Scotiabank

GLOBAL ECONOMICS

DAILY POINTS

March 7, 2023 @ *8:00 EST*

Contributors

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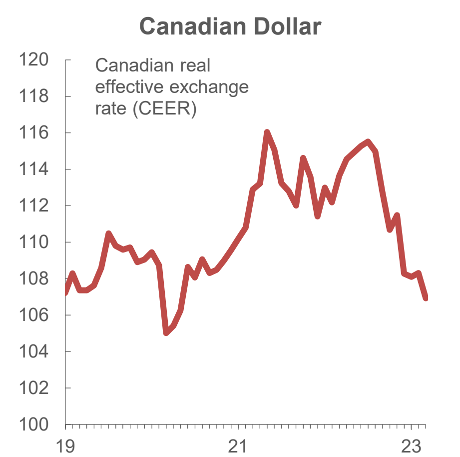
Chart 1



Sources: Scotiabank Economics, Bank of Canada.

On Deck for Tuesday, March 7

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	03-07	15:00	Consumer Credit (US$ bn m/m)	Jan	--	25.4	11.6
US	03-07	10:00	Powell Appears Before Senate Banking Panel				

KEY POINTS:

- **Global markets await Fed guidance**
- **Powell's testimony could inform size and peak considerations**
- **RBA hikes but eases financial conditions…**
- **…despite continuing to guide that further hikes are needed…**
- **…because the bias opened up meeting-by-meeting optionality**
- **BoC's preferred CAD measure at weakest since May 2020…**
- **…fanning inflation risk...**
- **…as BoC risks falling too far behind the Fed…**
- **…despite similar core inflation rates**

Mixed conditions across global markets await Fed Chair Powell's testimony as the week's potentially dominant macro risk. The USD is gaining a little ground, while sovereign bonds rally and equities are generally little changed across most regions except for China where equities fell by 1–2% overnight and where the policy rhetoric from the friends of Russia seems to oscillate by the day. Australia was the stand-out biggest mover across asset classes overnight given what the RBA did.

The RBA hiked by the expected 25bps but its overall communications eased financial conditions overnight. The interpretation of the bias drove a bull steepener move in Australia's curve as 2s richened by 13bps while terminal rate pricing was reduced by 14bps to now imply about 40bps of additional tightening and the A$ depreciated by three quarters of a cent to the USD.

So what did the RBA say that loosened financial conditions? It tweaked the language in the final paragraph of its statement. The prior statement said that hikes "will be needed over the months ahead" but this one struck out "months ahead" and the prior statement also said that "In assessing how much further interest rates need to increase" but this one said "In assessing when and how much further interest rates need to increase…". The wording change is deliberate in suggesting that the central bank is more data dependent and on a less committed path of tightening at each meeting. That stops short of the BoC's move toward a conditional pause in that the RBA is still saying that it thinks rates will have to move higher.

Day 1 of Fed Chair Powell's testimony before the Senate Banking Committee will start with a written statement before Powell speaks at 10amET and then turns to Q&A. Market sensitivities will particularly focus upon whether he intimates openness to +25bps or +50bps on March 22nd and whether he reveals what either he and/or the committee may be leaning toward in terms of the terminal rate this cycle.

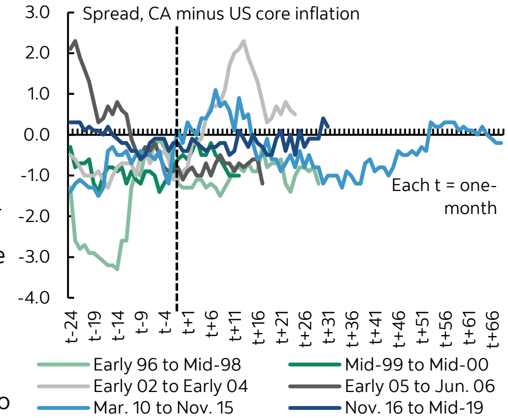
German factory order beat expectations. They climbed by 1% m/m in January (-0.7% consensus) and therefore built upon the 3.4% m/m gain in December. Orders are still 15% lower than the peak in mid-2021 and are hovering around pre-pandemic levels.

The C$ continues to weaken with a further loss of a third of a cent to the USD so far this week as USDCAD rises to 1.363. Of greater concern to the BoC is the broader debasement of the currency using its preferred measure and the risk this poses by way of stimulating trade through easier financial conditions and fanning import price pressures. Monitoring further developments in CAD will inform the risk that Macklem warns about the currency again at some point and reminiscent of when he explicitly did so last October.

Enter chart 1. It shows the BoC's Canadian Effective Exchange Rate index in real terms. This measures the currency's movements in trade-weighted terms against a basket of all other currencies of its trading partners and adjusts for relative changes in inflation rates in Canada and its trading partners. The BoC publishes the data on its website with a lag up to the end of 2022. My chart extends this to early March which we can do with reasonable comfort since we know the nominal exchange rates, the trade weights and January relative inflation rates for most trading partners. Relative inflation rates are unknown for February but I've assumed them to be unchanged until data arrives. It would take large changes in weighted relative inflation rates that on net move in the same direction to impact the CEER estimates relative to the other known variables.

