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GLOBAL ECONOMICS

DAILY POINTS

November 5, 2024 @ *7:25 EST*

Contributors

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On Deck for Tuesday, November 5

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	11-05	08:30	Merchandise Trade Balance (C$ bn)	Sep	--	-1.0	-1.1
US	11-05	08:30	Trade Balance (US$ bn)	Sep	-83.8	-84.0	-70.4
US	11-05	10:00	ISM Non-Manufacturing Composite	Oct	53.5	53.8	54.9
CA	11-05	13:30	Bank of Canada Releases Summary of Deliberations				

KEY POINTS:

- **Markets on tenterhooks as Americans vote in a global election**
- **The US election faces a vastly different market and macro backdrop this time**
- **RBA stays on hawkish hold**
- **China's private PMIs outperformed the state's**
- **Won underperforms on soft inflation**
- **US ISM-services is the main data risk today**
- **US trade deficit is blowing out, Canada's to be updated**
- **BoC's Summary of Deliberations won't reveal much**

Markets are on tenterhooks as Americans go to vote in a global election of direct consequence to many given the policy options under consideration. How long they remain that way is anyone's guess given uncertainty over when the results will be known, and then whether there are recounts aplenty and court challenges. Other developments are trivial by comparison. I will write about what's profoundly different today in markets and the macro backdrop versus the context of the 2016 election and the 2017 tax cuts in my fuller morning note.

RBA Stays on Hawkish Hold

The RBA remained on hold at a cash target rate of 4.35% with a hawkish bias. They still do not expect inflation to sustainably return to the midpoint of the 2–3% inflation target range until 2026 and remain of the view that inflation is too high especially upon removing temporary effects. Markets responded by shaving pricing for the February meeting by about 6bps to now only 8bps of a cut and retaining a decent shot at a first cut at the April 1st meeting and a full cut by May. Australia's curve was mildly cheaper and the A$ is the strongest major performer to the USD this morning.

China's Private PMIs Beat the State's

China's private composite PMI jumped 1.6 points higher to 51.9 in October's reading overnight. That increase was led by services (52.0, 50.3 prior) with a manufacturing assist that we knew from earlier (50.3, 49.3 prior). These are better numbers than the state PMIs but recall that there are meaningful differences in the state versus private PMIs. The private PMIs are more skewed toward smaller producers versus the SOEs that dominate the state PMIs, and the private PMIs are more slanted toward manufacturing in the export-oriented coastal cities.

South Korean CPI Dents the Won

The won is at the opposite end of currency performers after South Korean inflation came in weaker than expected. CPI was flat in m/m terms, and core was up 1.8% y/y (2.0% prior, 1.9% consensus).

North American Releases

On tap into the N.A. session will be two things.

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1. Data risk will mostly focus on US ISM-services (10amET). We already know that the US trade deficit will blow out based on the known merchandise numbers and that it has been widening for some time now (8:30amET). Canada's trade figures may somewhat inform Q3 growth tracking (8:30amET).

2. The BoC's Summary of Deliberations (1:30pmET) might inform the range of discussion around 25 or 50 at the last meeting and the potential range of viewpoints on Governing Council, but I doubt we'll learn anything material especially given all of the BoC communications of late.

THE US ELECTION FACES A VASTLY DIFFERENT MARKET AND MACRO BACKDROP THIS TIME

Think the election's market effects are likely to play out similarly to the first time around in 2016 and with the Tax Cuts and Jobs Act (TCJA) of late 2017? Here's a list of reasons to be skeptical starting with a summary list and then by expanding on the points. Key is that the starting points for valuations and the macroeconomic imbalances are different this time and matter enormously to the outcome.

1. There is much less room for equity multiple expansion today than back then. Similarly, tighter corporate spreads are more richly priced.

