Scotiabank

GLOBAL ECONOMICS

DAILY POINTS

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Contributors

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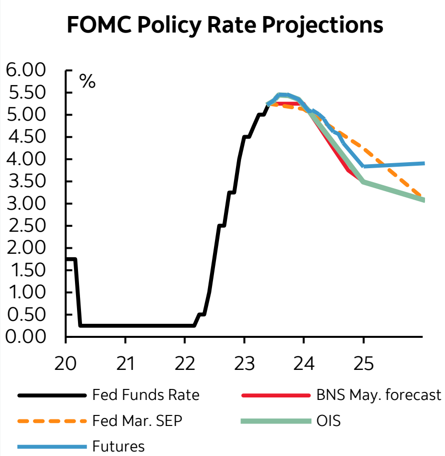
Chart 1



Sources: Scotiabank Economics, Bloomberg.

On Deck for Wednesday, June 14

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	06-14	07:00	MBA Mortgage Applications (w/w)	Jun 09	--	--	-1.4
US	06-14	08:30	PPI (m/m)	May	-0.2	-0.1	0.2
US	06-14	08:30	PPI ex. Food & Energy (m/m)	May	0.2	0.2	0.2
US	**06-14**	**14:00**	**FOMC Interest Rate Meeting (%)**	**Jun 14**	**5.25**	**5.25**	**5.25**
US	06-14	14:30	Fed Chair Holds Press Conference Following FOMC Meeting				

KEY POINTS:

- **Global markets await the Fed**
- **The Fed is likely to pause today…**
- **…despite strong data…**
- **…while embracing the high stakes gamble that policy lags will do the trick…**
- **…as it courts a more erratic, destabilizing path forward**

Nothing but the Fed matters today. Overnight developments were light and included April data on UK growth readings that don't matter, or at least not as much as the other day's jobs and wages and then next week's pre-BoE CPI figures. Swedish inflation landed higher than expected across all readings, driving a spike in local yields and a yawn elsewhere. US producer prices will offer inflation theatre before the Fed and nearly two-dozen Canadians won a Stanley Cup for another American city. Stocks are mostly higher across N.A. futures and European cash markets. The dollar is broadly softer. US Ts and Canadas are flat with gilts outperforming and EGBs underperforming. None of it matters until after the Fed with market expectations shown in chart 1.

The FOMC will issue a full suite of communications and they may well have to get the most out of every bit of it in order not to roil or confuse markets. Powell has had occasions when he has not done well at inflection points, to say the least, which may drive elevated vol around the communications. The statement and Summary of Economic Projections with the dot plot land at 2pmET. Chair Powell's press conference follows at 2:30pmET.

The only convincing reason for doing nothing is that nothing is expected and Powell has conditioned markets to deliver what they want while avoiding game day surprises on the administered rate adjustments. A hike would be extremely unusual with that well worn game plan.

My bias remains that there is a lot of literary licence being applied to Fed-speak that allegedly set up a pause at this meeting that just doesn't seem accurate. Governor—soon to be Vice Chair—Jefferson intimated a pause "at a coming meeting" which is ambiguous on timing which meeting. Chair Powell's remarks on May 19th were less about an explicit pause and more about shifting away from explicit set-ups toward heightened data sensitivity and leaving it to game day decisions. Powell said "Having come this far, we can afford to look at the data and the evolving outlook to make careful assessments," and that no decision had been made about the June meeting's outcome and that they will take each decision one at a time. I read "look at the data" as meaning, well, they'll look at the data rather than pre-committing from this point forward.

So what does the recent data say? Recent data does not merit a pause if they are still data dependent, given core CPI (recap **here**), nonfarm payrolls (recap **here**), the debt ceiling being out of the way, and regional banks having calmed down compared to when Powell last spoke and given the ambiguity around what he said (Jefferson too).

How about the argument around forward lags and whether they've already been given enough time to act?

- First, don't start the lags around the first hike in March 2022. Start them in the Fall of 2021 when US Ts began to more aggressively price expected hikes. Around 20 months later, we still have precious little evidence that damage is being done.
- Second, I side with Bullard's take that the real policy rate is toward the lower end of what would be restrictive territory. NY Fed President Williams disagrees with his research that nothing has changed to R* estimates now versus pre-pandemic. Count me skeptical. Highly so. The Fed chased neutral lower amid overly strong post-GFC opinions that it kept having to revise.
- Third, that lower end may not be restrictive enough if there are decent reasons for growth to be more resilient this time. US consumer finances are in the best shape in decades with a 22-year low in the debt-to-income ratio, a record low debt service burden, high cash balances and locked-in financing via the 30-year mortgage refinancing that occurred. This could make consumers better positioned to absorb higher prices for longer. Add to that the fact we've never had improving supply chains into a tightening cycle that give the ability to produce more, different labour dynamics that probably mean more resilience, weaker trend productivity and higher pressure on unit labour costs to name a few.
- Fourth, that lower end of the restrictive range may not be restrictive enough if the forces driving inflation over time are greater than in the past. This isn't about last month's or next month's inflation. It's about structural drivers. Generative AI may be a longer-run disinflationary force, but I'm skeptical toward the blue skying on this topic. I'm more of the belief that we remain at a highly nascent stage of revamping global supply chains given serial shocks to border frictions like the US election in 2016 and ensuing trade policy under both administrations, like the 2016 Brexit vote for which the British people are paying a steep price, like the pandemic, like the Ukraine War and good luck to us all if China-Taiwan frictions boil over. Lowering border frictions and financial distress while accepting higher operating expenses and passing them on could be with us for a long time given that supply chains take many years to change in slow moving fashion. Add to this misguided US immigration policy and basically no population growth that harms longer-term labour market functioning and these are among the reasons why inflation risk is still high over time along with the high risk of the Fed stopping too soon and making policy errors if they ease prematurely.

