

ON DECK FOR WEDNESDAY, OCTOBER 16

| Country | Date | Time | Indicator | Period | BNS | Consensus | Latest |
|---------|-------|-------|--|--------|------|-----------|--------|
| US | 10/16 | 07:00 | MBA Mortgage Applications (w/w) | Oct 11 | -- | -- | 5.2 |
| CA | 10/16 | 08:30 | Core CPI - Common (y/y) | Sep | -- | 1.8 | 1.8 |
| CA | 10/16 | 08:30 | Core CPI - Median (y/y) | Sep | -- | 2.2 | 2.1 |
| CA | 10/16 | 08:30 | Core CPI - Trim (y/y) | Sep | -- | 2.1 | 2.1 |
| CA | 10/16 | 08:30 | CPI, All items (m/m) | Sep | -0.1 | -0.2 | -0.1 |
| CA | 10/16 | 08:30 | CPI, All items (y/y) | Sep | 2.2 | 2.1 | 1.9 |
| CA | 10/16 | 08:30 | CPI, All items (index) | Sep | -- | 136.6 | 136.8 |
| CA | 10/16 | 08:30 | International Securities Transactions (C\$ bn) | Aug | -- | -- | -1.2 |
| US | 10/16 | 08:30 | Retail Sales (m/m) | Sep | 0.2 | 0.3 | 0.4 |
| US | 10/16 | 08:30 | Retail Sales ex. Autos (m/m) | Sep | 0.2 | 0.2 | 0.0 |
| US | 10/16 | 10:00 | Business Inventories (m/m) | Aug | -- | 0.2 | 0.4 |
| US | 10/16 | 10:00 | NAHB Housing Market Index | Oct | -- | 68.0 | 68.0 |
| US | 10/16 | 10:45 | Fed's Evans on Economy and Monetary Policy | | | | |
| US | 10/16 | 14:00 | U.S. Federal Reserve Releases Beige Book | | | | |
| US | 10/16 | 16:00 | Total Net TIC Flows (US\$ bn) | Aug | -- | -- | 43.8 |
| US | 10/16 | 16:00 | Net Long-term TIC Flows (US\$ bn) | Aug | -- | -- | 84.3 |

KEY POINTS:

- Markets playing it safe across asset classes
- CDN CPI: the BoC would likely look through this kind of expected rise
- Should the BoC import the Fed's inflation dialogue...
- ...and put more emphasis upon symmetry and expectations?
- China's threatened HK retaliation hangs over trade negotiations
- Are US retail sales still going strong?
- US bank earnings continue to beat
- UK core CPI climbs as expected
- Beige Book, Fed-speak on tap
- Bank of Korea cuts despite dissenters
- Canada auctions 2s today

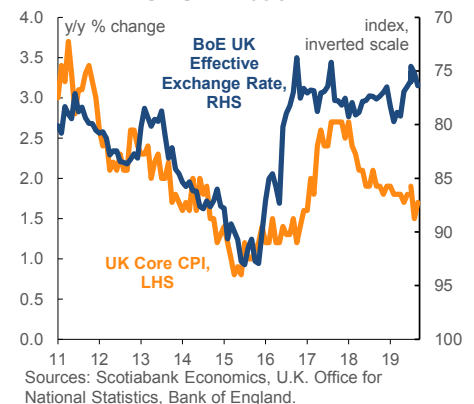
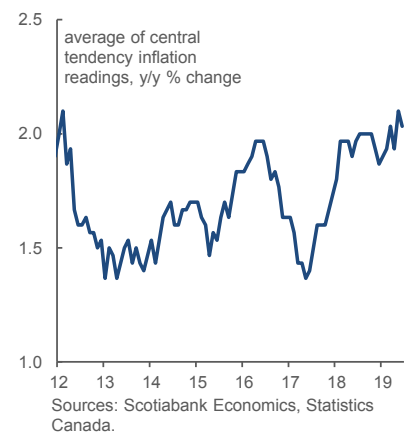
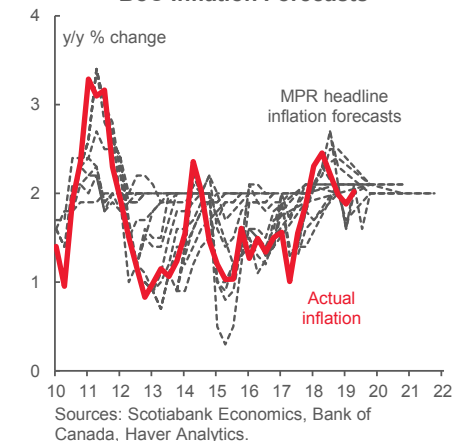
INTERNATIONAL

Markets are playing it somewhat safe across asset classes this morning. China's threatened retaliation against the US if Congress passes a bill requiring annual review of Hong Kong's special trading status is one factor hanging over markets particularly in terms of the scope for disrupting trade negotiations. Volatile Brexit headlines continue and will rise to a crescendo through to Saturday and likely beyond. US retail sales, earnings and Fed-speak are all on tap. Canada updates CPI and should have a Fed-style debate on symmetry and expectations (see below). UK inflation and an expected cut by the Bank of Korea round things out.