2. Ditto for margins.

3. Today's macro playbook is vastly different than 2016–18 (e.g. excess demand, versus excess supply back then).

4. Fiscal policy proposals could drive greater excess demand.

5. Today's proposals risk sharply shrinking the supply side through a three-pronged assault.

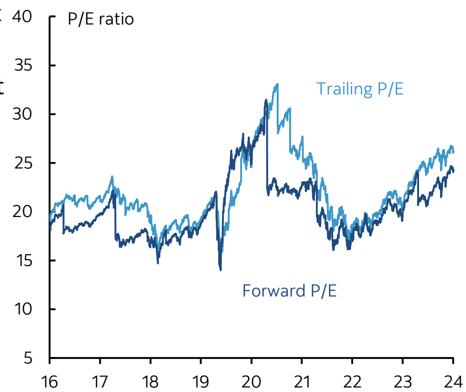
6. The policy proposals lack the relative focus of 2016. The 'good' proposals from a risk asset standpoint are accompanied by more damaging ones this time.

7. Beware money illusion.

8. Financials need to weigh potential regulatory easing against the consequences of other policy actions.

Chart 1

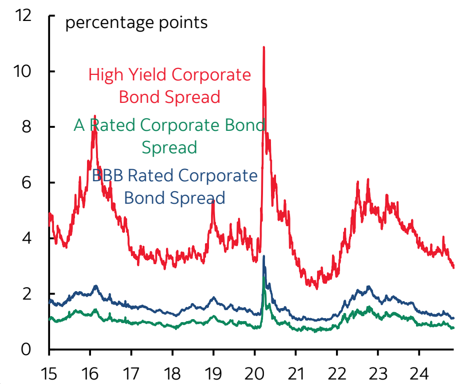
S&P500: Trailing & Forward P/E Ratio



Sources: Scotiabank Economics, Bloomberg

Chart 2

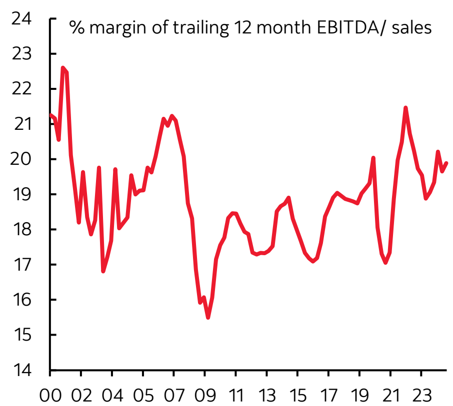
Spread between 10 Year US Corporate Bonds & US Treasury Bonds



Sources: Scotiabank Economics, Bloomberg.

Chart 3

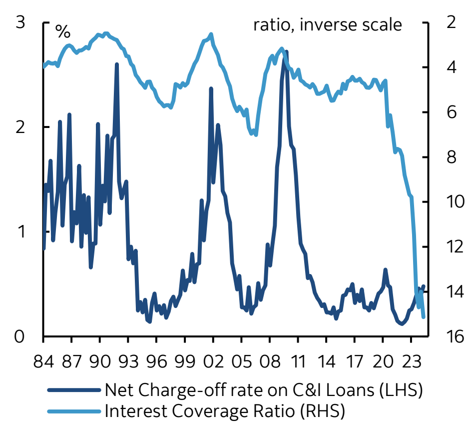
S&P 500 EBITDA Margin



Sources: Scotiabank Economics, Bloomberg.

Chart 4

Strong US Corporate Credit Quality



Sources:Scotiabank Economics, Haver, Bloomberg.

9. The geopolitics cannot be ignored and are vastly more complicated than in 2016–18.

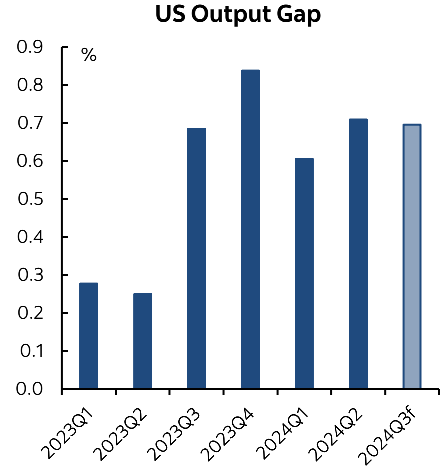
Here are expansions on these and related points.

