

ON DECK FOR FRIDAY, MAY 10

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	05/10	08:30	Building Permits (m/m)	Mar	--	2.4	-5.7
CA	05/10	08:30	Employment (000s m/m)	Apr	25	11.6	-7.2
CA	05/10	08:30	Unemployment Rate (%)	Apr	5.8	5.8	5.8
US	05/10	08:30	CPI (m/m)	Apr	0.4	0.4	0.4
US	05/10	08:30	CPI (y/y)	Apr	2.0	2.1	1.9
US	05/10	08:30	CPI (index)	Apr	--	255	254
US	05/10	08:30	CPI ex. Food & Energy (m/m)	Apr	0.2	0.2	0.1
US	05/10	08:30	CPI ex. Food & Energy (y/y)	Apr	2.1	2.1	2.0
US	05/10	14:00	Treasury Budget (US\$ bn)	Apr	--	160	-147

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KEY POINTS:

- **Markets appear relatively sanguine toward tariff escalation...**
- **...with several plausible explanations...**
- **...and as many arguments for why this could be a temporary response**
- **US CPI on tap, with tariff effects at risk of lifting it further**
- **CDN jobs: another decline would feed concern about front-loaded gains**
- **Brazilian inflation rises above target**
- **UK GDP growth improves, but at least some of it might be temporary**
- **German exports display green shoots, some of which potentially Brexit related**
- **Several Fed officials on tap today**

INTERNATIONAL

While the initial responses to the breakdown of US-China trade talks and the increase of US tariffs to 25% on US\$200 billion of Chinese imports from 10% overnight may not be quite as feared, caution still prevails. There is always a danger to sounding too cute by half in trying to explain today's market moves given the complex drivers and ongoing uncertainty, but there are at least 4-5 plausible reasons why global stocks aren't doing as badly as feared and just as many reasons why this may not last.

One reason is that China directed its state funds to jump on the grenade and buy up equities overnight but this may be a temporary band aid that ultimately needs fundamentals to back it.

Two is that at least they are still talking, albeit nominally, as the Chinese delegation didn't pack up and go home ahead of what are expected to be uneventful meetings today. That said, we're awaiting China's specific forms of retaliation as it pledged to do so overnight. What forms and magnitude such retaliation may take and what the US response and potential counter-response may be is highly uncertain but merits high caution.

Third, if you have to impose tariffs, then at least the way the USTR did it leaves considerable wiggle room for negotiations to continue; the tariffs exempt items currently in transit and so the effects won't be binding for weeks or in some cases longer. That, however, only buys time and the effects on purchasing decisions, orders and production will occur very quickly and well before tariffs hit incoming products.

Fourth, the US held back from imposing a 25% tariff on all Chinese imports and so market moves earlier this week may have priced in what happened overnight, but Trump's threat to go further remains in place.

Last, there is some prospect for China to add more stimulus to counteract at least some of the tariff effects, and this morning's guidance from the PBOC that there is "ample room" and flexibility to adjust liquidity is encouraging in this sense.

Nevertheless, what I find most disturbing is the US administration's position that tariffs are good because of revenues generated into the US Treasury which ignores the fact that they are ultimately paid by US businesses and consumers and Trump is ignoring the plethora of comments by business leaders to this effect. Second is the fixation upon shrinking the US trade deficit through use of tariffs and edicts. This morning's comments by Commerce Secretary Ross indicate that such logic is still at risk of being imposed upon the autos trade. All of this reflects such a misguided understanding of incidence effects upon inflation and the root causes of trade deficits and whether they matter as to get a first year economics student an 'F' if they displayed such a lack of understanding of the basic economics.

- So far, the only stock markets that are falling are in the US, Canada and some in Asia ex-China and only slightly so at that. US equity futures are down by less than ½% across the exchanges and TSX futures are down by only 0.1%. European cash markets are up by ½% or so on average with all exchanges in the black. Mainland China's exchanges were up by 3–4% with HK up 0.8%. Tokyo dipped by ¼% and so did Seoul.
- Sovereign bonds aren't really budging much. The US and Canada curves are flat and there is generally little movement in EGBs.
- The USD is in demand against a number of crosses but the yen, pound sterling and CAD are notable flat. Appreciating crosses include the rand, some Scandies, the Mexican peso and the Euro and euro-related currencies.
- Oil prices are up by as much as 1% in the case of Brent that is above US\$71 with WTI above US\$62.

