

DAILY POINTS

September 18, 2024 @ 8:35 EST

Contributors

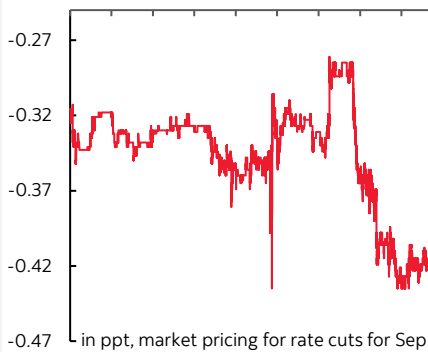
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Chart 1

Clearly the Fed's Not Doing Well At Managing Expectations

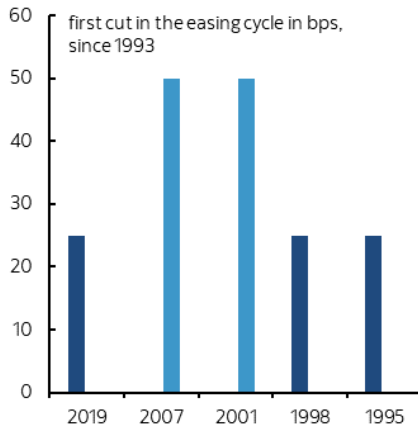
23 27 29 02 04 08 10 12 17
 Aug Aug Aug Sep Sep Sep Sep Sep



Sources: Scotiabank Economics, Bloomberg.

Chart 2

The First Cut is the Deepest - Sometimes



Sources: Scotiabank Economics, Bloomberg.

On Deck for Wednesday, September 18

| Country | Date | Time | Indicator | Period | BNS | Consensus | Latest |
|---------|-------|-------|--|--------|--------|-----------|--------|
| US | 09-18 | 07:00 | MBA Mortgage Applications (w/w) | Sep 13 | -- | -- | 14.2 |
| CA | 09-18 | 08:30 | International Securities Transactions (C\$ bn) | Jul | -- | -- | 11.0 |
| US | 09-18 | 08:30 | Building Permits (000s a.r.) | Aug | -- | 1410.0 | 1475.0 |
| US | 09-18 | 08:30 | Housing Starts (000s a.r.) | Aug | 1325.0 | 1318.0 | 1356.0 |
| US | 09-18 | 08:30 | Housing Starts (m/m) | Aug | 7.0 | 6.5 | 9.6 |
| CA | 09-18 | 13:30 | Bank of Canada Releases Summary of Deliberations | | | | |
| US | 09-18 | 14:00 | FOMC Interest Rate Meeting (%) | Sep 18 | 5.25 | 5.25 | 5.50 |
| US | 09-18 | 14:30 | Fed Chair Powell Holds Post-Meeting Press Conference | | | | |
| US | 09-18 | 16:00 | Total Net TIC Flows (US\$ bn) | Jul | -- | -- | 107.5 |
| US | 09-18 | 16:00 | Net Long-term TIC Flows (US\$ bn) | Jul | -- | -- | 96.1 |

KEY POINTS:

- **It's game day for global markets**
- **Fed is more likely to cut 25 than 50...**
- **...but either poor communication has made it a close call...**
- **...or we're in a different non-emergency era absent hand holding into decisions**
- **The Fed has multiple tools to manage markets beyond just the size of today's cut**
- **The Fed doesn't need to validate market pricing and has resisted to date**
- **Why the Fed can't follow the "Sahm Rule"**
- **Be careful with how to define real policy rates...**
- **...while real market rates are plunging**
- **Interpret recent dual mandate readings with care**
- **Nothing about the US should have the Fed in a rush to ease...**
- **...as markets are functioning well, and rapid growth is driving excess demand**
- **BoC's Rogers didn't sound supportive of upsizing**
- **Defining Canadian real rates alongside rate equivalence to mortgage easing**
- **UK core inflation doesn't support the BoE cutting tomorrow**
- **Brazil is expected to hike today in a worst nightmare scenario for global central banks**

Game day has finally arrived. It's Fed day and with it a seminal moment for US monetary policy that begins the easing process after all that we've been through over recent years. Except the occasion is marred by the Fed's poor communications that have driven elevated market volatility around size and pace issues right into game day.