Chart 2

Core Inflation (Excl. Food & Energy)



Sources: Scotiabank Economics, Bloomberg.

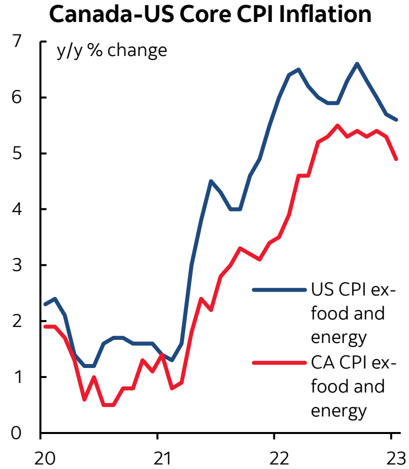
The punchline is that the CEER measure of the currency is at its weakest since May 2020 and hence around the pandemic's early days. Relative central bank policy divergence is among the drivers of this depreciation and particularly through the BoC versus Fed connection. Not all of this potential divergence may be priced at this point with markets uncertain toward the Fed's terminal rate and the relative paths thereafter.

I don't think that allowing CAD to be debased to this extent is with justification. In the past when the BoC has undercut the Fed it has tended to be because core inflation is materially lower in Canada than the US. Chart 2 is repeated from my Global Week Ahead article by showing core rates of inflation in the lead-up to peak policy rate convergence at time t=0 in past Canada-US monetary policy cycles.

Whether it's the case now that core CPI inflationary pressure is materially weaker on a sustained basis in Canada versus the US this time isn't clear to me. Chart 3 shows little difference in one measure being the year-over-year CPI ex-food and energy inflation rates that are 4.9% y/y in Canada and 5.6% in the US which isn't a meaningful difference in my opinion especially since there are material measurement differences. Chart 4 compares m/m annualized rates of core CPI inflation and arrives at a similar conclusion. Chart 5 compares m/m annualized core CPI inflation to the Fed's preferred core PCE gauge and reveals something similar. Finally, chart 6 shows the BoC's preferred trimmed mean and weighted median core CPI gauges that continue to run warm at well above a 2% target rate.

Chart 3

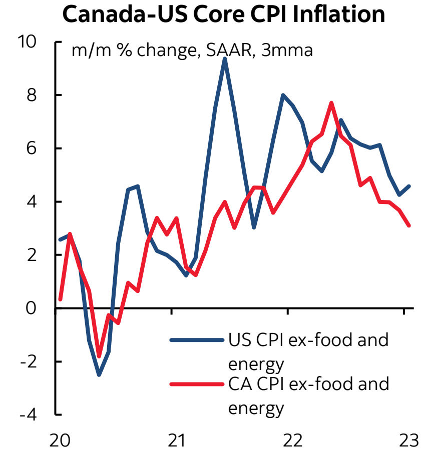
Canada-US Core CPI Inflation



Sources: Scotiabank Economics, Bloomberg.

Chart 4

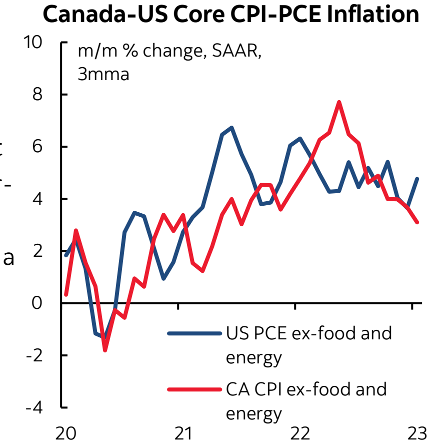
Canada-US Core CPI Inflation



Sources: Scotiabank Economics, Haver Analytics.

Chart 5

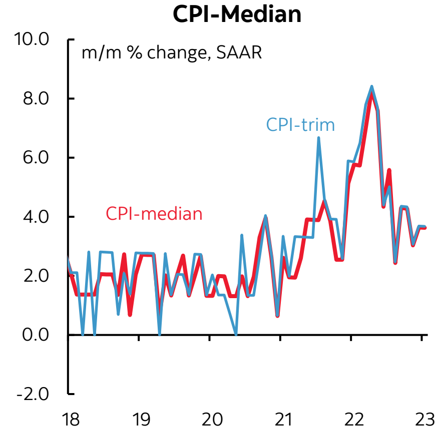
Canada-US Core CPI-PCE Inflation



Sources: Scotiabank Economics, Haver Analytics.

