ON DECK FOR TUESDAY, JUNE 4							
Country	**Date**	**Time**	**Indicator**	**Period**	**BNS**	**Consensus**	**Latest**
US	06/04	10:00	Durable Goods Orders (m/m)	Apr F	--	--	-2.1
US	06/04	10:00	Durable Goods Orders ex. Trans. (m/m)	Apr F	--	--	0.0
US	06/04	10:00	Factory Orders (m/m)	Apr	-1	-1.0	1.9

KEY POINTS:

- **Risk-on mood returns, pending Powell**
- **Will Fed's Powell reaffirm or push back on rate cut expectations?**
- **The Fed's two most dovish regional Presidents lean toward easing…**
- **...but are they aligned with the top of the house?**
- **Bullard's selective take on inflation expectations**
- **Fed's Evans seems ok with modest accommodation**
- **RBA cuts, Lowe sounds ambivalent toward more easing**
- **Eurozone core CPI declines because of a tardy Easter bunny**
- **UK construction PMI joins manufacturing PMI in contraction**

INTERNATIONAL

Risk on, risk off, and risk on again! Markets are gyrating in their view of the world at large and at least so far today they are in a better risk-on frame of mind with safe haven demand dropping and equities rallying. **Key will be whether Fed-speak reaffirms or pours cold water on this mood over the duration of the day as Powell and Brainard take to the podium.** Their appearances come in the wake of yesterday's rate-bullish guidance from St. Louis Fed President Bullard and ahead of the FOMC blackout a week from today before the June 18th–19th meeting. See below for comments and a critique of his remarks in the context of today's other appearances by Fed officials. Chicago's Evans gave a CNBC interview this morning and seemed ok with some accommodation to defend the 2% inflation target but I thought the balance of his remarks indicated that he's not as aggressive as market pricing for multiple rate cuts. Otherwise, Eurozone core CPI fell a bit more than expected but is so distorted by Easter as to be of questionable use two days ahead of the ECB decisions (see below). The RBA cut as universally expected, but guidance was ambivalent toward prospects for more cuts (see below).

- The USD is little changed on balance as the yen and the Swiss franc soften a touch while the Mexican peso leads appreciating crosses.

- The US rates curve is slightly bear flattening with the two year Treasury yield up 7bps and 10s up 5bps. Canada's curve is bear steepening a touch along with gilts. EGB yields are generally rallying in the 10s space including the 10 year bund at -0.21%.

- US equity futures are up by between about ¼% and ½%. TSX futures are up by about ½%. European cash markets are up by between ¼% (London, Paris) and just over 1% (Frankfurt, Milan). Asian equities ranged from little changed in Tokyo and Seoul to down by 1–1.5% in mainland China.

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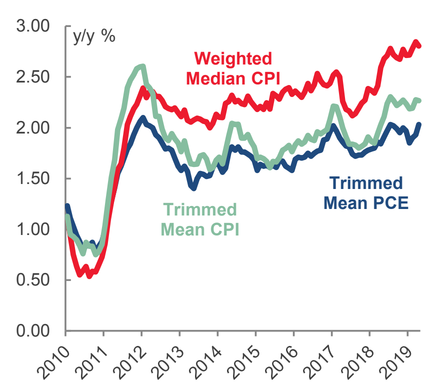
Rising EurozoneSupercore Inflation

Sources: Scotiabank Economics, Bloomberg.

Falling Market-Based Inflation Expectations - But No Crisis Yet

Source: Scotiabank Economics, University of Michigan,Bloomberg.

A Comparison of Alternative Federal Reserve Inflation Measures



Sources: Scotiabank Economics, FRB Dallas, FRB Cleveland.

- Oil prices are slightly lower with WTI just under US$53 and Brent just under US$61. Gold is little changed.

