

ON DECK FOR WEDNESDAY, NOVEMBER 20

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	11/20	07:00	MBA Mortgage Applications (w/w)	NOV 15	--	--	-0.1
CA	11/20	08:30	Core CPI - Common (y/y)	Oct	--	1.9	1.9
CA	11/20	08:30	Core CPI - Median (y/y)	Oct	--	2.2	2.2
CA	11/20	08:30	Core CPI - Trim (y/y)	Oct	--	2.1	2.1
CA	11/20	08:30	CPI, All items (m/m)	Oct	0.4	0.3	-0.4
CA	11/20	08:30	CPI, All items (y/y)	Oct	2.0	1.9	1.9
CA	11/20	08:30	CPI, All items (index)	Oct	--	136.6	136.2
US	11/20	14:00	FOMC Meeting Minutes				

KEY POINTS:

- Global asset classes in risk-off mode on trade worries
- China threatens retaliation if US HK bill becomes law...
- ...but its hope that Congress will back off is a pipedream...
- ...as the measures are almost certain to become law...
- ...even though they may backfire on Congress in the longer run
- PBOC cuts as expected
- Japanese export drop was driven by more than trade wars
- FOMC minutes may be faded and stale
- Canadian CPI upside?
- Is the BoC misreading the curve and stability issues?
- US oil inventories on tap

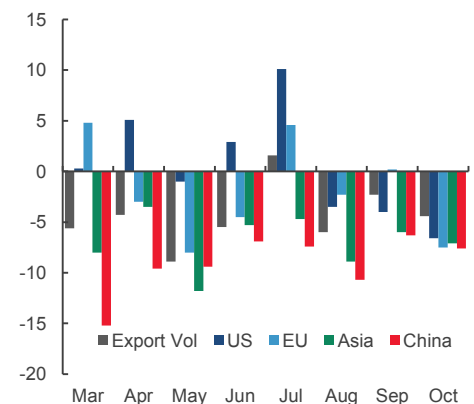
INTERNATIONAL

US-China tensions are inducing a risk off tone across global markets. This was to be expected as the US Congress advances its Hong Kong bill and China predictably lashed out against this overnight (see below). The PBOC cut its new benchmark rate as expected overnight (see below) and that had little effect on Chinese bonds that had already priced prior actions. Japanese trade got hammered overnight but not just because of trade wars (see below). On tap for today we should see markets largely looking through FOMC minutes (see below). Canadian inflation will be updated and could face marginal headline upside (see below) while nevertheless sticking around target. I further explain an argument for easing that is more oriented toward removing a made-in-Canada kink at the front end of the yield curve.

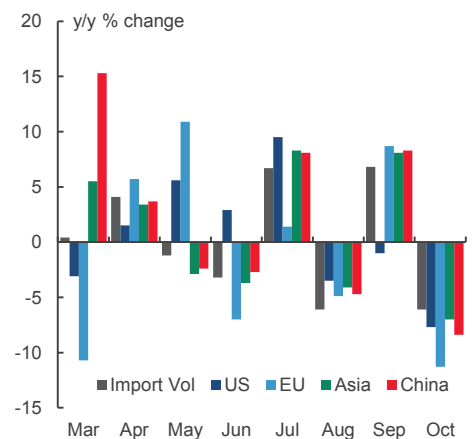
- Equities are somewhat on the run this morning. US and Canadian equity futures are down ¼%. European cash markets are down by between around ¼% (Paris, Milan) and 1% (London). Asian stocks fell by between around ¾% (Tokyo, HK, mainland China) and 1 ¼% (Seoul).
- The USD is broadly stronger against most crosses except the yen that is also picking up safe haven flows. The weakest crosses are the more trade and commodity dependent ones like the Scandies, Mexican peso, rand, C\$ and A\$.

CONTACTS

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

Japan's Merchandise Export Volumes


Sources: Scotiabank Economics, Bloomberg.

Japan's Merchandise Import Volumes


Sources: Scotiabank Economics, Bloomberg.

