

ON DECK FOR WEDNESDAY, JULY 31

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	07/31	07:00	MBA Mortgage Applications (w/w)	JUL 26	--	--	-1.9
US	07/31	08:15	ADP Employment Report (000s m/m)	Jul	150	150.0	102.2
CA	07/31	08:30	IPPI (m/m)	Jun	--	-0.2	0.1
CA	07/31	08:30	Raw Materials Price Index (m/m)	Jun	--	-3.0	-2.3
CA	07/31	08:30	Real GDP (m/m)	May	0.1	0.1	0.3
US	07/31	08:30	Employment Cost Index (q/q)	2Q	--	0.7	0.7
US	07/31	09:45	Chicago PMI	Jul	--	51.1	49.7
US	07/31	14:00	FOMC Interest Rate Meeting (%)	Jul 31	2.25	2.25	2.50

KEY POINTS:

- Markets brace for Fed Day...
- ...amidst plenty of other distractions
- US-China trade talks end early with no tangible progress
- Should the Fed ease because of external risks to the Eurozone?
- China PMIs remain weak
- Eurozone core CPI falls, Q2 GDP slips...
- ...reinforcing ECB stimulus expectations
- How much could the ECB buy per month in another QE round?
- Mexico's economy barely avoids technical recession...
- ...but the weakest 2Q MA in six years puts pressure on Banxico
- CDN GDP: a soft month of May?
- Australian core CPI is trending lower
- US ADP: it would take a big outlier move to matter
- BCB expected to cut Selic rate

INTERNATIONAL

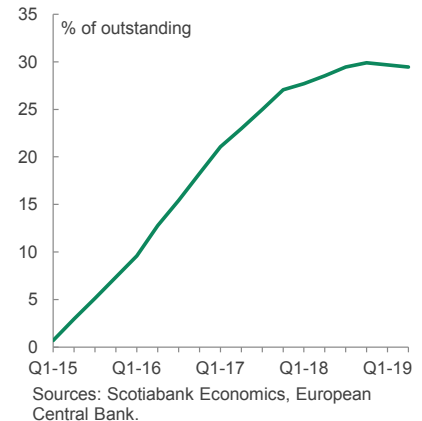
Global market movements are avoiding sharp stand-out swings across asset classes ahead of high uncertainty into the Fed. Overnight developments were generally on the dovish side of things with soft Eurozone and Chinese releases and no tangible progress cited at the conclusion of two days of trade talks between the US and China that ended a bit early. Powell's concerns about crosscurrents are therefore being reinforced into the statement and presser. Australian CPI remains soft (see below). Mexican GDP was soft but not as bad as feared (see below). Brazil is expected to ease (see below). The US releases ADP payrolls and Canada updates monthly GDP (see below for both). Oh, and if all that doesn't do it for you, then month-end rebalancing is occurring in the midst of it all.

- Sovereign bonds are slightly richer this morning. US Treasury yields are down by 1–2bps across maturities. Canada's curve is slightly underperforming as is the gilts curve. EGB yields are under mild downward pressure in bull flatteners following Eurozone data.

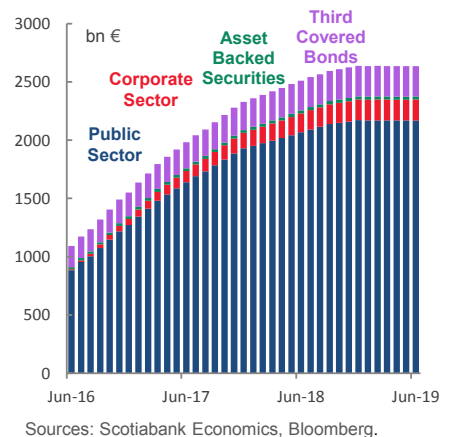
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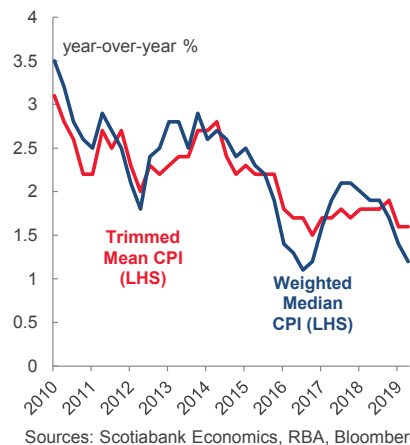
ECB's Holdings of European Union Sovereign Bonds



