

ON DECK FOR WEDNESDAY, OCTOBER 27

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	10-27	07:00	MBA Mortgage Applications (w/w)	Oct 22	--	--	-6.3
US	10-27	08:30	Durable Goods Orders (m/m)	Sep P	-1.5	-1.1	1.8
US	10-27	08:30	Durable Goods Orders ex. Trans. (m/m)	Sep P	0.3	0.4	0.3
US	10-27	08:30	Wholesale Inventories (m/m)	Sep P	--	1.0	1.2
CA	10-27	10:00	BoC Interest Rate Announcement (%)	Oct 27	0.25	0.25	0.25
CA	10-27	11:00	Bank of Canada's Macklem Holds Press Conference				

KEY POINTS:

- Dollar bloc front-ends cheapen on inflation, CB drivers
- BoC's Macklem to walk a fine dovish-hawkish line
- What the BoC will do to potential GDP growth may be key
- Macklem is unlikely to do a 180-degree turn after his last three appearances
- The credibility of the RBA's 3-yr yield target...
- ...faced a bigger challenge post-CPI...
- ...with spillover effects to the RBNZ
- Brazil's central bank expected to accelerate hiking
- US core durable goods orders: the positive streak continues

The biggest movers across sovereign curves include abrupt sell offs in both Australian and New Zealand bonds after Australian CPI surprised higher. Otherwise, the gilts and EGB curves are bull flattening with 10 year yields down 5–7bps. The US Treasury curve is bear flattening with the 2-year yield up a touch and the longer end down by ~2–3bps. Stocks are slightly in the red as Asian exchanges generally sold off overnight, European cash markets are down by ¼% to ½% and N.A. futures are little changed. The broad dollar is softening with negative risk sentiment buoying the yen and Swiss franc while CAD is slightly softer ahead of the BoC.

The credibility of the RBA's yield target and its overall dovish policy stance is being increasingly challenged. The RBA's 3-year government bond yield target of 0.1% was put under more strain overnight on the heels of an upside surprise to Australian inflation readings. The 3-year yield soared by 16bps to 92bps. Both trimmed mean CPI and weighted median CPI increased by 0.7% q/q non-annualized (consensus 0.5%) which pushed both measures higher to 2.1% y/y and into the RBA's 2–3% inflation target range for headline that itself eased back to 3% y/y (3.1% consensus, 3.8% prior). The annualized and seasonally adjusted q/q rates of both central tendency inflation gauges are at the upper end of the 2–3% target range (chart 1) which leans against any temptation to dismiss it as driven by year-over-year base effects. New Zealand's curve also sharply bear flattened with the two-year yield up 14bps.

Brazil's CB is expected to sharply hike the Selic rate with inflation having crossed 10% y/y (5:30pmET).

CANADA

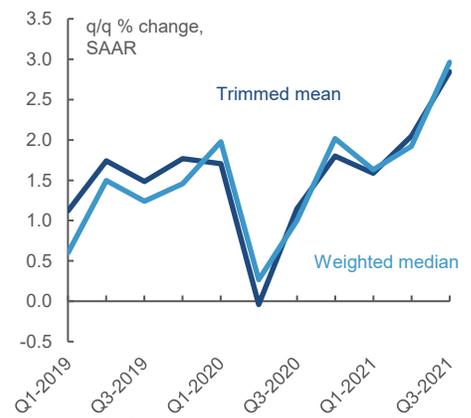
The Bank of Canada will be the main focus for many of us from about the 10amET–12pmET window. Please see yesterday afternoon's [note](#), the week ahead preview [here](#) and last Thursday's deck and client conference call replay for more.

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Chart 1

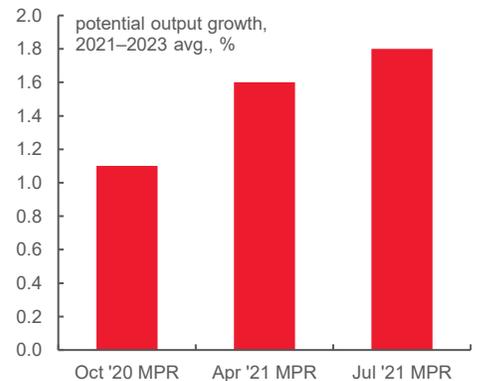
Australian Core CPI Measures



Sources: Scotiabank Economics, Australian Bureau of Statistics.

