Scotiabank

GLOBAL ECONOMICS

DAILY POINTS

July 26, 2022 @ 8:30 EST

Contributors

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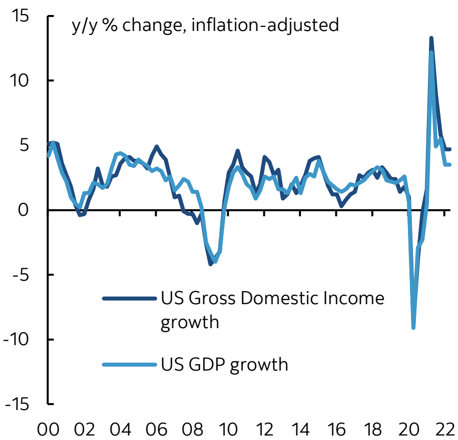
Chart 1

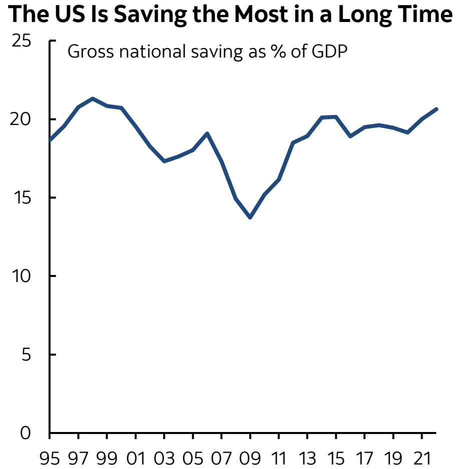
US GDI Versus GDP Growth



Sources: Scotiabank Economics, BEA.

Chart 2

The US Is Saving the Most in a Long Time



Sources: Scotiabank Economics, BEA, IMF.

On Deck for Tuesday, July 26

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
US	07-26	09:00	S&P/Case-Shiller Home Price Index (m/m)	May	--	1.5	1.8
US	07-26	09:00	S&P/Case-Shiller Home Price Index (y/y)	May	--	20.6	21.2
US	07-26	10:00	Consumer Confidence Index	Jul	98.0	96.9	98.7
US	07-26	10:00	New Home Sales (000s a.r.)	Jun	670	661	696
US	07-26	10:00	Richmond Fed Manufacturing Index	Jul	--	-17.0	-11.0

KEY POINTS:

- **Earnings drive mild risk-off sentiment**
- **Focus on inflation expectations in US consumer confidence**
- **Won gains on SK GDP beat**
- **The FOMC's forward guidance is likely to be reserved tomorrow**
- **The (not so) great GDI-GDP caper…**
- **…and how Fed hawks overstate references to the US job market**
- **Pandemic hospitalizations across jurisdictions**

This morning's markets are in mild risk-off mode. N.A. equity futures are down by up to 0.4% with European cash markets mixed between ¾% declines in Germany and Italy versus a rise of over ½% in London. Sovereign yields are declining in mostly bull flattener fashion in the US, UK and across EGBs that are rallying by more than the Anglo-American markets. The dollar is stronger with the yen holding firm along with the won on datag. Oil prices are up by about $2.

Earnings are driving some of this after Walmart's disappointment in the after-market and ahead of mild earnings risk today with GM already missing. European markets are caught between finding the balance between that miscreant Vladimir Putin's lying and thoroughly untrustworthy ways versus how genuine the issues are with the Nord Stream turbines and hence whether sharply reducing pipeline capacity is a harbinger of worse things to come in Winter. The macro calendar only contains one market-sensitive gauge in the form of US consumer confidence.

The only overnight reading was South Korean Q2 GDP that surprised to the upside of expectations which drove the won to be the class leader this morning. GDP grew by 0.7% q/q non-annualized (0.4% consensus). Details were mixed, however, as manufacturing, utilities, finance and the primary sector all contracted while growth was led by wholesale/ retail, transport/storage, info/comm, education and cultural sectors.

Within US consumer confidence during July (10amET), watch the included measure for 1-year ahead inflation expectations after June's 8% reading hit the highest in the history of the series back to 1987. The measure could pull below 8% given the modest decline in gasoline prices so far this month and the correlations. That point illustrates that consumers' expectations are not formulated in any sophisticated manner by folks who don't understand inflation, how it's measured and where it may go in future as opposed to looking at this week's grocery and gasoline bills. Markets trade on it though, so meh, guess that means it must matter right? Hmph. US releases will also include new home sales during June that may soften in line with advance indicators like model home foot traffic (10amET), US repeat-sales home prices during May (9amET) and the Richmond Fed's manufacturing gauge for July (10amET).