SCOTIA'S FOMC CALL

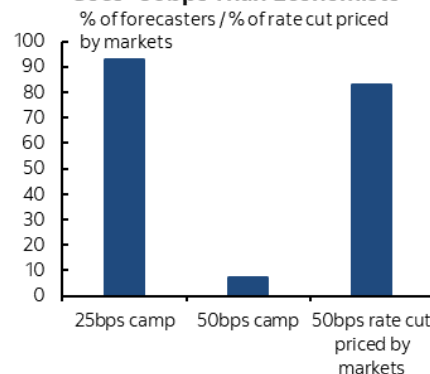
The fun starts at 2pmET when the statement and Summary of Economic Projections including the famed dot plot land, followed by Chair Powell's press conference at 2:30pmET.

Scotia's house call is -25bps and that's most likely in my opinion with risk of -50bps. There is no

certainty into this one in no small part because the Fed has been letting volatile markets flap in the breeze in a marked departure from Powell's handholding approach throughout

Chart 3

Markets More Convinced the Fed Goes -50bps Than Economists



Sources: Scotiabank Economics, Bloomberg Consensus.

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the hike cycle (chart 1). History is ambiguous toward the size of a first cut in an easing cycle (chart 2), but when they've gone big out of the gates it has typically been because of something really bad and ugly happening, like the GFC or dot-com shock. 92% of economists are in this camp within Bloomberg's survey of 114 forecasters. Only one US PD expects -50bps. Markets are much closer to -50bps with fed funds futures roughly 80% priced for a 50bps cut. It's economists versus markets on this one (chart 3). The camps are dug in and anyone trying to weigh in only now is kinda late to the party.

I've gone over the cases for -25bps and -50bps pretty thoroughly in my Global Week Ahead article published last Friday ([here](#)). On balance, I think upsizing out the gates would be a policy error. I won't repeat all of those points here but will address five issues.

IT'S NOT THE FED'S JOB TO VALIDATE MARKET PRICING AND THEY HAVEN'T BEFORE

One is that the Fed should not feel the need to validate speculative market pricing. It's not their job to bail out traders' books. They certainly did not bail out markets earlier this year when markets went bonkers for rate cuts. When those earlier priced cuts were not delivered, the economy and markets simply picked themselves up and moved on. The Fed's job is to deliver appropriate monetary policy for the broad conditions of the US economy judged through the dual mandate. The shrill cries I'm hearing from some about the consequences to disappointing markets ring hollow in my view.

THE SAHM "RULE" IS NO RULE AT ALL, AND COULD DRIVE WILDLY VOLATILE FED POLICY

Two is that the creator of the so-called "Sahm Rule" said yesterday that he thinks his "rule" supports -50bps. I side with the part of the forecasting community that says his rule is no rule at all under present circumstances. We need to carefully ask why the unemployment rate has risen in the US as it mostly reflects a sharp population shock rather than a large deterioration of the labour market. That population shock may be transitory. The Biden administration is already taking steps to curtail immigration. We also need to consider how the labour market may evolve in future including political risk should Trump get elected and impose sharp curbs against immigration that would crush labour force growth and put the unemployment rate back on a downward trend. Next year's Sahm "rule" might well be positioned as supporting rate hikes when that happens, and it would be silly for the Fed to chase what it says.

BE CAREFUL ABOUT REAL RATES

Three is the issue of how to view real rates. The real fed funds policy rate has increased as inflation has fallen, and this is used by some as justification for upsizing cuts out of the gates. One counter is that the real policy rate has to be defined in a forward-looking expectations sense by using expected inflation and arguably expected policy rates, not backward-looking inflation in the latest month's reading. On expected inflation, you tell me; everyone sucks at forecasting inflation 1 or more years ahead including the Fed, including markets, and including economists. It's a really tough thing to forecast and that should mitigate tendency to have an overly strong opinion toward the exact degree by which the real policy rate has tightened.

On expected policy rates, the market has already delivered substantial easing. The Fed would eventually have to deliver on at least some of that or else market conditions will tighten again, but it's not like you have the bond market behaving in totally oblivious fashion toward the prospects of policy easing. If the bond market is onto easing prospects, then shock therapy to wake it up isn't needed; ergo, keep your powder dry and don't upsize. The upsizing case would be stronger if the Fed strongly believed that markets needed to be jolted and woken up with the whole yield curve much higher than it is.

The other twist here is that when speaking about real rates it's not just the real fed funds rate that matters to the US economy. The real US 10-year Treasury yield has fallen by about 100bps from the year-ago peak to now, defined as the nominal yield minus the TIPS 10-year breakeven (chart 4). The 10-year real yield matters to key parts of the US economy, like the housing market where 30-year mortgages are priced off 10s as a key input.