The ECB's Asset Purchase Programme



Australia's Slipping Inflation



- The USD is little changed on a DXY basis this morning. The A\$, pound sterling and Mexican peso are leading appreciating crosses while the Euro, CAD and yen are all little changed. Depreciating crosses are being led by the Norwegian krone, rand, and won.
- US equity futures are in the black by about ¼% on average with TSX futures slightly underperforming. European cash markets range from a 0.6% drop in London to mild gains across the rest of Europe led by Italy.
- Oil prices are rallying with WTI and Brent up about 40 cents. Privately sourced US oil inventories fell last week and by more than expectations for today's government report (10:30amET).

Eurozone releases added further cause to expect ECB stimulus at the September meeting. Core inflation fell to 0.9% y/y (1.0% consensus, 1.1% prior). Q2 GDP growth fell to 0.2% q/q in line with expectations but half the rate of the prior quarter and the weakest since Q2 of last year.

This makes it more likely that a full suite of stimulus offerings will be announced in September. The easiest to deliver would be a deposit rate cut to -0.5% and tiering of reserves that exempts a significant portion from having to pay interest to the ECB in order to mitigate negative effects on bank profitability. That's not to say that structuring a tiering program would be easy per se, but the harder issues include announcing a fresh round of securities purchases under the Asset Purchase Program (APP).

For starters, an ECB announcement of intentions to purchase would face a significant implementation lag. More important is that it's also very unclear how much the ECB could buy. Chart 1 shows the fraction of central government debt securities held by the ECB at 29.5% under the Public Sector Purchase Program (PSPP). That lies just under the 32% self-imposed limit. The ECB could announce only €15–18 billion of further purchases per month for one year without increasing this limit assuming trend debt growth. Raising the limit is feasible but operationally and politically challenging and while maintaining the requirement to avoid buying at auction and hence crossing the red line toward directly funding governments that would spark convulsions across northern Europe. The BoJ holds about 47% of the JGBs market, but it's a more closed bond market with totally different dynamics. Then the issue becomes other APP purchases under the other three programs the ECB has previously used (chart 2). They included the ABS, corporate sector and covered bond programs, but principally the latter two. However, even at their combined peaks, those other three non-sovereign debt purchase programs summed to under €15 billion per month. Thus, sticking within the 32% sovereign limit and going to the absolute maximum of past combined purchases across the other three programs probably translates to about just over €30 billion per month in purchases. To do more requires either raising the PSPP limits (e.g. 34% or so would raise PSPP purchase flows to over €30 billion per month) and/or raising purchase flows across other programs which may raise a whole other set of complications in more limited markets.

China's state versions of purchasing managers' indices remained weak in July. The composite measure was basically flat at 53.1 (53 prior) as the manufacturing PMI inches up to 49.7 (49.4 prior) but the non-manufacturing PMI fell to 53.7 from 54.2. So manufacturing remains in contraction while principally services sector activity slowed a bit.

The A\$ is leading the pack among crosses to the USD this morning despite soft inflation. Australian headline CPI increased to 1.6% y/y (1.3% prior, 1.5% consensus) but the core measures slipped on average. Trimmed mean CPI was stable at 1.6% y/y but weighted median CPI fell to 1.2% from an upwardly revised 1.4%. On balance, as chart 3 depicts, Australian core inflation is making no progress toward the RBA's 2–3% inflation target range.

Mexico's economy barely avoided a technical recession in Q2. GDP was up by 0.1% q/q (-0.2% consensus) after contracting by 0.2% in Q1. That still leaves the two quarter moving average for GDP growth at its weakest in six years. The economy has stalled out with rising pressure upon Banxico to ease, including a plea to such effect from AMLO.

Brazil's central bank is expected to cut the Selic rate by 25bps to 6.25% at 5pmET. Two out of 44 forecasters predict a hold while 24 expect a ¼ point cut and 19 expect a half point cut. Slipping inflation has returned toward the lower end of the central bank's 3–6% target range, thereby unshackling the central bank to address weak growth.

