ON DECK FOR WEDNESDAY, MAY 1

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	05/01	07:00	MBA Mortgage Applications (w/w)	APR 26	--	--	-7.3
US	05/01	08:15	ADP Employment Report (000s m/m)	Apr	160	180.0	128.6
US	05/01	10:00	Construction Spending (m/m)	Mar	0.1	0.1	1.0
US	05/01	10:00	ISM Manufacturing Index	Apr	54.9	55.0	55.3
US	**05/01**	**14:00**	**FOMC Interest Rate Meeting (%)**	**May 1**	**2.50**	**2.50**	**2.50**
US	05/01		Total Vehicle Sales (mn a.r.)	Apr	17.3	17.0	17.5

KEY POINTS:

- **The Fed beckons with Asian, European markets mostly shut**
- **The Fed needs to sound more upbeat on US, global growth…**
- **…but will re-emphasize binary risks…**
- **…while pointing to softer inflation…**
- **…that Powell could patiently look through…**
- **…as core inflation could rebound over 2019**
- **The Fed might address short-term market liquidity…**
- **…but cutting IOER is just one among several possibilities**
- **Comparing measures of the current tightness of US monetary policy**
- **US ADP posts biggest gain since July**
- **US ISM, construction spending on tap**
- **UK manufacturing slows**
- **Peru's inflation jumps higher mostly on food prices**
- **NZ$ tumbles on soft jobs report…**
- **…that feeds RBNZ cut risk as soon as next week**
- **Poloz/Wilkins round #2**

INTERNATIONAL

It's mostly about the Fed today, but there are enough other interesting developments to influence markets. European markets ex-London and Asian markets are shut for May Day with Japan shut for the whole Golden Week. The UK manufacturing sector slowed in April. US ISM-manufacturing is expected to do likewise. Earnings remain a major factor across global markets. The latest round of US-China trade negotiations wrapped up with more negotiations in Washington next week. US Treasury Secretary tweeted they were "productive meetings" and repeated they will continue when the China delegation travels to Washington next week. The BoC's Poloz/Wilkins testimony resumes this time before the Senate and after the market close. European markets are shut outside of the UK for May day.

- US equity futures are up by between ¼% (S&P, DJIA) and over ¾% (Nasdaq). TSX futures are marginally higher. London is flat.

- The broad USD is little changed but there are several notable swings in individual crosses. The NZ$ is the weakest (jobs, see below). European crosses are leading the appreciating currencies.

- Oil prices are slightly lower in terms of Brent and WTI ahead of the US government's report on crude oil inventories at 10:30amET. Private industry

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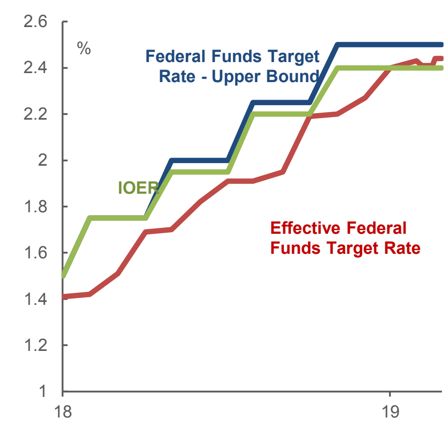
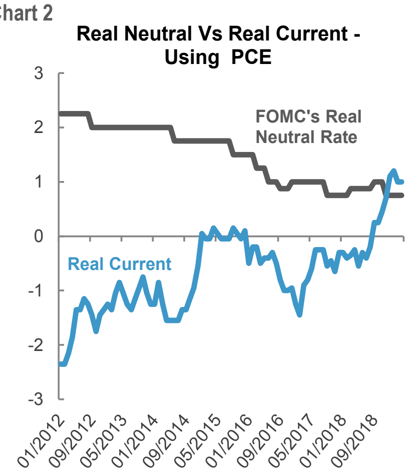
Chart 1



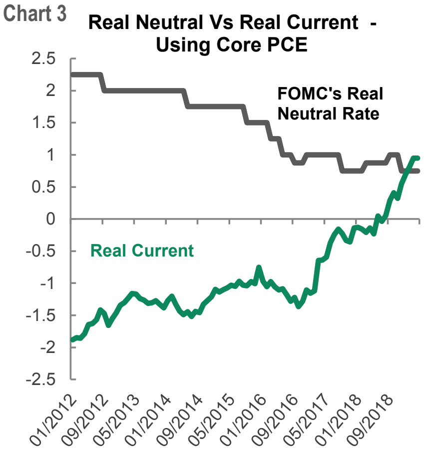
Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

Chart 3



Sources: Scotiabank Economics, Bloomberg.

data yesterday afternoon showed a significant gain in inventories for 6.81 million barrels.

