March 27, 2019 @ *9:15 EST*

ON DECK FOR WEDNESDAY, MARCH 27

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	03/27	08:30	Merchandise Trade Balance (C$ bn)	Jan	-3.4	-3.6	-4.6
US	03/27	08:30	Trade Balance (US$ bn)	Jan	-58	-57.0	-59.8
US	03/27	10:00	Current Account (US$ bn)	4Q	--	-130.0	-124.8
US	03/27	17:30	Fed's George Speaks to Money Marketeers of New York				

KEY POINTS:

- **Treasury curve inverts again**
- **Markets speculating upon a Fed rate cut after candidate Moore's remarks**
- **Dallas Fed's Kaplan indicates patience when observing the yield curve's signals**
- **Evaluating Canada's yield curves as recession signals**
- **San Fran Fed's Daly monitoring declining inflation expectations…**
- **…but not signalling concern toward the 2% anchor just yet**
- **ECB's Draghi hints at measures to mitigate negative rates impact…**
- **…while noting banks can be doing more themselves**
- **16 Brexit motions to be whittled down to indicative votes later today**
- **CDN trade improves in January…**
- **…but the overall Q1 net trade picture is looking terrible**
- **US trade deficit narrows as export growth improves…**
- **…but also as imports crater across all major categories**
- **NZ$ tanks as RBNZ guides toward a rate cut**
- **French confidence ticks higher; recovers 'yellow vests' effect**

INTERNATIONAL

A mild risk-off sentiment is working its way through global markets this morning after yesterday's risk-on session. The market is again speculating on the prospect of Fed rate cuts after Trump's candidate for the Fed's BoG—Stephen Moore—said he wanted a 50bps rate cut. I wouldn't treat that very seriously; even if he gets confirmed by the Senate (a big 'if'), he'd quite possibly be treated like the black sheep or embarrassing Uncle at the FOMC table. Nevertheless, the knee-jerk reaction is that the Treasury curve is inverting very mildly again. I thought the more insightful curve comments came from Dallas Fed President Kaplan (see below). Brexit votes may be a consideration into the North American market close this afternoon (see below). ECB President Draghi indicated mitigating tools to address the impact of negative rates on bank profitability may be in the cards (see below). The RBNZ is the latest global central bank to turn more dovish and guided toward a rate cut (see below). US, Canadian and Mexican trade figures are due out this morning. Also see below for a discussion of how useful Canada's yield curves are when it comes to predicting recessions; the bottom line is not very, and certainly less useful than the US curves at predicting the US cycle without getting into reasons why the US and global curves are distorted.

CONTACTS

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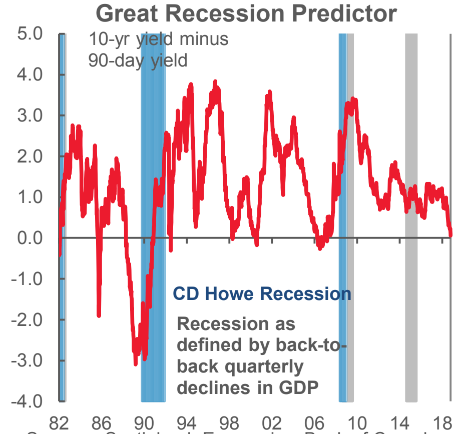
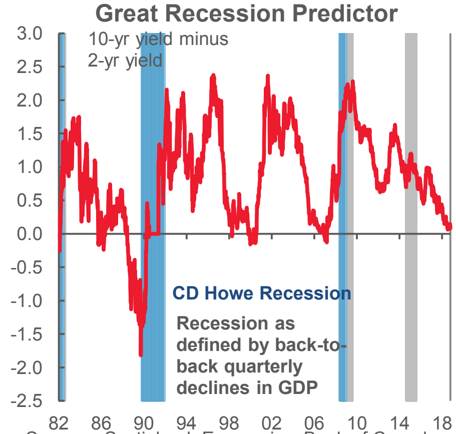
Canada's Curve Is Not A Great Recession Predictor



Sources: Scotiabank Economics, Bank of Canada, CD Howe.

