

ON DECK FOR FRIDAY, MAY 31

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	05/31	08:30	IPPI (m/m)	Apr	--	--	1.3
CA	05/31	08:30	Raw Materials Price Index (m/m)	Apr	--	--	2.8
CA	05/31	08:30	Real GDP (m/m)	Mar	0.5	0.3	-0.1
CA	05/31	08:30	Real GDP (q/q a.r.)	1Q	1	0.7	0.4
US	05/31	08:30	PCE Deflator (m/m)	Apr	0.3	0.3	0.2
US	05/31	08:30	PCE Deflator (y/y)	Apr	1.6	1.6	1.5
US	05/31	08:30	PCE ex. Food & Energy (m/m)	Apr	0.2	0.2	0.1
US	05/31	08:30	PCE ex. Food & Energy (y/y)	Apr	1.6	1.6	1.6
US	05/31	08:30	Personal Spending (m/m)	Apr	0.1	0.2	0.9
US	05/31	08:30	Personal Income (m/m)	Apr	0.2	0.3	0.1
US	05/31	09:45	Chicago PMI	May	--	54.0	52.6
US	05/31	10:00	U. of Michigan Consumer Sentiment	May F	--	101.3	102.4

KEY POINTS:

- **Markets de-risking on escalating trade tensions**
- **Trump announces heavy tariffs on Mexican imports...**
- **...that risks scuttling NAFTA passage**
- **China announce creation of its own blacklist**
- **Confidence is being sapped...**
- **...regardless of which one of two opposed narratives is chosen...**
- **...but retain some faith that checks on this US President will prevail**
- **Chinese manufacturing PMI softens, composite still signals growth**
- **German consumers retrench**
- **India's economy posts weakest growth in over four years**
- **German, Italy reinforce a much weaker Eurozone CPI print...**
- **...but controlling for energy and Easter require more data**
- **Bank of Korea holds**
- **CDN GDP: solid month, soft quarter?**
- **US core PCE: downside risk?**
- **Mixed Japanese readings**

INTERNATIONAL

Global markets are taking the reasonable step of de-risking in the face of escalating US-centric trade tension. New information overnight included Trump's announcement that a tariff on all imports from Mexico would begin on June 10th and be set at an initial starting levy of 5% rising to 25% on October 1st unless Mexico takes steps to block illegal migrants from entering the US and by corollary across its own borders with other countries which in turn requires their collaboration. Not being a value-added tax, the tariff would apply every time a part or final product passes across the US-Mexico border which would be very negative for trade, investment and jobs while raising prices in the US and inviting Mexico to retaliate. This comes as the Trump administration tries to advance USMCA in Congress and as each of Canada and Mexico have been expediting similar ratification measures. China also took the step of announcing its own list

CONTACTS

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

**Trump's Voter Support
Has Eroded Again**


of “unreliable” entities and threatened more announcements soon in response to the US blacklisting Chinese technology companies. At issue are two diametrically opposed theories about the future of the global economy and markets (see US section). Quite frankly I don’t have conviction toward which path we’re ultimately headed down, but in the face of doubt, de-risking first and asking questions later is sensible as developments are monitored. My net bias remains to retain some degree of faith that sundry checks and balances on Trump will exert themselves while counselling avoidance of a tendency to over-react, but the damage is nevertheless being done to market and business confidence in the interim. How do you plan for anything in this environment whether in the US or abroad?

In any event, here’s what markets are doing.

- Across currency markets, no one should be surprised by the fact that the Mexican peso is getting hammered and is down by 2½% versus the USD. CAD is the second weakest cross and is depreciating by just under ½%. Safe havens like the yen and Swiss franc are rallying.
- Sovereign bond yields are falling even more and the case for sub-2% on US 10s is strong. We’re at 2.16% now, down 5bps on the day. Canada 10s are performing similarly. EGB yields are down by between 2–5bps across the markets except for Italy where spreads are widening over bunds by about 7bps.
- US equity futures are down by over 1% across the exchanges. TSX futures are down by ¾%. European cash markets are down by between 1% (London) and nearly 2% (Frankfurt). Asian equities fell by 1.6% in Tokyo, ¾% in HK, and ¼% in India. Mainland China ranged from flat (Shenzhen) to down ¼% (Shanghai). Seoul was up a smidge.
- Oil prices are down by over a buck in terms of both WTI and Brent.

US-centered trade conflict clearly dominates everything else this morning, but other developments can be quickly summarized.

1. Chinese state PMIs: The May readings weakened through a hit to manufacturing. The manufacturing PMI fell by seven-tenths to 49.4 and hence marginally in contraction territory. The non-manufacturing PMI was stable at 54.3 and continues to signal growth. The overall composite PMI only fell by one-tenth to 53.3 which continues to signal growth in the broader economy.