- US equity futures are down about ¼%. TSX futures are flat. European cash markets are little changed on average after Asia generally rallied outside of mainland China.

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**Currency Effects
On UK Inflation**

Canadian Core Inflation

BoC Inflation Forecasts


- Safe haven currencies are somewhat in vogue. The USD is appreciating against sterling, the A\$/NZ\$, Scandies and several Asian crosses. The Euro, CAD, yen and Swiss franc are holding their own.
- US Treasury yields are dropping by 2–3bps across the curve from 2s through 10s. Canada's curve is rallying by less and with a 2s auction today (12pmET). Gilts are performing similarly to Treasuries but pulled in some of the rally earlier this morning on volatile Brexit headlines. Italy's curve is bull flattening.
- Oil prices are flat (Brent) to up a touch (WTI) with gold dead flat.

UK CPI inflation was in the ballpark of expectations and sterling shook it off. Core CPI climbed to 1.7% y/y as expected (1.5% prior). That reversed some of the prior month's decline but keeps it below the Bank of England's 2% CPI target and still on a general downward trend since the start of 2018. That slide has been less driven by the currency than in the past (chart 1). BoE Governor Carney speaks at 9amET and 6pmET today.

In any event, gilts and sterling both shook off the inflation figures with the greater focus upon never-ending Brexit negotiations. Negotiations between the Johnson administration and the Democratic Unionist Party appeared to have broken down as the DUP at first reportedly objected to the concessions that PM Johnson offered Brussels on how to treat the Irish border. Early this morning, however, the FT indicated that an anonymous government official said the DUP supports the customs proposals but the main point of contention is now over giving Northern Ireland a mechanism to achieve democratic consent over any special arrangements ([here](#)). The gilts curve is rallying by 3–5bps and sterling is among the weakest crosses to the USD. The two main deadlines ahead are the European Council meeting in Brussels tomorrow and Friday and Saturday's Benn Act deadline. It's too late for a deal to be presented to the leaders' summit and guidance has indicated there will be no negotiations during it. Ireland's PM Varadkar speculated there might be time for another summit before the end of October. Saturday requires the Johnson government to request an extension to the October 31st deadline until January 31st 2020 upon failing to approve a deal in a parliamentary vote.

The Bank of Korea cut its 7-day repo rate by 25bps to 1.25% as almost universally anticipated by markets and economists. Two cuts, with the other being in July, have brought the policy rate down by 50bps and thus reversed the policy tightening that occurred from November 2017 to one year later. The won depreciated a little after the suite of communications. Nevertheless, two dissenters out of seven board members offset at least some of Governor Lee's openness to further easing if needed as expressed in the statement ([here](#)) and his press conference.

CANADA

Canada updates CPI for September this morning (8:30amET). I've gone with -0.1% m/m and +2.2% y/y for headline. That would be a jump from 1.9% y/y in August. Consensus sits at -0.2% m/m NSA and +2.1%. The median sample of economists is skewed by one 1.6% reading and two 2% readings but I can't get it to stay down around such lows. Why?

1. A shift in year-ago base effects is a major reason. September 2018 saw an unusually large m/m seasonally unadjusted drop of -0.4% that then rebounded the next month. This year-ago transitory dip in September puts transitory upward pressure on September 2019 CPI. **I think the BoC would look through this reason behind a pop higher in inflation especially given the transitory nature of the shift in year-ago base effects.**
2. September is usually a fairly benign month for seasonal influences so m/m NSA CPI is likely to be roughly flat.
3. I tilted the September m/m NSA CPI down -0.1% on gasoline prices since they fell a little with about a 3 1/2% weight. It's a close call though since it winds up on the dividing line between a 0% m/m weighted gas price contribution and -0.1%.
4. Mortgage interest costs are likely still accelerating.

On 'core' Canadian CPI defined as the average of the three measures, I'd guesstimate unchanged at 2.0% y/y.

What's more interesting than the precise number, however, is that Canada is not having the same expectations debate as the US, so far. Perhaps it should. The policy aim is to keep inflation at the 2% midpoint of the 1–3% inflation control target range, but consider the following points.