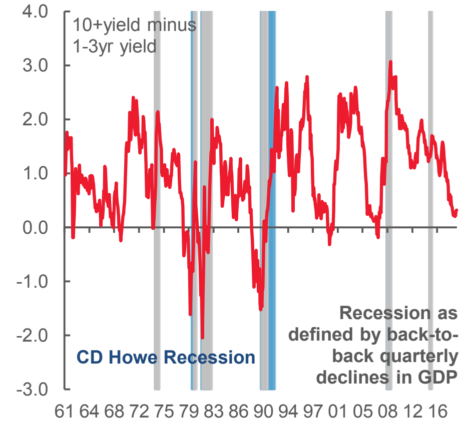
Canada's Curve Is Not A Great Recession Predictor



Sources: Scotiabank Economics, Bank of Canada, CD Howe.

- The USD is little changed on a DXY basis but this is masking considerable underlying moves. The NZ$ is the worst performer (RBNZ, see below). The Mexican peso and A$ plus CAD are among the other depreciating crosses. The Euro is little changed but the yen and pound sterling are up a little.
- Volatile bond markets are putting a bid to most sovereign curves particularly in the US as the Treasury curve mildly inverts again. The 90s yield of 2.45% is mildly above the 10s yield of 2.40% as 10s rally by about 3bps. That leaves a 90s10s negative slope of just 5bps which is small and of short duration over recent weeks (see Kaplan's remarks on this below). Canada's curve is also rallying by a similar amount to Treasuries but the trade figures had little incremental impact.
- Oil prices are mixed with WTI down a little and Brent up a little ahead of the US government's oil inventories report.
- US and Canadian equity futures are flat. European cash markets range from up 1.3% in Madrid to flat in London ahead of the Brexit votes.

Canada's Curve Is Not A Great Recession Predictor



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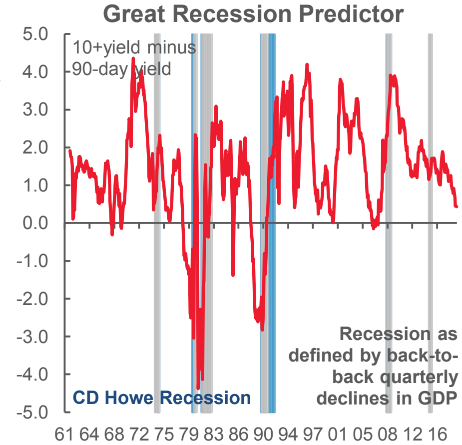

Sources: Scotiabank Economics, BoC, CD Howe.

The NZ$ is the worst performing semi-major currency cross versus the USD this morning thanks to a more dovish than anticipated RBNZ statement. While the RBNZ kept its policy rate on hold at 1.75%, the guidance pointed toward a potential near-term rate cut. The RBNZ's policy statement (here) didn't mince words one bit:

> "Given the weaker global economic outlook and reduced momentum in domestic spending, the more likely direction of our next OCR move is down."
>
> "Employment is near its maximum sustainable level. However, core consumer price inflation remains below our 2 percent target mid-point, necessitating continued supportive monetary policy."
>
> "The balance of risks to this outlook has shifted to the downside."

The OIS market is now pricing about a 40% chance of a cut at the next RBNZ meeting on May 7th, over 50% odds at the June meeting and about 75% odds at the August meeting.

The ECB's version of the Fed's Jackson Hole started earlier this morning. The main highlights include the kick-off speech by President Draghi (here). Draghi hinted at potential forthcoming measures to dampen the effects of negative rates on the banking sector as a barrier to passing through the benefits to the lending cycle:

> "We will continue monitoring how banks can maintain healthy earning conditions while net interest margins are compressed. And, if necessary, we need to reflect on possible measures that can preserve the favourable implications of negative rates for the economy, while mitigating the side effects, if any. That said, low bank profitability is not an inevitable consequence of negative rates. ECB analysis finds that the best-performing banks in the euro area in terms of return on equity between 2009 and 2017 share three key features: they have been able to significantly reduce their cost-to-income ratios; they have embarked on large-scale investments in information technology; and they have been able to diversify their revenue sources in a low interest rate environment."