- Sovereign bond yields are little changed on balance, but again, note that Europe ex-London is shut.

The UK manufacturing sector decelerated last month. The April PMI fell two points to 53.1. It has been oscillating for months now but remains in mild expansion territory. The underlying details were soft. New orders slipped by 1.2 points to 51.7 which indicates mild growth.

The NZ$ depreciated overnight in response to soft employment market figures. Jobs fell in Q1, but only by 0.2% q/q as employment growth in year-ago terms slipped to 1.5% (2.3% prior). Private sector wage growth also eased. **This fed expectations for policy easing** with OIS markets now pricing about a six-in-ten chance of an RBNZ cut next week and three-in-four chance of a cut in June.

Peru's inflation rate jumped to 2.6% y/y (2.25% prior) as expected. Upward pressure came from food/beverage prices (2.65% y/y, 1.9% prior) and energy influences upon transportation (2.9% y/y, 2.55% prior).

UNITED STATES

Before the Fed, we get several macro data reports out of the US and earnings. Apple's strong beat is helping US equity futures. Forty-two S&P500 earnings reports come out today with twenty-four in the pre-market. After Apple's release last evening, few in today's line-up can compare in terms of potential market effects.

US ADP private payrolls accelerated to the strongest job gain (+275k) since last July. The prior month was also revised up by 22k to 151k. Overall it's a strong job market signal but recall it throws frequent head fakes ahead of Friday's more important nonfarm payrolls report.

ISM-manufacturing (10amET) is expected to soften because of signals sent by the array of regional metrics, but this isn't guaranteed given issues such as under-sampling of some industries in the regional gauges (e.g. autos). **Construction spending** (10amET) is expected to moderate following the 1% gain the prior month.

The Fed statement will arrive at 2pmET followed by the presser at 2:30pmET. No forecasts or dots will be delivered this time after everything got updated on March 20th. See the Global Week Ahead here for more, but here are several key expectations. I'll save the main area that could be subject to policy shifts for last in the list below given its complexity.

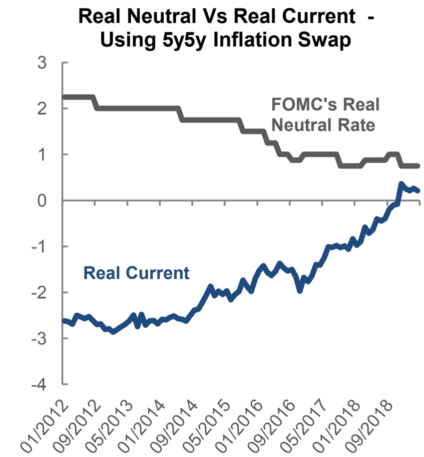
1. Better Growth

They have to sound more upbeat on the macro data to be credible. The opening paragraph's description of current conditions is where they'll do it and it should include more positive references to Q1 GDP growth, job gains that have rebounded and perhaps firmer measures of inflation expectations over 2019 to date. On the latter, the 5y5y and B/Es have significantly improved since the start of the year.