US earnings risk continues with 36 S&P firms releasing today. GM missed with EPS of US$1.14 ($1.31 consensus), UPS beat ($3.29, $3.15 consensus) and so did GE (US$0.78, consensus $0.37) and McD's (US$2.55 versus $2.46). Tech earnings hit in the after-market including Alphabet (formerly Google) and Microsoft.

Canadian earnings will include CN in the after-market and note Statcan's advance reading on wholesale trade during June (+0.5% m/m nominal) with minimal implications for Friday's advance look at June GDP.

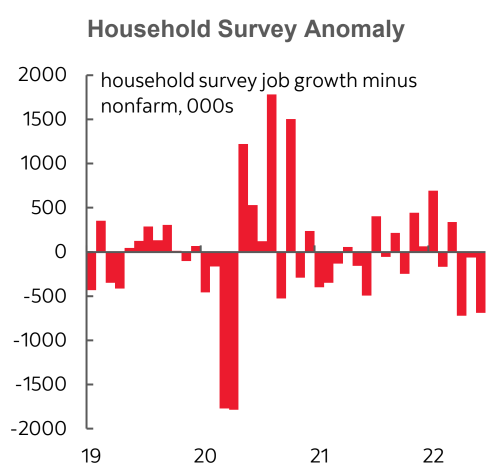
Tomorrow's FOMC statement and presser are likely to offer up a 75bps hike and sound less committal to the next meeting's move. We saw Powell use greater optionality in the June presser when he said they might hike 50 or 75 points in July following the blackout pivot. One reason for sounding even less committal this time is that the next meeting isn't until September 21st with only Jackson Hole in between and a lot can happen over this intervening period to make overly strong forward guidance today go off the rails by then. Further, if the Fed hikes 75 as expected tomorrow then the upper limit will be smack in the middle of the 2–3% neutral rate range that FOMC members estimate over a few pints and dart throwing. The closer they get toward restrictive territory—and they probably won't be there yet—the more data sensitive they are likely to become and by that I mean even more emphasis upon looking over their shoulders at what just happened in order to determine what they should do going forward!

Ahead of the Fed announcements tomorrow afternoon it may be worth considering arguments put forth by the most hawkish FOMC members. They posit that the economy is stronger than it appears because GDP understates growth this year whereas Gross Domestic Income (GDI) is a better gauge of strength, and that job growth is holding up well as a sign of resilience which suggests the economy can withstand further hikes. I don't really buy either point and have emphasized this in discussions with clients over recent weeks. I'd rather the FOMC sticks to talking about inflation as the prima facie argument for a hawkish bias and not muddy the waters with suspect arguments.

First, on GDP versus GDI, Fed hawks suggest that GDI is a more reliable gauge, and that GDP may be revised upward to meet GDI growth that has been stronger this year (chart 1). That's not really clear. In fact, it has the feel of a fabricated murder mystery absent a victim, weapon and perpetrator that might deserve a mischief charge or two. For one thing, it implies there have not been durable gaps post several rounds of revisions between the measures in the past when in fact the chart shows several such occurrences including other times when GDP has underperformed GDI like coming out of the GFC. Further, when GDP on an expenditure basis undershoots GDI such that economy wide spending is undershooting economy-wide income then it may be reflecting macro forces that are driving improvements in national saving and for sound reasons. The US gross national saving rate has risen of late and is just barely at its highest since the late 1990s (chart 2). This partly reflects a large recovery in US corporate profits from the low point at 2020Q2 to now, albeit amid modestly softer numbers this year, a narrowing of the US fiscal deficit from a peak of -16.8% of GDP in 2021Q1 to -4.3% in 2022Q2, and a narrower nominal trade deficit this year from the March peak of -US$108B to US$85.5 billion in May. The US personal saving rate has probably roughly normalized at about 5 ½% compared to the wild gyrations over 2020–21 when it soared on two separate occasions to peaks of 34% in April 2020 and 27% in March 2021 because of precautionary saving motives, partly because earlier shutdowns and aversion to mingling with sickies reduced opportunities to spend and partly due to initial responses to horde stimulus proceeds in the form of continued high cash and near-cash balances on household (and business) balance sheets. The point is that if income exceeds spending at the economy-wide level it shouldn't be automatically assumed that it's a problem with the GDP accounts notwithstanding the fact that they can indeed be heavily revised (in both directions!).

