KEY POINTS:

- Risk-off on headline chasing…
- ...as trade policy, Brexit, virus headlines dominated
- Markets ignore one agency’s Canada downgrade
- Banxico expected to cut
- More US rebound evidence on tap
- Turkey expected to cut again

TODAY’S NORTH AMERICAN MARKETS

A significant risk-off tone likely had multiple catalysts that were all headline driven with still nary a whisper of strategy. The Chief EU Brexit negotiator, Michel Barnier, made headlines this morning when he downplayed the possibility of a Brexit extension and guided that a deal was necessary by the October EU Summit and that the EU was standing its ground. I didn’t see him speak, but assume he had on his best poker face given about four years almost to the day of bluffing by both sides.

Stocks continued to be hit by trade policy concerns as argued in this morning’s note. The WTO is reportedly delaying its decision on what penalties the EU may apply against the US in the Boeing-Airbus dispute until September or October given a backlog of cases.

After multiple days of ignoring US Covid-19 cases, it’s possible that today was the day to pay attention, but it’s impossible to separate out the influences on stocks. Houston, for example, advised that it is expected to run out of intensive care capacity as soon as tomorrow. President Trump’s apparent decision to shift the burden of testing off the federal government after June 30th and onto private sites particularly in Texas reduces the efficacy of a prime tool in combatting the virus which is frequent testing.

Through it all, the US election may be operating in the back of investors’ minds.

Canada got downgraded by Fitch, but markets shook it off (see below).

- US stocks fell by between 1.8–2.4% with the Nasdaq at the bottom and DJIA at the top of the losses. Selling on the S&P500 was widespread across sectors but led by energy (-5.5%), as well as financials and industrials that both fell by 3.5%. Toronto fell 1.6%. European stocks fell by either side of 3% across the benchmarks.

- The USD strengthened somewhat. CAD shook off a downgrade, and the weakest crosses were the real, Mexican peso, some Scandies and the A$/NZ$.

- The US Treasury curve bull flattened with 10s down 4bps and 30s down 6bps. Canada’s curve underperformed especially toward the long end that was up 1bp.

- Oil prices fell by over 5% in terms of WTI and Brent.
How would it feel if you threw a downgrade party and nobody came? Ask Fitch.

Canada got downgraded to AA+ with a stable outlook on its long-term foreign currency issuer default rating by Fitch today. It remains AAA with S&P and Moody’s. The decision is here. Markets could not have cared much less, as Government of Canada yields and the currency were unaffected.

I’m not disputing their methodology in any depth frankly, but you could have taken the first paragraph of their write-up and applied it to virtually any sovereign credit in the world today. Lagging ratings actions are a relative game, and the relatives aren’t looking so good these days. Most market pricing is driven by investors that are not ratings constrained and that invest on other terms. As a case in point, when US$13 trillion of global debt trades at negative yields (chart 1) and Canada isn’t part of that, you can immediately grasp one reason behind why most investors are perfectly willing to hold a credit that offers rare yield pick-up in a yield-starved world. Besides, charts 2–4 depict the state of Canada’s finances compared to other countries.

We’ll see if Moody’s and S&P feel likewise, but even if so, the points above should stand. Agencies don’t have to agree with one another—they didn’t when S&P went solo on the US downgraded the US from AAA to AA+ in 2011. Further, quite frankly, Fitch’s US-based calls on Canada have been contentious in the past. Remember this doozie? Back in 2013, they said Canada’s housing market was 20% over-valued in real terms (it has since risen by one-third in nominal terms) and this served as input into a loan loss severity regression model that they developed. They reasoned that because Canadian data during a distress period was in short supply, that they could instead use the US experience in the GFC and apply it to Canada, without noting the many differences in the markets. That didn’t work out so well.

OVERNIGHT MARKETS

Overnight releases will be fairly light. German GfK consumer confidence for July arrives at 2amET and should reinforce the improving trend already evident in PMIs and the IFO and ZEW surveys. Turkey’s central bank is expected to cut by 25bps or 50bps (7amET). The ECB releases the account of its June 4th meeting (7:30amET).

TOMORROW’S NORTH AMERICAN MARKETS

All twenty-one economists in the Bloomberg consensus including Scotia’s Mario Correa expect Banxico to cut its overnight rate by 50bps tomorrow afternoon (2pmET). With headline inflation at 2.84% y/y and core inflation at 3.64% y/y compared to a target range of 2–4%, easing and guidance would rely in part upon the expected evolution of price pressures. As argued in the Global Week Ahead, however, policy guidance since the last time it cut on May 14th has been mixed.
US markets will digest four macro readings, three of which may partly inform rebound expectations while the fourth is a stale third swing.

Weekly jobless claims (8:30amET) barely budged lower two weeks ago against consensus expectations for a sharper decline. Will figures for last week reaccelerate the decline in first time claims? We think so, but also continue to keep an eye on repeat continuing claims that have come off the peak but remain elevated. Disappointment for a second week into the nonfarm reference period likely wouldn’t go over well.

Durable goods orders will likely get a lift from the transportation and particularly auto sectors tomorrow morning when estimates for May land (8:30amET). Consensus thinks +10% m/m and I’m at 12%. Orders excluding transportation and core orders ex defence and air will probably be lucky to post any growth. Going forward, excess capacity will put core orders on t

The advance merchandise trade deficit is expected to slightly narrow as the economy gradually came out of the worst of the shutdowns in May (8:30amET).

Q1 GDP will be revised for a second time (8:30amET) and this third estimate is the one that more fully incorporates services spending. Most expect little to no change to the previously estimated -5% contraction.
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