August 6, 2019 @ *9:00 EST*

ON DECK FOR TUESDAY, AUGUST 6

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	08/06	10:00	JOLTS Job Openings (000s)	Jun	--	--	7323

KEY POINTS:

- **Markets enjoying a false sense of calm?**
- **PBOC temporarily halts yuan's slide…**
- **…but its depreciation may well resume**
- **The US 'manipulator' charge is largely toothless…**
- **…ignores what a currency does when tariffs alter the terms of trade…**
- **…while Trump vastly underestimates China's ability to respond**
- **RBA holds as expected…**
- **…while a dovish bias reinforces cut pricing for later meetings**
- **German factory orders rebounded before mayhem ensued**
- **COPOM minutes reinforce BCB's easing bias**
- **Fed's Bullard on tap**
- **Canadian markets play catch up…**
- **…with BoC risks top of mind**
- **Global Week Ahead**

Please see the Global Week Ahead here. Key risks this week include:

- US-China trade tensions
- CBs: RBA, RBNZ, RBI, BoT, BSP, Peru
- CPI: China, Norway, Mexico…
- …Brazil, Colombia, Chile
- GDP: Japan, Indonesia, Philippines
- US ISM-services, PPI
- China exports
- German industry, exports
- UK GDP, other macro
- CDN jobs, housing
- CDN earnings
- US, CDN auctions

INTERNATIONAL

Markets are a touch calmer this morning as they wait for the next tweet to drop, but I wouldn't go anywhere nearly as far as to suggest that investor confidence has returned. Indeed, Trump has perhaps irreparably damaged investor and business confidence with the pain likely to be exhibited in intensified fashion through sentiment and activity readings over coming months in what could be a worse replay of the impact of the developments in May and June. Consumer confidence is also likely to be damaged in response to the stock market volatility and as seasonal market influences await in Q4 on the path to the holiday

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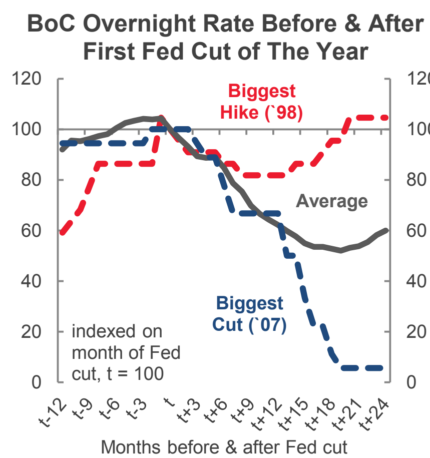


Sources: Scotiabank Economics, Federal Reserve, Bank of Canada.

shopping season in what could be a replay of last year. **Escalating trade tensions, Brexit concerns and seasonal dollar demand that raises hedging costs into dollar assets offer plenty of safe haven appeal over H2.**

The People's Bank of China set the daily reference rate for the yuan-dollar exchange rate at 6.9683 and hence back below the 7 threshold it had depreciated past yesterday, while draining liquidity from the offshore market in Hong Kong in a complementary move. The move was taken constructively as it was stronger than anticipated and thus served as a clearer sign that the currency won't be allowed to go into freefall in the near term. That's positive, at least for now, in three respects. First, it **stems some of the concern that China's savers will rush to the exits** from the banking system to convert into dollars and drive destabilizing capital flight with China attempting to thwart such efforts. Second, it **mitigates some concern toward knock-on currency debasement fears and capital flight risk from other EMs** seeking to compete with the weaker yuan. Third it suggests at least a **near-term calming of US-China trade tensions** following developments since Friday when Trump announced a 10%+ tariff rate on the remaining US$300 billion of Chinese imports and then labelled China a currency manipulator.

