

ON DECK FOR TUESDAY, MAY 14

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	05/14	08:30	Teranet - National Bank HPI (y/y)	Apr	--	--	1.5
US	05/14	08:30	Export Prices (m/m)	Apr	--	0.7	0.6
US	05/14	08:30	Import Prices (m/m)	Apr	--	0.7	0.6
US	05/14	03:15	Fed's Williams Speaks at SNB/IMF Event in Zurich	--	--	--	--

KEY POINTS:

- Markets in a calmer place
- Trump gets blowback from domestic lobbies
- Trump-Xi to meet in late June...
- ...with negotiations in limbo...
- ...after the US and China vented
- US auto tariffs decision is next
- US import prices still weakening...
- ...but exclude tariffs
- Evaluating the impact of tariffs on US inflation
- The risk of China dumping Treasuries is small
- Fed's Williams reinforces firmly on-hold message
- Canadian home price inflation softens
- UK wage growth slips again
- German investor confidence ebbs...
- ...to kick off another round of growth surveys
- Swedish krona appreciates post inflation

INTERNATIONAL

A calmer trading environment has settled in across markets perhaps on the hope that after having gotten all of that out of their systems and exchanged salvos, the US and China may refocus upon trade negotiations.

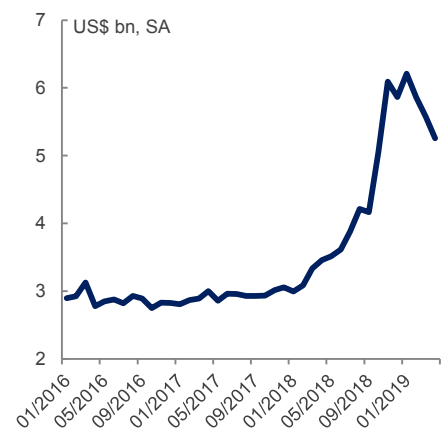
China shoved back with its tariff announcements yesterday that are available [here](#) including tariff schedule attachments in Mandarin for on-line translation if desired. Late yesterday, the US Trade Representative issued [this](#) list of about US\$300 billion of Chinese imports that may be subject to a 25% tariff at an uncertain point but sometime from late June onward. This would raise tariffs to cover virtually all Chinese imports with few exceptions like pharmaceuticals and rare earths. US business lobby groups have been very vocal alongside agricultural interests in expressing concern to the US administration. Trump has said he plans to meet with Xi Jinping at the G20 meeting in Osaka Japan but that isn't until June 28th-29th. We're still waiting for the US to accept China's invitation to another round of talks in Beijing.

Next up is the deadline for Trump to decide what to do on auto tariffs following the Commerce Department's assessment back in February; he must either decide by this Saturday or delay the process.

CONTACTS

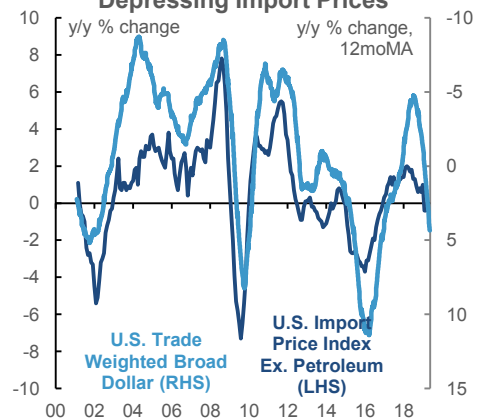
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US Treasury's Tariff Receipts



Sources: Scotiabank Economics, Bloomberg.

USD Strength Is Depressing Import Prices



Source: Scotiabank Economics, Bureau of Labour Statistics, Federal Reserve.

Other developments are comparatively light. UK wage growth ebbed a touch again. German investor confidence softened and kicked off another round of surveys of growth conditions. US import prices are due for an update but exclude duties and Canada only considers repeat-home sale prices. Fed-speak is limited with NY Fed President Williams warning about inflation stemming from tariffs but reinforcing the message that monetary policy is in the right place with no need to move up or down on rates.

- The USD is slightly appreciating on a DXY basis. Safe havens like the yen and Swiss franc are slightly weaker this morning. Each of the euro, CAD and A\$ are little changed. The Mexican peso is slightly firmer.
- Global sovereign bond yields are little changed. US and Canadian yields are under slight upward pressure across their curves. European sovereign yields are little changed with a minor exception being slight further spread widening in Italian 10s over bunds.
- Oil prices are up by as much as a buck in the case of Brent (US\$71.10) with WTI up a little less to US\$61.60. Gold is flat again.
- US equity futures are up by between 0.5–0.75% with the Nasdaq leading the way. TSX futures are similarly higher. European cash markets are up by between ½% and 1% across most of the bourses. Asian equities caught up to what was priced into North American equities through the US and Chinese announcements late yesterday. This had mainland Chinese equities selling off by about ¾% with HK down 1 ½% and Tokyo off by ½%. Only Seoul was up slightly.

