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GLOBAL ECONOMICS

DAILY POINTS

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Contributors

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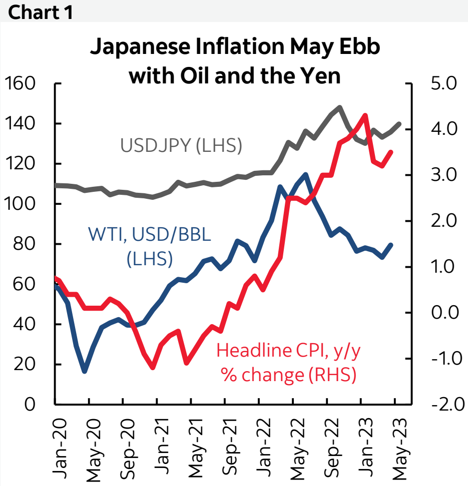
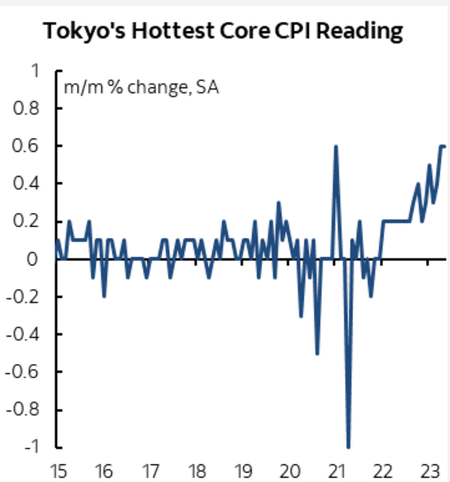
Chart 1



Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

On Deck for Friday, June 16

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	06-16	08:30	International Securities Transactions (C$ bn)	Apr	--	--	-19.1
CA	06-16	08:30	Wholesale Trade (m/m)	Apr	1.6	--	46.0
US	06-16	10:00	U. of Michigan Consumer Sentiment	Jun P	59.5	60.3	59.2

KEY POINTS:

- **Global markets digest ECB-speak, BoJ**
- **ECB officials lean toward multiple hikes**
- **BoJ stands pat…**
- **…but here are the guideposts to watch for signs of a pivot going forward**

Global asset classes are mixed to end the week amid light macro developments. N.A. equity futures are little changed, while European benchmarks are up by between ¼% and 1% perhaps in part lagging yesterday afternoon's S&P gains. US Treasuries, gilts and Canadas are slightly cheaper in bear flattener terms, while EGBs are a tad richer albeit volatile around ECB-speak. The dollar is flat on a DXY basis, with the most notable move being yen depreciation post-BoJ. There is practically no data risk (UofM pending, Canadian wholesale trade miss) amid a need to consider ECB- and Fed-speak that offer modest risk. I'll cover the BoJ decision below along with an empirical attempt at explaining the guideposts to monitor going forward.

A round of post-decision ECB-speak this morning generally leaned toward keeping hike options open beyond July with some of it keeping options open to possibly hike beyond September. That's consistent with my reading of yesterday's ECB communications and President Lagarde's press conference in that a) she reinforced the consensus set up for a July hike, and b) she said there was no discussion of a future pause or skip in their deliberations which is perhaps a signal on its own, and c) they raised their inflation forecasts to be above target throughout the entire horizon. That all leans against there just being 1–2 more hikes and then done, but we'll see. I can easily see a 4+-handled target rate.

Fed speakers start lining up today, but they offer low risk. Bullard already spoke earlier this morning, but I don't detect any comments of relevance to markets as he presented on optimal macroeconomic policies at a joint IMF-Norges Bank conference in Norway. Governor Waller spoke after Bullard at the same conference and on a four-person, 90-minute panel discussing 'challenges facing macroeconomy policy' of which there are a few! Waller sounded skeptical toward the argument that developments in US banking could add to credit tightening beyond the natural transmission mechanism of tighter monetary policy. Then Richmond Fed President Barkin (voting 2024) will speak on inflation shortly (9amET).

Data risk is very low with nothing out overnight and only US UofM consumer sentiment on tap this morning (10amET). UofM might get more attention than normal given nothing else to focus upon and if it sharply surprises.

BOJ DECISION AND WHAT TO WATCH FROM HERE

The BoJ left policy measures unchanged while offering cryptic clues that keep uncertainty at elevated levels toward policy actions over the second half of 2023. Each of the policy balance rate of -0.1% and the 10-year yield target of 0% +/- 50bps were left intact. Governor Ueda said that a "big shift" in the inflation view could merit a tighter stance which sets a high bar for the coming forecast changes at the July meeting to matter. He also made it clear that they don't feel compelled to set up any such moves in advance in favour of saying "It's inevitable that sometimes there's a certain element of surprise." The moves were widely expected, but there was clearly a tail in the market that was positioned for less dovishness. The yen weakened by about ½% to the USD and rose toward 141. The 10-year yield slipped just beneath 40bps. The Nikkei rallied by about 0.7%.