The hawks may also be exaggerating references to strengths in US job markets by pointing to continued gains in nonfarm payrolls. First, job growth today should not be relied upon as a gauge of how the economy will hold up to the full lagging effects of tightened monetary policy and financial conditions going forward. Second, most job readings not named nonfarm payrolls have been deteriorating. We see that in the household survey's spread to nonfarm payrolls (chart 3) as the household survey has registered declines in employment during two of the past three months including the latest. The household survey captures smaller businesses without payrolls that nonfarm doesn't and the household survey counts employed individuals versus nonfarm's job count which matters if there is a lot of labour churn going on because job switching during nonfarm's reference period can result in double counting of jobs whereas the household survey still only counts one employed individual. There are other issues between the two surveys, but the point is that nonfarm payrolls should not be exclusively relied upon to argue that the US job market can handle further hikes. In fact, that may be a bit of a disingenuous argument to some of us given that even a mildly sloped Phillips curve relationship probably requires higher unemployment in order to cool inflation alongside other drivers like durable improvements across supply chains versus nascent evidence of recent improvements.

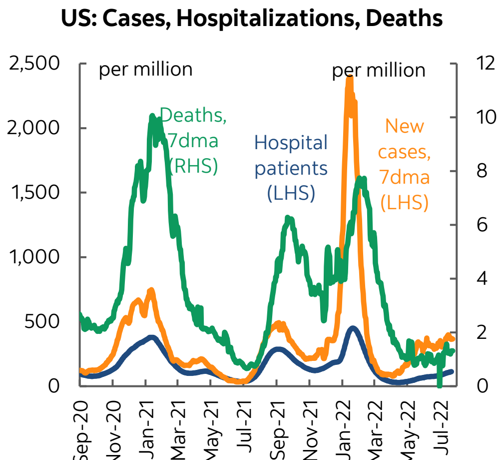
Chart 3



Sources: Scotiabank Economics, BLS.

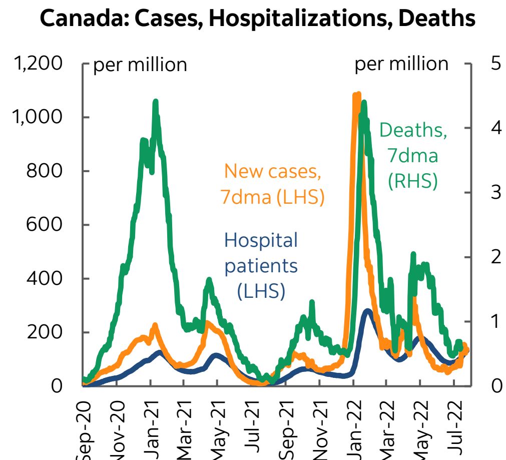
And for dessert (or by this point maybe a digestive aid! You pick), check out the charts on the next page (charts 4–8) that show more reliable gauges of the recent pandemic wave's effects. Don't waste any time looking at case numbers now, but the mild upward trends in hospitalizations require ongoing monitoring across multiple jurisdictions and particularly into the Fall and Winter (in the northern hemisphere at least).

Chart 4



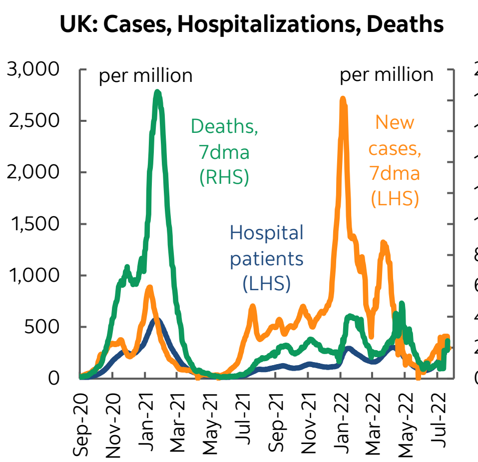
Sources: Scotiabank Economics, Our World in Data.

Chart 5



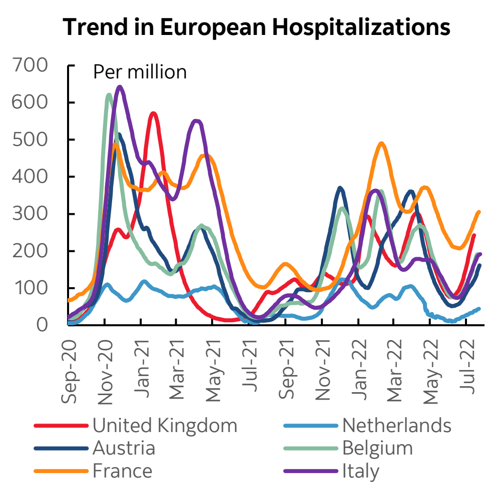
Sources: Scotiabank Economics, Our World in Data.

