

### DAILY POINTS

February 14, 2024 @ 7:55 EST

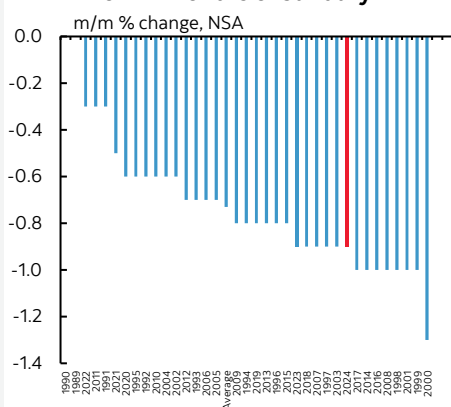
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Chart 1

#### Comparing UK Core CPI for All Months of January



Sources: Scotiabank Economics, Bloomberg.

### On Deck for Wednesday, February 14

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	02-14	07:00	MBA Mortgage Applications (w/w)	Feb 09	--	--	3.7
CA	02-14	09:00	Existing Home Sales (m/m)	Jan	--	--	8.7
US	02-14	09:30	Fed's Goolsbee Speaks in Q&A				
US	02-14	16:00	Fed's Barr Speaks at NABE Conference				

### KEY POINTS:

- **Bonds take a breather**
- **Gilts unwind post-jobs sell-off...**
- **...as core UK CPI was unusually soft**
- **EGBs get a lift from a solid German auction**
- **Let's see just how hot Canada's housing market was in January**
- **US PPI revisions to update SA factors, weights**
- **Indonesia's election results are tentatively pro-business**
- **Immigration, rates, and homebuilding in Canada**

Cupid saved an arrow for bonds this morning. Sovereign bonds are taking a bit of a breather after yesterday's sell off. The US 2-year yield is about 5bps lower this morning but is still about 16bps higher than before US CPI. Stocks are gently higher. The USD is retaining its post-CPI appreciation and is relatively unchanged this morning. Overnight developments were light and only included UK CPI, a strong German bond auction that helped EGBs and Indonesia's election. There is little on tap into the N.A. session this morning with just Canadian home sales and US PPI revisions due out.

UK core CPI put in a weaker than normal performance in January. Core was down -0.9% m/m NSA versus the historical average for months of January that is more like -0.7%. -0.9 is among the weaker readings on record (chart 1). Headline CPI was down -0.6% m/m NSA, doubling the decline that was expected by consensus and weaker than all but one of the 21 forecasts.

The result drove gilts to be dearer across the curve including an 8bps decline in the 2-year yield that unwound most of the rise that began after UK jobs and wages and then US CPI. It also drove sterling to be among the weaker performers to the USD this morning.

### Canadian Home Sales Were Probably Strong in January

Canadian existing home sales will probably post a second consecutive powerful gain after December's rise of over 8% m/m SA (9amET). Major cities from Toronto to Vancouver, Montreal to Calgary and QC have registered strong gains. A market reaction is unlikely, but it will help to inform housing momentum and hence BoC policy risks. Also watch listings, the sales-to-new-listings ratio, months' supply and the house price index that controls for compositional changes.

### US PPI Revisions on Tap

US producer price revisions are due out this morning (8:30amET). Like CPI, they will reflect updated seasonal adjustment factors for the last five years and revised weights. It doesn't carry the same pizzazz as CPI revisions, but the result could still be impactful to Treasuries.

### Indonesia's Election is Tentatively Pro-Market

It seems likely that Indonesia's election has been won by the candidate who had been leading in the polls all along. Defense Minister Prabowo Subianto is leading in early counts

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with official results not expected to arrive for some time. Subianto is relatively business- and market-friendly and viewed as somewhat of a continuity candidate given his role in former President Joko Widodo who hit his two-term limit. Still, Subianto is tagged for having committed human rights abuses in the past and viewed as a risk to democratic institutions. That has geopolitical analysts relatively cautious toward what to expect from his regime.

Also on tap will be minor releases including Colombia's industrial production during December (10amET) and Russia's CPI for January (11amET).

### Canadian Immigration, Homebuilding and Rates

Canada's Housing Minister, Sean Fraser, suggested that Bank of Canada interest rate cuts would help builders build more homes and help to alleviate pressures on housing affordability. Here's his direct quote:

"Don't ignore the impact that interest rates have on restricting supply. My expectation is if we see a dip in interest rates over the course of this year, a lot of the developers that I've spoken to will start those projects that are marginal today."

This comment feeds off of rising sentiment among builders and governments that housing shortages are the BoC's fault which of course is music to the ears of governments that most would agree are to blame for decades of mismanagement of housing policies. I don't agree with the Minister's take.