Two days ahead of the ECB's decisions, Eurozone core CPI decelerated by a bit more than consensus anticipated. Core CPI of 0.8% (1.3% prior, 0.9% consensus) brings the reading back down to March's level after a brief spike in April to 1.3%. **The strong caution is that the Easter bunny was a tad tardy this year compared to normal years** and that likely pushed service related prices higher than normal in April and lower than normal in the months on either side as seasonal adjustment factors struggled to compensate. Sure enough, services prices dragged 0.4% off the overall reading last month. We'll need the greater breakdown of details in the revisions that land on June 18th to be sure, but for now, it appears likely that 'supercore' CPI will be more resilient at that time after removing packaged holiday prices. At risk is that core CPI is providing a head fake against what remains a two year upward trend in Eurozone 'supercore' CPI that removes the annual Easter distortions (see chart). See the six-point preview of ECB expectations in the Global Week Ahead (here) for more.

The RBA cut its cash rate by 25bps to 1.25% as universally expected overnight. That's the first easing since August 2016 after an easing campaign that stretched back to late 2011. The statement is here and Governor Lowe's ensuing speech is here. That he cut is of absolutely no surprise to markets or economists. **The information is on the bias which is more clearly stated in Lowe's speech and that was less clear about the need for future cuts than markets may be assuming:**

> "This brings me to the second question: are interest rates going to be reduced further?
>
> The answer here is that the Board has not yet made a decision, but it is not unreasonable to expect a lower cash rate. Our latest set of forecasts were prepared on the assumption that the cash rate would follow the path implied by market pricing, which was for the cash rate to be around 1 per cent by the end of the year. There are, of course, a range of other possible scenarios and much will depend on how the evidence evolves, especially on the labour market.
>
> If you accept the argument that a sustainably lower rate of unemployment in Australia is achievable, the question that we should all be thinking about is: how do we get there?
>
> It is possible that the current policy settings will be enough – that we just need to be patient. But it is also possible that the current policy settings will leave us short. Given this, the possibility of lower interest rates remains on the table. Monetary policy does have an important role to play and we have the capacity to play that role if needed.
>
> In saying that, I also want to recognise that monetary policy is not the only option. There are certain downsides from relying just on monetary policy and there are limitations on what, realistically, can be achieved. So, as a country, we should also be looking at other options to reduce unemployment."

Another weak macro report hit the UK this morning. The purchasing managers' index for the construction sector unexpectedly fell into contraction. The reading of 48.6 (50.5 prior, 50.6 consensus) was the weakest since March of last year. This follows yesterday's decline in the manufacturing PMI to a contractionary 49.4 print ahead of tomorrow's services and composite PMIs.

UNITED STATES

Fed-speak may well risk roiling markets today with only very limited macro data on tap. Factory orders are due out at 10amET but the April reading should just largely follow the already known 2.1% decline in durable goods orders lower pending possible revisions.

There is about a one-in-five chance of a Fed rate cut on June 19th and a roughly 60% chance of a July rate cut. As the Chicago Fed's special conference on monetary policy strategy and communications kicks off, we may hear hints that either strengthen such pricing or push back upon it. Please see the agenda here.

At the top of the heap will be a speech by Fed Chair Powell at 9:55amET. The topic is "monetary policy strategy, tools, and communication practices." In theory, the focus of the conference is supposed to be upon longer run issues concerning the framework as opposed to becoming some sort of new venue at which the Fed can drop major hints about pending policy decisions. **The scope for disappointment in his remarks is therefore non-negligible but that in itself could be a sign he feels no need to rush a decision the week after next**. Nevertheless, the issue is whether the escalation of the US-China conflict and Trump's Mexican tariffs are game changers to Powell versus his earlier efforts to push back on cut talk in part by emphasizing transitory influences upon below-target core PCE inflation.

This afternoon at about 3:45pmET we'll hear from Governor Lael Brainard who will moderate a panel that will discuss "what does full employment look like for your community or constituency?"

St. Louis Fed President James Bullard is among the more thoughtful and markets-oriented of Fed officials and he shook up fed funds futures pricing yesterday. Yesterday, Bullard said the following:

"A downward policy rate adjustment may be warranted soon to help re-center inflation and inflation expectations at target and also to provide some insurance in case of a sharper-than-expected slowdown."

