ON DECK FOR FRIDAY, AUGUST 2

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	08/02	08:30	Merchandise Trade Balance (C$ bn)	Jun	-0.3	-0.3	0.8
US	08/02	08:30	Average Hourly Earnings (m/m)	Jul	0.2	0.2	0.2
US	08/02	08:30	Average Hourly Earnings (y/y)	Jul	3.1	3.2	3.1
US	08/02	08:30	Average Weekly Hours	Jul	--	34.4	34.4
US	08/02	08:30	Nonfarm Employment Report (000s m/r	Jul	175	170.0	224.0
US	08/02	08:30	Trade Balance (US$ bn)	Jun	-54	-54.5	-55.5
US	08/02	08:30	Unemployment Rate (%)	Jul	3.7	3.7	3.7
US	08/02	10:00	Factory Orders (m/m)	Jun	1.1	0.7	-0.7
US	08/02	10:00	U. of Michigan Consumer Sentiment	Jul F	--	98.5	98.4

KEY POINTS:

- **Tariffs sink stocks, drive safe havens higher**
- **China should just walk away…**
- **…and gamble on post-election outcomes**
- **…as the US refuses to drop post-agreement tariffs**
- **Why tariff risks to inflation are overdone…**
- **…shifting the focus to downside risks to US activity readings…**
- **…with a US manufacturing recession in reach**
- **Nonfarm: an upside could be faded…**
- **…while a downside surprise would reinforce sentiment**
- **Will Canadian exports reverse the prior gain?**
- **US trade, factory orders on tap**

INTERNATIONAL

Most of the focus to close out the trading week will be upon two considerations. First, the world is a considerably less safe place with Trump escalating trade tensions and pulling out of the 1987 Intermediate-Range Nuclear Forces Treaty with Russia this morning. China announced it will retaliate if the US goes ahead with a 10% tariff on the remaining US$300 billion of imports, but did not spell out how. One obvious way is to entirely walk away from the trade talks and hunker down and take your chances on the US election outcome, though it's not clear to me that some of the Democrats are much better options for trade peace. China would be justified in walking away because of the US insistence that tariffs will remain in place even after an agreement; this stunt was pulled by the US in the NAFTA talks and it took the better part of a year to get the steel and aluminum tariffs reversed. A point of unity, however, should be China's fentanyl trade and its impact upon both the US and Canada amidst longstanding concerns (e.g. here). In short, both parties can easily be accused of bargaining in bad faith. As a result of trade tensions, bonds are rallying, stocks are falling and currency safe havens like the USD, yen and Swiss franc are rallying. If China were to simply walk away, then the theory that Trump is trying to secure Fed rate cuts to boost markets would be offset by prolonged or worsened trade tensions making this approach a huge gamble into November 2020.

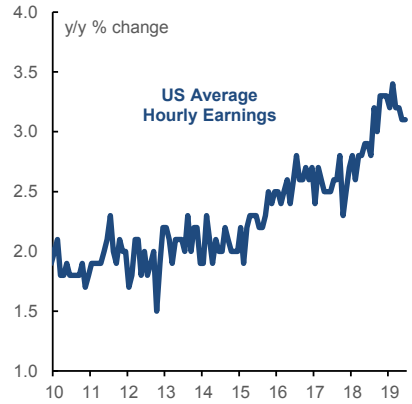
CONTACTS

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

Onshore & Offshore Yuan

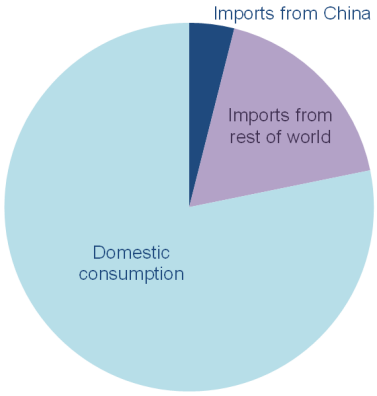
Source: Scotiabank Economics, Bloomberg.

Hourly Wages



Sources: Scotiabank Economics, Bureau of Labor Statistics.

US Consumption: Domestic vs. Import Sources



Sources: Scotiabank Economics, US Census Bureau.

Second will be nonfarm payrolls and wage growth (see below). I'm not sure nonfarm has the capacity to right this ship with an upside surprise versus doing more damage if it surprises lower. The big nonfarm risk might be the next report. Canada updates trade figures for June this morning and they are likely to reverse the distorted export gain that was posted the prior month. The US also updates trade figures.