- Sovereign bond yields are under downward pressure everywhere and through bull flattener moves in 2s10s. 10 year yields are down by about 3–4bps across the US, Canada, UK, core Eurozone and Japan.
- Oil prices are a tad higher but we'll see how that evolves after 10:30amET US crude inventories. We'll also see if the drop in Western Canada Select continues following yesterday's decline that was induced by the CN strike as explained in yesterday morning's note.

China's Foreign Ministry predictably lashed out at the US Congress overnight. After the Senate unanimously passed the Hong Kong Human Rights and Democracy Act last evening, China issued [this](#) statement. Cutting through the verbiage, the salient point is that China threatened retaliation if steps are not taken to prevent the Act from becoming law.

That seems to be a pipedream that isn't competently reading the political winds in Congress. Both the House and Senate passed separate versions of the bill with unanimous support across both Democrats and Republicans. I had one eye on a bit of the live streamed Senate proceedings at work c/o Bloomberg last evening and the strident message was wrapped in a somewhat self-indulgent patriotic defence of human rights and democracies. It might be nice to see such unanimity across Congress aimed at its own President maybe on topics like dreamers, treatment of families at the Mexican border, trade policy, etc. In any event, **timing next steps is uncertain** as the different House and Senate bills will have to be reconciled into one Act either in conference or separately and then passed again before it goes to Trump's desk. At that point, a unanimous Congress would give Trump no veto powers.

I'm also a bit mixed on the merits of the Act to be honest, but only because subjecting Hong Kong's special status to an annual review by the dysfunctional US Congress could permanently raise uncertainty toward investment in Hong Kong and ultimately backfire. It's like the failed quest of the US administration to have a sunset clause in the USMCA/CUSMA deal that would subject it to periodic reviews or termination. Exposing fundamental business decisions to the vagaries of the dysfunctional US political cycle and Congressional elections every couple of years may not serve anyone's interests over time. Today's it's all mom and apple pie stuff to stand in solidarity with protesters; tomorrow could see Congress blamed for harming Hong Kong's longer run economic interests. Meh. Who thinks longer term these days...

Don't be misled by headlines about PBOC easing. They shifted to a new benchmark policy rate that gets set on the 20th of each month. That rate is the one-year Loan Prime Rate. It was cut by 5bps in keeping with the first cut on November 5th to the one year lending facility rate and the second cut to the seven day repo rate on November 18th. Those cuts were designed to stem the sell-off in China's bond market that began in September and they generally worked. Cutting the new benchmark policy rate that is now on a fixed schedule is like whipping the horse after it crossed the finish line. The move was well anticipated and had little effect on Chinese bond prices.

Japanese exports fared worse than guesstimated overnight but that could have been partly due to temporary factors. October's exports fell by 9.2% y/y (consensus -7.5%). Imports tumbled by more (-14.8% y/y, -15.2% consensus). In volume terms, all regions were weak (see charts) as exports to the US, EU, the rest of Asia and specifically China all fell by around 7% y/y. Ditto for import volumes that fell by 11% y/y from the EU and 7–8% from each other major region. Beyond the effects of the US-China trade war, two other factors likely played a role and at least one of them is probably transitory. Typhoon Hagibis formed on October 4th and lasted until October 20th after hitting Japan on October 12th. This storm disrupted shipping activity in the region. Second, the spat between South Korea and Japan contributed to some of the weakness.

UNITED STATES

Minutes to the FOMC's two day meeting that culminated in the statement and press conference on October 30th are due out this afternoon (2pmET). I think the Fed has set the narrative so expect **few surprises** if any. Canned buzz phrases are likely to be repeated, such as how monetary policy is not on a preset course, that 'material' shocks to the outlook are required to merit additional easing, that the US economy is solid, but the Fed is ready to act if needed.

