ON DECK FOR FRIDAY, JANUARY 4

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	01/04	08:30	Employment (000s m/m)	Dec	10.0	10.0	94.1
CA	01/04	08:30	Unemployment Rate (%)	Dec	5.6	5.7	5.6
CA	01/04	08:30	IPPI (m/m)	Nov	--	0.0	0.2
CA	01/04	08:30	Raw Materials Price Index (m/m)	Nov	--	--	-2.4
US	01/04	08:30	Nonfarm Employment Report (000s m/m)	Dec	185.0	184.0	155.0
US	01/04	08:30	Unemployment Rate (%)	Dec	3.7	3.7	3.7
US	01/04	08:30	Household Employment Report (000s m/m)	Dec	--	--	233.0
US	01/04	08:30	Average Hourly Earnings (m/m)	Dec	0.2	0.3	0.2
US	01/04	08:30	Average Hourly Earnings (y/y)	Dec	2.9	3.0	3.1
US	01/04	08:30	Average Weekly Hours	Dec	--	34.5	34.4
US	JAN 4-11		Construction Spending (m/m)	Nov	0.2	0.2	-0.1
US	JAN 4-11		New Home Sales (000s a.r.)	Oct	570.0	568.5	544.0
US	01/04	10:15	**Fed Chair Powell plus Bernanke and Yellen interviewed at AEA**				
US	01/04	10:15	**Fed's Bostic Speaks at AEA in Atlanta**				

KEY POINTS:

- **Global markets in risk-on mode ahead of nonfarm, Powell**
- **China cuts required reserves by 1%...**
- **...and the door may be open to doing more**
- **Powell unlikely to signal major course shift today...**
- **...while next week's Fed communications pose higher risk…**
- **…but overall data has been rather solid…**
- **…versus attempts at cherry-picking the evidence**
- **The Fed, Trump and lollipops**
- **Nonfarm: softer wage growth, solid job growth?**
- **ADP's head fakes**
- **Don't look for shutdown effects in today's US figures**
- **CDN jobs: what happens after a record gain?**
- **Eurozone CPI softens as expected...**
- **...with weak core inflation unchanged**
- **UK PMIs signal soft growth**
- **Probably no progress toward a funding deal today**
- **WTI rallying ahead of US inventories**

INTERNATIONAL

The week will end with a bang in what is thus far a constructive tone across world markets. Thank China with the PBoC slashing the required reserve ratio and broadly applying it across lenders. Nevertheless, retain some trepidation ahead of key developments today including US jobs, Chair Powell and his predecessors, Canadian jobs, and more shutdown debate in the US. European inflation was in line with expectations and UK PMIs slightly beat expectations to signal moderate growth

- US equity futures are up by around 1 ¼% to 1 ¾% this morning. TSX futures are up by just under 1%. European cash markets are up by 1–2% across the

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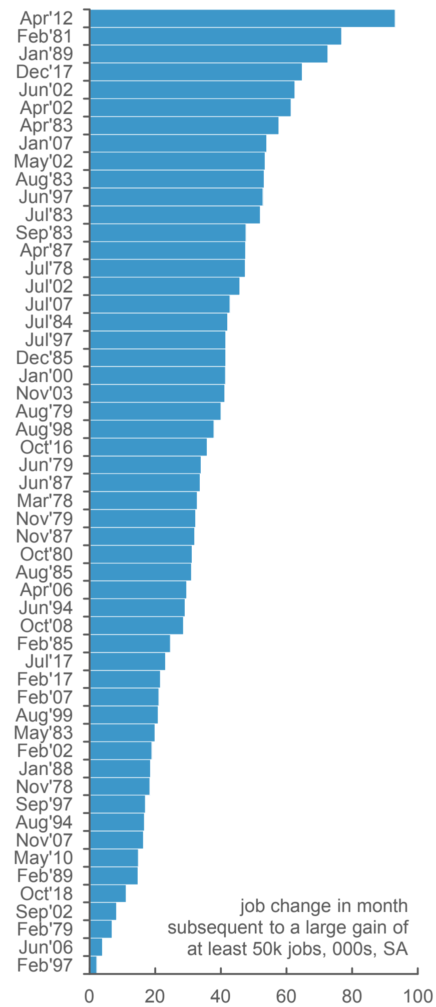
Big Gains Don't Have to Beget Big Losses



Sources: Scotiabank Economics, Statistics Canada, Haver Analytics.

exchanges. Asian equities were a little more mixed but had generally shut before the PBoC's announcement. Tokyo fell 2 ¼%, HK was up by the same amount, mainland China's exchanges were up by over 2% and Seoul rallied by just under 1%.