1. Equity valuations were relatively lower back in 2016 (election) and 2018 (TCJA) and had more upside (chart 1). It's less likely we'll get multiple expansion this time. The S&P500 trailing P/E ratio stood at about 19.1 times earnings and the 1-year forward P/E ratio was at about 18.1 times in early November 2016. In December 2017 those ratios stood at about 22 times and 20.5 times respectively. Ignore 2020's pandemic distortions. Today, those same ratios are at 26.1 and 24.3 times respectively. Bubble risk is a more serious factor this time.

2. The same applies to corporate spreads (chart 2). High yield index spreads were running around 4½% in late 2016 versus below 3% now. The BBB corporate proxy spread was running around 150bps in late 2016 versus just over 100 now.

Chart 5

US Output Gap



Sources: Scotiabank Economics.

3. Margins don't have the same room to expand this time either (chart 3). S&P500 EBITDA/sales is running at about 20% now versus 17% in 2016; today's margins are around cycle highs.

4. Corporate credit worthiness is also vastly different now. Back in late 2016, US nonfinancial corporate interest coverage stood at 4.4 times and it was 4.66 times when the TCJA was passed in late 2017. Today it's at over 15 times (!), probably closely to the 16–17 times range when we get the full set of Q3 accounts. That's the highest in at least about a half century going back to 1980 (chart 4). It helps explain why corporate spreads are tight, and why charge-off rates on C&I loans are very low.

5. Folks are going with the 2016 macro playbook but today is different. A lot has changed. Back in 2016, the US was in excess aggregate supply with a negative output gap using both OECD and IMF estimates of the gap. Stimulating didn't do as much to pre-pandemic inflation that was hovering around +/-2% and bonds were in a relatively much more benign environment and so there were no or few offsets to stimulative policy. Today, however, the US is in excess demand (chart 5) with a tight labour market generating strong wage gains. If demand-side policies stimulate further, then it's more likely this time that monetary policy and automatic stabilizers like bonds and the dollar will offset. The net effect on earnings is unclear.

6. There is greater danger that the supply side contracts this time than in 2016–18. In 2016 Trump was talking about initiatives that could expand the supply side, like infrastructure investment which he now wants to curtail through reducing clean energy and other investments and that would be a negative investment shock. The impact of trade wars on supply chains would be another hit to the supply side. So would curtailing population growth (Dems) if not shrinking population outright (GOP) versus relatively much milder immigration plans out of the 2016 election.

7. Stimulating the demand side via fiscal policy efforts carries uncertain and competing macroeconomic effects alongside reducing the supply side. For instance, tax cuts could be offset by spending cuts, but certainly nowhere even remotely close to what is subject to speculation especially if SALT deductions are eliminated. The net could be substantial inflation, in which case the Fed won't be cutting as much, the terminal rate will be higher, and both bonds and the dollar may sterilize the outcome.

8. Money illusion is behind a lot of market narratives now. Don't think solely in nominal terms (ie: the sense that you are better off simply because the dollar value of something has gone up). The inflation that post-election policies could spark wouldn't necessarily drive real gains and could put upward pressure on weighted average discount rates. This industry falls for money illusion arguments over and over.

9. For financials, Trump's 2016 playbook was easier to digest: tax cuts, easier regs, maybe finance some infrastructure, done. It's much less clear now given trade policy risks to world growth, the risk that higher Treasury yields drag the 7.3% 30-year fixed mortgage rate much higher and hit loan appetite, and if the client base shrinks with a negative population shock. A largely unspoken risk is how ratings agencies may respond by potentially first putting the US government on negative outlook with downgrade risk and triggering a wave of sector/ corporate downgrades.