The USD is mixed this morning in no small part due to the fact that other safe havens like the yen and Swiss franc are competing for the haven effect. The euro is also a touch stronger this morning. The USD is up against the yuan (chart 1), won, A$/NZ$, Mexican peso and CAD.

- Sovereign bond yields are under universal downward pressure. Germany's 10 year yield is at a record low of -0.5%. 10s across Europe are 1–8bps lower with Swiss 10s leading the way on both the magnitude of the rally and the depth of its yield (-0.89%). The US Treasury curve is rallying by 2–3bps. Canadas are rallying by about 1bp across maturities.

- Oil prices are up by over a buck in terms of both WTI and Brent but they are still lower on net over the past two days in response to the trade shock. Gold is slipping and is down by about US$7 this morning after a sizeable gain over the course of yesterday's session.

- European and Asian stocks caught up to yesterday afternoon's North American sell-off following Trump's tweets, but North American equities continue to decline. US equity futures are down by between ¼% and ¾% with the Nasdaq leading the decline. TSX futures are also down by just over ¼%. European cash markets are down by between 1% (Spain) and over 2½% (Euro Stoxx 50, Paris, Dax). Asian equities fell by generally between 1% (Seoul) and over 2% (HK, Nikkei).

UNITED STATES

Nonfarm payrolls and wages are due out at 8:30amET for the month of July. I've gone with stable wage growth of 3.1%, an unchanged unemployment rate of 3.7% and a payroll rise of 175k. If these estimates are close to the mark, then the incremental impact upon the Fed will be small. In light of negative trade policy developments, it's feasible that a significant upside surprise will be faded as a stale look-back in the face of forward-looking risks, while a downside surprise could reinforce bullish rate sentiment. Whether wage growth has already peaked on a sustained trend basis will also be informed by more evidence (chart 2).

If May's downside nonfarm surprise was influenced in part by the deterioration in US-China trade talks, then August payrolls a month from now may be the more vulnerable print since today's headlines are hitting on the path toward the nonfarm reference period for August.

The US also releases trade figures for June (8:30amET) and factory orders during June (10amET). The trade deficit is likely to be little changed given we already know the advance goods trade deficit was fairly stable in June but still trending around a record. Factory orders will probably follow the already reported gain in durable goods orders higher.

The inflation fears stemming from Trump's threatened 10%+ tariffs on the remaining US$300 billion of imports from China not already hit by tariffs are overdone for several reasons. What this means is that the focus should be more upon risks to activity readings than inflation insofar as the likelihood of a Fed rate cut in September is concerned.

- As chart 3 demonstrates, the share of total US consumer spending that goes toward imports from China is fairly small compared to the huge weight upon domestically sourced consumption of goods and services. Retail prices are more vulnerable than total core PCE inflation, especially in categories that are more heavily weighted toward imports from China.

- Yuan depreciation helps to offset some of this. Trump seriously needs a lesson on currency markets if he'll listen, however, in that claiming manipulation in cheap populist fashion is a stretch versus simply observing that this is what currencies do in response to external shocks. The yuan has depreciated by about 16% to the USD since 2014, about 11% since US-China trade tensions escalated around March of last year, and over 1% since just over a week ago.

- Transhipments are a way of circumventing the US tariffs by re-routing products made in China through other points of entry. Witness the rise in exports to the US from Taiwan as one example.

- Incidence effects mean that some of the tariff will be absorbed by margins in China, some will be absorbed by margins of importers, retailers and other businesses in the US, and some will be passed on to consumers. While Trump likes to emphasize tariff proceeds going to the US Treasury, he neglects the other incidence effects that lower Treasury receipts: higher cost of goods sold due to import tariffs gets written off against taxes, and to the extent to which economic activity from confidence damaging tariffs is lessened, tax receipts also get hit.
- Inflation expectations are not shifting higher. The 10 year TIPS breakeven, for example, shifted lower over yesterday into this morning by about 6–7bps.
- Nevertheless, US consumers may have slightly more willingness to pay higher prices now in the context of faster wage growth than, say, a couple of years ago.
- Advance ordering over the next month ahead of the holiday shopping season could lock-in prices for a time.