Is Ueda right? That's a tough call that time and data will inform along with the BoJ's future posture, but the arguments are more balanced than some of the diametrically opposing commentaries I've seen.

On the dovish side, the standard narrative is that Japan has seen many false starts to inflation since its property and market bubbles burst 3+ decades ago and been burned by premature actions from the BoJ in the past. Japanese inflation is also buoyed by some transitory drivers such as the ongoing lagging effects of last year's yen weakness and higher oil prices (chart 1). Japanese real wages also remain weak at least according to the hard data to date, and so this missing link is waiting for clearer evidence. Add to this uncertainty over the external environment.

BoJ Guideposts Drawn From Empirical Evidence

So, what's the evidence and when would we expect to see the air being cleared on the transitory versus longer-lived drivers of inflation? How could things turn out to be more dovish or more hawkish? I'm certainly distant from the BoJ but feel that there is still value to offering a framework of thinking that considers the evidence on the drivers of inflation.

BoJ research (example **here**) has estimated that a one standard deviation movement in the yen (roughly 4%) adds 0.1–0.2% to inflation over 2–8 quarters before subsiding. Over the March 2022 to October 2022 period, the yen depreciated by about 30% to the dollar. If the effects are linear then this would translate into between a ¾% to 1½% lift to headline inflation with the effects gradually working through the system in 2023 into 2024. The effects may not be linear (ie: each standard deviation move in the yen could carry different, possibly greater, effects upon inflation than the prior standard deviation move). The effects may also depend upon what was expected, the duration of the adjustment, and whether it's fair to take the adjustment over that six-month period in isolation of moves before and after.

BoJ research also says that a one standard deviation in oil prices of roughly 15% would add 0.1–0.3% to inflation inside of a year before subsiding. Over roughly the first half of 2022, WTI oil jumped by about 70% in USD terms (we can't double count the yen effects). Ergo, that could imply that inflation would be expected to rise by between ½% and 1½% due to oil prices and that this effect should be peaking about now, given that the oil surge has since abated.

If the effects are purely additive (another big if…perhaps they feed on each other…) then the total effects of yen depreciation and oil price increases in 2022 on inflation should be between 1¼% to 3% and spread over a 1–2 year period. The oil price effect should be dropping out first starting over 2023H2 and so whether Japanese inflation eases or not over this period may be critically important to the BoJ.

Ok, so what has happened to Japanese inflation so far? The freshest Tokyo measure is running at 3.2% y/y, up from around 1% toward the start of last year and -1% in 2021. That's a 2–3% lift depending upon starting points. Much of the inflation that Japan is getting to date has been driven by prior movements in oil and the yen, but all of it? Not if we go with the added lower bound estimates of both the oil and yen effects on inflation, but maybe if we go with the upper bound effects and only if we're talking over the full 2-year period for both effects to work through. Not if we go with the shorter end of the estimated intertemporal effects (2-quarters for yen effects, inside a year for oil's effects).

Given that it has only been around a year since these movements at best, given the caveats to this analysis that were noted above and given that the full effects are supposed to be spread out over a longer period than what has happened to date, it is perhaps difficult to pin all of the movement in Japanese inflation that we have seen upon just the yen and oil. Other factors like global supply chain influences may also be factors. Still, I'll repeat the prior point that at least one of these effects (oil) should be expected to begin dropping out soon; if it does not, then this would suggest something grander is driving Japanese inflation and that may be what Ueda is waiting to observe.

Serial shocks?

But what if Japan is faced with serial shocks to these drivers with each successive wave running the risk of unmooring price expectations? That gets a bit more complicated and is why we need to monitor financial conditions. So far, the evidence for this is pretty muted. Breakevens are all around 1% across varying terms so clearly markets are saying this is all just transitory, yet markets don't necessarily have the upper hand on forecasting inflation compared to anyone else as we've seen in spades throughout the experiences of the past few years.

To assess serial shocks to the drivers of inflation means, in part, looking at the evidence of what is happening to broad financial conditions. One reason for acting now could be to counter an easing of monetary policy conditions based upon the following evidence:

- Some point to the fact that the real policy rate has turned more negative as inflation has risen.
- I think you could make the same point about the fact that the nominal 10-year JGB yield has dropped to under 40bps and hence is no longer testing the upper end of the +50bps band as it was until trouble hit global banking markets in March. So, they could counter such shorter- and longer-term real rate developments.
- Ditto for the currency that has been depreciating throughout this year from about 128 to the dollar toward about 141 now. This risks a new round of serial upward lagging pressures upon inflation. The more such shocks you get, the more you risk seeing expectations rise.
- and the same applies to stocks. The Nikkei has sharply rallied by 25% since about mid-March. Yes, 25%. Ueda had a comment overnight that pinned this on growth expectations. Growth? Where?? Perhaps it's a Ueda put.

