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GLOBAL ECONOMICS

DAILY POINTS

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Contributors

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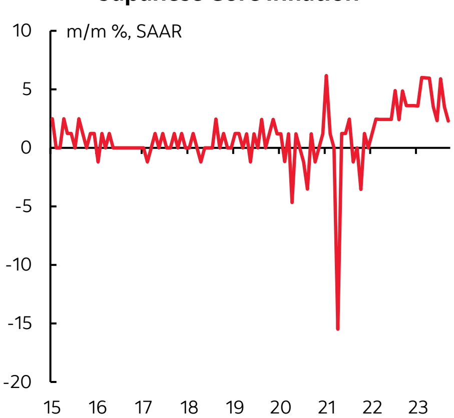
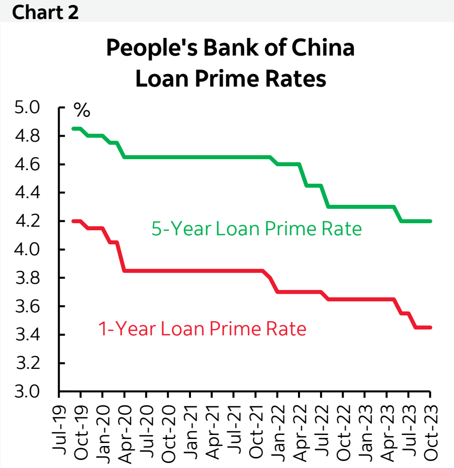
Chart 1



Sources: Scotiabank Economics, Ministry of Internal Affairs and Communications.

Chart 2



Sources: Scotiabank Economics, People's Bank of China.

On Deck for Friday, October 20

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	10-20	08:30	Retail Sales (m/m)	Aug	-0.3	-0.1	0.3
CA	10-20	08:30	Retail Sales ex. Autos (m/m)	Aug	--	-0.1	1.0
US	10-20	09:00	Fed's Harker Speaks on Economic Outlook				
US	10-20	12:15	Fed's Mester Speaks at Manhattan Institute for Policy Research				

KEY POINTS:

- **Markets feel like they did last Friday**
- **Defensive positioning ahead of weekend uncertainties**
- **Chair Powell validated a November pause…**
- **…flagged multiple 'persistence' question marks…**
- **…and is not yet fussed by bond markets…**
- **…and a full transcript of his Q&A is provided**
- **Japanese core CPI came and went with little fanfare**
- **Chinese banks left their lending rates unchanged**
- **UK retail sales were worse than expected**
- **Canada to revise August retail sales, offer initial September guidance**

This feels just like last Friday.

Markets are playing defence as they face heightened uncertainty toward developments in the Middle East into the weekend. Positioning is driving a bull flattener in US Ts and Canadas, versus mild 2s10s bull steepening across gilts and EGBs. Equities are soft, with N.A. futures down by about ¼% and European cash markets down by around 1% following a weak Asian overnight session. Oil is up by over a buck.

As tensions and developments worsen across the Middle East, calendar-based developments are light and of minimal consequence.

Japanese core CPI came and went with little fanfare. CPI ex-fresh food and energy was up by 0.2% m/m SA in September, a tick above the previously released measure for just Tokyo which probably explains why the y/y rate was slightly above consensus at 4.2% (4.3% prior, 4.1% consensus). The annualized rate is shown in chart 1.

Chinese banks left their 1- and 5-year Loan Price Rates unchanged as expected following the PBOC's decision at the start of the week to stay on hold (chart 2). Banks are under funding pressures as the central bank injected liquidity to help take down a surge in government bond issuance. China's two-year yield has risen by about 30–35bps since August and back toward Springtime levels as pessimism has diminished.

Folks in the UK are in no mood to shop. September's retail sales volumes fell by -0.9% m/m (-0.4% consensus) and -1% m/m excluding gasoline (-0.4% consensus). Markets are already priced for no change at the November 2nd BoE decision.