Discussions around short-term market dysfunction into year-end and conditionality around trade using the frequency of citation approach to reflect consensus are the things to possibly watch for. There may be further discussion of policy options to address short-term funding market pressures such as a standing repo facility, but the Fed seems quite content with its current approach to have the NY Fed pump repo flows and snap up T-bills in order to inject cash into the system. We'll see come year-end pressures.

Differences of opinion toward monetary policy directions may be stale; George and Rosengren dissented against the cut at that meeting but the bias now being communicated should please all of the FOMC with the doves not asking for more. Chair Powell's JEC testimony on November 13th and 14th further laid down the narrative in ways that make the minutes stale.

CANADA

Canada updates CPI for October this morning (8:30amET). Clearly the world's fate hangs on it. Or not. I'm a tick above consensus at 2.0% y/y and 0.4% m/m NSA because I think special factors that depressed the month-ago NSA rate will probably shake out. They include Ontario's record tuition cut, the shift to cheaper winter grade gasoline, and cell phone/internet price wars that took longer to arrive in Canada than in the US. That's in addition to assumptions on base effects, typical seasonal influences on the month-ago NSA and gas prices. My guess is that the average of the three core measures is glued to the 2.0–2.1% y/y zone but the usual problem is that it's impossible to estimate or model very short run swings in average core since by definition you have to know the volatile tails to weed out and we just don't have that information until game day.

While yesterday's speech on financial stability matters by BoC SDG Wilkins ([here](#)) made a number of good observations, there is one issue that I think merits further consideration. The bottom line to what follows is that the BoC is too fussed about the pass-through argument of rate cuts into mortgages and housing markets and there is a stronger case for cutting the policy rate.

At the heart of the matter is that I think the BoC is misreading the rates curve, its drivers and its implications for stability including differences between now and 2015 while assuming too much by way of the degree of control they have further up the curve. It's completely different than in 2015.

In early 2015, the BoC engineered both a fixed and variable rate lift to housing. Back then, the 5 year GoC yield was well above the overnight rate by about half a point before they started to cut (chart 3). Cutting twice swamped the boat in terms of mortgage demand because it unexpectedly pushed the whole term structure lower and flattened the curve. That was a made-in-Canada development and it positioned the BoC as the culprit to lighting up housing imbalances. Later on this effect would be magnified as the child benefits cash infusion onto T4s could be leveraged up. The effect was to transfer future housing and consumption demand to the past and explains part of why conditions have since softened.

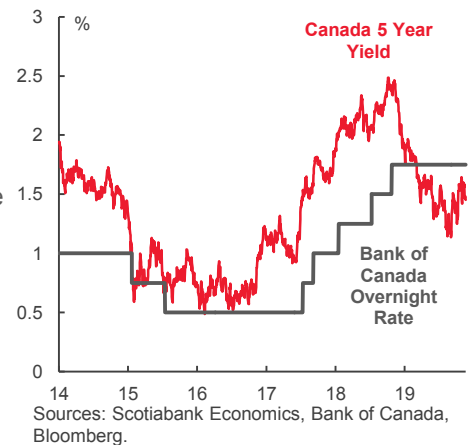
Today, however, the overnight rate is above the fiver by about 35bps (the peak was 62bps in early September). So the horse has left the barn on easier mortgage conditions that drove a flood of fixed rate demand over recent months. There is arguably nothing the BoC can do about that so they should turn their rates focus to what they can control which is the very front end. Some of the term structure further out may be priced on BoC easing, but much of it is externally driven through carry considerations in a reach for yield environment driven by must-invest mandates and on the back of what the Fed & ECB have done. A key driver of the 5 year GoC yield's decline over the past year was the movement in bunds and Ts. The reach for yield appetite drove fixed mortgage rates lower.

So at this point, cutting a couple of times probably wouldn't induce a flood of variable rate demand.

Cutting, however, would remove a kink at the front-end that makes it over a quarter point more expensive to borrow for working capital requirements than 2–5 year periods. That creates an inequity in that it penalizes businesses in a relative sense. Cutting would ease corporate financial conditions a bit and soften the Canadian dollar in the face of serious risks to global trade and Canada's standing within this picture. The slope of the curve is distorting financing conditions and that is a very made-in-Canada phenomenon this time around.