2. Softer Inflation

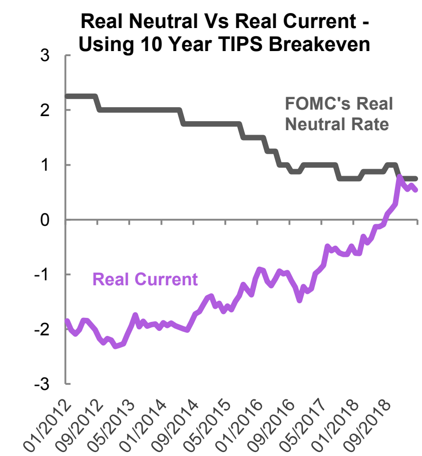
The fly in the ointment is that core PCE inflation has ebbed to 1.55% y/y in March from a peak of 2% last July. I think there is a very strong case for looking through

Chart 4



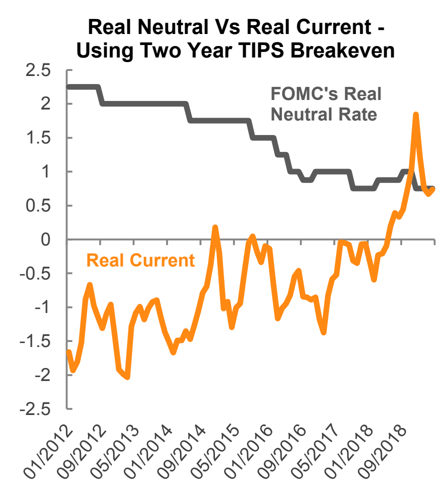
Sources: Scotiabank Economics, Bloomberg.

Chart 5



Sources: Scotiabank Economics, Bloomberg.

Chart 6



Sources: Scotiabank Economics, Bloomberg.

this. The broad dollar's surge in 2018 is spilling over into disinflationary influences this year that are likely to be transitory, while the push into excess aggregate demand over recent quarters has not been given enough time to drive core inflation higher. Next week's CPI figures could begin to carve out a trough in inflation readings and I estimate headline CPI will be 2% y/y with core ticking up to 2.1% y/y.

3. Global Conditions

A generally more positive tone toward the fundamentals might extend globally as Q1 wasn't as bad as feared for European or Chinese growth.

4. Buzzwords

'Patient', 'waiting', 'watching' and 'flexible' will likely be emphasized again given binary risks to the outlook.

5. Binary Risks

Expect a lot of reference to ongoing trade policy uncertainty as a check on backward data.

6. Controlling short-term market rates

The main consideration is how the FOMC might choose to address pressure upon the short-term rates complex relative to target policy rates. Recall the issue is that the Effective Fed Funds rate is at 2.45% and slightly breaching the 2.4% Interest on Excess Reserves rate that is set 10bps below the upper limit of the Fed funds target range (see chart 1). At issue is credibility in steering market rates toward targets and also using this EFF overshoot as a signal that perhaps liquidity conditions remain too tight even after the policy changes announced in March.

There are multiple possibilities beyond simply buying time which itself is an option.

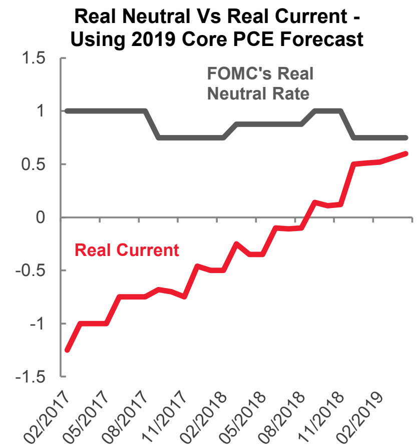
They might lower the Interest on Excess Reserves rate while leaving the fed funds target range unchanged. This would be a means of distancing EFF from the upper bound of the fed funds target range. One might ask 'why bother', however, and I'm not totally convinced they'll do this or convinced of the merits to doing so. They've tried this approach twice already and yet the EFF rate keeps breaching the IOER rate. Is the third time a charm?

In any event, cutting IOER would be a technical adjustment, not a shift in monetary policy directions, as they attempt to steer market rates to their IOER rate. If you see some headline like 'they cut!' then stop reading. In fact, both times the Fed widened the fed funds upper target spread over the IOER rate were done when the Fed was hiking the fed funds target range and hence tightening policy. Widening the IOER-FF spread would just be about effectively controlling market rates toward targets that have already been set but that are being slightly breached.

Further, they have other tools they could use instead. Anything that positively affects liquidity could help migrate short-term rates slightly lower. That suite of tools is quite vast.

