ON DECK FOR THURSDAY, MAY 2

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	05/02	08:30	Initial Jobless Claims (000s)	APR 27	220	217.5	230.0
US	05/02	08:30	Continuing Claims (000s)	APR 20	1660	--	1655.0
US	05/02	08:30	Productivity (q/q a.r.)	1Q P	2.6	1.2	1.9
US	05/02	08:30	Unit Labor Costs (q/q a.r.)	1Q P	2.0	2.1	2.0
US	05/02	10:00	Factory Orders (m/m)	Mar	1.2	1.4	-0.5

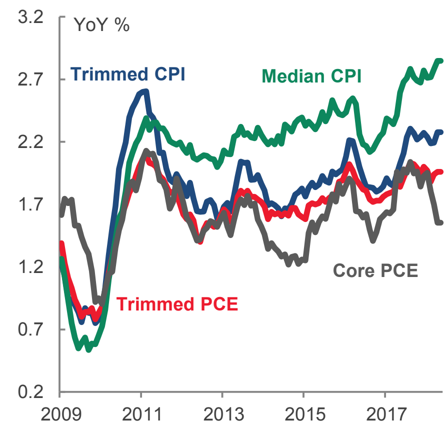
CONTACTS

Derek Holt, VP & Head of Capital Markets Economics
416.863.7707
Scotiabank Economics
derek.holt@scotiabank.com

KEY POINTS:

- **Treasuries continue to cheapen post-FOMC**
- **Markets are on watch for the Fed's shift in preferred inflation metrics…**
- **...as the Fed may be becoming more like the BoC and RBA**
- **US wage gains are not inflationary…**
- **…as unit labour costs are under downward pressure…**
- **…thanks to strong productivity growth…**
- **...but there remain other underlying inflation drivers**
- **US jobless claims hold onto the spike higher, but could be distorted**
- **The BoE is in no rush to hike**
- **Canada's curve cheapens thanks to Fed, Poloz**
- **German consumers step back**
- **UK construction PMI eases out of contraction**
- **US factory orders: Boeing, Boeing, gone?**

Is The Fed Changing Its Preferred Inflation Measure?



Sources: Scotiabank Economics, Bloomberg.

INTERNATIONAL

Earnings remain a focal point but the 48 S&P500 firms releasing today are not likely to influence the broad market tone while 21 TSX Canadian firms include several household names (e.g. BCE, SNC-Lavalin, Great-West, Maple Leaf Foods, Bombardier, MartinRea and Linamar).

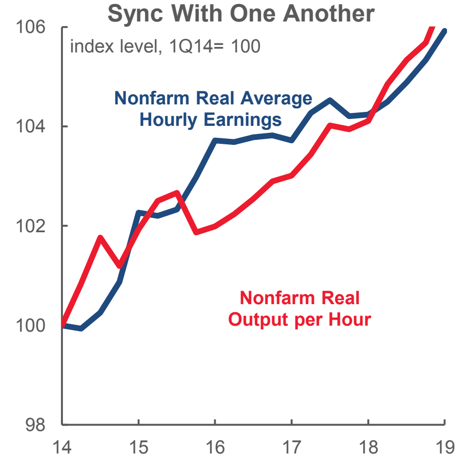
- Sovereign bond markets are witnessing mild sell-offs across the US Treasury, Canada (BoC, see below) and gilts markets (BoE, see below). Treasuries are continuing the cheapening post-FOMC from yesterday regardless of this morning's figures for productivity and unit labour costs (see below).

- The USD is retaining the appreciation post-Fed but not building upon it this morning. Currency movements are idiosyncratic in nature with the won (CPI) leading appreciating crosses but with most currencies little changed.

- Oil prices are selling off with WTI and Brent both down by about a buck and a half to US$62.10 and US$70.80 respectively. This is building upon the unexpectedly large build in US crude oil inventories that climbed by the most last week since November which itself was toward the upper bound of weekly increases over recent years.

- US and Canadian equity futures are little changed with a slight negative tinge on balance. Europe's return from holiday is pushing the DAX up slightly but

US Real Wages & Productivity Are In Sync With One Another



Sources: Scotiabank Economics, BLS.

all other exchanges down by between 0.2% (London) and 1.2% (Madrid). Asian markets also partially returned from holiday ex-Japan and mainland China with HK rallying by ¾% and Seoul up 0.4%.