1. Canadian core inflation has fallen shy of the 2% mid-point of the target range 81 months out of the 90 months since the start of 2012 on a monthly y/y basis (chart 2). That's despite the BoC's constant forecasts drawn from quarterly MPRs predicting an imminent return to the 2% target (chart 3). Thus, 90% of the time over the past almost eight years, the BoC has not hit its inflation target using core as the operational guide despite its forecasts it would do so. Should they really be content with only having just hit their target in very recent times? This is where other perspectives are also of added value below.

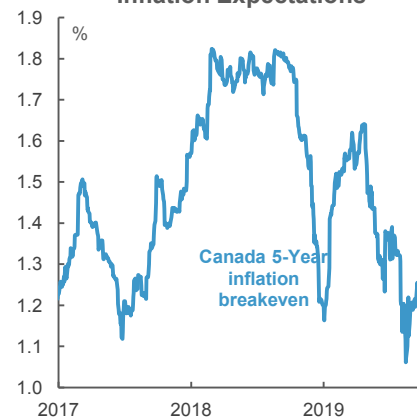
2. Obviously if they're not even hitting 2% then the BoC hasn't worked the range to prove symmetry versus treating 2% as a ceiling. They have only exceeded the 2.0% target in four months since 2012 and only by 0.1% or less each time. Thus, they've been in the upper half of their range only about 4% of the time;

3. Market expectations (distorted as they are) are well below target with all RRB break evens around 1 1/4%. See chart 4.

4. And the last BOS survey showed 64% of businesses expect CPI to land in the lower half of the BoC's 1–3% target range which may imply they think the BoC's target is a ceiling and not a range with an implied expected inflation target that is sub-2%(chart 5). Markets and businesses are alike in that neither source of expectations thinks 2% is the mid-point versus the nosebleed marker for the BoC.

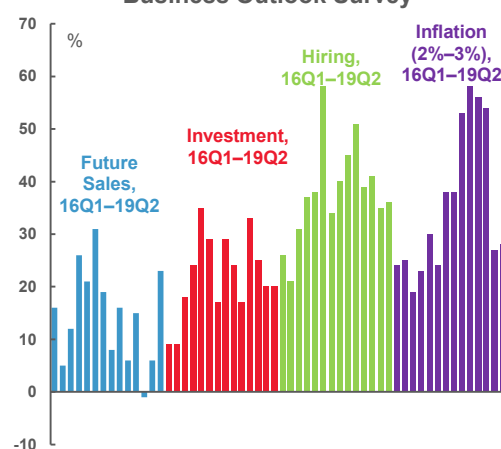
Amidst all of the back patting at the BoC with respect to the success of the inflation targeting regime and getting 'close to home', there is arguably at least as strong a case for them to attempt an overshoot or tolerate one as there is for the Fed. There are risks to such an approach, just as there are risks to persistently undershooting what you say is your target, but it's a debate worth having and yet we are not doing so on this side of the border. In fact, there is an argument for how tightly integrated economies and capital markets between the US and Canada may see the Fed's increasing emphasis upon symmetry to its 2% target serving to drag the BoC down the same path.

Markets Backing Off Canadian Inflation Expectations



Sources: Scotiabank Economics, Bloomberg.

Business Outlook Survey



Sources: Scotiabank Economics, Bank of Canada.

UNITED STATES

Earnings releases, retail sales and Fed speak heat things up in US markets today.

US retail sales (8:30amET) will further inform the extent to which consumer spending is performing well against other risks in the economy. With two-thirds of the quarter in the bag and barring revisions, retail sales are tracking 5.9% higher in q/q SA terms in Q3 pending September figures. Modest gains are expected for headline and core sales ex-autos and ex-autos & gas. My estimates are 0.2% m/m for both headline sales and sales ex-autos.

Fourteen S&P 500 firms are on the docket for earnings releases today with an even split in pre- and post-market reports. Bank earnings generally continue to beat expectations. Bank of America posted adjusted EPS of US\$0.75 (consensus 68 cents). BoNYM beat with EPSE of US\$1.07 (\$0.99 consensus). Comerica beat with EPS of US\$1.93 (\$1.9 consensus). PNC Financial also beat with EPS of US\$2.94 (\$2.8 consensus). The after-market will bring out Netflix, Kinder Morgan and IBM.

Fed-speak will include release of the Beige Book (2pmET) and three speakers. Governor Brainard speaks at 3pmET but at a crypto currency conference. Chicago's Evans (voting) speaks on the economy and policy (9amET) and Dallas President Kaplan (alternate) speaks at 1pmET. The biggest Fed-speak event of the week may be Vice Chair Clarida's talk on Friday.

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