

KEY POINTS:

- USD gains, gold hits a nearly seven year high
- Canada eases insured mortgage stress test
- CDN manufacturing sector posts a negative surprise
- US Empire gauge climbs as first of the ISM indicators
- What to watch for in the FOMC minutes
- US housing starts, producer prices on tap
- CDN CPI: higher headline, flat to lower core?
- UK CPI is expected to edge higher
- Swedish inflation is expected to slightly decline
- Turkey's central bank expected to slash its policy rate again
- US housing starts & producer prices on tap

Corporate news and coronavirus concerns continued to weigh upon risk appetite throughout the day. The result drove the USD higher along with gold prices. Solid but tangential US data was ignored. Weak Canadian data helped Canadian short rates slightly outperform the front-end of the US Treasury curve but the C\$ largely ignored it. Canada relaxed its insured mortgage stress test to address a technical distortion that was tightening conditions beyond the original intent, but the spirit of the stress test was retained. Overnight markets will focus upon UK inflation, Swedish inflation, and further easing by Turkey's central bank. Tomorrow's North American session will bring out Canadian inflation, Fed minutes and US housing starts and producer prices.

- US equities closed between flat (Nasdaq), down ¼% (S&P) and down ½% (Dow). The TSX closed unchanged. This followed declines of up to ¾% (Dax) across Europe except for a small gain in Milan.
- US and Canadian sovereign bond yields rallied by 2–3bps across maturities with Canada's curve slightly outperforming after weak Canadian data. The gilts curve rallied by 2–3bps.
- The USD appreciated against most crosses especially the Scandies, real, A\$/NZ\$, won and euro. The yen held its own along with sterling.
- Oil prices were flat at the end of the day in terms of both WTI and Brent. Gold was up US\$21 to US\$1602 and thus closed over US\$1600/oz for the first time since late March 2013.

TODAY'S NORTH AMERICAN SESSION

Canada relaxed its mortgage stress test somewhat after manufacturing data disappointed expectations.

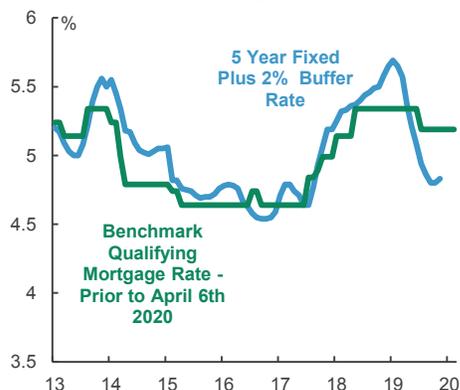
Canadian Finance Minister Bill Morneau announced changes to the insured mortgage stress test today ([here](#)). The new stress test will require qualifying at the greater of the borrower's contract rate and a new Benchmark Rate defined as 200bps added to the weekly median 5-year fixed insured mortgage rate as calculated by the Bank of Canada from federally-backed

CONTACTS

Derek Holt, VP & Head of Capital Markets Economics
 416.863.7707
 Scotiabank Economics
derek.holt@scotiabank.com

Evan Andrade, Research Analyst
 416.862.3080
 Scotiabank Economics
evan.andrade@scotiabank.com

Chart 1

Canada's Insured Mortgage Qualifying Rate


Sources: Scotiabank Economics, Bank of Canada, Statistics Canada..

mortgage insurance applications adjudicated by mortgage insurers. The new stress test will take effect on April 6th. The reason for changing is that the existing stress test mortgage rate was straying too far above the original 200bps average spread that was prevalent when the B20 mortgage stress test was introduced in January 2018. That resulted in tightening mortgage qualifications by more than was originally intended. Chart 1 provides a depiction of the extent to which the two measures have recently strayed from one another. The original intent of requiring a strict stress test on affordability is maintained; the only thing that changes is that a more suitable benchmark reference rate will be used that restores the stress test toward what was originally intended.