So if their concern is a repeat of 2015 when they cut and inflamed housing then it is different because of a) B20 and other macroprudential rules which they've acknowledged, and b) because of the curve that is more driven by external carry motives which they have not acknowledged.

Bank of Canada Overnight Rate & 5 Year Bond Yield



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	Canada - BoC	1.75	
	1.57	1.60	1.64	1.59	1.62	1.69	1.74	1.78	1.89	2.21	2.25	2.37			
	1.50	1.51	1.57	1.42	1.45	1.54	1.41	1.44	1.55	1.55	1.58	1.70	US - Fed	1.75	
	-0.64	-0.63	-0.62	-0.60	-0.58	-0.56	-0.37	-0.34	-0.30	0.15	0.19	0.22			
	-0.21	-0.20	-0.19	-0.22	-0.20	-0.17	-0.11	-0.08	-0.04	0.42	0.45	0.47	England - BoE	0.75	
	0.54	0.56	0.56	0.50	0.52	0.53	0.69	0.73	0.76	1.24	1.27	1.27			
	Spreads vs. U.S. (bps):												Euro zone - ECB	0.00	
	-8	-8	-7	-17	-17	-15	-34	-34	-34	-67	-67	-67			
	-221	-223	-226	-219	-220	-225	-211	-212	-219	-206	-206	-214			Japan - BoJ
-178	-180	-183	-180	-182	-187	-185	-186	-193	-180	-180	-189				
-103	-104	-108	-109	-110	-116	-105	-105	-113	-98	-98	-109	Mexico - Banxico	7.50		
Level						% change:								Australia - RBA	0.75
Last	Change					1 Day	1-wk	1-mo	1-yr	New Zealand - RBNZ	1.00				
S&P/TSX	17011	-13.7					-0.1	0.6	3.9			14.3			
Dow 30	27934	-102.2					-0.4	0.9	4.3			14.2			
S&P 500	3120	-1.9					-0.1	0.9	4.5			18.1			
Nasdaq	8571	20.7					0.2	1.0	5.9			24.1			
DAX	13128	-93.4					-0.7	-0.8	3.9			18.6			
FTSE	7248	-75.6					-1.0	-1.4	1.4			4.3			
Nikkei	23149	-144.1					-0.6	-0.7	2.9			7.3			
Hang Seng	26890	-204.2					-0.8	1.2	0.6			4.1			
CAC	5887	-22.1					-0.4	-0.3	4.4			19.5			
Level						% change:						Next Meeting Date			
WTI Crude	55.50	0.29					0.5	-2.8	3.2	3.9	Canada - BoC	Dec 04, 2019			
Natural Gas	2.56	0.05					2.2	-1.4	10.5	-43.3	US - Fed	Dec 11, 2019			
Gold	1473.64	1.19					0.1	0.7	-1.1	20.6	England - BoE	Dec 19, 2019			
Silver	17.13	0.33					2.0	2.3	-1.8	19.3	Euro zone - ECB	Dec 12, 2019			
CRB Index	177.70	0.54					0.3	-1.5	1.1	-3.3	Japan - BoJ	Dec 19, 2019			
Level						% change:						Mexico - Banxico	Dec 19, 2019		
USDCAD	1.3303	0.0035					0.3	0.4	1.6	-0.0					
EURUSD	1.1058	-0.0020					-0.2	0.5	-0.8	-2.7					
USDJPY	108.47	-0.0700					-0.1	-0.3	-0.1	-3.8					
AUDUSD	0.6812	-0.0016					-0.2	-0.4	-0.8	-5.6					
GBPUSD	1.2902	-0.0024					-0.2	0.4	-0.4	0.9					
USDCHF	0.9925	0.0020					0.2	0.2	0.7	-0.3	Australia - RBA	Dec 02, 2019			
												New Zealand - RBNZ	Feb 11, 2020		

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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