2. Eurozone inflation: Germany and Italy released CPI figures for May. They broadly reinforce what we had already learned from the French and Spanish readings but controlling for energy and Easter effects is difficult. Germany’s individual states released earlier this morning and the just-released national add-up fell to 1.3% y/y (2.1% prior). Italian CPI decelerated to 0.9% y/y on an EU-harmonized basis (1.1% prior).

3. Miscellaneous: I use this catch-all category to summarize other more tertiary developments. German consumers hit the skids in April with retail sales volumes plummeting by 2.0% m/m (consensus +0.1%) which is the second biggest drop in over five years behind only the 2.9% decline in December of last year. India’s economy decelerated by more than expected with growth dropping to 5.8% y/y which is the softest growth since 2014Q4. The Bank of Korea kept its policy rate unchanged at 1.75% as universally expected last evening as it plays off financial stability concerns attached to easing against a front row seat on trade wars. Japanese macro data was mixed as industrial output grew (+0.6% m/m, consensus 0.2%), retail sales were flat (+0.6% consensus), housing starts fell by 5.7% m/m (-0.6% consensus) and Tokyo CPI decelerated in May (1.1%, 1.3% prior, 1.2% consensus) as an advance signal for national CPI for this month.

UNITED STATES

As for the previously cited two diametrically opposed theories on the way forward in markets and the global economy, the first one goes as follows. It posits that **there is a cancer on the world economy and markets and it goes by the name ‘Trump.’** The instability he and his reckless administration persistently foment at home and abroad clouds the outlook and confirms the fear all along that he was unfit to govern. When trade negotiations and deals prove to be worthless because the US signature has been debased then the only fair assumption is to brace for soured trade and investment prospects across the global economy including in the US. In this scenario, China, America’s NAFTA partners, Europe and Japan all balk at even attempting negotiation with this US administration and we wind up in a protracted stalemate that severely damages confidence. Markets are adding to bets that the

Fed will act as enabler of this administration's protectionist anti-business bias by cutting rates, notwithstanding the higher inflation that will ensue from tariffs and negative supply shocks. Easing policy would result in Trump capturing the Fed—as he has so many others—and risks missing the forest for the trees in that protectionism and volatile policy will only be further incentivized. Washington is unstable and hammering the business climate? Pull out the security blanket and spread it over Trump. Fed funds futures are pricing a full percentage point of rate cuts by the end of 2020. The rate cut assumption that used to be predicated upon the simplicity of the US economy simply running out of gas late in the cycle has been supplanted by the more reasonable view that the Fed may indeed ease in response to escalating trade wars on seemingly every front with the US at its epicentre.

The competing theory is that it's all overblown. Not even Trump's base likes all of this as his job approval rating is falling (see chart). Not even his most ardent GOP supporters on many things including Trump's controversial immigration steps—like Chuck Grassley and Joni Ernst—are standing by him on the Mexican tariff gambit. Maybe threatening a 5% multiplicative tariff on all imports from Mexico that would scuttle NAFTA 2.0 ratification won't see the light of day, but we'll find out soon enough with a June 10th ultimatum. If it does, US consumers will cry foul as the inflation implications will soon show up on-line and across the country's malls and right into the primaries. The legality of applying this 5% tariff against all imports from Mexico is in question through a new channel that may abuse the original intent of the International Emergency Economic Powers Act. Maybe Congress will finally act to usurp Trump's use of such special powers through a broad move by the GOP and Democrats to take back such powers as last summer's movement leaned toward. The legality is further challenged by contravening the NAFTA agreement and WTO rules, though we'd get rulings ages after the fact. Perhaps AMLO's cool-under-pressure response overnight will assist in striking a calmer agreement. Maybe Trump will hear the stock market's response. Maybe US businesses will cry out so loudly about the impact upon their US-Mexican and indeed global supply chains as to motivate either the administration or members of Congress to avert the tariff scenario. Maybe this is just a pressure tactic on the Democrats to push them into passing USMCA in exchange for Trump backing off tariffs. Perhaps this is all just another example of how Trump repeatedly diverts attention from Mueller, his taxes, impeachment risk and other negative headlines by shifting the attention toward his repeated targets during such times: immigrants and Mexico; it's working as I don't see a single headline on any of those matters this morning and maybe in Trump's mind it is mission accomplished. All of this, however, assumes some degree of rationality by the US President and some degree of a master plan while there is definite cause for questioning this.

PCE inflation (8:30amET) and the Dallas Fed's trimmed mean inflation measure are due out today. Spending should be soft given we know that retail sales fell by 0.2% m/m in April with the key control group coming in flat after a very strong 1.1% gain the prior month. In some sense, consumption softness in April is a bit of payback for the magnitude of recovery in March and the environment of confidence shocks and distortions to seasonal influences merits looking to the trend which has been fairly soft thus far in 2019. Income growth should be better and driven by jobs and wages. If income growth does indeed outpace consumption growth, then the saving rate should benefit after it fell from 7.3% in February to 6.5% in March in order to finance that month's spending. In the wake of yesterday morning's Q1 core PCE revisions (note [here](#)), there is downside risk to the consensus estimate for unchanged core PCE at 1.6% y/y. That's not certain, however, as we don't know the distribution of the revisions over Q4 and Q1 and whether the narrow drivers will persist into April. Regardless, the focus will once again be upon weeding out potentially transitory categories.