Chart 2

Did the BoC Upward Drift on Potential Overshoot?



Sources: Scotiabank Economics, Bank of Canada MPRs.

Macklem has to walk a fine dovish-hawkish line today. Briefly, I expect them to shift to the reinvestment phase, repeat that they won't hike until slack is gone, reinforce that "considerable excess capacity" still exists after softer than expected '21Q1–Q3 GDP including forecast misses and negative GDP revisions with the gap poised to close later than markets have priced lift-off, and to raise nearer term inflation forecasts.

I won't repeat the whole underlying rationale, but one key issue is that there is a lot of uncertainty around what they may do with potential GDP growth within the output gap framework. Recall that the BoC has been steadily revising it higher from a low of 1.1% y/y on average over 2021–23 in the October 2020 MPR to 1.6% in the April 2021 MPR to 1.8% in the July 2021 MPR (chart 2). They have backed off their worst estimates for damage to the economy's productive potential compared to when they were assuming more labour market scarring and more damage to investment confidence closer to the depths of the pandemic. The evidence on material scarring is now weak at best, given the jobs recovery, while investment is ripping with equipment spending up 25% q/q SAAR in Q2 and another double digit gain being tracked in Q3. I doubt they back pedal on that upward trend in estimates of potential GDP growth over a three year time frame, or at least not by enough to shut spare capacity sooner than 2022H2. Growth has disappointed over 2021Q1–3 and some of the drivers of potential GDP have not worsened.

Relative risk-reward to what is priced around the April MPR meeting merits leaning against nearer term hike pricing. Messaging around inflation (transitory, more persistent bottleneck and supply chain issues etc) is unlikely to change at this time. Ditto around wages. In fact, I think much of the final two paragraphs in the September statement will remain intact except for the final two sentences that are likely to embrace language around the shift to the reinvestment phase.

Macklem's comments in a media roundtable on October 14th also reinforce the tone of his two prior appearances that were recapped [here](#). The lack of a published transcript and public appearance make us more reliant upon the media's varied reporting than was the case during his two prior events, but here is the broad tone of what he said less than two weeks ago.

- For one, he emphasized his view that inflation is being narrowly driven by one-offs, supply disruptions and transitory factors that will persist for longer than expected but that will still fade. That's highly debatable in my view, but it's the Governor's view at this point and perhaps significantly influenced by his efforts to manage market expectations.
- He also indicated that there continues to be significant slack in the overall economy and the job market. On the job market, he said that recovering lost jobs "is an important milestone, but it's not the destination." That reinforces the scattershot approach across a suite of labour market readings in the recent discussion paper by BoC staffers. Here too the signal is debateable as I don't think it should be the role of monetary policy to aim for perfection across all labour market outcomes and this could just be hyperbole anyway.
- On growth, Macklem said "We're still expecting a good rebound. It may be not quite as fast as we had" in the July MPR. That's a clear (and expected) signal that a more muted rebound after negative GDP revisions especially in Q2 will reveal wider than expected slack in the economy. The BoC has to sharply downgrade its Q3 GDP growth expectations.
- His remarks on potential GDP growth were interesting in that he didn't take sides on the direction of potential changes, saying that there are upside and downside arguments to further revisions which implies no great conviction toward how alterations may affect the BoC's beloved output gap framework.
- So, if inflation is a headfake, there is still slack in the economy and job markets, and the BoC (and others...) doesn't really know what potential GDP growth will be then hike as soon as 6 months from here? Not likely imo when the Governor has said all along he won't hike until spare capacity has been exhausted.

UNITED STATES

Durable goods orders fell by less than expected in September (-0.4% m/m, consensus -1.1%). Core orders ex-air and defence were up by 0.8% m/m (consensus 0.5%) which surpassed expectations even after considering a minor downward revision to the prior gain (0.5% instead of 0.6%). That makes this the seventh straight monthly gain in the core orders book. The order book for core equipment is reflecting the pressures on the supply chain to address capacity issues including bottlenecks.