First is that BoC Governor Macklem was correct when he recently said this:

"It's very clear in the data that the effects of interest rates on demand are much bigger than those on supply."

Ergo, housing imbalances would probably have worsened absent rate hikes in the past few years and would probably worsen further if the BoC were to slash rates going forward because the lift to demand would be dominant.

Second is to challenge the assertion that builders fund their longer-tailed housing developments at very short-term rates. Some, yes, in the overall capital structure mix. But with strong equity markets and the steep decline in corporate bond yields since last Fall's peak, they've already seen substantial relief in their funding costs.

Third is to further explore which funding point matters most—the very short-end, or further up the curve. On that note, the Canada 5-year yield is probably only marginally higher than where it should be relative to reasonable assumptions about the neutral policy rate and term premium. I wouldn't expect that much more relief that is already priced in 5s.

Fourth is that this whole argument latches onto a familiar complaint from builders that high interest rates prevented them from building more homes in recent years in order to meet a massive surge in immigration. It has been a challenging market for them, but I've previously addressed this as misguided ([here](#)).

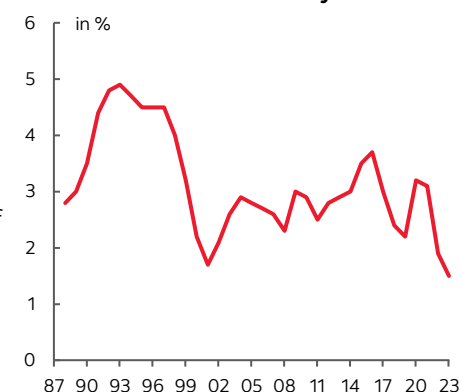
In economics, you can't just shock one variable and assume that nothing else about the world would change. In other words, you can't just say that had interest rates been lower over recent years, more homes could have been built due to cheaper financing costs without having to worry about any other consequences to a lower for longer rate policy.

Why? The alternate state of the world in which rate hikes had not occurred (or the present world should the BoC cut prematurely) probably would have sparked the following consequences:

- even greater upward pressure on broad inflation, including housing input costs faced by builders.

Chart 2

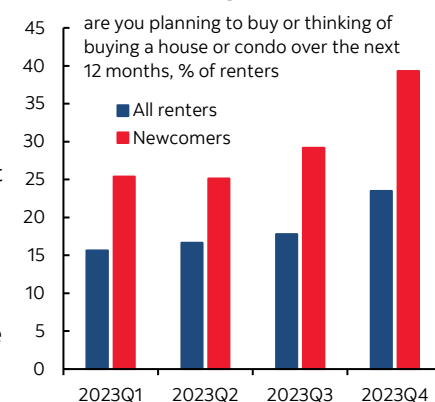
#### Canada Rental Vacancy Rate



Vacancy rate for 2023 is an estimate as per CMHC's annual survey in October 2023. Sources: Scotiabank Economics, CMHC.

Chart 3

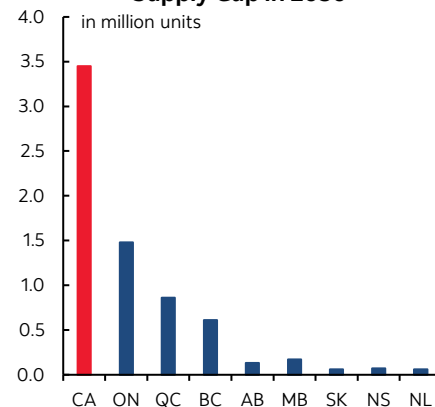
#### Newcomers Continue to Boost Housing Demand



Sources: Scotiabank Economics, Bank of Canada.

Chart 4

#### Estimate of Housing Supply Gap in 2030



Sources: Scotiabank Economics, CMHC.

- higher term-funding costs as markets would have ditched the country's public and private bonds in a total loss of confidence in its ability to ever get inflation under control. The resulting lower prices and higher yields would have been sought to compensate for higher inflation risk.
- With the Fed tightening while the BoC would have been whistling by the graveyard, Canada could have been having a two-for-one sale on CAD to the USD with even more imported price inflation including housing inputs.
- And you think wage pressures and labour scarcity have been bad in recent years? Try a totally overheated economy with massive runaway inflation; wage pressures and labour scarcity would have been even worse.

But surely the demand side would have had more stimulus at lower rates to offset all of this additional pressures on costs, right? Uh, maybe not. Fixed mortgage rates would have presumably been under upward pressure alongside builders' term funding costs on the market's lack of faith in the country's management of inflation risk. Variable rates would have been cheaper, for a time, until either imbalances sparked even tighter monetary policy later or until the whole powder keg blew open, creating a boom bust scenario for housing.