If the inflation shock is muted, the attention will shift to the damage to domestic activity readings. ISM-manufacturing fell to 51.2 yesterday and the global manufacturing sector is paying the price for US protectionism. Advance ordering ahead of the September 1st proposed tariff hike is likely to occur which could temporarily boost new orders including in preparation for the holiday shopping season. After that, ISM faces further downside risk.

CANADA

On the back of the probably transitory distortions that unexpectedly drove Canada into a trade surplus during May, **today's trade figures (8:30amET) are likely to witness a return to deficits in June.** Recall the transitory and idiosyncratic nature of the large 4.6% m/m jump in exports during May (here) that may well reverse course as such influences lose momentum. The figures will kick off tracking for June GDP and revisions will also be incorporated into estimates of trade's contribution to Q2 GDP growth.

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.	1.71	1.73	1.85	1.65	1.68	1.85	1.85	1.89	2.07	2.39	2.44	2.59
CANADA	1.47	1.47	1.47	1.36	1.37	1.40	1.38	1.40	1.46	1.61	1.63	1.72
GERMANY	-0.78	-0.78	-0.75	-0.73	-0.71	-0.67	-0.50	-0.45	-0.38	0.00	0.10	0.21
JAPAN	-0.20	-0.18	-0.21	-0.25	-0.22	-0.23	-0.16	-0.13	-0.15	0.33	0.37	0.36
U.K.	0.43	0.45	0.49	0.33	0.37	0.48	0.55	0.59	0.69	1.24	1.28	1.35
	Spreads vs. U.S. (bps):											
CANADA	-24	-26	-38	-30	-31	-45	-47	-50	-61	-78	-81	-87
GERMANY	-249	-251	-260	-239	-240	-252	-235	-234	-245	-239	-235	-238
JAPAN	-191	-192	-206	-190	-190	-208	-202	-202	-222	-206	-207	-223
U.K.	-128	-128	-136	-132	-132	-137	-130	-130	-138	-115	-116	-125

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	16377	-29.5	-0.2	-0.7	-0.6	-0.2
Dow 30	26583	-280.9	-1.0	-2.1	-0.8	5.0
S&P 500	2954	-26.8	-0.9	-1.7	-0.7	4.5
Nasdaq	8111	-64.3	-0.8	-1.5	0.0	4.0
DAX	11940	-313.0	-2.6	-3.9	-4.7	-4.8
FTSE	7452	-132.8	-1.8	-1.3	-1.4	-1.6
Nikkei	21087	-453.8	-2.1	-2.6	-3.1	-6.3
Hang Seng	26919	-647.1	-2.3	-5.2	-6.8	-2.9
CAC	5406	-151.3	-2.7	-3.6	-3.1	-1.0
Commodities	Level		% change:			
WTI Crude	55.38	1.43	2.7	-1.5	-1.5	-19.7
Natural Gas	2.17	-0.04	-1.6	-0.1	-3.3	-23.1
Gold	1437.84	-7.36	-0.5	1.3	1.4	19.0
Silver	16.00	-0.47	-2.9	-3.2	4.9	3.4
CRB Index	174.03	1.23	0.7	-1.8	-2.1	-9.7
Currencies	Level		% change:			
USDCAD	1.3223	0.0011	0.1	0.4	0.9	1.5
EURUSD	1.1103	0.0018	0.2	-0.2	-1.6	-4.2
USDJPY	106.83	-0.5100	-0.5	-1.7	-1.0	-4.3
AUDUSD	0.6789	-0.0011	-0.2	-1.8	-2.9	-7.8
GBPUSD	1.2127	-0.0001	-0.0	-2.1	-3.7	-6.8
USDCHF	0.9845	-0.0059	-0.6	-0.9	-0.2	-1.1

Central Banks	Current Rate
Canada - BoC	1.75
US - Fed	2.25
England - BoE	0.75
Euro zone - ECB	0.00
Japan - BoJ	-0.10
Mexico - Banxico	8.25
Australia - RBA	1.00
New Zealand - RBNZ	1.50

Next Meeting Date	
Canada - BoC	Sep 04, 2019
US - Fed	Sep 18, 2019
England - BoE	Sep 19, 2019
Euro zone - ECB	Sep 12, 2019
Japan - BoJ	Sep 19, 2019
Mexico - Banxico	Aug 15, 2019
Australia - RBA	Aug 06, 2019
New Zealand - RBNZ	Aug 06, 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.