But what about the risk of systemic shocks due to Fed overtightening, the doves cry. Surely that must halt their actions, no? To me, the lesson learned from CS, First Republic, SVB etc—each of which may have blown up markets for longer if this were 2008—is that regulators will stomp on signs of systemic risk and snuff it out more effectively than in the past. Fifteen years of experience dealing with unconventional policies give public policy makers including the Fed more tools to use to lean heavily against systemic risk. That could make parallels to past Fed tightening cycles that historically have caused challenges somewhat off base if not entirely so this time.

How to condition the bias is where the tricky balancing act comes in and where the sparks could fly in Powell's hands.

1. Dots: Recall that in March they signalled that the Fed would be done now at 5.25%, with about 75bps of cuts next year and 125bps of cuts in 2025 down to 3–3.25% for the policy range. The cleanest thing would be to repeat that and then for Powell to say ignore the dots, they just drew them with a pack of crayons and don't carry much significance while being data dependent anyway. Shrug your shoulders, say you don't know, and use the trick of absorbing lots of time answering questions so you don't have to answer too many. Then we'll do the same thing we did since January for the BoC while evaluating a conditional skip or pause and the material risk that the Fed could have to come back and hike again later. The dirtier scenario would be to explicitly signal another hike(s) in which case if you have the conviction to do so then why didn't you do it now? That just seems silly to me especially if they signal another hike as soon as the July meeting; no conviction now, but by golly we know what we're gonna do in July! Pffft. Tweaking 2024 wouldn't be very credible in my view because they only have 75bps in cuts and markets won't believe that guidance anyway. Markets have no trust left for what central bankers say about the longer term.

2. Forecasts: Their UR forecast for this year is materially higher than our own (4.5% versus 3.8%). Their core PCE inflation forecast at 3.6% is a little lower than our 3.8%.

3. Presser: Expect tight for long, maybe not done, but definitely in no rush to cut guidance with unchanged QT plans. Hopefully the accident-prone version of Powell that we've seen in the past is no longer with us, but his accidents have been more likely around moments when the FOMC is not comfortable with providing explicit path guidance.

4. Dissenters: I expect some no matter what they do and probably on the hawkish side. Then onto follow-up with individual views that might include dissenting explanations being issued starting shortly after the communications.

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.	4.68	4.67	4.56	4.00	3.99	3.94	3.82	3.82	3.80	3.93	3.92	3.95
CANADA	4.56	4.56	4.58	3.76	3.76	3.73	3.47	3.46	3.44	3.34	3.33	3.28
GERMANY	3.01	2.97	2.94	2.51	2.48	2.47	2.46	2.42	2.46	2.60	2.56	2.60
JAPAN	-0.06	-0.07	-0.06	0.10	0.08	0.09	0.43	0.43	0.43	1.25	1.25	1.27
U.K.	4.85	4.90	4.57	4.52	4.53	4.26	4.43	4.43	4.25	4.61	4.62	4.50
	Spreads vs. U.S. (bps):											
CANADA	-12	-10	2	-24	-23	-21	-35	-35	-36	-59	-59	-67
GERMANY	-166	-169	-162	-149	-152	-147	-136	-139	-134	-133	-136	-134
JAPAN	-474	-474	-462	-390	-391	-385	-339	-339	-337	-268	-267	-268
U.K.	17	23	1	51	54	31	61	62	45	68	69	55

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	19990	69.1	0.3	0.0	-2.1	2.3
Dow 30	34212	145.8	0.4	1.9	2.7	12.7
S&P 500	4369	30.1	0.7	2.0	5.9	17.0
Nasdaq	13573	111.4	0.8	2.2	10.5	25.3
DAX	16329	98.7	0.6	2.3	2.6	22.7
FTSE	7636	41.1	0.5	0.2	-1.5	6.2
Nikkei	33502	483.8	1.5	5.0	14.0	25.8
Hang Seng	19408	-113.0	-0.6	0.8	-1.1	-7.9
CAC	7357	66.5	0.9	2.1	-0.8	23.7
Commodities	Level		% change:			
WTI Crude	70.45	1.03	1.5	-2.9	0.6	-40.8
Natural Gas	2.35	0.01	0.3	0.7	3.5	-67.4
Gold	1947.61	3.87	0.2	0.4	-3.1	7.7
Silver	24.19	-0.02	-0.1	2.3	1.4	12.2
CRB Index	260.81	3.87	1.5	0.1	1.1	-17.4
Currencies	Level		% change:			
USDCAD	1.3290	-0.0028	-0.2	-0.6	-1.3	2.6
EURUSD	1.0806	0.0013	0.1	1.0	-0.6	3.7
USDJPY	140.02	-0.2000	-0.1	-0.1	2.9	3.4
AUDUSD	0.6792	0.0025	0.4	2.1	1.4	-1.1
GBPUSD	1.2646	0.0034	0.3	1.7	0.9	5.4
USDCHF	0.9029	-0.0023	-0.3	-0.8	0.8	-9.9

Central Banks	
Current Rate	
Canada - BoC	4.75
US - Fed	5.25
England - BoE	4.50
Euro zone - ECB	3.75
Japan - BoJ	-0.10
Mexico - Banxico	11.25
Australia - RBA	4.10
New Zealand - RBNZ	5.50
Next Meeting Date	
Canada - BoC	Jul 12, 2023
US - Fed	Jun 14, 2023
England - BoE	Jun 22, 2023
Euro zone - ECB	Jun 15, 2023
Japan - BoJ	Jun 16, 2023
Mexico - Banxico	Jun 22, 2023
Australia - RBA	Jul 04, 2023
New Zealand - RBNZ	Jul 11, 2023