There are a few implications:

1. The rule change could translate into a 3–4% increase in the price of a home that would be affordable to insured mortgage borrowers subject to the unchanged C\$1 million purchase ceiling under the new stress test criteria.
2. Because of the deferred April 6th implementation date, it may be that mortgage pre-approval and purchase activity will be delayed until that date. This could carry implications for funding and mortgage markets over the coming 1½ months. It could mean weaker than normal housing data over the duration of February and March and stronger than usual activity in April and perhaps May.
3. Competitive equity is slightly improved. That's because the stress test only applies to federally regulated lenders. They were being increasingly penalized compared to other lenders that are not regulated by OSFI. The fact that the stress test does not apply to non-banks remains a competitive distortion against banks.

December Canadian manufacturing shipments declined 0.7% m/m much lower than the +0.7% m/m consensus expectation (See our full report [here](#)). Stripping away price effects, volumes were down 0.4% m/m. The largest decline came from the transportation sector, falling 6.7% m/m. Q4 economic growth has already been weak and this release shaved 4 basis points off Scotiabank's Q4 GDP nowcast, which now sits at 0.1% y/y. The Bank of Canada should be concerned about the weak hand off to Q1, that now faces a negative shock to commodity prices due to China's Coronavirus outbreak.

Canadian PM Trudeau re-emphasized that the **illegal rail blockades will be addressed through negotiation** which suggests a longer degree of business interruption effects on at least February's macro readings. We continue to monitor the length of this disruption and what it may mean for downside risk to near-term growth tracking.

February New York Federal Reserve empire state manufacturing index rose to 12.9 from 4.8 in January—interpreted as a rise to 56.9 from 52.1 in ISM adjusted terms. Large rebounds in a few January regional Fed surveys guided a surprisingly positive January ISM print. Large improvements in other regional surveys this month will inform us on trade uncertainty levels in the manufacturing sector under the US-China phase one trade deal.

US homebuilder confidence slipped a touch with the NAHB reading declining to 74 from 75 for the second consecutive small decline. Prospective homebuyer traffic through new model homes also slightly weakened.

OVERNIGHT

January UK inflation data will be released Wednesday morning at 4:30 am EST. CPI is expected to rebound in January to 1.6% y/y from December's weak print of 1.3% y/y. The uptick is to be driven by a projected increase in energy prices but core inflation is also expected to tick a little higher. If expectations are met, then the market bias may shift a little further away from Bank of England cuts by this summer.

Japan's December machine orders and January trade balance will be released this evening at 7:00pmEST. Machine orders will largely be ignored as Q4 saw the worst quarterly GDP print in six years. Year over year Japanese exports have fallen in 13 consecutive months and is expected to fall again. However, the first trade balance print of 2020 will inform us on the magnitude of the initial coronavirus impact which threatens supply chains globally.

The Turkish central bank will make a monetary policy announcement at 6:00 amEST. We anticipate the repo rate will come down to 10.75% from 11.25% as the central bank continues its aggressive easing cycle. President Erdogan continues to push for a single digit interest and inflation rates in 2020.

Sweden will update CPI inflation for January (3:30amET) and both headline and underlying rates are expected to marginally pull back. It likely doesn't matter to the Riksbank after the central bank hiked to 0% in an effort to get away from negative rates while pledging to remain on an extended hold.

NORTH AMERICAN RELEASES TOMORROW

January Canadian CPI will be released at 8:30amEST. Our estimates see an uptick in headline inflation to 2.4% y/y from December's 2.2% y/y. A change in year-ago effects could be the source of mild disinflationary pressure but this should be more than offset by seasonality and higher gasoline prices. In addition, we have forecast a deceleration in the average of the three Bank of Canada core inflation measures to 2% y/y down from 2.0% y/y prior.

Minutes to the January 28th–29th FOMC meeting will be released at 2pmEST tomorrow. A recap of the communications that followed that meeting is [here](#). A full run-down of expectations is available in the US section of the Global Week Ahead [here](#).

January US housing starts and building permits will also be released at 8:30 am EST. Housing starts are expected to decline to 1.4 million in January after a warm weather boost was given to December's 1.6 million unit start pace. The housing starts growth trend remains strong as builder optimism remains high despite a small weakening in February, and consumers remain resilient. There is also room for housing starts to surprise to the upside as the mean temperature deviation from seasonal was even greater in January compared to December.