Has UK wage growth peaked? Wages excluding bonuses decelerated to 3.3% y/y which is the second minor deceleration in a row from a peak of 3.5% two months ago. Tenths here and there don't fundamentally alter a narrative, but at the margin the wage figures don't put incremental pressure upon the Bank of England.

German investors turned sour toward the investment climate going forward. The ZEW survey showed an improvement in current conditions but the expectations component to the survey registered its first decline since October. The ZEW survey matters because it is the first of three main surveys that signal growth momentum given correlations with GDP growth over time. The purchasing managers' index and IFO business confidence gauges arrive one week from Thursday.

The Swedish krona appreciated in the wake of slightly greater inflation reported for April earlier this morning. Underlying inflation moved up two-tenths to 2% y/y and excluding energy it increased by one-tenth to 1.6%. The Riksbank targets inflation of 2%. Overall, the report was in line with the Riksbank's expectations and broadly returns inflation to target. Governor Ingves noted afterward: "I can't say that today's inflation data changes anything when it comes to our rate path and our plan to raise rates. If the world develops like we have forecast, then it's reasonable to believe that our view will stand." After raising its policy rate in December, the Riksbank more recently guided that the next hike would come a year or more after the initial hike.

CANADA

Canada should be quiet with just Teranet repeat-home sale prices for April to consider. Prices were still up by 1.2% y/y last month which is similar to the pace of soft increases in 2013 even though headlines may emphasize it's the weakest since the symbolic year of 2009 notwithstanding the fact that this measure of home prices fell by 6.5% that year.

UNITED STATES

NY Fed President John Williams repeated the Fed's main policy communications these days by noting that "The policy is in the right place. I don't see any reason to have a bias up or downward in the current circumstances. We're going to evaluate, assess, to see the best decision to get us to our goals." He went on to note that tariffs will boost inflation by a few tenths through what is implemented thus far.

There are several reasons why markets may well have gone too far in pricing in the assumption that trade conflicts will merit policy easing. One is that the Fed may feel it already eased enough at the March FOMC in anticipation of a bumpy ride ahead. They did so by tapering bond roll-offs starting this month, ending roll-offs after September and then returning as a net Treasury buyer thereafter while tamping down the dot plot. Second, the inflation outlook may not be conducive to easing due to tariffs, lagging

effects of the move into excess demand conditions over the past year, and the fact the broad dollar's appreciation over 2018 has largely moved sideways since and thus capped the disinflationary effects. The Fed is also focused upon the role of transitory factors depressing inflation while growth holds up rather nicely in the huge domestic economy that is now getting lower borrowing costs through bond and mortgage markets.

On inflation, the US updated import prices for April this morning and ex-petroleum they softened further (-0.6% m/m). That brings the year-ago pace of change in import prices ex-petroleum down to -1% y/y. The figures exclude duties/tariffs so we won't learn anything new about tariff effects with this release (more on that in a moment). Import price changes excluding oil have been decelerating for about the past year and are tightly correlated with movements in the USD (see chart).

More broadly, what is the impact of tariffs upon US consumer price inflation? This is a complicated question that requires controlling for many other influences upon prices. A burgeoning literature is seeking to do just that. First, consider a few basic points including one that refutes Trump's math.

- The US importer of record has to directly pay the tariffs imposed by the US, Chinese importers pay the tariffs imposed by China.
- those revenues flow to the US Treasury and to China's customs agency/MoF.
- The amounts are nowhere close to Trump's claim of US\$100 billion flowing into the US Treasury from tariff proceeds. See the accompanying chart for the monthly amounts being collected each month. Whether annualized or just added up within the fiscal year, they're way shy of his amount.
- in assessing the impact upon inflation, what matters is who indirectly pays the tariffs after the initial bill is paid. By assuming China is paying these duties and the US is getting richer through the proceeds into Treasury's coffers, the Trump administration sounds like some European mercantilist power from hundreds of years ago.
- who ultimately pays tariffs depends upon tax incidence analysis by individual good/service and sector. It depends upon the pricing power that exists and possibly competing influences (like USD strength). Theoretically, some of the tariffs may be sloped off to Chinese suppliers but the literature below finds no evidence of this. Some may get passed to US consumers. Some may get passed on to US businesses. Some gets passed onto workers, and some to shareholders through margins. There is an argument to be made that one way or the other the full effects of tariffs are borne by US households as consumers, workers and shareholders ultimately pay the proceeds going to the US Treasury. There is also what's labelled the phenomenon of strategic mark-ups of complementary or unrelated goods by companies sneaking in price increases and blaming tariffs.

As for the evidence, here are some links to studies on the tariff effects follow.