German exports surprised higher in another sign of green shoots. Exports were up 1.5% m/m in March (-0.4% consensus, -1.3% prior). Imports were up 0.4% and in line with consensus after a sharp 1.6% decline the prior month. That said, there may be a Brexit stocking argument here. Exports to non-eurozone countries within the EU were up 3.7% y/y and were thus faster growing than exports to Eurozone economies (1.6%) and other non-european countries (2.7%).

UK GDP was in line with consensus. Q1 growth of 0.5% q/q (non-annualized, SA) accelerated from 0.2% the prior quarter. Consumption played a significant role (+0.7%) as did government spending (+1.4%). Exports were flat and imports spiked up by 6.8% (again, all non-annualized). That's a big import leakage effect on growth but the offset was that inventories were up a lot against in Q1 as they were in Q4. In fact, the two-quarter rise in inventories was the biggest since 2014 and reflected Brexit stockpiling out of fear that the UK would crash out of the EU. That didn't happen and so now companies may be stuck with bloated inventories and a need to reduce production to burn them off which will weigh on Q2 GDP growth.

Brazil is under added inflationary pressure with its main IBGE/IPCA inflation reading hitting 4.9% y/y last month. That pushes inflation above the mid-point of the 3–6% inflation target range and serves as a constraint against easing in favour of BCB's patient guidance that was provided in Wednesday's policy decision.

UNITED STATES

While US CPI gets updated for April this morning (8:30amET), the backward reading faces upside pressure over coming months through tariff effects. I'll come back to that in a moment after laying out the call. For now, note the main point of emphasis to what follows: inflation is not supporting the cut camp, and b) don't assume that tariffs would bring about monetary easing as they will risk upward pressure upon the price stability part of the Fed's dual mandate.

Headline CPI inflation is forecast to rise from 1.9% in March to 2.0% in April (consensus 2.1%). Core CPI inflation is forecast to rise to 2.1% from 2% previously (consensus 2.1%). The driver that works against such calls is the shift in year-ago base effects that would on its own drop inflation to 1.5%. Instead, this is the time of year when seasonal price gains on a month-

ago basis can be large and they peak around the February through May period as apparel lines change seasons, as travel often picks up and as consumers in northern climates come out of hibernation. An average pace of seasonal price gains for a month of April would print headline inflation around 1.8%. Gasoline prices, however, have been soaring over recent months. In March, gas was little changed compared to the same month last year while April raised this by 3% that alone would raise headline inflation by 0.1% in year-ago terms versus March. On a month-ago basis, gasoline was up 10% in April. As for core CPI, a typical month of April alone would be enough to raise core CPI by a tick. More fundamentally, the drivers of inflation going forward are more likely to be a) a recent shift into excess aggregate demand conditions (chart 3), b) the fact the broad dollar's disinflationary influences are ebbing as the dollar moves sideways (chart 4) and c) the gradual abatement of transitory factors that Chair Powell emphasized.

For more about whether CPI matters in the context of the Fed's emphasis upon transitory and idiosyncratic factors that have the top of the house emphasizing central tendency trimmed and weighted median measures please see the Global Week Ahead for this past week [here](#).

On tariffs, most economists disagree with Trump that they are not and will not impact US inflation without controlling for other considerations. So far, the effects of initiatives to date have been modest because a) the share of US consumption hit by tariffs has been small, and b) the distribution of tariffs has been more skewed toward producer than consumer prices. That's changing now and we're entering a complex world of incidence effects and gauging retaliatory measures during which developments could easily turn much, much more negative for everyone.

[This](#) piece from the San Francisco Federal Reserve is still pertinent in that they estimated a 25% tariff on all Chinese imports to the US **would boost the PCE measure of inflation by 0.3% beyond the estimated 0.1% impact of prior tariffs for a total effect of 0.4%.**

[This](#) piece from the NY Fed's economists estimated that prior to the latest batch of tariffs, previously announced tariffs added **about "a third of a percent" to CPI and PPI inflation in 2018** and that the effects of tariffs tend to occur within a three-month period.

Several Fed officials will have a chance to weigh in on the tariffs issue and CPI this morning including two from the very top of the house. Governor Brainard speaks at 8:30amET, NY Fed President Williams speaks at 10amET and Atlanta Fed President Bostic (nonvoting 2019) speaks at 9:08amET.

