Scotiabank.

GLOBAL ECONOMICS

DAILY POINTS

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Contributors

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On Deck for Thursday, July 18

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	07-18	08:30	Initial Jobless Claims (000s)	Jul 13	240	229.0	222.0
US	07-18	08:30	Continuing Claims (000s)	Jul 06	1870	1856.0	1852.0
US	07-18	08:30	Philadelphia Fed Index	Jul	--	2.9	1.3
US	07-18	10:00	Leading Indicators (m/m)	Jun	--	-0.3	-0.5
US	07-18	16:00	Total Net TIC Flows (US$ bn)	May	--	--	66.2
US	07-18	16:00	Net Long-term TIC Flows (US$ bn)	May	--	--	123.1
US	07-18	13:45	Fed's Logan Gives Opening Remarks				
US	07-18	18:05	Fed's Daly Participates in Fireside Chat				
US	07-18	19:15	Fed's Bowman Gives Keynote Address				

KEY POINTS:

- **Markets yawning into the ECB's non event**
- **UK wage growth remains sticky, jobs rise, lending caution to the BoE**
- **Australia's job market remains on fire…**
- **…but the RBA will focus more on coming wages, inflation**
- **A light N.A. calendar**
- **If CAD is outperforming because of Carney headlines, then think twice**
- **Why the BoC won't adjust QT next week**

There are no real global macro forces behind market moves this morning. Instead, the focus is upon UK and Australian employment readings and how they may inform BoE and RBA moves, plus widespread expectations that the only reason for the ECB's Lagarde to stand at her lectern this morning is because the calendar says that she must. The most exciting thing about it may be what message she wishes her necklace to declare this time!

The USD is broadly stronger, except against the A$ (strong jobs) and CAD (see below). Sovereign yields are gently higher across most markets except for a flat UK front-end post jobs which is a questionable reaction. Cash equities are highest in Europe but N.A. futures are little changed.

The ECB's Non Event

The ECB should be a non-event for the most part. Nobody expects a policy rate change in the 8:15amET statement. No forecasts are due until September. They are waiting for the next round of wage figures and further evidence on inflation when core inflation in m/m terms and wage growth both remain quite warm. Lagarde is unlikely to tee up September when she speaks at 8:45amET. The end. So what are your weekend plans?

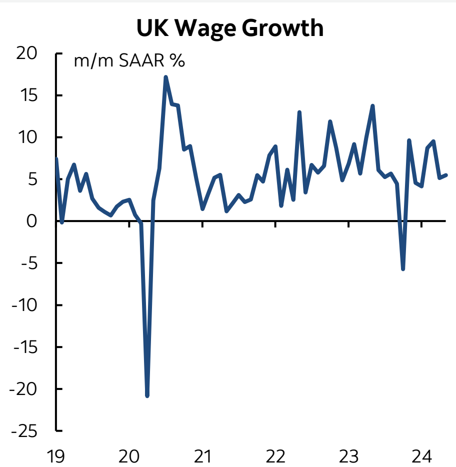
UK Wages, Jobs Add to the BoE's Caution

Markets took the batch of UK job market readings as a case to add a touch more to August 1st BoE pricing that is a 50–50 call. In my opinion, the batch of readings taken together may add to caution at the BoE. Along with relatively firm core CPI in m/m SAAR terms, it could well be that the 'finely balanced' part of the MPC that held at the prior meeting with a cut bias may be unlikely to join the minority who favoured easing in the 7–2 vote.

Start with wage growth. UK wage growth remains firm at 5.5% m/m SAAR in May (chart 1). It has been very sticky for an extended period. The year-over-year rate ebbed to 5.2% in May from 5.8% the prior month, but we need to look at the m/m SAAR readings that are free of shifts in year-ago base effects. I don't know why so many people look at y/y rates when they should have gotten a harsh base effects 101 lesson in the pandemic.