The latter charge is laughable in terms of basic economics; the US assertion is that since China did not intervene against where the market would have taken the currency on Monday, it was manipulating it lower. The nominal yuan-dollar exchange rate has depreciated by about 12% since March 2018 which is what it should have done as tariffs altered the terms of trade with the US (the ratio of export to import prices). It's an external shock that a managed flexible currency would respond to by depreciating. Besides, after causing the global financial crisis, the US has gone through a decade of manipulating every financial market market through Fed policy while bailing out multiple US industries through taxpayer assistance. Hence, it is galling to America's trading partners that it should see fit to accuse someone else of manipulating markets when quite frankly the US set the gold standard for market manipulation.

While the market developments cited below are adding stability today, the trade developments, yuan reactions and possible PBOC actions are probably anything but over.

- US equity futures are up by about 1% on average across the exchanges after falling by about three times that amount yesterday. Since the high on July 26th, the S&P500 is down about 5½% if this morning's futures rally sticks into the cash market, and back at levels set on June 6th. TSX futures are dropped by about 2% as Canada returns from holiday to catch up. European cash markets range from flat (London) to up as much as about ¾% in Paris. Asian equities generally followed western markets lower again overnight.

- The VIX index of equity market volatility is a little lower this morning after hitting the highest level since early January off of the volatility driven by the Trump trade toward the end of last year.

- US Treasury yields are up by 3–5bps in a bear steepener move. Canadian yields are plunging by about 7–9bps in a catch-up post-holiday move. As markets intensify Fed rate cut bets, chart 1 is on their mind in that it shows that usually the BoC follows the Fed's easing moves. Yields on gilts are up by 1–2bps through to 10s. EGB yields are lower by 1–4bps in 10s with the German 10 year at a record low of -0.54% and 10 year JGBs at -0.19% which is toward the BoJ's outer limit on the 0% target +/-20bps.

- Oil prices are flat)WTI) to higher by 25 cents (Brent). Gold is up US$2 this morning and about US$185 since the end of May on US real rate developments.

- The USD is mixed, as it appreciates to the yen, euro and Euro-related, and CAD crosses while depreciating against the A$/ pound sterling, and several other crosses. Bear mind we're not far from the seasonal up-turn in demand for dollar funding that has tended to occur in Q4 and that can be destabilizing to global financial markets.

In addition to the yuan fixing, **the PBOC also skipped open market operations in terms of the mixture of repo, medium-term lending facility and targeted medium term lending facility operations** that are frequently monitored as a gauge of what the central bank thinks about market liquidity and where it wishes to guide market rates. That said, the 7-day repo rate has already dropped by 45bps since the end of July, partly signaling anticipation of rate cuts and reversal of special factors. Repo rates have been volatile in the wake of the surge in demand for liquidity around corporate tax season that the PBOC attempted to meet through added liquidity, but the more recent driver has been trade tensions.

German factory orders rebounded before US-China mayhem ensued. Orders were up by 2.5% m/m in June, but this just continues the volatile pattern as the prior 2.0% drop was reversed. All of the jump was in capital goods orders (+3.7%) with consumer goods slipping again. Foreign orders rose 5% (-3.9% prior) as the domestic order book fell by 1%. The order book has been stabilizing around fairly low levels over recent months. The intensified trade tensions are likely to drive orders lower going forward.

