housing and are doing it again with subsidy cheques aplenty, increasing withdrawal limits under the Home Buyers' Plan, and extending amortization periods for insured mortgages on new homes. The Bank of Canada kept policy far too loose for too long while fiscal policy stimulus long ago outlived its usefulness, the combination of which added to inflation and soaring house prices over the pandemic recovery period. The granddaddy of all examples of excessive housing stimulus is Canada's thoroughly mismanaged immigration policy that is targeting too many arrivals too soon without preparing for their arrivals while tuly messing up on temporary immigration that it still has not addressed.

- The real intent of taxing home equity is not to help young people trying to buy a home. It’s to give Ottawa more money to spend on social programs without doing further damage to deficits and the massive future annual bills for interest expense on the debt. Full stop.
- Taxing capital gains on principal residences would just be a beginning. Once governments introduce new tax policies, they only keep returning to the well. ‘Just a little bit more’ is getting to be a tired and out of touch mantra, but I guarantee you that once the initial furor subsides, future governments would be raising the rate of taxation on your home. Income taxes and mill rates certainly have not gone down since their introductions.
- While we are in the soft landing camp at Scotiabank Economics and always have been, the uncertainty around the outlook is high and an abrupt shock like taxing capital gains on principal residences could incite a harsher than desired outcome.
- If house prices fell in future—such as in a future nasty recession— then governments would bleed more because of tax losses. On the assumption that taxing housing’s capital gains would be symmetrical policy as in other cases, capital losses could amplify procyclical risks to government finances and blow-out deficits even more during downturns. Think back to coming off the late 1980s boom after which it took many years into the 2000s for Toronto house prices to recover; fiscal deficits were already running at a high level and would have been made worse for a long time if capital losses could have been written off by taxpayers. In such a scenario, the nation’s credit rating could be imperiled.
- Some say that because the US taxes capital gains on a principal residence over US$500k (married couples) or $250k (individuals) that Canada should do so. First off, anything that starts with how US tax policy is a model for the world is probably immediate cause for skepticism! In this case, it’s just plain wrong. The US treats housing kind of like how Canada treats RRSPs. In the US, capital gains are taxed, but you get to write-off mortgage interest and SALT deductions including property taxes so you can't double dip by subsequently not paying it back later. It's a deferred tax bill on housing in the US, like Canada’s RRSPs. Canada is very different. You don't generally (some do) get those deductions, so you shouldn't be taxed later. If Canada starts taxing principal residences in order to emulate the US, then allow for mortgage interest deductibility. Personally, I think that’s trying to make two wrongs into a right, but if you’re going to go the route of comparing to the US then don’t cherry pick the arguments.

Lastly, taxing capital gains on principal residences would be the ultimate own-goal from a political standpoint in my opinion. An election looms by no later than October 2025 and no earlier than next Spring given that multiple MPs including the NDP leader have not reached the six-year qualifying periods for their public pensions. Pick your battles, with the battle over home equity likely to be a divisive doozy.

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.	4.61	4.63	4.71	4.23	4.24	4.33	4.27	4.30	4.36	4.47	4.49	4.53
CANADA	3.91	3.93	4.02	3.45	3.48	3.57	3.46	3.49	3.56	3.39	3.42	3.46
GERMANY	2.90	2.92	2.92	2.52	2.56	2.56	2.52	2.58	2.59	2.68	2.74	2.74
JAPAN	0.34	0.36	0.36	0.61	0.59	0.59	1.09	1.09	1.10	2.23	2.22	2.28
U.K.	4.10	4.13	4.17	3.95	4.00	4.03	4.10	4.16	4.17	4.61	4.66	4.67

	Spreads vs. U.S. (bps):											
CANADA	-70	-70	-68	-77	-77	-76	-82	-81	-80	-108	-107	-106
GERMANY	-172	-170	-179	-171	-168	-176	-175	-172	-177	-178	-175	-179
JAPAN	-427	-427	-435	-362	-366	-373	-319	-320	-326	-224	-227	-225
U.K.	-51	-50	-54	-28	-24	-30	-17	-14	-19	15	17	14

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	22043	-83.6	-0.4	0.4	-0.1	11.2
Dow 30	39292	-52.8	-0.1	0.3	1.1	15.8
S&P 500	5577	4.1	0.1	1.9	4.0	26.5
Nasdaq	18429	25.5	0.1	3.1	7.2	34.7
DAX	18327	91.2	0.5	-0.3	-0.9	16.9
FTSE	8187	46.9	0.6	0.2	-0.5	12.6
Nikkei	41832	251.8	0.6	3.1	6.9	29.9
Hang Seng	17472	-51.6	-0.3	-2.8	-3.9	-6.4
CAC	7550	41.2	0.5	-1.1	-4.4	5.7

Commodities	Level		% change:			
WTI Crude	81.22	-0.19	-0.2	-1.9	4.5	11.3
Natural Gas	2.38	0.04	1.5	-2.3	-18.1	-10.9
Gold	2377.06	12.97	0.5	0.9	6.6	23.5
Silver	31.06	0.07	0.2	6.0	2.6	36.7
CRB Index	289.98	-0.93	-0.3	-0.5	-0.5	9.7

Currencies	Level		% change:			
USDCAD	1.3635	-0.0001	-0.0	-0.0	-0.9	2.7
EURUSD	1.0825	0.0012	0.1	0.4	0.6	-1.6
USDJPY	161.50	0.1700	0.1	-0.1	2.8	14.3
AUDUSD	0.6742	0.0001	0.0	0.6	2.0	1.0
GBPUSD	1.2810	0.0024	0.2	0.5	0.6	-0.4
USDCHF	0.8981	0.0003	0.0	-0.4	0.2	1.4

Central Banks	Current Rate	Next Meeting Date
Canada - BoC	4.75	Jul 24, 2024
US - Fed	5.50	Jul 31, 2024
England - BoE	5.25	Aug 01, 2024
Euro zone - ECB	4.25	Jul 18, 2024
Japan - BoJ	-0.10	June 14, 2024
Mexico - Banxico	11.00	Aug 08, 2024
Australia - RBA	4.35	Aug 06, 2024
New Zealand - RBNZ	5.50	Jul 09, 2024