Chart 6



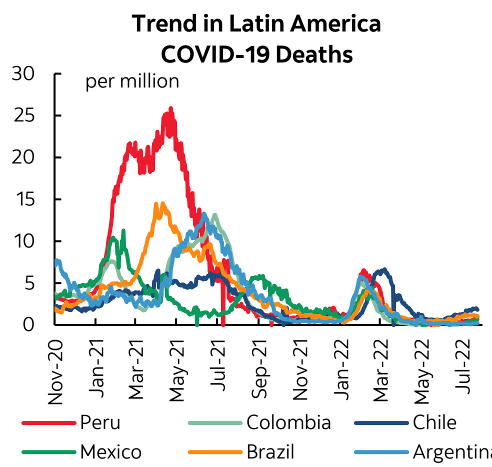
Sources: Scotiabank Economics, Our World in Data.

Chart 7



Sources: Scotiabank Economics, Our World in Data

Chart 8



Sources: Scotiabank Economics, Our World in Data.

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.	2.99	3.02	3.24	2.83	2.88	3.15	2.74	2.80	3.02	2.98	3.02	3.18
CANADA	3.07	3.10	3.29	2.81	2.88	3.12	2.79	2.86	3.08	2.80	2.85	3.03
GERMANY	0.34	0.41	0.64	0.66	0.76	1.02	0.92	1.02	1.28	1.20	1.28	1.47
JAPAN	-0.07	-0.08	-0.07	0.00	0.00	0.03	0.21	0.20	0.24	1.19	1.22	1.27
U.K.	1.81	1.83	2.04	1.66	1.69	1.91	1.90	1.94	2.18	2.47	2.49	2.69
	Spreads vs. U.S. (bps):											
CANADA	8	9	5	-2	-1	-3	5	6	6	-19	-17	-15
GERMANY	-265	-261	-260	-217	-213	-214	-182	-178	-175	-178	-174	-171
JAPAN	-306	-309	-331	-283	-288	-313	-253	-260	-278	-180	-180	-191
U.K.	-118	-119	-120	-117	-119	-125	-84	-86	-84	-51	-53	-49

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	19104	121.6	0.6	0.9	0.2	-5.3
Dow 30	31990	90.8	0.3	3.0	1.6	-9.0
S&P 500	3967	5.2	0.1	3.5	1.4	-10.3
Nasdaq	11783	-51.4	-0.4	3.7	1.5	-20.6
DAX	13122	-88.4	-0.7	-1.4	0.0	-16.0
FTSE	7349	43.2	0.6	0.7	2.0	4.6
Nikkei	27655	-44.0	-0.2	2.6	2.9	-1.1
Hang Seng	20906	342.9	1.7	1.2	-6.0	-16.7
CAC	6226	-11.3	-0.2	0.4	2.5	-5.4
Commodities	Level		% change:			
WTI Crude	98.55	1.85	1.9	-5.4	-8.4	37.0
Natural Gas	9.68	0.95	10.9	33.2	55.6	135.9
Gold	1717.03	-2.76	-0.2	0.3	-6.0	-4.5
Silver	18.75	-0.06	-0.3	-0.7	-10.1	-25.5
CRB Index	284.76	3.60	1.3	-0.3	-4.6	29.7
Currencies	Level		% change:			
USDCAD	1.2886	0.0040	0.3	0.1	0.1	2.7
EURUSD	1.0125	-0.0095	-0.9	-1.0	-4.3	-14.2
USDJPY	136.68	-0.0100	-0.0	-1.1	0.9	23.8
AUDUSD	0.6928	-0.0027	-0.4	0.4	0.0	-6.2
GBPUSD	1.1974	-0.0069	-0.6	-0.2	-2.4	-13.3
USDCHF	0.9655	0.0012	0.1	-0.3	1.0	5.4

Central Banks	
Current Rate	
Canada - BoC	2.50
US - Fed	1.75
England - BoE	1.25
Euro zone - ECB	0.50
Japan - BoJ	-0.10
Mexico - Banxico	7.75
Australia - RBA	1.35
New Zealand - RBNZ	2.50
Next Meeting Date	
Canada - BoC	Sep 07, 2022
US - Fed	Jul 27, 2022
England - BoE	Aug 04, 2022
Euro zone - ECB	Sep 08, 2022
Japan - BoJ	Sep 22, 2022
Mexico - Banxico	Aug 11, 2022
Australia - RBA	Aug 02, 2022
New Zealand - RBNZ	Aug 16, 2022