INTERPRET DUAL MANDATE READINGS WITH CARE

Falling inflation and decelerating inflation are definitely rebalancing risks toward easing. The issue is how much easing and how fast which hinges about how bad you think the dual mandate is evolving and how much it might further deteriorate from here. On that, I'm still of the belief that payrolls and inflation readings over recent—very recent—months need to be interpreted with care.

Chart 4



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Nonfarm Payrolls: Negative annual benchmarking revisions were benchmarked to a weak measure that excludes undocumented workers ([here](#)). Also, I still believe SA factors are distorting job growth to be higher earlier in the year and lower now so you need to take a full year perspective. Payrolls are averaging just under +200k/mth in the last six months which may be below earlier break even estimates but less so now with the Biden administration clamping down on immigration, and way less so if Trump wins and reverses population. I don't see alarming signs in the job market that should motivate the Fed to rush.

Inflation: We've had three months of softness in core PCE, maybe a fourth at month-end. That's significant, but declaring inflation risk to be over feels like declaring the Leafs will win the Cup based on their record by December. Categories like rent, OER and core services were still warm in the latest CPI and longstanding expectations for shelter inflation to dwindle keep getting pushed out. I also think SA factors are distorted in the pandemic era which is why Powell said at his July 31st presser that he was focusing on 12 months of data, aware that core inflation can be over stated earlier in the year and understated around now. In terms of drivers, the US economy is still in excess aggregate demand, with growth continually exceeding expectations, which makes it difficult to get inflation durably down to 2% with the lagged effects unless the economy very suddenly tanks and very soon. US real wage growth is mildly accelerating. American consumer fundamentals are strong and marked by low debt payments to incomes, high liquidity, accelerating real wage gains and strong net worth gains. Supply chains are in a multi-year period of being revamped and, like China's effects in the opposite disinflationary direction post-WTO entry, the multi-year effects of today's supply chain challenges will take years to work through at higher cost passed on. And US fiscal policy is likely to be bad news no matter who wins in November. Front loading into potentially Trump's ill-advised tariffs would be dicey, maybe more appropriate into second round effects.

WHERE'S THE EMERGENCY?

Fourth, there is nothing—repeat nothing—about the US that should have the Fed violating prior forward guidance that the path down would not be symmetrical in size and pace to the path up by delivering a large cut today. Markets are functioning well and simply going through volatile price discovery. Growth remains robust at a seemingly steady 3% q/q SAAR pace even into Q3 that exceeds potential growth. The economy remains in excess demand with a positive output gap that questions the durability of the summertime soft patch for inflation. There are no signs that GDP growth is slowing below potential growth in a way that would shift the economy toward economic slack. Since GDP growth and employment growth are highly correlated (that's Okun's "law"), it's hard to get too negative on jobs. I'll go over more of my views on inflation and jobs tracking in the fuller morning note including the data quality issues around both.

MULTIPLE TOOLS CAN BE APPLIED TO MANAGING MARKET EXPECTATIONS

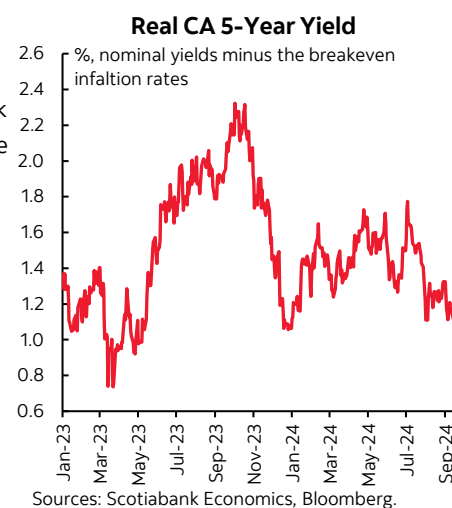
Fifth, today's decisions are about much more than just the game day policy rate choice. There are multiple scenarios around how they might manage the policy rate, the dot plot of the Committee's forward expectations, their macro projections, the statement tweaks and Chair Powell's combination of Committee and personal views that may be expressed in the presser. One scenario could be cut 25 and sound very open to upsizing if needed in which case markets retain decent probability of a bigger cut later and then we'll see what happens on the path to then. Or cut 50bps today and perhaps say it's a one-and-done move to catch up to what "several" Committee members thought about cutting in July but that it was unlikely that such a choice would become a pattern.