The British Parliament will hold another series of non-binding indicative votes commencing at 3pmET through to around 5pmET. No fewer than sixteen proposals have been put forth and Speaker John Bercow will pick which ones make it through to a vote. The range of options showcases how thoroughly lost the British Parliament has become toward the issue as the EU's extended deadline of April 12th approaches. Briefly, they are as follows and note the focus upon various iterations of a customs union proposal:

- **Cash motion:** seeks to secure a two-thirds majority for parliament to even hold any indicative votes;
- **Norway plus option:** This is a cross-party motion to seek access to the EU single maket with a comprehensive customs arrangement;
- **Eustice motion:** Also the Norway model, but absent a customs union;
- **Labour's motion:** Support May's agreement but only if a customs union with the EU is sought;
- **Snell motion:** Secure a customs union with the EU;
- **Clarke motion:** leave the EU only with a permanent customs union in place;
- **Baron I motion:** Leave the EU even without a deal by the extended April 12th deadline;
- **Baron II motion:** Leave on May 22nd (before European parliamentary elections) with an amendment to PM May's agreement that would secure unilateral rights for the UK to exit the Irish backstop;
- **Quince motion:** reaffirm a commitment to the original 2016 referendum results;
- **MacNeil motion:** revoke the Article 50 Brexit agreement entirely if there is no agreement four days before the April 12th deadline;
- **Blackford motion:** Secure approval from the Scottish and Welsh assemblies before leaving the EU;
- **Cherry/Grieve/Cable motion:** require a last minute confirmation vote on a hard Brexit if within two days of the April 12th deadline there is no agreement;
- **Beckettt/Kyle motion:** hold another referendum;
- **Malthouse motion I:** May's deal minus the Irish backstop;
- **Malthouse motion II:** Absent support for May's deal with the backstop, seek a so-called standstill agreement during which time a trade agreement is negotiated;
- **Fysh motion:** a managed no-deal.

French consumer confidence ticked up a touch in March and has recovered the swoon since last August that was partly induced by the yellow vests movement that began in mid-November. Confidence remains lower than the peak in mid-2017.

CANADA

A pair of data releases for Canada was moderately constructive but highlighted divergent developments in labour versus trade indicators. StatsCan's sister jobs survey to the more widely followed Labour Force Survey of households registered a strong gain in January. **The payrolls survey posted a job gain of 71,200 which reinforces the 66,800 job gain reported in the LFS for the same month.**

Canada's trade balance for January narrowed somewhat to C$4.25 billion from a downwardly revised deficit of C$4.8 billion in December. The volume balance deteriorated as export volumes increased by less than import volumes. Nevertheless, this masks constructive developments on both sides of the trade ledger as export volumes rose by 0.9% m/m and import volumes were up by 1.5% m/m. This was the first increase in export volumes since July and recall that at the margin the January figures were feared due to the impact of Alberta's imposed oil production cuts. So at the margin, the January figures are better than they could have been.

Having said this, Canada's exports are getting clobbered on a trend basis. Export volumes dropped by almost 10% q/q at a seasonally adjusted and annualized rate in Q4 over Q3 and with January's tally we're now tracking another 12% drop. Import volumes fell 1.4% in Q4 after an 8.7% drop in Q3 but they are now tracking a 7.7% surge in Q1.

How useful is Canada's yield curve as a predictor of recessions? Not very is the bottom line. The curves are worse predictors of the Canadian business cycle than the US curves without even getting into issues such as whether they are much more policy distorted this month due to debt ceiling plus Fed and ECB actions which remains my view as opposed to using them unadjusted for recession warning purposes. The accompanying four charts—with help from Scotia's Alena Bystrova—show different measures of the yield curve's slope and different measures of recession. One measure of recession is the technical definition of back-to-back quarterly declines in GDP and the other measure is the CD Howe's Canadian version of a more comprehensive definition along the lines of the NBER's approach to dating cycles in the US. The first two charts show shorter history using the 90s10s and 2s10s slopes comparable to charts frequently used in the US. The second set of two charts show longer history with longer time series using the spread between the 10 year and over yield minus the 1–3 year average yield as well as the spread between the 90s and 10+ yields. The conclusions are as follows.