Chart 6

Canadian CPI-Trim and CPI-Median



Sources: Scotiabank Economics, Statistics Canada

In my view, Canada continues to face more inflation risk over time than the US. Its labour productivity absolutely blows. Its labour market is tighter. Its labour unions are more activist. Its currency is sinking versus a strong USD. Output gaps as a relative driver of inflation? Oh please, gimme a break, it's totally fabricated and made-up data in a cycle that has little to do with gap drivers of inflation anyway. Canada enjoys an ongoing terms of trade lift to its economy. Its governments continue to spend into another budget season. Its nonfinancial corporate balance sheets are strong. There is very little housing inventory to accommodate surging immigration stimulus with the fastest population growth among a peer group of industrialized nations. There is more services pent-up demand in Canada than the US. Its exports benefit from what is so far a resilient US economy marked by very strong consumer finances. Canada's household finances are weaker but the one-trick ponies that scream about developments in the tails of the distribution of mortgage debt are ignoring the rest of the macro picture and exaggerating the frailties with 60% of Canadian households not having a mortgage through heavy use of anecdotes. The tail within the 40% who do own a home with a mortgage who are the most pressured who took out variable rate mortgages at the pandemic low for rates and pandemic highs for house prices and didn't lock in are experiencing unfortunate pain. Unfortunately, however, the purpose of monetary policy tightening is to rein in their activities and to do so in the context of the broader macro picture that has many other moving parts in an open economy that is highly influenced by commodities and external developments. The adjustments they face with their homes need to be considered in the context of the adjustments in response to a massive influx of higher immigration. Further, measures of supply chain progress are mixed as the manufacturing PMI indicates lengthening lead times versus the Ivey PMI's improvements, while cautioning that Ivey is an overly broad mishmash of public and private sectors.

Last, the inflation fight is about the long game, not the last one or two reports for anything. I'm still of the belief that the inflation regime has pivoted toward permanently higher inflation risk and how the world economy is at a highly nascent stage of addressing this. Debasing the currency in long lived fashion against the backdrop of a holistic interpretation of the macro picture could well prolong Canada's inflation fight. The country has a choice. More rates pain. Or more inflation pain for longer.

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.	4.87	4.89	4.82	4.24	4.25	4.18	3.94	3.96	3.92	3.88	3.89	3.92
CANADA	4.25	4.25	4.20	3.55	3.57	3.52	3.33	3.35	3.33	3.19	3.21	3.20
GERMANY	3.26	3.32	3.14	2.81	2.90	2.74	2.68	2.75	2.65	2.62	2.66	2.61
JAPAN	-0.04	-0.04	-0.03	0.21	0.21	0.22	0.50	0.51	0.51	1.44	1.42	1.38
U.K.	3.79	3.78	3.69	3.69	3.70	3.70	3.82	3.87	3.83	4.15	4.21	4.14
	Spreads vs. U.S. (bps):											
CANADA	-62	-64	-62	-69	-69	-67	-61	-61	-60	-68	-69	-72
GERMANY	-161	-157	-168	-143	-136	-144	-126	-121	-127	-126	-123	-131
JAPAN	-490	-492	-485	-403	-404	-397	-344	-345	-342	-244	-247	-254
U.K.	-108	-111	-113	-54	-55	-48	-12	-9	-10	28	32	22

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	20515	-66.8	-0.3	1.5	-1.0	-3.7
Dow 30	33431	40.5	0.1	1.6	-2.1	1.9
S&P 500	4048	2.8	0.1	1.7	-2.8	-3.6
Nasdaq	11676	-13.3	-0.1	1.8	-3.6	-9.0
DAX	15675	21.8	0.1	2.0	2.3	22.1
FTSE	7955	24.7	0.3	1.0	1.1	14.3
Nikkei	28309	71.4	0.3	3.1	2.5	14.2
Hang Seng	20534	-68.7	-0.3	3.8	-3.5	-1.1
CAC	7381	8.1	0.1	1.6	3.5	23.4
Commodities	Level		% change:			
WTI Crude	80.00	-0.46	-0.6	3.8	3.7	-33.0
Natural Gas	2.61	0.04	1.5	-5.0	1.0	-46.0
Gold	1839.48	-7.38	-0.4	0.7	-1.8	-7.9
Silver	21.09	-0.01	-0.0	1.7	-5.8	-16.2
CRB Index	273.59	-1.47	-0.5	1.9	1.0	-10.1
Currencies	Level		% change:			
USDCAD	1.3638	0.0025	0.2	-0.1	1.8	6.4
EURUSD	1.0666	-0.0015	-0.1	0.9	-0.6	-1.7
USDJPY	136.17	0.2400	0.2	0.0	3.9	18.1
AUDUSD	0.6666	-0.0064	-1.0	-0.9	-4.2	-8.9
GBPUSD	1.1990	-0.0035	-0.3	-0.3	-0.5	-8.5
USDCHF	0.9336	0.0029	0.3	-0.9	1.3	0.9

Central Banks	
Current Rate	
Canada - BoC	4.50
US - Fed	4.75
England - BoE	4.00
Euro zone - ECB	3.00
Japan - BoJ	-0.10
Mexico - Banxico	11.00
Australia - RBA	3.60
New Zealand - RBNZ	4.75
Next Meeting Date	
Canada - BoC	Mar 08, 2023
US - Fed	Mar 22, 2023
England - BoE	Mar 23, 2023
Euro zone - ECB	Mar 16, 2023
Japan - BoJ	Mar 10, 2023
Mexico - Banxico	Mar 30, 2023
Australia - RBA	Mar 06, 2023
New Zealand - RBNZ	Apr 04, 2023