He backed it up with this powerpoint presentation. The Mexican tariff threat appears to have played a role in Bullard's shift in stance since a little over a week ago he was saying:

> "Rates are at a good place in the U.S. right now, if anything we are a little restrictive I would say. I am concerned we may have slightly overdone it with our December rate hike but I was pleased that the committee pivoted. I don't think we are there yet, I think it is premature at this point but this is something that could be done, possibly."

Bullard has a candid way of communicating with the markets which is appreciated. Among FOMC officials, I find that at times he can be too extreme, almost as if he positions himself as a hedge fund manager hammering away at the case for an overweight position. He can also be somewhat volatile. Against his debateable "I told you so" assertion about the December 2018 meeting, recall that in mid-2016, he rather stridently and publicly slammed Chair Yellen and his colleagues for "...causing unnecessary confusion over future Fed policy, and eroding the credibility of the FOMC." His beef back then was that he felt the dot plot was too steep in forecasting rate hikes; Bullard protested by saying there was little reason to raise rates at all, boycotted the long-run element of the dot plot and showed only one hike in total by the end of 2018. In so doing, Bullard forecast one out of eight hikes that would come to be delivered by the FOMC. He now reckons that of those eight hikes, the Fed might have overdone it on one of them last December which is fair game, but what about the other seven? I don't see any hint that he thinks the broad cumulative pace of hikes was inappropriate although in fairness to him Bullard did not vote in 2017 or 2018 and only voted in 2016 (without dissent) and this year.

I'd like to dig into two elements of his presentation because I think doing so strikes to the heart of much of the debate over Fed rate cuts. First, slides 8–9 show that **growth is forecast to return to about potential and this is one of his set-ups for a rate cut.** Bullard has US GDP growth easing to about the long-run potential rate of growth in the US economy over the 2019–21 horizon. That hardly strikes one as alarmist given the unsustainability of very strong US growth over recent quarters that has pushed the US economy into excess aggregate demand.

Second, Bullard's slides 10–13 are worth expanding upon. **Bullard expresses concern that inflation itself and inflation expectations are too low.** At issue are the credibility of the inflation target and the symmetry of policy adjustments (ie: ease when inflation is underperforming 2% over the forecast horizon and tighten above). Bullard provides evidence of too low inflation expectations by pointing to PCE and core PCE measures (slide 12) and three measures of inflation expectations expectations: the Fed's preferred 5y5y gauge (chart 2), the TIPS 5 year breakeven and the 2 year continuously compounded zero-coupon yield. In all cases, he subtracts 30bps from these market measures since they are formulated around CPI expectations and CPI tends to overestimate the Fed's preferred PCE inflation gauge by around this amount over time.

What I have difficulty with is in leaving it at those measures in that Bullard is being perhaps overly selective when it comes to a) which measures of actual inflation he emphasizes, and b) which measures of inflation expectations he chooses.

For instance, with all of the talk about transitory influences upon low core inflation, Chair Powell and others emphasize measures of inflation that are less sensitive to a handful of price influences in the tails. Chart 3 shows other inflation measures that narrow the focus toward more of a central tendency to price pressures using the Dallas Fed's trimmed mean PCE gauge and the Cleveland Fed's weighted median CPI and trimmed mean CPI measures. **All three of these measures are at or above the Fed's 2% inflation target and if we subtract the same 0.3% off the CPI gauges then on average they're all in the ballpark of what I'd suggest to be comfortably aligned with the Fed's 2% goal.** Why didn't Bullard mention these gauges? If he strongly dislikes them then I'd like to hear why, but the alternative of relying upon headline measures that may be temporarily distorted is dissatisfying.