90s10s:

- False positives when curve inverted but no recession: 1986, 2000, and possibly late 2006 through early 2007 when it inverted quite a while ahead of Canada's brief recession;

- Accurate signals: early 1990s recession;

- 2015 was a false negative when curve didn't invert and one definition of recession was hit.

2s10s:

- False positives when curve inverted but no recession: 1986, Sept 1998, 2000;

- Accurate signals: early 1990s recession, GFC although quite early;

- False negatives when curve didn't invert and one definition of recession was hit: 2015

10+ minus 1–3:

- There were several false signals in the 1960s when the curve either inverted or came very close to doing so in addition to the above-noted caveats;

- The curve only inverted right about when the 1974 recession hit;

10+ minus 90s:

- Again, there were several false signals in the 1960s in addition to the earlier caveats;

- the curve never inverted ahead of the 1974 recession.

UNITED STATES

Fed-speak is once again informative to key debates and more important than the lone data report that I'll address briefly before turning to the Fed remarks.

Exports were up by 0.9% m/m with imports down by 2.6% and so the narrower trade deficit of US$51.1 billion (US$59.9 billion month before) was achieved through a combination of good (exports) and not-so-good considerations (imports). The deterioration in imports was broadly based and reflects a softer pull-effect of the domestic economy. While it bears noting that multiple import categories posted strong gains in December, every major import category fell in January led by a 4.9% drop in capital goods imports (+4.7% prior), a 5% decline in industrial supplies (flat prior), a 0.5% drop in autos (flat prior) and a 0.6% decline in consumer goods (+4.4% prior). **The goods balance of trade on a volume basis improved as the volume of exports climbed by 2.1% and the volume of goods imports fell by 2%.**

Comments from the regional Fed Presidents at Dallas this morning and San Francisco yesterday inform debates about Fed policy should react to an inverted yield curve and the outlook for inflation.

Dallas Fed President Robert Kaplan is the first Fed official to speak sensibly about how to react to the yield curve's inversion and he did so by emphasizing how premature discussion of a rate cut may be. In comments to the WSJ, Kaplan stated:

> "I'd need to see an inversion of some magnitude and/or some duration, and right now we don't have either. If you see an inversion that goes on for several months…that's a different kettle of fish. We're not there yet."

San Fran Fed President Mary Daly's speech yesterday (here) is worth considering in terms of views on inflation. In particular, consider the following direct quote:

> "Inflation consistently below target tugs at inflation expectations. While there is no sign today that the anchor has drifted down significantly, we are seeing signs that inflation expectations are edging lower. This bears close watching. We need to be vigilant on this front, and work to deliver 2 percent inflation on a sustained basis. The Federal Reserve's continued credibility with consumers and businesses depends on it."

What does she mean by reference to "signs that inflation expectations are edging lower"? Pieces by her and NY Fed President Williams this year have referenced declines in the following measures from the period of 2005–07 compared to 2017–18:

- The UofM sentiment survey's 5 year inflation expectations metric has dropped ½ % to 2.49% on average.
- The 5y5y breakeven rate has dropped 35bps to 2.09%
- The Cleveland Fed's 10 year expectations measure has dropped 54bps to 1.98%

All of these rates are at or above the 2% target. They are not signalling overly great concern and hence why she is saying "there is no sign today that the anchor has drifted down significantly" but they are watching.

Daly goes on to describe three types of wedges between tight labour markets on the one hand and wage and price pressures on the other that may be impeding the transmission of tight conditions to inflationary pressures.

- Alternative forms of compensation are not being captured in traditional measures like wages and salaries. This includes factors like free transportation, flexible workweeks, unlimited time off, help with student loan repayment and housing benefits.
- A loss of worker bargaining power including through declining unionization, automation, globalization etc.
- Firms have lost pricing power in a global market which makes it difficult to pass on higher wages to final goods prices.