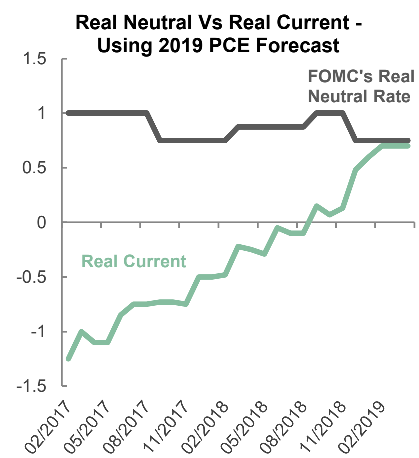
For one, the FOMC could make further tweaks to the balance sheet plans they just rolled out at the last meeting. Instead of ending run-off of the SOMA portfolio after

Chart 7



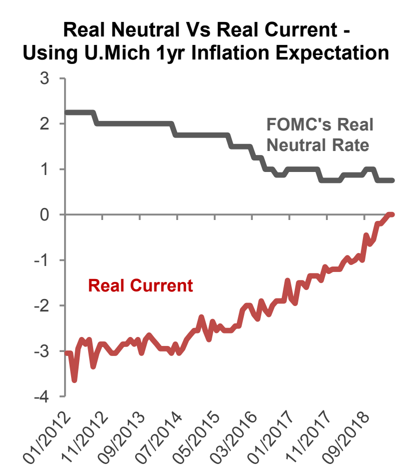
Sources; Scotiabank Economics, Bloomberg.

Chart 8



Sources; Scotiabank Economics, Bloomberg.

Chart 9



Sources; Scotiabank Economics, Bloomberg.

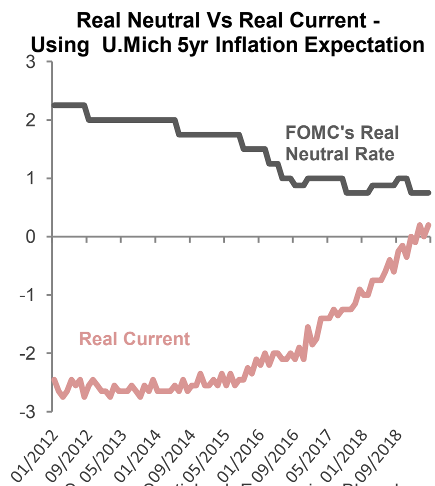
September they could do so earlier and possibly now. This would mean higher reserves in the banking system at an earlier stage than communicated at the March FOMC. Bear in mind, however, that it's only as of this month that the Fed's roll-offs on Treasury holdings get cut in half from US$30 billion per month to US$15 billion per month and then zero after September and so this could already bake-in a positive influence upon short-term market liquidity. The Fed could state that this tapering effect needs to be given time to influence short-term liquidity.

Bringing forward MBS rollover into Treasuries or announcing this will be done not on the weighted average maturity basis they previously announced but in favour of a portion of the short-term curve is another possibility.

Another option could be to twist the curve in a sense by reinvesting maturing longer-run Treasury flows into shorter-term securities. This is a long-run normalization target anyway and several FOMC members have noted they are moving in this direction.

Establishing a repo facility, engaging in more aggressive open market operations led by the NY Fed's markets desk, or jawboning short rates by formally setting a limit to an EFF overshoot of IOER could be options.

Chart 10



Sources: Scotiabank Economics, Bloomberg.

Finally, charts 2–9 illustrate alternative measures of the current stance of the real Fed policy rate compared to the FOMC's estimated real neutral policy rate. There has been a lot of misleading commentary on these comparisons so a few observations may have merit.

1. To start with, it can be misleading to compare a measure of the current policy stance at this point in the cycle to the long-run equilibrium target.

2. Further, recall that IOER is 10 bps below the real Fed funds rate so bear this in mind when comparing real current fed funds measures to the real neutral rate.

3. Regardless, the real current rate itself depends upon which deflator is used and the best course of action is to compared multiple measures as charts 2–9 do.

4. Using multiple measures of the real current policy rate by using multiple measures of inflation yields different impressions of whether policy may be tighter than the long-run guidepost or looser. Most charts I've seen only use backward looking core PCE or headline PCE but that's not necessarily the best inflation gauge.