BOC'S ROGERS DIDN'T SOUND OPEN TO UPSIZING INTO OCTOBER

Bank of Canada Senior Deputy Governor Rogers said last evening that "there's still a bit of work to do" on inflation and "We want to see a sustainable return to 2 per-cent inflation. So that's still to come." She remarked that they wish to see further progress on bringing core inflation lower. I think she's right to have that stance as argued [here](#). Overall, these did not sound like comments that are teeing up upsizing rate cuts any time soon. We'll also get the not-minutes Summary of Deliberations on the path to the September 4th decision at 1:30pmET today, though it will likely garner little attention just ahead of the Fed. BoC Governor Macklem speaks on Friday and may offer further remarks, although his topic is "The Impact of AI on productivity, on labour markets and price-setting behaviour" at an NBER event in Toronto on AI's effects.

By the way, the same arguments on real rates that were provided earlier also apply to Canada. In Canada, key is the 5-year real bond yield that has plunged by over 100bps over the past year (chart 5). This matters to the mortgage and housing markets such that the market's easing needs to be considered alongside the policy rate. Plus, Ottawa's extension of mortgage amortization to

Chart 5



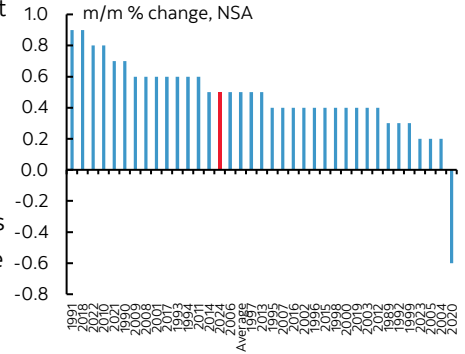
30 years from 25 has a rate equivalence of about -90bps for borrowers. Regulatory and monetary easing are likely to be joined by even faster fiscal stimulus into an election year which should make forecasters nervous toward the kind of pressure that some shops are applying to the BoC to shift to emergency mode via rapid rate cuts. With information we have to date, I find that would be just plain irresponsible.

UK CORE INFLATION DOES NOT SUPPORT A BOE CUT TOMORROW

UK markets didn't take so kindly to the latest core inflation reading. The gilts front-end is underperforming all other major markets with the 2s yield up by about 6bps while sterling is among the outperformers on a general down day for the dollar. The pattern of sticky m/m core CPI readings was maintained in August. Core CPI was up by 0.5% m/m NSA which matched the historical average for like months of August (chart 6) which I guess is better than the hotter than seasonally normal readings that marked every print from February to July, but probably not cool enough to give confidence to cut tomorrow. The year-over-year core rate of 3.6% edged up from 3.3% the prior month in line with consensus. Services led the way especially via travel-related categories.

Chart 6

Comparing UK Core CPI for All Months of August



Sources: Scotiabank Economics, UK Office for National Statistics.

BANK INDONESIA STARTS CUTTING

Bank Indonesia surprised markets by cutting its policy rate by 25bps overnight. A decent minority (10 of 36) expected the cut. The rupiah largely shook it off and the two-year Indonesian bond yield only slightly richened.

BRAZIL'S CENTRAL BANK IS FACING GLOBAL CENTRAL BANKERS' WORST NIGHTMARE

anco Central do Brasil is expected to hike its Selic rate by 25bps today (5:30pmET). Yes hike. After cutting the rate seven times since August 2023 from 13.75% down to 10.5%, BCB is faced with whipsawing borrowers in what amounts to the scenario most feared by central bankers. After easing, renewed pressures are inviting a reversal on the path to a new Governor—Gabriel Galípolo—taking over next year.