CANADA

Canada spins the wheels on the jobs report for April this morning (8:30amET). I went with 20k and as it turns out consensus is at 11.6k with the usual wide range from -10k to +26k. Canada has created 115,000 jobs so far this year. At the margin, however, the small loss of 7,200 jobs in March adds some intrigue to this morning's print in that another downside would incrementally heighten some concern that a pillar to housing and consumption is softening. One or two reports wouldn't cut it in that regard, but at the margin that's the direction the debate and market concerns would go.

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.	2.25	2.26	2.33	2.24	2.25	2.32	2.44	2.44	2.53	2.87	2.86	2.92	Canada - BoC	1.75		
CANADA	1.59	1.58	1.64	1.56	1.55	1.62	1.69	1.68	1.76	1.93	1.93	2.00	US - Fed	2.50		
GERMANY	-0.62	-0.63	-0.59	-0.47	-0.47	-0.41	-0.04	-0.05	0.03	0.61	0.60	0.67	England - BoE	0.75		
JAPAN	-0.16	-0.16	-0.15	-0.16	-0.16	-0.16	-0.05	-0.05	-0.04	0.54	0.54	0.57	Euro zone - ECB	0.00		
U.K.	0.73	0.74	0.80	0.85	0.87	0.95	1.12	1.13	1.22	1.66	1.66	1.74	Japan - BoJ	-0.10		
	Spreads vs. U.S. (bps):												Mexico - Banxico	8.25		
CANADA	-66	-68	-70	-68	-69	-71	-76	-77	-76	-94	-94	-92	Australia - RBA	1.50		
GERMANY	-287	-289	-292	-270	-272	-274	-249	-249	-250	-226	-226	-225	New Zealand - RBNZ	1.50		
JAPAN	-241	-242	-248	-240	-241	-249	-249	-249	-257	-233	-232	-235				
U.K.	-153	-152	-154	-138	-138	-138	-132	-132	-131	-121	-120	-118				
Equities	Level						% change:						Next Meeting Date			
	Last	Change		1 Day	1-wk	1-mo	1-yr									
S&P/TSX	16322	-75.7		-0.5	-0.5	-0.5	2.3							Canada - BoC	May 29, 2019	
Dow 30	25828	-139.0		-0.5	-1.8	-1.3	4.4							US - Fed	Jun 19, 2019	
S&P 500	2871	-8.7		-0.3	-1.6	-0.6	5.4							England - BoE	Jun 20, 2019	
Nasdaq	7911	-32.7		-0.4	-1.6	-0.7	6.8							Euro zone - ECB	Jun 06, 2019	
DAX	12063	89.0		0.7	-2.8	1.3	-7.4							Japan - BoJ	Jun 20, 2019	
FTSE	7232	24.9		0.3	-1.6	-2.6	-6.1									
Nikkei	21345	-57.2		-0.3	-4.3	-1.6	-5.1									
Hang Seng	28550	239.2		0.8	-5.1	-5.2	-7.3									
CAC	5337	23.9		0.4	-3.8	-2.1	-3.8									
Commodities	Level						% change:									
	Level		Change		1 Day	1-wk	1-mo	1-yr								
WTI Crude	61.97		0.27		0.4	0.0	-4.1	-13.2							US - Fed	Jun 19, 2019
Natural Gas	2.59		-0.01		-0.3	0.8	-4.1	-8.0							England - BoE	Jun 20, 2019
Gold	1285.12		1.09		0.1	0.5	-1.8	-2.8							Euro zone - ECB	Jun 06, 2019
Silver	14.82		-0.11		-0.7	1.0	-2.9	-9.9							Japan - BoJ	Jun 20, 2019
CRB Index	179.24		0.23		0.1	-1.4	-5.5	-12.4								
Currencies	Level						% change:									
	Level		Change		1 Day	1-wk	1-mo	1-yr								
USDCAD	1.3478		0.0001		0.0	0.4	1.2	5.6							Mexico - Banxico	May 16, 2019
EURUSD	1.1232		0.0017		0.2	0.3	-0.4	-5.7							Australia - RBA	Jun 04, 2019
USDJPY	109.72		-0.0200		-0.0	-1.2	-1.2	0.3							New Zealand - RBNZ	Jun 25, 2019
AUDUSD	0.6992		0.0003		0.0	-0.4	-2.5	-7.2								
GBPUSD	1.3014		0.0000		0.0	-1.2	-0.6	-3.7								
USDCHF	1.0128		-0.0022		-0.2	-0.4	1.0	0.9								

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.

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