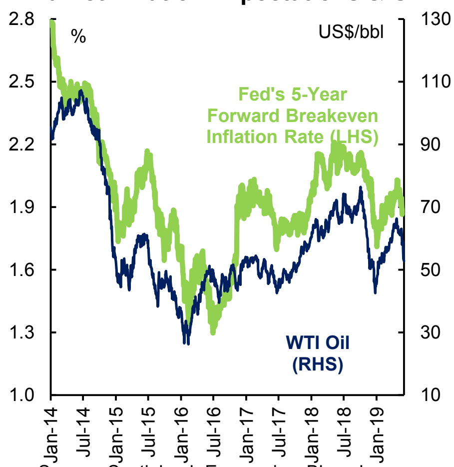
Further, Bullard could have also looked at more measures of inflation expectations. In fact, relying only upon market measures may be dicey given they may just largely reflect oil prices (chart 4) and given research that suggests they don't tell us much about future inflation. This piece from the San Francisco Fed concluded:

> "....market-based inflation forecasts generally are no more accurate than surveys of professional forecasters or simple forecast rules. This suggests that financial markets can provide little additional useful forward-looking information about inflation."

As for other measures, here we go:

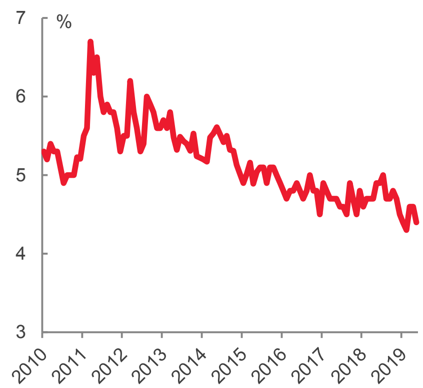
- The Bloomberg economists' consensus expects core PCE and headline PCE inflation to equal 2.0% in 2020 and 2021 after a temporary decline to 1.7% and 1.6% respectively this year.

Market Inflation Expectations & Oil



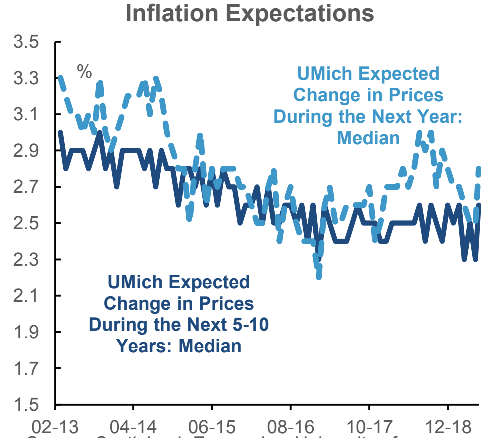
Source: Scotiabank Economics, Bloomberg.

Conference Board's Consumer Inflation Expectations



Sources: Scotiabank Economics, The Conference Board.

There is No Crisis In Consumers' Inflation Expectations

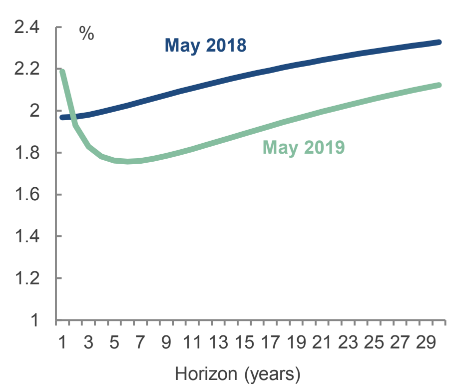


Source: Scotiabank Economics, University of Michigan,Bloomberg.

NY Fed Survey of Households' Inflation Expectations

Sources: Scotiabank Economics, Federal Reserve of New York.

Latest Estimated Inflation Term Structure Compared To Previous Year



Sources: Scotiabank Economics, Federal Reserve Bank of Cleveland.

- Charts 5–7 show three measures of consumer expectations including the Conference Board's, the University of Michigan's and the NY Fed's surveys. All of these range from above to ludicrously above the 2% inflation target.
- Chart 8 shows the Cleveland Fed's modelling of the inflation term structure now compared to where it was a year ago (more here). There has been a definite downshift based upon a model that uses Treasury yields, inflation data, inflation swaps and survey-based measures of inflation expectations. How it performs in actually forecasting inflation over the one to ten year horizon is debatable.