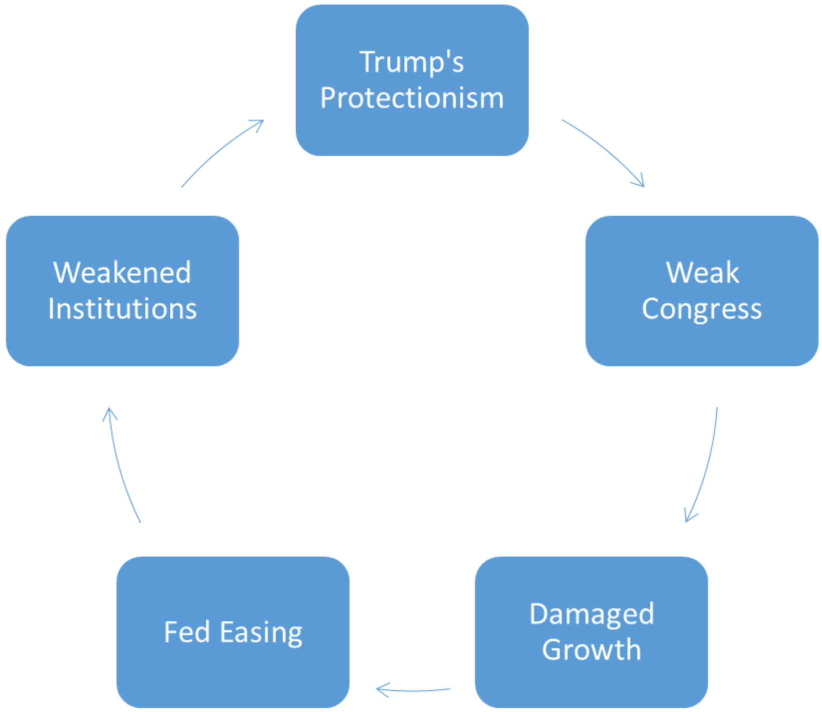
The Reserve Bank of Australia left its cash rate target unchanged at 1% overnight as universally expected. Governor Lowe will provide semi-annual testimony to Parliament on Friday including updated forecast. The statement (here) noted what markets already expect by way of a dovish bias: "The Board will continue to monitor developments in the labour market closely and ease monetary policy further if needed to support sustainable growth in the economy and the achievement of the inflation target over time." OIS markets have about 50–50 odds of a cut on September 3rd, rising to about three-in-four chances by October 1st and almost fully priced for the November and December meetings.

COPOM minutes to the July 30th–31st meeting reinforced the dovish bias by Brazil's central bank that resulted in a 50bps cut to its Selic target rate. Recall that the accompanying statement referenced how inflation prospects "should permit additional adjustment of the degree of stimulus." The minutes stated that the inflation outlook is conducive to further easing.

St. Louis Fed President Bullard (voting 2019) speaks on the US economy at noon today. His level of dovishness is likely to increase in the wake of recent events. Governor Brainard and KC President George (voting 2019, dissenter) simply noted yesterday that they are monitoring developments. I'd like to hear him comment on how a dovish Fed is enabling Trump's protectionism since Trump's moves against China began to happen less than twenty-four hours after the Fed cut rates and Chair Powell revealed his book, so to speak, but saying calmer trade tensions lean against a series of rate cuts. Chart 2 is still my favourite way of depicting the intertwined nature of US trade tensions and monetary policy.

The move to designate China a currency manipulator is purely symbolic. The IMF is unlikely to go anywhere with it. The door it would open is, in any event, of little consequence other than providing a political speaking point for Trump. Sanctions could be applied against China including through procurement programs down the road and more aggressive tariff actions could use the status for cover that might fool some I suppose. Further trade aggression by the US administration would continue to underestimate China's multi-faceted tool kit for retaliation that goes well beyond more limited room for retaliation on tariff rates. China's President-for-life Xi Jinping and China's uniparty state can weather political and economic storms far longer than the US that is gripped by elections every two years including Presidential elections every four years with the next one fifteen months away. Among the options are the following:

- entirely walk away from trade talks and shift toward full-on contingency plans, thus thoroughly removing Trump's argument China needs a deal more than the US and is begging for one.
- gradually devalue the yuan further alongside stricter capital controls and tightened action against tactics to evade them like fake invoicing.
- reintroduce tariffs on US autos that it suspended in June as a peace move.
- cripple a good portion of the global tech business by flexing its muscle further on access to rare earths.
- turn its back on purchases of US aircraft in favour of alternatives like Airbus.
- substitute away from demand for US crude oil.
- discourage travel groups from going to the US.
- discourage students from going to the US.
- discouraging deals with US firms.
- develop and publish an "unreliable entities" list that would be negative to firms seeking business with China.
- Launch negative p/r and protests against US companies in China. Engage in brand shaming, protests and boycotts.
- Intensify inspections and harassment of US firms in China.
- Geopolitical moves could include continuing to back away from pressuring North Korea, take more direct action to assert its dubious claims to sovereignty in the South China Sea, drop all cooperation toward restricting fentanyl exports, sponsor US election interference, and raise or indirectly sponsor cyberattacks.