- Sovereign bonds are getting hit moderately hard this morning. US Treasury yields are up by 4–6bps across maturities. Canadas are similarly cheaper. European sovereign yields are up by 1–5bps in 10s with gilts leading the cheapening.
- Oil prices are rallying ahead of US inventories (11amET). WTI and Brent are both up by over a buck.
- The USD is mildly on the defensive this morning. The strongest appreciating crosses are the rand, A$, pound sterling, Mexican peso and CAD.

The PBoC cut its required reserves ratio by 1% in two steps this morning. It could well ease policy further and inject substantially greater liquidity going forward. The RRR for large banks will decline by 50bps on January 15th and another 50bps on January 25th. The PBoC estimated that US$116 billion of liquidity will be released into the system as a result. The central bank claims this step remains 'targeted' and not a sign of a departure in that its "prudent monetary policy stance hasn't changed." Guidance from the central bank and China in general at market inflection points is to be treated with a grain of salt with one example being the yuan depreciation denials of 2015 that ultimately backfired. Further PBoC easing could come partly on the back of pending data releases like next week's CPI but also on updates to collapsing foreign direct investment and strong credit figures. The other catalyst for further liquidity injections is the path to the Lunar New Year on February 5th when industry shuts down in advance and throughout the full week, the world's biggest annual migration of workers returning home unfolds, and seasonal demand for liquidity and credit soars to fund holiday travel and shopping. Amidst downside risks to growth, the last thing the Chinese Communist Party wants when reams of folks are traipsing through train terminals and airports is to avoid decisive action to stimulate the economy and lend confidence.

Overnight Chinese data wasn't particularly revelatory in terms of informing the PBoC moves. The private sector Caixin purchasing managers' index climbed three tenths to 52.2 on the back of moderate growth in the services sector. The services PMI was little changed at 53.9 (53.8 prior). That offset the weakness in the earlier release for the manufacturing PMI that slipped below the 50 dividing line into slight contraction at 49.7. Recall that services account for 51.6% of China's economy while manufacturing accounts for 29.3% as at 2017; it often seems that markets still view the Chinese economy as just a manufacturer of cheap low quality goods when that impression is so far removed from modern realities.

Eurozone headline CPI inflation fell to 1.6% y/y (1.7% consensus, 2% prior) and core remained unchanged at a soft 1% y/y. Generally the report did not surprise a) because of the known effects of cooling energy prices, and b) because several countries like Germany and Spain release in advance.

The UK economy continues to grow at a soft but mildly better than expected pace. That's the takeaway from the conclusion to the round of purchasing managers indices for December. The composite PMI came in better than expected (51.4, 50.8 consensus) and was revised up a tick to 50.8 the prior month. That was largely because the services sector performed better than consensus anticipated with the services PMI landing at 51.2 (50.7 consensus). The UK manufacturing PMI has already been released and also beat expectations earlier this week while the construction PMI softened in line with expectations.

UNITED STATES

The marquee global release of the week is of course today's US nonfarm payrolls and companion household survey (8:30amET). Here is a rundown of expectations.

- **wage growth may decelerate a bit**. I get 2.9% y/y (3.1% prior, consensus 3.0%). This is based upon base effects that alone would bring year-ago wage growth down to 2.7% y/y, and then after including fairly standard seasonal wage gains I get 2.9% y/y.
- **I'm at 185k for headline nonfarm which as it turns out came in close to consensus at 180k.** ADP may be thought to add upside but again, be careful toward the often huge deviations between initial ADP and initial private nonfarm.

- the wildcard is that this household survey (from which the part rate and UR are derived) is the one each year that includes **annual revisions** to seasonal adjustment factors going back years in time. This one revises back to 2014. That could affect UR estimates.

- the sister nonfarm payrolls report will then be subject to its years of annual revisions in the next payrolls report a month from now on Feb 1st. Why they can't adjust SA factors years back in time in the same month's report for both the household and payroll reports is beyond me.

- **don't look for shutdown effects on the numbers.** Shutdowns don't mean firings as opposed to furloughs. This shutdown is a partial one and so even the furlough effect is smaller than during other shutdowns. Shutdowns may delay Federal government hiring, but that's a tiny share of overall hiring at about a 1–3k monthly clip this year. As for hours worked, the reduction for federal workers won't be captured in this report as the shutdown that began on the 22nd fell outside of the nonfarm reference period (pay period including the 12th each month) and the household survey's reference period (the week including the 12th of each month, may not be the same as the 'pay period'). Besides, the shutdown occurred when seasonal hours get reduced anyway due to holidays.

- **does ADP mean nonfarm upside**? Maybe, but don't get too carried away. Since ADP improved its methodology in October 2012, the spread between initial ADP and initial private nonfarm estimates in absolute value terms has averaged 49k. The spread between final ADP and final private nonfarm estimates has averaged 43k. Therefore, even after revisions, there is a significant difference between the two measures of private payroll changes. The individual deviations can be huge in both directions. The biggest single month over-estimation of private nonfarm payrolls by ADP in the initial estimates was +175k in September 2017. The biggest single month under-estimation of private nonfarm payrolls by ADP in the initial estimates was -106k in November 2014. The ADP beat (271k, and hence 91k over consensus) is relatively large but not outside of the bounds of historical over/under spreads.