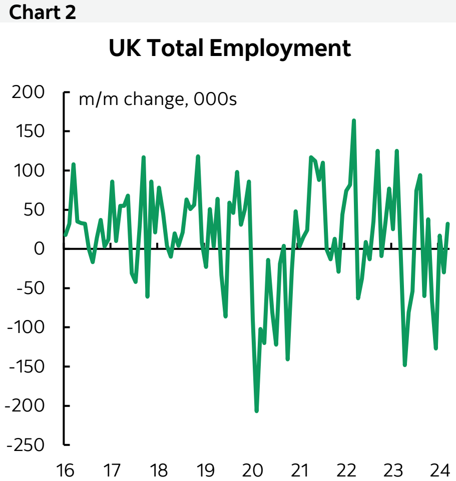
Total UK employment lags, but the May data was up by 32k, reversing the prior month's decline (chart 2). The trend remains soft. On a year-to-date basis, employment is down by

Chart 1



Sources: Scotiabank Economics, UK Office for National Statistics.

Chart 2



Sources: Scotiabank Economics, UK ONS.

175k. Fresher payroll employment figures for June were up by 15.5k for a two-month gain of nearly 70k and 91k more payroll positions ytd (chart 3). Squaring the circle arrives at the conclusion that smaller, off-payroll employment is dragging down the overall job market this year.

The UK unemployment rate was unchanged at 4.4% but is up from 3.8% at the end of last year.

Australia's Job Market Remains on Fire

Australia's job market remains on fire (chart 4). Another 50k jobs were created in June with almost all of them full-time (43k). The unemployment rate ticked up to 4.1% though as the pace of job growth was greater than the expansion of the labour force (+60k). The participation rate ticked up to 66.9%. Hours worked were up by 0.8% m/m SA.

The result drove the A$ to be the strongest performer versus the dollar this morning. Australia's rates curve only slightly bear flattened and yet unspectacularly so relative to other curves. August 6th RB hike pricing only edged up a couple of basis points to about a one-in-four chance. This market reaction is probably because the RBA will be much more focused upon CPI figures on July 30th and then Q2 wages on August 12th. Nevertheless, it's a central bank where the dialogue remains whether policy is tight enough as opposed to any nearer-term push toward easing.

Light N.A. Developments

There is only light data including jobless claims and the Philly Fed's gauge (both at 8:30amET) and a TIPS auction in the US today (1pmET) with nothing on tap for Canada. There are no market moving N.A. earnings on the docket.

Why is CAD Outperforming?

So, why is CAD outperforming this morning? I'm not entirely sure. It's not because of data or oil or central bank comments or any shift in BoC pricing for next week's decision. The only headline overnight was about how PM Trudeau asked Mark Carney to join the Libs in a dark Luke-I'm-your-father sort of way, either by seeking a byelection or throwing his hat in the ring for the general election to be held no later than October 2025. I suppose markets might view that as a somewhat more disciplined emergent policy bias given Carney's gently critique that policy is not focused enough upon growth and productivity. I almost felt like laughing as I wrote that, however, because the pattern to date has been that Trudeau calls the shots when it comes to spending largesse. And I'm sorry, but does anyone really truly think that Trudeau will turn more fiscally prudent into an election year when the Libs-NDP tacit coalition is performing so poorly in the polls? Now, if Trudeau were to step aside, then maybe it's a different picture <insert louder laughter here>.

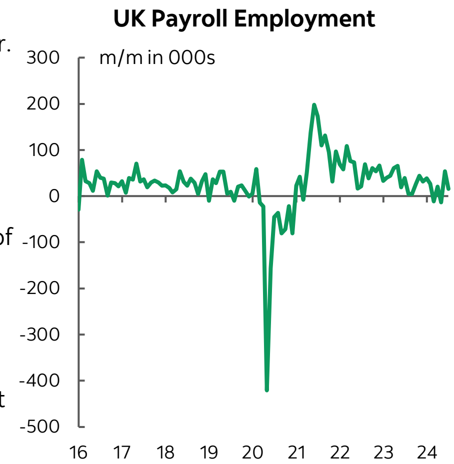
BoC Not Expected to Change QT—And Don't Micromanage the Outcomes!