UNITED STATES

It's Fed day! Thank heavens we don't have to do this again until September 18th!! **The statement arrives at 2pmET and Chair Powell's press conference is at 2:30pmET.** Full expectations are provided in the Fed preview within the US section of the Global Week Ahead ([here](#)). In a nutshell, a 25bps cut with data dependent guidance is expected. If the markets are looking for Powell to say "Yep, I'm gonna cut four times between now and the end of 2020" or anything close to such affirmative guidance then I think that's pretty naïve. Watch the risk of dissenters for the first time under Powell no matter what the Fed does. The Fed may wind up balance sheet unwinding earlier than expected, but the gains are so trivial relative to market pricing and relative to what it would mean to shut down unwinding about two months earlier than would otherwise be expected as to be largely inconsequential. Please see the week ahead discussion for more on policy options toward controlling short-term market rates

That being said, an additional matter worth broaching is whether the Fed is being pushed into easing by the ECB through the currency given ECB expectations in response to weak growth and inflation. I don't buy that notwithstanding pieces like [this](#) one for WSJ subscribers and Vice Chair Clarida's speech on the impact of external shocks on past Fed actions back in March ([here](#)).

First, what has always bugged me is the degree of circular logic. The argument is that the Fed has to ease because if it doesn't then weaker foreign growth will come home to roost in the US via a stronger dollar. Fed easing would offset this 'currency war' mechanism. If the Fed robs the ECB of a weaker euro, however, then the Eurozone arguably gets no growth assist from easing given its greater degree of openness and reliance upon trade and hence greater degree of potential response to a softer currency. US exporters get softer growth prospects into the Eurozone. Either way, the US imports softer Eurozone growth, but with much less effect given the much greater dominance of the US domestic economy.

More important, however, is a series of arguments that spell out how today is different from the EZ and China devaluation episodes that Clarida emphasizes. I think that seriously misjudges the differences this time around.

Thus, the second point is that **the argument ignores moral hazard issues with Trump that are fundamentally different this time compared to prior foreign shocks.** Trump's damage to the global economy is part of why European growth is so soft including the spillover effect of weakened Chinese growth and its impact upon Eurozone exporters!! Ease, and Trump will go harder after foreign trading partners and turn more protectionist. Trump's trade policies need a security blanket that the Fed risks giving to him. Trump wasn't a consideration in 2012 and 2015 during the Eurozone and China challenges and so the Fed didn't have to be concerned about emboldening protectionist US policies that could further damage global growth. What Clarida is missing, in my opinion, is the definite risk that the Fed amplifies US protectionism by applying the same playbook it has used during past external shocks. Doing so could well have rates and protectionism feeding off of one another on a slippery downward slope.

Third is that during the Eurozone debt crisis and China's devaluation when external risks also influenced the US economy, the US had significant slack. During the EZ crisis, the output gap was pushing -3%. During the China devaluation, the US output gap was still around -1% using the CBO's estimates. **Today the US economy is in excess aggregate demand. Growth remains above potential thanks to the domestic economy. Why ease under such conditions?**

Fourth, **the Eurozone is not in an existential crisis this time**, like Draghi's July 2012 'whatever it takes' moment. Clarida's parallels between today and to that time might be exaggerated.

Fifth is that there may be greater financial stability consequences to easing this time around. During the EZ crisis, the US S&P500 P/E multiple was under 15. During the Chinese devaluation, the US P/E was 18–19. It's just under 20 now. Pump, pump, pump....

Sixth is that the argument assumes that a lower Fed rate will soften the dollar. Markets moved toward pricing four cuts over 2019–20 by the Fed long before they moved on the ECB. Yet the broad dollar strengthened. The Fed can't control longer spreads to the same degree, like the 10s US-German spread.

Seventh may be the reliance upon the bond market as a recession signal this time around. I still think it's distorted. The credit curve is not inverted. Real fed funds is usually massively positive before recessions but is barely so now. Stylized fundamentals don't point to recessions. Debt ceiling constraints on issuance since March 1st, the ramping up of the Fed's Treasury holdings over the next few years following the changes in March, rising private demand for funding/matching and safe haven demand on trade risks, and the volatility around low global policy rates are also plausible explanations of lower longer term yields. Easing because the bond curve is inverted is a big play on the bond market being as reliable an indicator of recession risk as it has tended to be in the past and I'm a whole lot less sure of that this time around.

ADP payrolls probably won't get a whole lot of attention at 8:15amET given it's Fed day. It's worth keeping an eye on it for outlier movements that can be indicative of what to expect for Friday's nonfarm payrolls, but barring a big movement in either direction it will be faded given a normally spotty track record at predicting nonfarm private payrolls.