Canada will also update retail sales this morning (8:30amET). Statcan has previously guided that the value of sales fell -0.3% m/m in August, but it's preliminary estimates can be subject to large revisions. We'll also get a preliminary take on sales in September.

The US calendar will be empty other than the last little bits of Fed speak before tomorrow's blackout.

RECAP OF FED CHAIR POWELL'S REMARKS

Federal Reserve Chair Powell's remarks (**here**) and Q&A before the Economic Club of New York yesterday afternoon was about as expected, except for the shockingly lax security. A bunch of hooligans seeking to blame the Fed for climate issues got far too close to the Fed Chair in my opinion. Before sharing a full transcript of his Q&A I'll flag key parts of his remarks. All in all, it was much ado about nothing at least from a market standpoint. He validated a pause on November 1st while keeping a data dependent door open to further hiking. He argued that the bond selloff is a substitute for further rate hikes if it is persistent. He spent a lot of time on the resilience of the US economy. On key issues like the neutral rate, he largely dodged them.

For one, Powell made it clear that the FOMC will require further evidence of a strong economy in order to tighten further. That reinforces widespread expectations that the FOMC will stay on hold on November 1st. Key is the following passage:

> "We are attentive to recent data showing the resilience of economic growth and demand for labor. Additional evidence of persistently above-trend growth, or that tightness in the labor market is no longer easing, could put further progress on inflation at risk and could warrant further tightening of monetary policy."

This concluding paragraph reinforce the cautious near-term nature of the FOMC's assessments:

> "Given the uncertainties and risks, and how far we have come, the Committee is proceeding carefully. We will make decisions about the extent of additional policy firming and how long policy will remain restrictive based on the totality of the incoming data, the evolving outlook, and the balance of risks."

The fact that some variant of debatable persistence featured four times in the Chair's written remarks says something by way of these uncertainties. They don't know for how long strong growth, strong labour markets and lower inflation readings may persist. Nobody does quite frankly. Furthermore, Powell signalled that he's not yet fussed by bond market developments because "persistent changes in financial conditions can have implications for the path of monetary policy" and not fleeting ones.

A key issue is how much further evidence that he wishes to evaluate. Bond market tightening would probably be of greater concern to the Chair if it persisted through 2024Q1. On the fundamentals, it's unclear if he means a few reports, and hence on the way to the Dec 13th meeting, or more evidence. By the December meeting, however, note that we'll get a strong Q3 GDP report next week, two more payrolls and wages reports, two more PCE reports, two more CPI reports etc etc. The second of those CPI reports is the day before the Dec FOMC communications right at the start of their two day meeting. Members submit their projections for that SEP including dot plot the Friday before, but can submit revised views by the end of the first of the two FOMC meeting days. Ergo, depending upon how things go, they may have quite a lot of information to inform risks into December 13th.

Here is my effort toward providing a full transcript of the Q&A provided in real time yesterday with any errors or omissions largely attributable to how fast my fingers could type!

Q1. Are you surprised at how resilient the US economy has been?

A1. Yes, growth has been above its longer run trend, so that's been a surprise. Real wages are improving as inflation comes down. Consumer spending has driven much of this. Maybe the economy is less affected by interest rates. Many companies will have termed out their debt. The same may be true of households. The economy may be somewhat less susceptible to the effects of interest rates. On the other hand, interest-sensitive sectors like housing and purchases of durable goods have been affected. We see policy working through its usual channels and it may just be that rates haven't be high enough for long enough.

Q2. Is it true that companies have termed out debt? Does it mean you have to go further with rate hikes?

A2. I don't think so. We are seeing the effects of rate increases as I mentioned and also in the exchange rate.

Q3. How much effect has the Fed had? Where are you in the process? At the 25% point or later in terms of seeing it in the economy?

A3. There's no precision. One thing that has changed is that central banks have moved from being secret to very transparent. The transmission of tighter policy happens before policy moves which didn't used to be the case. We are seeing the effects, just not as quickly as we would like.