I would not look for any changes to the Bank of Canada's policy of quantitative tightening in next week's communications. The program will remain on autopilot.

The spread between the Canadian Overnight Repo Rate Average (CORRA) and the BoC's overnight rate began to widen in early June and hit about 5bps which is testing the limits of past deviations (chart 5). This can be thought of as the analog to if the effective fed funds rate were to materially deviate from where the Federal Reserve is targeting. This is a sign that the BoC's ability to steer market rates toward the policy rate is being challenged as funding market pressures intensify.

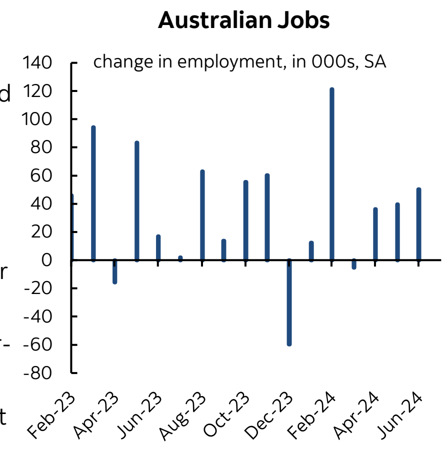
One driver of this intensification might be the BoC's QT policy that allows its maturing bond holdings to drop off the balance sheet with zero reinvestment. This occurs in lumpy fashion because of the uneven distribution of its holdings (chart 6) and it drains Lynx settlement balances (chart 7). If the BoC retains its 100% roll-off rate, then its holdings of Government of Canada bonds are projected to decline as shown in chart 8. Less liquidity sloshing around the banking system is thought to be contributing to wider spreads, but this may not be true.

Chart 3



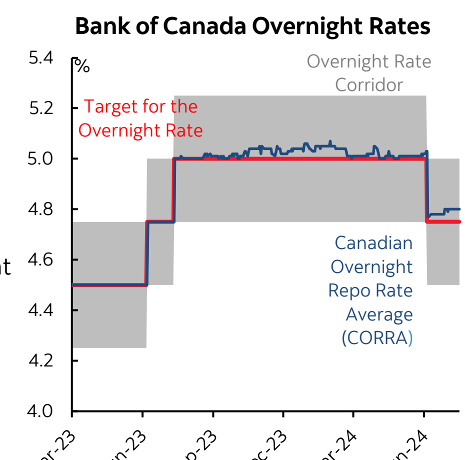
Sources: Scotiabank Economics, UK ONS.

Chart 4



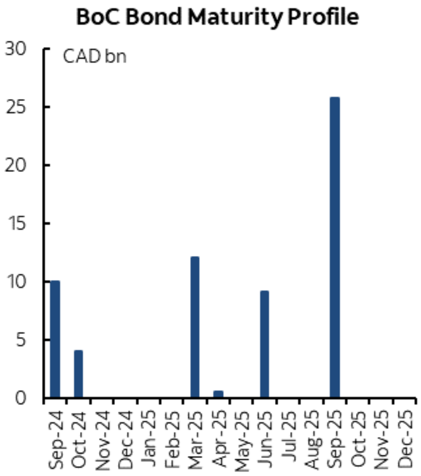
Sources: Scotiabank Economics, Australian Bureau of Statistics.