The BoJ could well come to view this easing of financial conditions as inappropriate over time especially if second half inflation persists despite the estimates that point to oil's effects dissipating over this period.

Further, the annual Shunto Spring wage negotiations established the fastest wage gains in about 30 years. Now the problem here is that it isn't showing up in the data. Yet. Labour cash earnings are up by only 1% y/y in nominal terms and falling in real terms, but the data only does until April. The shunto wage agreements are estimated to work through wage data over several ensuing months. Hence, whether hard wage growth data accelerates over coming months or not could also be impactful to the BoJ especially if they think it may be more than just a one-off.

For now, it's important to acknowledge that Tokyo core cpi recently accelerated to 0.6% m/m SA nonannualized for the hottest gain since January 2021 except this time it's not a flash in the pan as it was back then (chart 2). This time it's part of an ongoing upward trend. If month-over-month inflation data persists at such levels and especially if it continues to accelerate while transitory drivers drop out and wage data improves, then this would be of rising consequence to the BoJ over coming meetings and we can't rule out the possibility that they factor all of this into their forecasts for inflation and discussion of the risks to this forecast when they update projections at next month's meeting.

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.	4.69	4.65	4.60	3.94	3.91	3.91	3.73	3.72	3.74	3.84	3.84	3.88
CANADA	4.54	4.49	4.49	3.67	3.64	3.68	3.35	3.33	3.37	3.22	3.21	3.25
GERMANY	3.12	3.13	2.92	2.58	2.61	2.42	2.48	2.50	2.38	2.55	2.58	2.52
JAPAN	-0.06	-0.06	-0.06	0.08	0.09	0.08	0.41	0.43	0.43	1.24	1.24	1.26
U.K.	4.93	4.91	4.54	4.55	4.54	4.25	4.38	4.38	4.24	4.48	4.50	4.48
	Spreads vs. U.S. (bps):											
CANADA	-16	-16	-11	-27	-27	-23	-38	-39	-37	-62	-63	-64
GERMANY	-157	-152	-168	-136	-131	-149	-126	-122	-137	-129	-126	-137
JAPAN	-476	-471	-466	-386	-382	-383	-332	-329	-332	-260	-260	-262
U.K.	24	26	-6	61	62	34	65	66	50	64	66	60
Equities	Level						% change:					
		Last			Change		1 Day	1-wk		1-mo	1-yr	
S&P/TSX		20027			12.3		0.1	0.7		-1.1	5.4	
Dow 30		34408			428.7		1.3	1.7		4.2	15.0	
S&P 500		4426			53.3		1.2	3.1		7.7	20.7	
Nasdaq		13783			156.3		1.1	4.1		11.7	29.5	
DAX		16358			67.6		0.4	2.6		2.9	25.5	
FTSE		7641			12.2		0.2	1.0		-1.4	8.5	
Nikkei		33706			220.6		0.7	4.5		9.4	29.8	
Hang Seng		20040			211.5		1.1	3.4		3.0	-4.9	
CAC		7364			72.8		1.0	2.1		-0.6	25.1	
Commodities	Level						% change:					
WTI Crude		70.76			0.14		0.2	0.8		-0.1	-39.8	
Natural Gas		2.56			0.02		0.9	13.4		7.6	-65.7	
Gold		1966.39			8.38		0.4	0.3		-1.1	5.9	
Silver		23.41			-0.42		-1.8	-1.1		-2.0	9.1	
CRB Index		266.91			6.65		2.6	2.4		2.7	-15.8	
Currencies	Level						% change:					
USDCAD		1.3209			-0.0014		-0.1	-1.0		-2.0	2.0	
EURUSD		1.0966			0.0021		0.2	2.0		1.0	4.0	
USDJPY		140.97			0.6800		0.5	1.1		3.4	6.6	
AUDUSD		0.6884			-0.0001		-0.0	2.1		3.4	-2.3	
GBPUSD		1.2841			0.0057		0.4	2.1		2.8	4.0	
USDCHF		0.8909			-0.0009		-0.1	-1.4		-0.6	-7.8	

Central Banks	
Current Rate	
Canada - BoC	4.75
US - Fed	5.25
England - BoE	4.50
Euro zone - ECB	4.00
Japan - BoJ	-0.10
Mexico - Banxico	11.25
Australia - RBA	4.10
New Zealand - RBNZ	5.50
Next Meeting Date	
Canada - BoC	Jul 12, 2023
US - Fed	Jul 26, 2023
England - BoE	Jun 22, 2023
Euro zone - ECB	Jul 27, 2023
Japan - BoJ	Jun 15, 2023
Mexico - Banxico	Jun 22, 2023
Australia - RBA	Jul 04, 2023
New Zealand - RBNZ	Jul 11, 2023