Fixed Income	Government Yield Curves (%):									Central Banks						
	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				
U.S.	0.48	0.44	0.39	1.17	1.18	1.17	1.58	1.61	1.66	2.01	2.04	2.14	Canada - BoC	0.25		
CANADA	0.89	0.87	0.80	1.35	1.34	1.30	1.61	1.63	1.64	1.98	2.01	2.04	US - Fed	0.25		
GERMANY	-0.66	-0.66	-0.66	-0.48	-0.44	-0.47	-0.17	-0.12	-0.13	0.19	0.24	0.29	England - BoE	0.10		
JAPAN	-0.08	-0.10	-0.10	-0.06	-0.05	-0.05	0.10	0.11	0.09	0.70	0.71	0.70				
U.K.	0.60	0.63	0.68	0.76	0.80	0.82	1.04	1.11	1.15	1.23	1.32	1.39				
Spreads vs. U.S. (bps):																
	Level			Level			Level			Level						
CANADA	41	42	41	17	16	13	2	2	-2	-3	-3	-10	Euro zone - ECB	0.00		
GERMANY	-115	-110	-105	-165	-162	-164	-175	-173	-178	-182	-180	-184	Japan - BoJ	-0.10		
JAPAN	-57	-54	-49	-123	-123	-122	-148	-150	-156	-131	-134	-143				
U.K.	12	18	30	-41	-38	-35	-55	-50	-51	-78	-73	-75	Mexico - Banxico	4.75		
Equities	Level						% change:									
	Last			Change			1 Day		1-wk		1-mo		1-yr			
S&P/TSX	21173			-111.4			-0.5		-0.1		3.5		32.2		Australia - RBA	0.10
Dow 30	35757			15.7			0.0		0.8		2.5		30.2			
S&P 500	4575			8.3			0.2		1.2		3.0		34.9		New Zealand - RBNZ	0.50
Nasdaq	15236			9.0			0.1		0.7		1.8		33.3			
DAX	15696			-61.5			-0.4		1.1		0.8		30.1			
FTSE	7271			-6.4			-0.1		0.7		2.9		26.9			
Nikkei	29098			-7.8			-0.0		-0.5		-3.6		24.3		Canada - BoC	Oct 27, 2021
Hang Seng	25629			-409.5			-1.6		-1.9		4.6		3.7		US - Fed	Nov 03, 2021
CAC	6745			-21.9			-0.3		0.6		1.4		42.6			
Commodities	Level						% change:									
	Level			Level			1 Day		1-wk		1-mo		1-yr			
WTI Crude	83.81			-0.84			-1.0		-0.1		11.1		111.8		England - BoE	Nov 04, 2021
Natural Gas	6.01			0.13			2.1		16.2		5.3		99.0		Euro zone - ECB	Oct 28, 2021
Gold	1793.89			0.98			0.1		0.7		2.5		-6.0			
Silver	24.32			-0.06			-0.2		2.5		7.3		0.1		Japan - BoJ	Oct 28, 2021
CRB Index	241.18			0.60			0.2		0.3		5.7		60.0			
Currencies	Level						% change:									
	Level			Level			1 Day		1-wk		1-mo		1-yr			
USDCAD	1.2406			0.0016			0.1		0.7		-1.8		-5.9		Mexico - Banxico	Nov 11, 2021
EURUSD	1.1622			0.0026			0.2		-0.2		-0.6		-1.5			
USDJPY	113.72			-0.4400			-0.4		-0.5		2.5		8.9		Australia - RBA	Nov 01, 2021
AUDUSD	0.7517			0.0016			0.2		0.0		3.2		5.4			
GBPUSD	1.3748			-0.0019			-0.1		-0.5		0.4		5.4		New Zealand - RBNZ	Nov 23, 2021
USDCHF	0.9180			-0.0021			-0.2		-0.1		-0.8		1.0			

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