5. In any event, all real current policy rate measures are hundreds of basis points below where they stood going into past recessions.

6. Finally, the real policy rate is just one measure of monetary policy conditions this cycle. Unconventional policy actions require focusing upon others including real Treasury yields. The Fed's actions have crushed the real 10 year T yield. You can't consider monpol actions upon real yields by only considering the policy rate.

CANADA

Governor Poloz and SDG Wilkins reappear for round 2 of their parliamentary testimony today. This time it will be before the Standing Senate Committee on Banking, Trade and Commerce after the market close (4:15pmET). Yesterday's opening statement (here) was generally more positive sounding in my opinion than the BoC's efforts to sound positive last week. Amidst a barrage of totally partisan questioning during an election year, the Governor didn't bat an eye at February GDP (-0.1%) that followed the strongest month for growth since last Spring and that informs an expected Q4-Q1 soft-patch anyway.

Twenty TSX firms release earnings including Loblaw, Fortis and Manulife today.

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.	2.28	2.27	2.32	2.28	2.28	2.31	2.50	2.50	2.52	2.92	2.93	2.94
CANADA	1.56	1.56	1.51	1.54	1.54	1.49	1.71	1.71	1.67	1.98	1.99	1.99
GERMANY	-0.58	-0.58	-0.57	-0.41	-0.42	-0.39	0.01	0.00	0.04	0.66	0.65	0.69
JAPAN	-0.15	-0.15	-0.15	-0.16	-0.16	-0.15	-0.04	-0.04	-0.04	0.57	0.57	0.57
U.K.	0.76	0.76	0.76	0.90	0.91	0.90	1.18	1.19	1.18	1.69	1.69	1.71
	Spreads vs. U.S. (bps):											
CANADA	-72	-71	-80	-75	-74	-82	-79	-79	-84	-94	-94	-94
GERMANY	-286	-285	-289	-270	-270	-270	-249	-250	-248	-226	-228	-224
JAPAN	-243	-242	-247	-245	-244	-246	-254	-254	-256	-235	-236	-237
U.K.	-152	-150	-156	-138	-137	-142	-133	-132	-134	-123	-124	-123

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	16581	-19.6	-0.1	-0.5	2.2	6.2
Dow 30	26593	38.5	0.1	-0.2	1.3	10.3
S&P 500	2946	2.8	0.1	0.4	2.7	11.0
Nasdaq	8095	-66.5	-0.8	-0.3	3.4	13.5
DAX	12344	16.1	0.1	0.9	5.7	-2.1
FTSE	7416	-2.2	-0.0	-0.7	1.3	-1.4
Nikkei	22259	-48.9	-0.2	0.3	5.0	-0.9
Hang Seng	29699	-193.7	-0.6	-0.9	0.5	-3.6
CAC	5586	5.4	0.1	-0.1	3.3	1.2
Commodities	Level		% change:			
WTI Crude	63.50	-0.41	-0.6	-3.6	3.1	-5.6
Natural Gas	2.60	0.03	1.1	5.7	-3.9	-7.1
Gold	1280.60	-2.95	-0.2	0.4	-0.6	-1.8
Silver	14.99	0.02	0.1	0.1	-0.8	-8.5
CRB Index	183.53	-0.72	-0.4	-1.6	-1.0	-8.8
Currencies	Level		% change:			
USDCAD	1.3402	0.0014	0.1	4.4	0.7	
EURUSD	1.1225	0.0010	0.1	-8.2	0.1	
USDJPY	111.40	-0.0200	-0.0	2.4	0.0	
AUDUSD	0.7040	-0.0008	-0.1	-7.4	-1.0	
GBPUSD	1.3065	0.0033	0.3	-6.5	-0.3	
USDCHF	1.0166	-0.0027	-0.3	3.9	1.8	

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	May 29, 2019
US - Fed	May 01, 2019
England - BoE	May 02, 2019
Euro zone - ECB	Jun 06, 2019
Japan - BoJ	Jun 20, 2019
Mexico - Banxico	May 16, 2019
Australia - RBA	May 07, 2019
New Zealand - RBNZ	May 07, 2019