Q4. You need to know how much has had an effect to know how much more you need to do, no?

A4. We are starting to see the effects. One reason we have slowed down is to give policy time to work. We have to use our eyes and risk management to slow down the pace to see if we are seeing the full effects.

Q5. What is long-run potential growth?

A5. It's not something that moves around over time, but my own guess is it's somewhere around 2% which is a little higher than others would say.

Q6. Do you see historical precedence for a growing economy amid rate hikes?

A6. That's a question about what is the neutral level of rates. It's really hard to know that in five years. Past estimates of neutral were lower. What has changed with the pandemic? Less effect from demographics, globalization etc. I wouldn't want to speculate. The effective lower bound is not an issue and the economy is handling it well.

Q7. Where is neutral and long-term interest rate?

A7. I don't know. We're finding it. It was around 50bps in real terms before the pandemic and it may have risen since, but the real question is whether it will be higher in the long-term and we don't know.

Q8. You must have an estimate. A theory.

A8. We all write down our estimates. The evidence is that the economy is handling higher rates which may tell us that the neutral rate has risen, or we haven't been high enough for long enough. We have to be focused upon what the economy is telling us even if lags are involved. I would say the economy is telling us policy is not too tight now.

Q9. What's the next phase going to look like after going through secular stagnation and then the pandemic?

A9. The effective lower bound was a big problem for monetary policy. If rates were close to zero in good times, then how do you cut? Had central banks lost their power? The most common answer to deal with this was a run-hot inflation make-up strategy. Then came the pandemic, the response, and then pandemic inflation. Is that a secular change? Or are these other factors coming back? Some books have argued that the 20 years before the pandemic was a perfect storm of disinflation and that we're now in a very different environment of rolling supply shocks etc. I think it's unknowable. It's not something you can settle in advance.

Q10. What did you learn from the pandemic?

A10. To put yourself in the place of legislators and central bankers. There was no playbook. People thought there might not be a vaccine and there might not be an economy for five years. Could we have done less and had a little bit of inflation? I guess we could. But look at where we are. We have the strongest economy and the most progress on inflation. We're back to pre-pandemic performances on several measures. If we had perfect hindsight we might not have had as much inflation if we had done less. [ed. in my view, Powell is letting himself off the hook here. Throughout 2020–21 he was giving speeches on fully inclusive maximum employment goals and ignoring the abundant evidence on healing financial markets, changing behaviour, and rising inflationary pressures.]

Q11. What is happening to bond markets?

A11. It's hard to say what's exactly going on. It's not about expectations about higher inflation or shorter-term policy moves. The move is in longer-term bonds and term premiums and not principally looking at shorter-run matters. Markets are seeing the resilience of the economy to high interest rates and revising their views on longer-term rates. There may be heightened focus upon fiscal deficits. And QT. Also, if markets think we're going through rolling supply challenges. Then the question is does it matter to us? Actual and expected changes in our policy affect financial conditions. Persistent changes in financial conditions affect the economy. Are we seeing these higher longer-term bond show through financial conditions and yes, I think they are. Financial conditions indices are showing tightening and a lot because of longer-term rates. Then the question is whether it is endogenous, in other words if it's because they expect us to do more and that doesn't seem to be the case. We need to see evidence over time.

Q12. Is this temporary or longer-term?

A12. Some could be shorter term and some longer term. Fiscal policy and changes in stock versus bond correlations could be longer-term factors. Markets have been volatile. We have to let this play out and watch it. It's clearly a tightening in financial conditions and we have to watch it carefully.

Q13. To what extent do you think long-term supply of Treasuries is an issue? Defence spending will be elevated for years. Do you take that into account in setting monetary policy?

A13. There is a lot of talk about the very large resource demands needed by the IMF and other organizations, military, climate change etc. We don't comment on fiscal policy as they have oversight over us and not the other way around. We know that we're on an unsustainable path. The path is unsustainable, not the level of debt. How much we raise rates in six months won't be driven by this unless there should be some big new fiscal measures.