Overall, my point is that a fuller suite of measures of actual inflation and inflation expectations doesn't as obviously support Bullard's point while lower growth toward potential with a positive output gap at present doesn't state an obvious case for easing.

My personal belief remains that the Fed shouldn't necessarily look through tariff effects upon inflation if we're going through a permanent negative supply shock that reverses decades of trade liberalization and that easing could further enable Trump's protectionist instincts. Throwing a security blanket over President Trump's damaging trade policies could make the Fed as responsible for future protectionism as Trump himself. This moral hazard problem is a serious issue with such an erratic President.

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.	2.10	2.11	2.15	2.07	2.07	2.11	2.26	2.26	2.32	2.68	2.69	2.75
CANADA	1.54	1.53	1.58	1.48	1.47	1.53	1.58	1.58	1.64	1.83	1.83	1.88
GERMANY	-0.64	-0.65	-0.64	-0.56	-0.56	-0.52	-0.17	-0.18	-0.12	0.47	0.46	0.54
JAPAN	-0.16	-0.17	-0.15	-0.18	-0.19	-0.16	-0.08	-0.09	-0.06	0.49	0.47	0.52
U.K.	0.62	0.60	0.65	0.66	0.65	0.71	0.91	0.89	0.95	1.50	1.49	1.52
	Spreads vs. U.S. (bps):											
CANADA	-56	-58	-56	-59	-60	-58	-68	-69	-68	-86	-87	-87
GERMANY	-275	-275	-278	-263	-263	-264	-243	-244	-244	-221	-223	-222
JAPAN	-227	-228	-230	-225	-226	-228	-234	-235	-238	-220	-223	-224
U.K.	-148	-151	-150	-140	-142	-140	-135	-137	-137	-119	-120	-124

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	16131	-166.0	-1.0	-1.2	-2.7	0.5
Dow 30	25126	-221.4	-0.9	-2.9	-5.5	1.9
S&P 500	2783	-19.4	-0.7	-2.8	-5.5	2.2
Nasdaq	7547	-60.0	-0.8	-3.1	-6.8	1.1
DAX	11870	32.6	0.3	-0.7	-3.8	-7.1
FTSE	7216	30.8	0.4	-1.6	-2.7	-6.2
Nikkei	20943	-60.8	-0.3	-1.0	-5.9	-4.9
Hang Seng	27115	-120.8	-0.4	-0.6	-8.7	-9.8
CAC	5238	16.3	0.3	-0.8	-6.2	-3.5
Commodities	Level		% change:			
WTI Crude	59.03	0.22	0.4	-3.9	-7.6	-13.5
Natural Gas	2.60	-0.03	-1.1	2.1	0.8	-10.0
Gold	1277.91	-1.84	-0.1	-0.4	-0.4	-1.8
Silver	14.38	-0.11	-0.7	-0.4	-4.0	-12.7
CRB Index	180.55	0.21	0.1	0.6	-2.0	-11.2
Currencies	Level		% change:			
USDCAD	1.3495	-0.0024	-0.2	0.2	0.8	4.8
EURUSD	1.1136	0.0005	0.0	-0.4	-0.7	-4.5
USDJPY	109.71	0.1200	0.1	0.1	-1.5	0.7
AUDUSD	0.6917	0.0000	0.0	0.2	-1.9	-8.7
GBPUSD	1.2629	0.0003	0.0	-0.2	-3.1	-4.9
USDCHF	1.0088	0.0009	0.1	0.5	-1.0	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	1.50
Next Meeting Date	
Canada - BoC	Jul 10, 2019
US - Fed	Jun 19, 2019
England - BoE	Jun 20, 2019
Euro zone - ECB	Jun 06, 2019
Japan - BoJ	Jun 20, 2019
Mexico - Banxico	Jun 27, 2019
Australia - RBA	Jun 04, 2019
New Zealand - RBNZ	Jun 25, 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.