So where does this leave us? I find it disturbing that immigration policy in this country seeks to compound the policy errors. Immigration is excessive relative to the country's ability to absorb new arrivals particularly in the most pressured cities. Period. The temp residents file was totally mismanaged. The fastest population growth in a peer group of other nations with nowhere to put them and infrastructure bottlenecks has contributed to inflationary imbalances. Rental markets are very tight (chart 2), surveys point toward surging demand for owner-occupied housing (chart 3) and the country needs vastly more homes to be built to alleviate pressures on housing affordability than anything that is likely to be delivered through modest announcements (chart 4). You can't make up for decades of mismanaged housing supply and the compounding effects of excessive immigration overnight. Politicians need to stop scapegoating the BoC for all the mistakes that governments have made.

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.	4.62	4.66	4.43	4.29	4.32	4.07	4.30	4.32	4.12	4.47	4.46	4.33	Canada - BoC	5.00
CANADA	4.33	4.36	4.13	3.77	3.80	3.58	3.62	3.65	3.48	3.46	3.47	3.38		
GERMANY	2.75	2.77	2.63	2.34	2.36	2.24	2.37	2.39	2.32	2.54	2.56	2.54	US - Fed	5.50
JAPAN	0.14	0.13	0.11	0.36	0.34	0.32	0.75	0.73	0.72	1.81	1.80	1.78		
U.K.	4.61	4.71	4.48	4.10	4.19	3.97	4.08	4.15	3.99	4.61	4.65	4.57	England - BoE	5.25
	Spreads vs. U.S. (bps):													
CANADA	-29	-30	-30	-52	-52	-49	-68	-67	-64	-101	-100	-95	Euro zone - ECB	4.50
GERMANY	-187	-189	-180	-195	-196	-183	-193	-192	-181	-193	-191	-179		
JAPAN	-448	-453	-432	-393	-398	-375	-355	-359	-340	-266	-267	-254	Japan - BoJ	-0.10
U.K.	-2	5	5	-19	-13	-10	-22	-16	-13	14	19	24		
Equities	Level						% change:						Mexico - Banxico	11.25
	Last	Change					1 Day	1-wk	1-mo	1-yr				
S&P/TSX	20585	-482.3					-2.3	-1.8	-1.9	-0.6	Australia - RBA	4.35		
Dow 30	38273	-524.6					-1.4	-0.6	1.8	12.3				
S&P 500	4953	-68.7					-1.4	-0.0	3.5	19.8	New Zealand - RBNZ	5.50		
Nasdaq	15656	-286.9					-1.8	0.3	4.6	30.9	Next Meeting Date			
DAX	16941	59.8					0.4	0.1	1.4	10.1				
FTSE	7582	70.2					0.9	-0.6	-0.6	-4.7	Canada - BoC	Mar 06, 2024		
Nikkei	37703	-260.7					-0.7	4.3	5.0	37.1				
Hang Seng	15879	132.8					0.8	2.4	-2.1	-23.7	US - Fed	Mar 20, 2024		
CAC	7670	44.8					0.6	0.8	2.7	6.3				
Commodities	Level						% change:							
WTI Crude	77.95	0.08					0.1	5.5	7.3	-1.4	England - BoE	Mar 21, 2024		
Natural Gas	1.65	-0.04					-2.4	-16.2	-50.3	-35.8				
Gold	1990.16	-2.98					-0.1	-2.2	-2.9	7.3	Euro zone - ECB	Mar 07, 2024		
Silver	22.87	-0.05					-0.2	2.5	-0.8	4.0				
CRB Index	273.05	-0.26					-0.1	1.5	3.3	-0.2	Japan - BoJ	Mar 19, 2024		
Currencies	Level						% change:							
USDCAD	1.3540	-0.0024					-0.2	0.6	0.8	1.5	Mexico - Banxico	Mar 21, 2024		
EURUSD	1.0705	-0.0004					-0.0	-0.6	-2.2	-0.3				
USDJPY	150.61	-0.1900					-0.1	1.6	3.3	13.1	Australia - RBA	Mar 18, 2024		
AUDUSD	0.6479	0.0026					0.4	-0.6	-2.7	-7.3				
GBPUSD	1.2552	-0.0040					-0.3	-0.6	-1.4	3.1	New Zealand - RBNZ	Feb 27, 2024		
USDFH	0.8868	-0.0003					-0.0	1.4	3.6	-3.8				

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