Fixed Income — Government Yield Curves (%):

	2-YEAR Last	2-YEAR 1-day	2-YEAR 1-wk	5-YEAR Last	5-YEAR 1-day	5-YEAR 1-wk	10-YEAR Last	10-YEAR 1-day	10-YEAR 1-wk	30-YEAR Last	30-YEAR 1-day	30-YEAR 1-wk
U.S.	1.60	1.58	1.85	1.55	1.52	1.84	1.75	1.71	2.06	2.30	2.25	2.58
CANADA	1.38	1.46	1.53	1.26	1.35	1.44	1.29	1.37	1.49	1.54	1.61	1.74
GERMANY	-0.81	-0.81	-0.76	-0.77	-0.76	-0.68	-0.53	-0.52	-0.40	-0.03	-0.01	0.18
JAPAN	-0.22	-0.21	-0.21	-0.27	-0.27	-0.24	-0.18	-0.19	-0.15	0.31	0.29	0.36
U.K.	0.45	0.44	0.45	0.34	0.32	0.41	0.53	0.51	0.63	1.21	1.19	1.36

Spreads vs. U.S. (bps):

	2-YEAR Last	2-YEAR 1-day	2-YEAR 1-wk	5-YEAR Last	5-YEAR 1-day	5-YEAR 1-wk	10-YEAR Last	10-YEAR 1-day	10-YEAR 1-wk	30-YEAR Last	30-YEAR 1-day	30-YEAR 1-wk
CANADA	-22	-12	-32	-30	-17	-40	-47	-34	-57	-76	-64	-84
GERMANY	-241	-239	-260	-232	-227	-252	-228	-223	-246	-233	-227	-240
JAPAN	-182	-179	-205	-182	-179	-208	-193	-190	-221	-199	-197	-222
U.K.	-115	-114	-140	-121	-120	-143	-122	-120	-142	-110	-106	-123

Equities	Level: Last	Level: Change	% change: 1 Day	1-wk	1-mo	1-yr
S&P/TSX	16272	-105.4	-0.6	-1.6	-1.6	-0.9
Dow 30	25718	-767.3	-2.9	-5.5	-4.5	0.8
S&P 500	2845	-87.3	-3.0	-5.8	-4.9	-0.2
Nasdaq	7726	-278.0	-3.5	-6.8	-5.3	-1.7
DAX	11702	43.9	0.4	-3.7	-6.9	-7.1
FTSE	7224	0.2	0.0	-5.5	-4.4	-5.7
Nikkei	20585	-135.0	-0.7	-5.2	-5.3	-8.5
Hang Seng	25976	-175.1	-0.7	-7.7	-9.7	-6.6
CAC	5279	37.1	0.7	-4.2	-5.6	-3.6

Commodities	Level		% change:			
WTI Crude	54.75	0.06	0.1	-5.7	-4.8	-20.7
Natural Gas	2.11	0.04	1.7	-1.5	-12.9	-26.4
Gold	1467.76	3.98	0.3	2.6	4.9	21.6
Silver	16.49	0.29	1.8	0.6	8.4	7.3
CRB Index	171.82	0.33	0.2	-3.7	-5.0	-11.4

Currencies	Level		% change:			
USDCAD	1.3231	0.0027	0.2	0.6	1.0	1.7
EURUSD	1.1183	-0.0020	-0.2	0.3	-0.3	-3.2
USDJPY	106.41	0.4600	0.4	-2.0	-2.1	-4.5
AUDUSD	0.6785	0.0029	0.4	-1.3	-2.7	-8.1
GBPUSD	1.2170	0.0027	0.2	0.1	-2.8	-6.0
USDCHF	0.9765	0.0030	0.3	-1.4	-1.8	-2.1

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.