1. There are two NBER research pieces ([here](#) and [here](#)) on the impact of the 2018 tariffs on prices that show full pass-through of tariffs to import prices (ie: Americans paid the full price, not Chinese exporters).
2. The San Francisco Federal Reserve evaluated the impact of tariffs on PCE inflation and estimated the total effect at 0.4% ([here](#)).
3. The NY Fed's research ([here](#)) estimates that the impact on is about "a third of a percent" to CPI and PPI inflation in 2018 from tariffs and that the effects of tariff hikes show up mostly within a three month period.
4. On the impact of tariffs upon strategic mark-ups, please see [this](#) piece.
5. There is also [this](#) piece that estimates the impact of tariffs on growth, wages and jobs. They conclude that the tariffs—as a tax hike—offset about half of their estimated effect of the Tax Cuts and Jobs Act on economic growth. This group has generally been very supportive of the TCJA and views tariffs as putting at risk the act's economic benefits.

Regarding other ways that China can retaliate, I've never bought the forced selling of Treasuries argument and will repeat the reasons here.

a) China owns US\$1.13T of US Treasuries or about one-third of China's reserves and so there is the proverbial problem of how they'd cut their noses off to spite their faces;

b) the yuan is a dirtied managed cross against the USD. Selling USD and Treasuries could spark further yuan appreciation to the dollar.

c) China may then have to court other options to offset the currency effect. Where the chips land is uncertain. There is the risk of going back to 2015 when the pros and cons of yuan devaluation tipped over toward cons through capital flight from China;

d) If China sells, perhaps others buy as broad macro risks escalate and as relative carry whether hedged or not could become more attractive to other investors (Japan, recycled petro flows, Europe, US institutional accounts, US households etc). A sharply adverse scenario could have multiple buyers stepping up to the plate and the only thing China could have on its plate may be a currency mess and uncertainty over where to reallocate the Treasury proceeds.

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.	2.19	2.19	2.29	2.19	2.18	2.26	2.41	2.40	2.46	2.84	2.84	2.86	Canada - BoC	1.75	
CANADA	1.59	1.58	1.58	1.56	1.55	1.55	1.68	1.66	1.68	1.91	1.90	1.94	US - Fed	2.50	
GERMANY	-0.64	-0.63	-0.61	-0.49	-0.48	-0.46	-0.08	-0.07	-0.04	0.56	0.57	0.62	England - BoE	0.75	
JAPAN	-0.16	-0.16	-0.15	-0.16	-0.16	-0.16	-0.05	-0.05	-0.05	0.54	0.55	0.55	Euro zone - ECB	0.00	
U.K.	0.71	0.71	0.75	0.83	0.84	0.90	1.10	1.10	1.16	1.65	1.65	1.68	Japan - BoJ	-0.10	
	Spreads vs. U.S. (bps):														
CANADA	-60	-61	-71	-63	-64	-71	-73	-74	-77	-93	-94	-92	Mexico - Banxico	8.25	
GERMANY	-283	-282	-289	-268	-267	-272	-248	-247	-250	-228	-227	-225	Australia - RBA	1.50	
JAPAN	-235	-235	-244	-235	-235	-242	-246	-245	-251	-230	-229	-232	New Zealand - RBNZ	1.50	
U.K.	-149	-148	-153	-136	-135	-136	-131	-130	-130	-120	-118	-119			
Equities	Level						% change:						Next Meeting Date		
	Last			Change			1 Day	1-wk	1-mo	1-yr					
S&P/TSX	16193			-104.1			-0.6	-1.8	-1.7	0.7			Canada - BoC	May 29, 2019	
Dow 30	25325			-617.4			-2.4	-4.2	-4.1	1.7			US - Fed	Jun 19, 2019	
S&P 500	2812			-69.5			-2.4	-4.1	-3.3	3.0			England - BoE	Jun 20, 2019	
Nasdaq	7647			-269.9			-3.4	-5.9	-4.2	3.2			Euro zone - ECB	Jun 06, 2019	
DAX	11925			48.4			0.4	-1.4	-0.6	-8.1			Japan - BoJ	Jun 20, 2019	
FTSE	7224			60.7			0.8	-0.5	-2.9	-6.3					
Nikkei	21067			-124.0			-0.6	-3.9	-3.7	-7.9					
Hang Seng	28122			-428.2			-1.5	-3.7	-6.0	-9.6					
CAC	5317			54.9			1.0	-1.5	-3.4	-4.0					
Commodities	Level						% change:								
WTI Crude	61.64						0.60						1.0 0.4 -3.5 -13.1		
Natural Gas	2.66						0.04						1.6 5.0 0.2 -6.3		
Gold	1298.68						-1.22						-0.1 1.1 0.6 -1.1		
Silver	14.66						-0.14						-0.9 0.0 -2.7 -12.5		
CRB Index	179.12						1.48						0.8 -0.2 -4.9 -12.1		
Currencies	Level						% change:								
USDCAD	1.3479						0.0001						0.0 0.0 0.8 5.2		
EURUSD	1.1213						-0.0009						-0.1 0.2 -0.8 -6.0		
USDJPY	109.55						0.2500						0.2 -0.6 -2.2 -0.1		
AUDUSD	0.6937						-0.0007						-0.1 -1.1 -3.3 -7.8		
GBPUSD	1.2925						-0.0033						-0.3 -1.1 -1.3 -4.7		
USDCHF	1.0078						0.0014						0.1 -1.2 0.4 0.7		

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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