CANADA

Canada updates GDP for the month of May this morning (8:30amET). I've estimated 0.1% m/m growth which turns out to be consensus. The consensus range runs from 0% to 0.3% with a nearly even distribution of forecasters across all ticks within that range. One uncertainty is the extent to which strength in export volumes will be backed by gains in sector GDP for export intensive parts of the economy as opposed to such an export gain coming out of inventories. Other than that, besides manufacturing volumes, the rest of the economy was quite weak in May as retail and wholesale volumes fell, hours worked declined and housing starts fell. See the Canadian section of the Global Week Ahead for further discussion.

Fixed Income	Government Yield Curves (%):												Central Banks	
U.S. CANADA GERMANY JAPAN U.K. CANADA GERMANY JAPAN U.K.	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		
	1.83	1.85	1.82	1.83	1.84	1.81	2.05	2.06	2.04	2.57	2.58	2.57	Canada - BoC	1.75
	1.53	1.53	1.42	1.44	1.44	1.36	1.49	1.49	1.44	1.74	1.74	1.70	US - Fed	2.50
	-0.76	-0.76	-0.78	-0.69	-0.68	-0.69	-0.41	-0.40	-0.38	0.16	0.18	0.21	England - BoE	0.75
	-0.20	-0.21	-0.20	-0.24	-0.24	-0.23	-0.15	-0.15	-0.15	0.35	0.36	0.36		
	0.44	0.45	0.48	0.40	0.41	0.47	0.63	0.63	0.68	1.36	1.36	1.32		
	Spreads vs. U.S. (bps):													
	-31	-32	-40	-39	-40	-45	-56	-57	-60	-83	-84	-87	Euro zone - ECB	0.00
	-260	-260	-260	-252	-252	-250	-246	-246	-242	-241	-240	-236	Japan - BoJ	-0.10
-203	-205	-202	-207	-208	-204	-220	-221	-219	-222	-222	-221			
-139	-140	-134	-143	-143	-135	-142	-142	-137	-121	-123	-126			
Equities	Level					% change:					Mexico - Banxico <td>8.25</td>		8.25	
	Last	Change			1 Day	1-wk	1-mo	1-yr						
S&P/TSX	16466	-26.1			-0.2	-0.6	0.5	0.2	Australia - RBA					1.00
Dow 30	27198	-23.3			-0.1	-0.6	2.2	7.0	New Zealand - RBNZ					1.50
S&P 500	3013	-7.8			-0.3	0.3	2.4	7.0						
Nasdaq	8274	-19.7			-0.2	0.3	3.3	7.8						
DAX	12180	32.6			0.3	-2.7	-1.8	-4.9						
FTSE	7599	-48.0			-0.6	1.3	2.3	-1.9						
Nikkei	21522	-187.8			-0.9	-0.9	1.2	-4.6						
Hang Seng	27778	-368.8			-1.3	-2.6	-2.7	-2.8						
CAC	5520	8.9			0.2	-1.5	-0.3	0.2						
Commodities	Level					% change:								
WTI Crude	58.50	0.45			0.8	4.7	0.1	-14.9	England - BoE					Aug 01, 2019
Natural Gas	2.15	0.01			0.4	-3.3	-7.0	-22.9	Euro zone - ECB					Sep 12, 2019
Gold	1430.49	-0.40			-0.0	0.3	1.5	16.9	Japan - BoJ					Sep 19, 2019
Silver	16.46	0.07			0.4	0.2	8.1	6.2						
CRB Index	178.67	0.33			0.2	0.3	-1.3	-8.2						
Currencies	Level					% change:								
USDCAD	1.3151	0.0000			0.0	0.1	0.1	1.1	Mexico - Banxico					Aug 15, 2019
EURUSD	1.1149	-0.0006			-0.1	0.1	-1.2	-4.6	Australia - RBA					Aug 06, 2019
USDJPY	108.58	-0.0300			-0.0	0.4	0.1	-2.9	New Zealand - RBNZ					Aug 06, 2019
AUDUSD	0.6892	0.0020			0.3	-1.2	-1.1	-7.2						
GBPUSD	1.2171	0.0019			0.2	-2.5	-3.7	-7.3						
USDCHF	0.9900	-0.0004			-0.0	0.5	0.2	-0.0						

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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