Fixed Income	Government Yield Curves (%):												Central Banks			
	2-YEAR			5-YEAR			10-YEAR			30-YEAR			Current Rate			
	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk				
U.S.	1.41	1.43	1.42	1.40	1.42	1.42	1.56	1.59	1.60	2.01	2.04	2.07	Canada - BoC	1.75		
CANADA	1.47	1.49	1.48	1.35	1.37	1.36	1.33	1.36	1.35	1.45	1.49	1.47	US - Fed	1.75		
GERMANY	-0.65	-0.65	-0.64	-0.62	-0.62	-0.60	-0.41	-0.40	-0.39	0.11	0.12	0.14	England - BoE	0.75		
JAPAN	-0.15	-0.14	-0.15	-0.15	-0.13	-0.15	-0.06	-0.03	-0.06	0.35	0.38	0.38	Euro zone - ECB	0.00		
U.K.	0.53	0.55	0.50	0.48	0.51	0.44	0.61	0.64	0.57	1.10	1.13	1.06	Japan - BoJ	-0.10		
	Spreads vs. U.S. (bps):															
CANADA	6	6	6	-5	-5	-6	-23	-23	-25	-56	-55	-59	Mexico - Banxico	7.00		
GERMANY	-206	-208	-206	-201	-203	-202	-197	-199	-199	-190	-192	-193	Australia - RBA	0.75		
JAPAN	-157	-157	-158	-155	-155	-157	-162	-162	-166	-166	-166	-169	New Zealand - RBNZ	1.00		
U.K.	-88	-88	-92	-92	-91	-99	-95	-95	-103	-91	-91	-100				
Equities	Level						% change:									
	Last			Change			1 Day		1-wk		1-mo		1-yr			
S&P/TSX	17858			10.0			0.1		0.7		1.7		12.8		Canada - BoC	Mar 04, 2020
Dow 30	29232			-165.9			-0.6		-0.2		-0.4		12.9		US - Fed	Mar 18, 2020
S&P 500	3370			-9.9			-0.3		0.5		1.2		21.4		England - BoE	Mar 26, 2020
Nasdaq	9733			1.6			0.0		1.1		3.7		30.2		Euro zone - ECB	Mar 12, 2020
DAX	13681			-102.7			-0.7		0.4		1.1		21.1		Japan - BoJ	Mar 19, 2020
FTSE	7382			-51.2			-0.7		-1.6		-3.8		2.3			
Nikkei	23194			-329.4			-1.4		-2.1		-3.5		8.9		Next Meeting Date	
Hang Seng	27530			-429.4			-1.5		-0.2		-5.3		-2.5		Canada - BoC	Mar 04, 2020
CAC	6057			-29.1			-0.5		0.0		-0.7		17.2		US - Fed	Mar 18, 2020
Commodities	Level						% change:									
WTI Crude	52.11			0.06			0.1		5.1		-11.0		-6.3		England - BoE	Mar 26, 2020
Natural Gas	1.97			0.13			7.1		11.4		-1.8		-25.1		Euro zone - ECB	Mar 12, 2020
Gold	1601.76			20.63			1.3		2.2		2.9		20.7		Japan - BoJ	Mar 19, 2020
Silver	17.80			0.09			0.5		0.1		-1.4		13.6			
CRB Index	173.81			0.86			0.5		2.9		-5.0		-4.1			
Currencies	Level						% change:									
USDCAD	1.3262			0.0027			0.2		-0.2		1.6		0.2		Mexico - Banxico	Mar 26, 2020
EURUSD	1.0790			-0.0046			-0.4		-1.2		-2.7		-4.6		Australia - RBA	Mar 02, 2020
USDJPY	109.88			0.0000			0.0		0.1		-0.3		-0.7			
AUDUSD	0.6687			-0.0027			-0.4		-0.4		-2.7		-6.2		New Zealand - RBNZ	Mar 24, 2020
GBPUSD	1.3000			-0.0008			-0.1		0.4		-0.1		0.6			
USDCHF	0.9833			0.0025			0.3		0.8		1.5		-2.1			

Source: Bloomberg. All quotes reflect Bloomberg data as at the time of publishing. While this source is believed to be reliable, Scotiabank cannot guarantee its accuracy.

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