10. The market moves since 2016 have had many drivers that make it impossible to fully disentangle everything. "Trump trades" or "Harris trades" have been correlated with many other developments such as persistently strong US growth that has many explanations, volatile easing expectations by the Fed, political developments abroad (eg. Mexico), and geopolitical factors.

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.	4.19	4.16	4.10	4.18	4.15	4.08	4.32	4.29	4.26	4.50	4.47	4.50
CANADA	3.11	3.09	3.07	3.07	3.04	3.02	3.27	3.23	3.24	3.31	3.28	3.36
GERMANY	2.28	2.26	2.14	2.29	2.26	2.16	2.43	2.40	2.34	2.63	2.58	2.63
JAPAN	0.46	0.47	0.46	0.58	0.59	0.60	0.94	0.95	0.98	2.22	2.22	2.22
U.K.	4.48	4.44	4.26	4.39	4.33	4.19	4.50	4.46	4.32	4.95	4.92	4.79
	Spreads vs. U.S. (bps):											
CANADA	-107	-107	-103	-111	-111	-106	-105	-105	-101	-119	-119	-114
GERMANY	-191	-190	-196	-189	-189	-192	-189	-189	-192	-187	-189	-187
JAPAN	-372	-370	-364	-360	-356	-348	-338	-333	-327	-228	-225	-228
U.K.	30	27	16	21	19	11	18	17	6	45	46	29

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	24256	0.9	0.0	-1.3	0.4	22.4
Dow 30	41795	-257.6	-0.6	-1.4	-1.3	22.7
S&P 500	5713	-16.1	-0.3	-1.9	-0.7	31.1
Nasdaq	18180	-59.9	-0.3	-2.1	0.2	34.9
DAX	19170	21.7	0.1	-1.6	0.3	26.2
FTSE	8184	-0.3	-0.0	-0.4	-1.2	10.3
Nikkei	38475	421.2	1.1	-0.3	-0.4	17.6
Hang Seng	21007	439.5	2.1	1.5	-7.6	16.9
CAC	7380	8.2	0.1	-1.7	-2.1	4.7
Commodities	Level		% change:			
WTI Crude	71.85	0.38	0.5	6.9	-3.4	-10.8
Natural Gas	2.76	-0.03	-0.9	17.4	-3.5	-21.6
Gold	2740.90	4.12	0.2	-1.2	22.9	37.6
Silver	32.84	0.04	0.1	-1.6	2.4	45.1
CRB Index	282.75	3.31	1.2	1.8	-3.1	0.3
Currencies	Level		% change:			
USDCAD	1.3883	-0.0019	-0.1	-0.2	1.9	1.3
EURUSD	1.0896	0.0018	0.2	0.7	-0.7	1.7
USDJPY	152.21	0.0800	0.1	-0.7	2.7	1.4
AUDUSD	0.6624	0.0039	0.6	1.0	-2.0	2.1
GBPUSD	1.2987	0.0030	0.2	-0.2	-0.7	5.2
USDCHF	0.8624	-0.0017	-0.2	-0.6	0.9	-4.1

Central Banks	
Current Rate	
Canada - BoC	3.75
US - Fed	5.00
England - BoE	5.00
Euro zone - ECB	3.40
Japan - BoJ	-0.10
Mexico - Banxico	10.50
Australia - RBA	4.35
New Zealand - RBNZ	4.75
Next Meeting Date	
Canada - BoC	Dec 11, 2024
US - Fed	Nov 07, 2024
England - BoE	Nov 07, 2024
Euro zone - ECB	Dec 12, 2024
Japan - BoJ	June 14, 2024
Mexico - Banxico	Nov 14, 2024
Australia - RBA	Nov 04, 2024
New Zealand - RBNZ	Nov 26, 2024