Through it all, pity the Fed official that has to speak in this environment! Best of luck to you. The lucky straws have been drawn by the NY Fed's President Williams (12pmET) and Atlanta Fed President Bostic (9:15amET, nonvoting until 2021).

CANADA

Canada updates GDP at 8:30amET and it should showcase solid growth during the month of March (around ½% m/m) but within a soft overall quarter. Consensus is at 0.7% q/q for Q1 (annualized) and Scotia is at 1.0%. The BoC had forecast 0.3% in the April MPR. Bullish activity readings have since been released across all measures of activity. I've written enough about expectations this week so let's just see the print when markets are focused upon forward-looking risks anyway.

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.	1.99	2.06	2.17	1.96	2.02	2.12	2.16	2.21	2.32	2.59	2.64	2.75	Canada - BoC	1.75
CANADA	1.48	1.52	1.56	1.40	1.45	1.50	1.50	1.55	1.61	1.77	1.81	1.86	US - Fed	2.50
GERMANY	-0.67	-0.64	-0.63	-0.59	-0.56	-0.52	-0.20	-0.18	-0.12	0.43	0.47	0.54	England - BoE	0.75
JAPAN	-0.17	-0.16	-0.15	-0.19	-0.18	-0.17	-0.09	-0.08	-0.07	0.46	0.49	0.51		
U.K.	0.60	0.61	0.64	0.62	0.66	0.71	0.86	0.90	0.96	1.45	1.49	1.52		
Spreads vs. U.S. (bps):														
CANADA	-51	-54	-61	-56	-57	-62	-66	-66	-71	-83	-83	-89	Euro zone - ECB	0.00
GERMANY	-266	-270	-280	-254	-258	-264	-236	-239	-244	-216	-217	-222	Japan - BoJ	-0.10
JAPAN	-216	-223	-232	-215	-220	-229	-225	-229	-239	-214	-215	-225		
U.K.	-139	-145	-152	-134	-136	-141	-130	-132	-137	-114	-115	-123		
Equities	Level			Change			% change:							
	Last						1 Day	1-wk	1-mo	1-yr				
S&P/TSX	16089			-42.2			-0.3	-0.5	-3.0	0.2			Mexico - Banxico	8.25
Dow 30	25170			43.5			0.2	-2.4	-5.4	3.1			Australia - RBA	1.50
S&P 500	2789			5.8			0.2	-2.4	-5.3	3.1			New Zealand - RBNZ	1.50
Nasdaq	7568			20.4			0.3	-2.4	-6.5	1.7			Next Meeting Date	
DAX	11682			-219.9			-1.8	-2.7	-5.4	-7.3				
FTSE	7140			-77.8			-1.1	-1.3	-3.7	-7.0			Canada - BoC	Jul 10, 2019
Nikkei	20601			-341.3			-1.6	-2.4	-7.4	-7.2			US - Fed	Jun 19, 2019
Hang Seng	26901			-213.8			-0.8	-1.7	-9.4	-11.7			England - BoE	Jun 20, 2019
CAC	5171			-77.9			-1.5	-2.7	-7.4	-4.2			Euro zone - ECB	Jun 06, 2019
Commodities	Level			Change			% change:							
WTI Crude	55.40			-1.19			-2.1	-4.3	-13.3	-17.4			Japan - BoJ	Jun 20, 2019
Natural Gas	2.57			0.02			0.9	-0.3	-0.2	-12.9				
Gold	1298.72			10.07			0.8	1.1	1.2	0.0			Mexico - Banxico	Jun 27, 2019
Silver	14.40			0.03			0.2	-0.6	-3.9	-12.0			Australia - RBA	Jun 04, 2019
CRB Index	177.14			-1.63			-0.9	0.1	-3.9	-12.7			New Zealand - RBNZ	Jun 25, 2019
Currencies	Level			Change			% change:							
USDCAD	1.3554			0.0054			0.4	0.9	1.2	4.6				
EURUSD	1.1151			0.0022			0.2	-0.5	-0.6	-4.6				
USDJPY	108.74			-0.8800			-0.8	-0.5	-2.4	-0.1				
AUDUSD	0.6912			0.0000			0.0	-0.2	-1.9	-8.7				
GBPUSD	1.2574			-0.0034			-0.3	-1.1	-3.5	-5.4				
USDCHF	1.0056			-0.0022			-0.2	0.3	-1.3	2.0				

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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