Chart 5



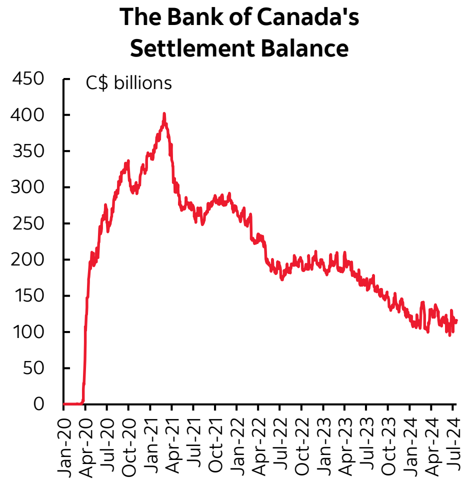
Sources: Scotiabank Economics, Bloomberg.

Chart 6



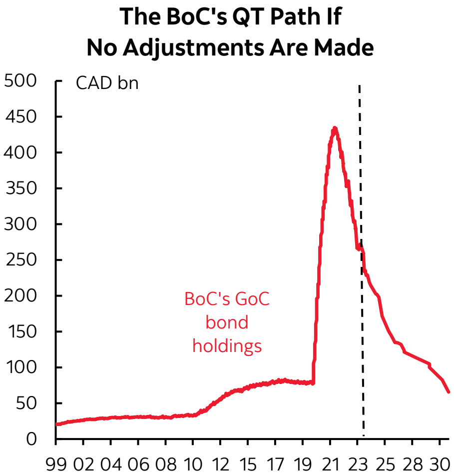
Sources: Scotiabank Economics, Bank of Canada.

Chart 7



Sources: Scotiabank Economics, Bank of Canada.

Chart 8



Sources: Scotiabank Economics, Bank of Canada.

One reason why the BoC is very unlikely to alter QT plans at this meeting is because of its practice of communicating balance sheet intentions well in advance. The BoC would likely deliver a speech in advance of a material change rather than springing a surprise that could roil bond markets.

The second reason is that the BoC has previously dismissed QT as the root cause of such spread widening and may do so again now. When the spread widened over the final months of last year and earlier this year, they said that market positioning for expected rate cuts was the dominant driver (**here**). Market positioning has intensified once again and the BoC may be of a similar opinion on the drivers of wider spreads today.

The third reason is that the BoC is not close to its stated targets for settlement balances. Deputy Governor Gravelle delivered a speech in March that reiterated the goal of bringing down balances to between C$20–60 billion which would equate to somewhere between about ¾% and 2% of 2024 nominal GDP. The balance sits at $116 billion and at almost 4% of 2024 nominal GDP right now and therefore roughly double the BoC's highest targeted estimate.

The BoC has also made it clear that they prefer using alternative tools for managing the CORRA-overnight rate spread. This has included using repo operations, introducing receiver general auctions, and cash management bills. The BoC just restarted repo operations for the first time since January yesterday with two operations which signals an ongoing preference toward using this tool. Watch how the CORRA-o/n spread evolves and whether the BoC continues to add to repo operations.

I think the BoC should remain neutral toward the narrow distribution of holdings of settlement balances. They should not seek to micromanage the distribution of settlement balances across individual firms or see that narrow distribution as a problem for the overall policy stance on QT. Different firms have different needs for settlement balances, different risks and risk tolerance, different opportunities, and different global funding operations. This guides different choices and the BoC's job is to target broad conditions, not to pick winners and losers. The BoC has other tools to address potential problems in the system kind of like what we saw in the Fed's responses to strains across regional banks last year while sticking to its guns on broader policy goals.

Lastly, let's not lose sight of the BoC's number one objective here: they want out of bond markets. They wish to normalize their portfolio of Government of Canada bond holdings to a level that is only suited toward what is needed for the normal conduct of monetary policy. There is a very high bar set against knocking them off this course even if it means having to lean on a convoluted and distorting patchwork of supports to funding markets along the way.