| 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. | 3.63 | 3.61 | 3.64 | 3.47 | 3.44 | 3.44 | 3.68 | 3.65 | 3.65 | 3.99 | 3.96 | 3.97 | Canada - BoC | 4.25 |
| CANADA | 2.93 | 2.92 | 3.02 | 2.74 | 2.71 | 2.75 | 2.92 | 2.89 | 2.91 | 3.10 | 3.07 | 3.08 | US - Fed | 5.50 |
| GERMANY | 2.25 | 2.23 | 2.15 | 2.06 | 2.03 | 1.97 | 2.18 | 2.14 | 2.11 | 2.45 | 2.40 | 2.40 | England - BoE | 5.00 |
| JAPAN | 0.38 | 0.39 | 0.39 | 0.48 | 0.49 | 0.51 | 0.83 | 0.83 | 0.86 | 2.00 | 1.99 | 2.06 | | |
| U.K. | 3.89 | 3.82 | 3.79 | 3.71 | 3.64 | 3.62 | 3.84 | 3.77 | 3.76 | 4.41 | 4.35 | 4.37 | | |
| | Spreads vs. U.S. (bps): | | | | | | | | | | | | | |
| CANADA | -69 | -69 | -62 | -74 | -73 | -70 | -76 | -76 | -74 | -89 | -89 | -89 | Euro zone - ECB | 3.65 |
| GERMANY | -138 | -138 | -149 | -141 | -141 | -147 | -150 | -150 | -154 | -154 | -156 | -157 | Japan - BoJ | -0.10 |
| JAPAN | -325 | -322 | -325 | -299 | -295 | -294 | -285 | -282 | -280 | -200 | -197 | -191 | Mexico - Banxico | 10.75 |
| U.K. | 27 | 22 | 15 | 23 | 19 | 17 | 15 | 12 | 11 | 42 | 39 | 41 | Australia - RBA | 4.35 |
| Equities | Level | | | | | | % change: | | | | | | New Zealand - RBNZ | 5.25 |
| | Last | Change | | | 1 Day | 1-wk | 1-mo | 1-yr | | | | | Next Meeting Date | |
| S&P/TSX | 23678 | -24.4 | | | -0.1 | 2.9 | 2.7 | 15.5 | | | | | Canada - BoC | Oct 23, 2024 |
| Dow 30 | 41606 | -15.9 | | | -0.0 | 2.1 | 2.3 | 20.2 | | | | | US - Fed | Sep 18, 2024 |
| S&P 500 | 5635 | 1.5 | | | 0.0 | 2.5 | 1.4 | 26.5 | | | | | England - BoE | Sep 19, 2024 |
| Nasdaq | 17628 | 35.9 | | | 0.2 | 3.5 | -0.0 | 28.6 | | | | | Euro zone - ECB | Oct 17, 2024 |
| DAX | 18722 | -4.0 | | | -0.0 | 2.1 | 2.2 | 19.0 | | | | | Japan - BoJ | June 14, 2024 |
| FTSE | 8260 | -49.4 | | | -0.6 | 0.8 | -0.6 | 7.9 | | | | | Mexico - Banxico | Sep 26, 2024 |
| Nikkei | 36380 | 176.9 | | | 0.5 | 0.6 | -2.7 | 9.4 | | | | | Australia - RBA | Sep 24, 2024 |
| Hang Seng | 17660 | 237.9 | | | 1.4 | 2.5 | 1.3 | -1.5 | | | | | New Zealand - RBNZ | Oct 08, 2024 |
| CAC | 7458 | -29.1 | | | -0.4 | 0.8 | 0.1 | 2.5 | | | | | | |
| Commodities | Level | | | | | | % change: | | | | | | | |
| WTI Crude | 70.75 | -0.44 | | | -0.6 | 5.1 | -7.7 | -22.7 | | | | | | |
| Natural Gas | 2.36 | 0.04 | | | 1.6 | 4.1 | 11.3 | -13.4 | | | | | | |
| Gold | 2573.91 | 4.41 | | | 0.2 | 2.5 | 15.4 | 33.1 | | | | | | |
| Silver | 30.68 | -0.23 | | | -0.7 | 7.9 | 9.0 | 33.0 | | | | | | |
| CRB Index | 278.66 | 1.80 | | | 0.7 | 5.0 | 1.2 | -3.7 | | | | | | |
| Currencies | Level | | | | | | % change: | | | | | | | |
| USDCAD | 1.3591 | -0.0007 | | | -0.1 | 0.1 | -0.3 | 0.8 | | | | | | |
| EURUSD | 1.1120 | 0.0006 | | | 0.1 | 1.0 | 0.3 | 4.0 | | | | | | |
| USDJPY | 141.89 | -0.5200 | | | -0.4 | -0.3 | -3.2 | -3.9 | | | | | | |
| AUDUSD | 0.6779 | 0.0023 | | | 0.3 | 1.6 | 0.7 | 5.3 | | | | | | |
| GBPUSD | 1.3212 | 0.0051 | | | 0.4 | 1.3 | 1.7 | 6.7 | | | | | | |
| USDFX | 0.8444 | -0.0028 | | | -0.3 | -0.9 | -2.1 | -5.9 | | | | | | |

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