- **Last, always recall that the 90% confidence interval surrounding nonfarm payroll changes is +/- 115,000 jobs.** Most of any wild swings from month to month tend to fall within the bounds of random statistical noise. Tamp down strident conviction of economists—including some who rely on nonfarm 'models'—when they sound convinced that their estimate that is a few tens of thousands different from someone else's is superior.

I don't expect a whole lot from the panel including Fed Chair Powell and former chairs Yellen and Bernanke this morning (10:15amET). That said, the panel runs for two hours so anything goes. The bigger risk in terms of Fed communications could be next week including Wednesday's FOMC minutes but also the next day's focused speeches by Chair Powell to the Economic Club of Washington and Vice Chair Clarida to the Money Marketeers of New York University on Thursday.

Generally speaking, I think Powell will be comfortable with the broad tone of data since the December FOMC meeting and won't signal any abrupt course shift. ISM manufacturing disappointed but with a lot of caveats surrounding the context (here). What else have we learned? GDP growth came in at 3.4% for the final Q3 estimate. The Atlanta Fed's 'nowcast' for Q4 was lowered to 2.6% in Q4 post-ISM which remains very healthy growth. Core capital goods orders slipped by 0.6% m/m in November but were revised up the prior month in offsetting fashion. Inflation-adjusted consumption growth was strong and revised up in the figures for November. Core PCE inflation *increased* to 1.9% y/y in December. Consumer confidence slipped but remains very cyclically strong. ADP private payrolls were strong. Vehicle sales held in at 17.5 million units in December. Obviously nonfarm is pending, but overall, I find stories and headlines that cherry pick the bad stuff and ignore all of the good data to be unhelpful to dispassionate discourse on Fed policy risks.

So data supports the Fed staying on track with the pre-nonfarm caveat. That brings me to what I think is the added argument for the Fed to continue to signal data dependent rate hikes and avoid any about face. It has to do with the Fed's role as disciplinarian. In the face of the Trump administration's blatant protectionism, **the Fed has to remain cognizant toward the risks of stagflation is protectionist tendencies really get out of sorts**. Throughout the debate is **a moral hazard problem confronting the Fed**. If it eases up, it rewards the appalling behaviour in the White House. Staying the course might actually impose needed discipline upon the Trump administration's damaging trade policies to the ultimate benefit of the long-run outlook of the US and world economies. Carry on, Chair Powell, and treat Trump's criticism as akin to an unruly kid encountering his parent's guiding discipline toward why he can't recklessly do whatever he wishes in cavalier fashion. If the Trump administration wishes to calm markets down, then the solution is easy: stop threatening the Fed, quit the protectionist game, and behave like adults on funding the US government. To back off on rate hike plans would be the Fed essentially like the parent who gives a lollipop to the kid throwing a public tantrum. And in any event, markets have priced out any Fed rate hikes, so blaming the Fed for equity volatility is a ruse.

Further to this line of thinking, markets make take some comfort if something constructive resulted from today's 11:30amET meeting between Trump and Congressional leaders on funding the US government and border security. Given how entrenched the stances have become, it's hard to see much good resulting from today's meeting. The House passed a bill to reopen government with no wall funding last evening that the Senate won't take up and Trump would veto anyway as he dug in his heels on border wall funding.

CANADA

Canada updates labour market conditions during December with its household survey today 8:30amET). Here are some loose expectations and thoughts.

- I went with +10k and an unchanged UR of 5.6%. It's not with much conviction though and consensus guesses are all over the map from a drop of -25k to a rise of 25k and no real clustering of expectations.
- The sensible downside risk may be thought to be derived from the record that was set for a single month's job gain the prior month when 94,100 jobs were created.
- But, the upside risk is that outlier gains usually signal momentum or catch up on hiring plans. This may also be a function of the statistical methodology behind the Labour Force Survey that involves multiple equations applied to sample data.
- In fact, since the commencement of the modern day LFS in 1976, there have been 54 times when there has been a monthly job gain of 50k or more and the month following every single one of those episodes was also up. Always. Please see the accompanying chart that depicts job changes the month after all of these super-sized gains.
- to narrow the sample further, there have been 11 times when the monthly gain has been at least 80k and the following month always saw a job gain. There is always a first time for disappointment, but if you follow patterns and precedent or just watch the equation estimation effects then the odds may well favour another gain.
- Further, hiring intentions remain strong according to the BoC's BOS survey.
- does it all matter anyway? Yes and no. We know to watch trends in the LFS, not monthly volatility in what at times can be a survey that draws its shares of guffaws. That said, the trends are very favourable. The three month moving average for job growth is running at 56k, the six month MA is 34k and the 12 month MA is 18k. The job market has added 154k jobs over the first eleven months of 2018 to date. That year to date figure is depressed by the surge in hiring in Dec '17 that then fell in January which distorted the starting reference point for the year to date figures. One way of controlling for that is to take the two full past years to smooth over that distortion to ytd calcs. Over 2017–18, Canada has created a whopping 581,300 jobs. Or, take the change in employment since the end of last January to get around the prior distortion and that's up 242,000. Job growth has been quite strong.