Having said all of that, I've tried to convey what I think the BoC will do based on their guidance. My personal belief is that they are trying to push settlement balances too low and that they are therefore courting problems in funding markets and possibly future accidents. The FOMC targets excess reserves at 10–12% of GDP and hence vastly higher than the BoC because the FOMC has greater experience and harsh memories of the last time they tried to push cash in the banking system so low. The BoC may face this lesson in future and should tread much more carefully. The one thing the BoC has in its favour, however, is that the FOMC has its back; at the end of the day, it's how the FOMC manages excess reserves and liquidity that matters the most including its spillover effects into 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.	4.46	4.44	4.52	4.11	4.08	4.14	4.18	4.16	4.21	4.40	4.38	4.42
CANADA	3.68	3.67	3.75	3.33	3.31	3.41	3.36	3.34	3.43	3.34	3.31	3.38
GERMANY	2.79	2.78	2.79	2.42	2.40	2.44	2.44	2.42	2.46	2.63	2.60	2.66
JAPAN	0.34	0.33	0.34	0.59	0.58	0.61	1.04	1.04	1.09	2.16	2.17	2.24
U.K.	3.99	4.02	4.07	3.90	3.92	3.92	4.07	4.08	4.07	4.57	4.57	4.59
	Spreads vs. U.S. (bps):											
CANADA	-78	-77	-77	-77	-76	-73	-82	-82	-78	-106	-106	-104
GERMANY	-167	-166	-172	-169	-168	-170	-174	-174	-175	-177	-178	-176
JAPAN	-412	-411	-417	-352	-350	-353	-314	-312	-312	-224	-220	-219
U.K.	-47	-42	-45	-21	-16	-22	-11	-8	-14	17	19	17

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	22851	-144.2	-0.6	2.2	5.7	12.1
Dow 30	41198	243.6	0.6	3.7	6.1	17.9
S&P 500	5588	-78.9	-1.4	-0.8	1.8	22.7
Nasdaq	17997	-512.4	-2.8	-3.5	0.8	25.4
DAX	18472	34.7	0.2	-0.3	1.9	14.6
FTSE	8237	49.7	0.6	0.2	0.6	10.5
Nikkei	40126	-971.3	-2.4	-4.1	4.0	22.0
Hang Seng	17778	39.0	0.2	-0.3	-3.5	-6.2
CAC	7607	35.7	0.5	-0.3	-0.3	3.9
Commodities	Level		% change:			
WTI Crude	82.71	-0.14	-0.2	0.1	1.4	9.2
Natural Gas	2.05	0.02	0.8	-9.5	-29.5	-21.9
Gold	2465.42	6.63	0.3	2.1	10.6	24.6
Silver	30.92	0.05	0.2	-0.1	5.7	24.6
CRB Index	286.06	0.27	0.1	-1.3	-3.3	5.2
Currencies	Level		% change:			
USDCAD	1.3678	-0.0005	-0.0	0.3	-0.3	3.9
EURUSD	1.0930	-0.0009	-0.1	0.6	1.8	-2.7
USDJPY	156.48	0.2800	0.2	-1.5	-0.9	12.7
AUDUSD	0.6734	0.0005	0.1	-0.4	1.2	-1.1
GBPUSD	1.2984	-0.0025	-0.2	0.5	2.2	-0.4
USDCHF	0.8841	0.0007	0.1	-1.4	-0.0	3.1

Central Banks	Current Rate
Canada - BoC	4.75
US - Fed	5.50
England - BoE	5.25
Euro zone - ECB	4.25
Japan - BoJ	-0.10
Mexico - Banxico	11.00
Australia - RBA	4.35
New Zealand - RBNZ	5.50

Central Banks	Next Meeting Date
Canada - BoC	Jul 24, 2024
US - Fed	Jul 31, 2024
England - BoE	Aug 01, 2024
Euro zone - ECB	Jul 18, 2024
Japan - BoJ	June 14, 2024
Mexico - Banxico	Aug 08, 2024
Australia - RBA	Aug 06, 2024
New Zealand - RBNZ	Aug 13, 2024