The Bank of England's policy communications did little to signal the hawkish shift that some forecasters had suggested would occur and there is nothing here to support the tail call that the BoE could hike later this summer. Being 'Super Thursday' we got the quarterly Inflation Report (here), and of course the statement and minutes (here) before Governor Carney's press conference. There were no dissenters, against the expectation that perhaps at least one MPC member might dissent in favour of tightened policy. The initial headline that hit the wires regarding how more than one hike may be needed over the cycle to contain inflation sparked some immediate volatility but this was offset by a downward revision to inflation projections with no expectation that inflation will return to target until late in the projection horizon. Each of the mean, mode and median inflation measures are expected to flirt with the 2% target by early next year but to not remain sustainably at target until late 2020 and into 2021. Near-term economic growth is expected to largely disappear to 0.2% in Q2 after Brexit related stocking. The BoE assesses that GDP growth will be "slightly stronger than previously anticipated, but marginally below potential." They conclude that there is "currently a small margin of excess supply in the economy" which Q2 GDP projections won't improve upon. Doesn't sound like a rush to hike by summer to me. Carney's press conference did emphasize that he thinks markets are under-pricing rate hikes in future, but again, he's in no immediate rush to change things up for now while noting that pushing out the Brexit timeline did not have a meaningful impact upon the BoE's forecasts.

The **UK construction PMI improved** to 50.5 (49.7 prior) which was roughly expected and signals a return to very slight growth after two very small undershoots of the 50 dividing line between expansion (above) and contraction (below). No biggie overall.

German retail sales volumes slipped by -0.2% m/m (-0.5% consensus) and the prior month's large gain was revised lower from +0.9% m/m to 0.5%. Both readings follow the whopping 2.9% jump in January but that only reversed the 3% decline to end 2018.

UNITED STATES

US markets face several releases of interest especially from the standpoint of what wage gains mean to inflation.

1. Jobless claims: Jobless claims held firm at 230k so we now have two weeks of higher readings than the prior period in which claims fell to the lowest level since 1969 at 193k. Strikes and distortions in the retail and education sectors might explain it, but the fact claims didn't fall back again was against the theory that the later than usual timing of the Easter holiday might have artificially pushed claims higher the prior week. More data is needed to assess the smoothed effects of holiday and sector distortions. For now, however, it's irrelevant to tomorrow's nonfarm payrolls report since the figures we're getting are outside of the nonfarm reference period that is the pay period including the 12th of each month. It was during that week that claims hit the lowest since 1969. For tomorrow's nonfarm report, **I'm expecting 180k for nonfarm and a mild acceleration in wage growth to 3.3% y/y.** The latter is based upon a combination of shifting year-ago base effects and seasonal month-ago influences around this time of year.

2. Productivity and unit labour costs: Productivity growth soared to 3.6% q/q at a seasonally adjusted and annualized clip in 2019Q1. That was the fastest since 2014Q3 which in turn was the quickest since 2009. By corollary, unit labour costs—essentially productivity adjusted employment costs—fell by 0.9% q/q. Unit labour costs have been decelerating over the past year as productivity and broad growth have been solid. ULC was rising at a recent peak rate of 2.5% y/y in 2017Q3 and now is only up 0.1% y/y. The plain English translation is that wage gains aren't inflationary if productivity keeps up this pace while at the same time real wage gains over time are principally driven by productivity growth. So it's a win-win in a sense: consumers get faster wage gains, but so far at least it isn't inflationary. See the first chart for a visual depiction of how inflation-adjusted wages and productivity are moving in lock-step to one another.

That having been said, Fed Chair Powell clearly changed the focus upon relevant inflation metrics yesterday. Indeed, one can fairly ask whether the Fed is going through a rather BoC- or RBA-like transformation in thinking toward inflation metrics by demonstrating a preference toward readings that weed out the more volatile components in the tails. **He did so by emphasizing trimmed and median measures that are not slipping like core PCE suggests inflation is holding around target which was the center point of his "I'm not cutting" message to markets.** That matters more than wages not being inflationary due to faster productivity growth. It also means watch those readings each month more than core PCE. See the second chart for a depiction of the trimmed and median measures that Powell was mentioning during his press conference and how they are not falling like core PCE did in Q1. PCE is too sensitive to the transitory, idiosyncratic measures that Powell suggested were causing core PCE inflation to be unexpectedly but temporarily soft in Q1.