Fixed Income — Government Yield Curves (%):

	2-YEAR Last	2-YEAR 1-day	2-YEAR 1-wk	5-YEAR Last	5-YEAR 1-day	5-YEAR 1-wk	10-YEAR Last	10-YEAR 1-day	10-YEAR 1-wk	30-YEAR Last	30-YEAR 1-day	30-YEAR 1-wk
U.S.	2.66	2.67	2.73	2.65	2.67	2.73	2.79	2.81	2.89	3.01	3.05	3.14
CANADA	1.93	1.92	2.02	1.94	1.94	2.04	2.00	2.01	2.10	2.16	2.16	2.27
GERMANY	-0.60	-0.60	-0.61	-0.30	-0.30	-0.30	0.25	0.23	0.25	0.86	0.83	0.89
JAPAN	-0.14	-0.15	-0.15	-0.12	-0.14	-0.13	0.05	0.03	0.04	0.75	0.72	0.79
U.K.	0.77	0.74	0.72	0.92	0.88	0.87	1.31	1.27	1.24	1.82	1.79	1.79
	Spreads vs. U.S. (bps):											
CANADA	-73	-75	-72	-71	-73	-69	-78	-80	-79	-86	-89	-87
GERMANY	-325	-327	-334	-295	-297	-303	-254	-258	-264	-215	-222	-226
JAPAN	-280	-282	-289	-277	-281	-286	-274	-278	-286	-226	-233	-236
U.K.	-189	-194	-201	-173	-179	-187	-148	-154	-165	-119	-126	-135

Equities	Level: Last	Level: Change	% change: 1 Day	1-wk	1-mo	1-yr
S&P/TSX	14142	-122.3	-0.9	-4.1	-6.3	-12.6
Dow 30	22860	-464.1	-2.0	-7.1	-6.6	-7.8
S&P 500	2467	-39.5	-1.6	-6.9	-6.9	-8.1
Nasdaq	6528	-108.4	-1.6	-7.7	-6.4	-6.3
DAX	10588	-22.9	-0.2	-2.6	-5.8	-19.2
FTSE	6706	-6.0	-0.1	-2.0	-4.9	-11.8
Nikkei	20166	-226.4	-1.1	-5.7	-6.2	-11.8
Hang Seng	25753	129.9	0.5	-1.3	-0.8	-12.3
CAC	4676	-16.6	-0.4	-3.7	-6.0	-13.2

Commodities	Level		% change:			
WTI Crude	45.18	-0.70	-1.5	-11.8	-17.3	-22.6
Natural Gas	3.65	0.07	1.9	-4.6	-18.0	40.5
Gold	1260.06	0.16	0.0	1.7	2.8	-0.5
Silver	14.77	0.13	0.9	0.6	2.3	-8.7
CRB Index	171.74	-0.92	-0.5	-4.8	-7.2	-8.5

Currencies	Level		% change:			
USDCAD	1.3540	0.0031	0.2	1.2	2.3	6.3
EURUSD	1.1412	-0.0034	-0.3	0.9	0.2	-3.9
USDJPY	111.21	-0.0700	-0.1	-1.9	-1.6	-1.9
AUDUSD	0.7096	-0.0012	-0.2	-1.1	-2.3	-7.9
GBPUSD	1.2653	-0.0003	-0.0	0.6	-1.0	-5.5
USDCHF	0.9912	0.0033	0.3	-0.7	-0.4	0.3

Central Banks

Current Rate	
Canada - BoC	**1.75**
US - Fed	**2.50**
England - BoE	**0.75**
Euro zone - ECB	**0.00**
Japan - BoJ	**-0.10**
Mexico - Banxico	**8.25**
Australia - RBA	**1.50**
New Zealand - RBNZ	**1.75**

Next Meeting Date	
Canada - BoC	**Jan 09, 2019**
US - Fed	**Jan 30, 2019**
England - BoE	**Feb 07, 2019**
Euro zone - ECB	**Jan 24, 2019**
Japan - BoJ	**Jan 23, 2019**
Mexico - Banxico	**Feb 07, 2019**
Australia - RBA	**Feb 04, 2019**
New Zealand - RBNZ	**Feb 12, 2019**

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.