Daly says the Fed is another wedge in that it has been successful at anchoring inflation (ahem…). Over time, people have come to believe in the lowered inflation goals compared to decades past which automatically self-limits inflation.

In conclusion, it's tough to say strongly what Daly is inferring—or not—by way of Fed policy linkages. I'd suggest that they're not too fussed at this point with each measure averaging down to around their target or slightly above, but they want to see if the downward drift in measures of inflation expectations has further legs to it or not. That's not something to be settled by a few months of inflation data. By taking averages over years, her and Williams (and recall Clarida's remarks some time ago) are truly taking a patient approach to evaluating the measures of expectations over fairly lengthy periods.

Fixed Income	Government Yield Curves (%):											
	2-YEAR			5-YEAR			10-YEAR			30-YEAR		
	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk	Last	1-day	1-wk
U.S.	2.21	2.27	2.40	2.17	2.21	2.33	2.39	2.42	2.53	2.85	2.87	2.97
CANADA	1.47	1.51	1.60	1.43	1.46	1.55	1.54	1.57	1.67	1.84	1.86	1.98
GERMANY	-0.58	-0.56	-0.53	-0.42	-0.39	-0.33	-0.05	-0.02	0.08	0.56	0.58	0.74
JAPAN	-0.17	-0.17	-0.16	-0.18	-0.18	-0.16	-0.07	-0.07	-0.04	0.54	0.54	0.57
U.K.	0.68	0.66	0.74	0.80	0.79	0.91	1.02	1.01	1.16	1.53	1.53	1.63
	Spreads vs. U.S. (bps):											
CANADA	-74	-76	-80	-74	-75	-78	-85	-85	-86	-101	-101	-99
GERMANY	-280	-283	-293	-259	-259	-266	-244	-244	-244	-229	-229	-223
JAPAN	-238	-243	-256	-234	-238	-249	-246	-249	-256	-232	-233	-240
U.K.	-154	-161	-166	-137	-142	-142	-137	-142	-137	-132	-134	-134

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	16155	89.3	0.6	-0.2	0.5	6.2
Dow 30	25658	140.9	0.6	-0.9	-1.3	7.5
S&P 500	2818	20.1	0.7	-0.5	0.9	7.9
Nasdaq	7692	54.0	0.7	-0.4	1.8	9.7
DAX	11465	45.6	0.4	-1.2	-0.2	-4.2
FTSE	7190	-6.0	-0.1	-1.4	1.2	2.7
Nikkei	21379	-49.7	-0.2	-0.9	-0.8	0.3
Hang Seng	28728	161.3	0.6	-2.0	-0.1	-6.7
CAC	5327	20.1	0.4	-1.0	2.0	4.1
Commodities	Level		% change:			
WTI Crude	60.00	0.06	0.1	0.3	5.4	-8.0
Natural Gas	2.70	-0.04	-1.6	-4.4	-3.7	0.2
Gold	1316.10	0.41	0.0	0.3	-0.3	-2.2
Silver	15.44	-0.09	-0.5	0.2	-2.5	-7.0
CRB Index	184.93	-0.30	-0.2	-0.4	0.9	-5.4
Currencies	Level		% change:			
USDCAD	1.3410	0.0029	0.2	0.8	1.9	4.1
EURUSD	1.1263	-0.0003	-0.0	-1.3	-0.9	-9.2
USDJPY	110.47	-0.1700	-0.2	-0.2	-0.5	4.9
AUDUSD	0.7089	-0.0046	-0.6	-0.4	-0.7	-7.7
GBPUSD	1.3232	0.0020	0.2	0.3	-0.6	-6.5
USDCHF	0.9941	-0.0003	-0.0	0.2	-0.7	5.0

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	Apr 24, 2019
US - Fed	May 01, 2019
England - BoE	May 02, 2019
Euro zone - ECB	Apr 10, 2019
Japan - BoJ	Apr 25, 2019
Mexico - Banxico	Mar 28, 2019
Australia - RBA	Apr 01, 2019
New Zealand - RBNZ	May 07, 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.