3. Factory orders (10amET): Watch for revision risk here through the durable goods component and specifically the transportation sector. Our aerospace analyst Turan Quettawala notes that Garuda Indonesia cancelled about 50 737-Max jet orders from Boeing in March. He also notes that the 210 plane order cancellation by India's Jet Airways is an assumption that some have inferred from Boeing's reduced order backlog in their recent results and Jet Airways is in bankruptcy. To put such numbers in perspective, Boeing initially reported 95 plane orders for all of 2019Q1. If not a revision this morning, then April's durable orders on May 24th will garner closer scrutiny toward downside risks.

CANADA

Canada's calendar is quiet with just a 2 year auction at 12pmET.

Canada's curve is cheapening again this morning in follow-through from the upward jump in short-term rates yesterday afternoon. There are two drivers. One is that the Fed sounded more hawkish than markets were assuming yesterday and the thinking is this eases the path for the BoC to possibly return to hiking. Second is that round two of Governor Poloz's testimony yesterday was hawkish sounding and somewhat more so than previously. Note the following quote:

> "It is hard to believe that the economy would settle in in a place where it's growing at potential, and inflation's on target, and we have unemployment at a 40-year low, and that we'd need a negative real rate of interest in order to sustain that. Now, we know, based on what we've done and what we said in our latest interest rate announcement, is that that's exactly what we've concluded."

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.	2.33	2.31	2.33	2.32	2.30	2.33	2.52	2.50	2.53	2.92	2.90	2.94
CANADA	1.60	1.57	1.55	1.57	1.54	1.53	1.72	1.70	1.70	1.97	1.96	1.99
GERMANY	-0.59	-0.58	-0.59	-0.42	-0.41	-0.43	0.01	0.01	-0.01	0.66	0.66	0.64
JAPAN	-0.15	-0.15	-0.15	-0.16	-0.16	-0.16	-0.04	-0.04	-0.03	0.57	0.57	0.59
U.K.	0.76	0.74	0.74	0.90	0.88	0.87	1.17	1.15	1.16	1.69	1.67	1.68
	Spreads vs. U.S. (bps):											
CANADA	-73	-73	-78	-75	-76	-80	-80	-80	-83	-95	-94	-95
GERMANY	-291	-289	-292	-274	-271	-276	-251	-249	-254	-226	-225	-230
JAPAN	-248	-245	-248	-248	-246	-249	-256	-254	-256	-235	-234	-236
U.K.	-157	-157	-159	-142	-142	-146	-136	-135	-138	-123	-124	-126

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	16503	-78.0	-0.5	-0.5	1.5	5.6
Dow 30	26430	-162.8	-0.6	-0.6	1.0	10.5
S&P 500	2924	-22.1	-0.8	-0.1	2.0	10.9
Nasdaq	8050	-45.7	-0.6	-0.6	2.6	13.4
DAX	12354	9.5	0.1	0.3	5.7	-2.0
FTSE	7365	-20.7	-0.3	-0.9	-0.4	-2.4
Nikkei	22259	-48.9	-0.2	0.3	5.0	-0.9
Hang Seng	29944	245.1	0.8	0.5	1.3	-2.8
CAC	5556	-30.5	-0.5	-0.4	2.8	0.6
Commodities	**Level**		**% change:**			
WTI Crude	62.04	-1.56	-2.5	-4.9	-0.9	-8.7
Natural Gas	2.59	-0.03	-1.0	3.1	-3.4	-5.8
Gold	1267.30	-9.48	-0.7	-0.8	-1.9	-2.9
Silver	14.88	-0.11	-0.7	0.5	-1.3	-8.4
CRB Index	182.18	-1.48	-0.8	-2.0	-2.3	-9.6
Currencies	**Level**		**% change:**			
USDCAD	1.3460	0.0014	0.1	-0.2	0.9	4.5
EURUSD	1.1200	0.0004	0.0	0.6	-0.0	-6.3
USDJPY	111.51	0.1300	0.1	-0.1	0.2	1.5
AUDUSD	0.7006	-0.0009	-0.1	-0.1	-0.9	-6.5
GBPUSD	1.3046	-0.0004	-0.0	1.1	-0.6	-3.9
USDCHF	1.0187	0.0006	0.1	-0.2	2.1	2.0

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	May 29, 2019
US - Fed	Jun 19, 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

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.