Q14. There is also the question of who's buying. One big buyer has stepped out, the Fed, and some others overseas may. How do you take this into account?

A14. Overseas have been buying robustly. We look at broad conditions, interest rates and broader asset prices. We wouldn't change monetary policy because we think the US is on an unsustainable path. We follow our dual mandate.

Q15. As you talk to CEOs, what are you hearing about the cost of capital?

A15. I talked to several people this week who run companies and they all say the economy is strong. There are some areas that are softening but look at retail sales. Companies are profitable. The cost of capital matters to smaller companies and early stage companies. The best thing we can do with our blunt tools is longer term price stability. Higher bond yields are not just following our guidance and are doing more than that. [ed. ergo, like other FOMC officials, Powell leans toward the rate substitute angle].

Q16. Labour market question

A16. There are very many signs that the labour market is getting back into balance.

Q17. What have you learned about the relationship between inflation and labour markets?

A17. What it was before the pandemic is shown by inflation versus unemployment in the prior forty years. That relationship went down and down and was very flat. Now it will tell you that the relationship is back. Do we think that's a sustainable thing? I don't know. What happened is that if people expect 2% inflation then that's what will happen such that even in very tight labour markets we didn't have inflation. The models used to be all saying we should be seeing more inflation pre-pandemic so we learned that the Phillips curve was flat, mostly dead. I don't think that now, today's inflation, is driven by the Phillips curve. It was more about constrained supply and demand more broadly due to the pandemic.

Q18. What about the banking sector's risks?

A18. We see that things have settled down. We ensured that there was ample liquidity and set up a new facility for banks to borrow. We're still on the case. Banks are generally very well capitalized and highly liquid. We benefit from all those reforms under Dodd-Frank and Basel III.

Q19. Yet you want more capitalization?

A19. It's a proposal that's out there and we are receiving comments.

Q20. How about commercial real estate?

A20. Commercial real estate is not a principal or major risk for the major banks. It is more for the regional banks. What we've done is our supervisors are in there ensuring there are adequate plans and supervision. All of the bank regulators are working with banks with concentrated challenges. There will be losses for sure. But we're working through it and we're on that case. We don't see it as presenting much broader problems, but our job is to ensure it doesn't.

Q21. What about the pressure on the regional banks? What if there was more consolidation?

A21. They are very important. We have 4500 banks. More than others. Community banks, regionals, gsibs etc. The regionals do great business with many companies. I would not like them to get the same attention and treatment as gsibs. We think the regionals are an enormously important part of the system. [ed. My view remains that the US has far too many banks, many of which are small with inadequate risk management and funding operations, undiversified lending and funding bases, and this is a big reason why the US repeatedly rolls through banking crises.]

Q22. Do you enjoy what you're doing?

A22. Yes.

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.	5.15	5.16	5.06	4.91	4.96	4.64	4.94	4.99	4.61	5.07	5.11	4.75
CANADA	4.88	4.89	4.85	4.34	4.36	4.20	4.13	4.17	3.95	3.90	3.93	3.70
GERMANY	3.16	3.21	3.14	2.82	2.85	2.68	2.92	2.93	2.74	3.12	3.10	2.93
JAPAN	0.08	0.08	0.05	0.37	0.37	0.32	0.84	0.84	0.76	1.82	1.80	1.69
U.K.	4.94	4.99	4.85	4.68	4.71	4.46	4.69	4.67	4.39	5.12	5.07	4.83
	Spreads vs. U.S. (bps):											
CANADA	-27	-27	-21	-57	-60	-44	-81	-83	-66	-117	-119	-105
GERMANY	-199	-196	-192	-209	-211	-196	-202	-206	-188	-195	-201	-182
JAPAN	-507	-508	-501	-455	-458	-432	-410	-415	-385	-324	-331	-307
U.K.	-21	-17	-21	-23	-25	-18	-25	-32	-23	5	-4	7

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	19349	-101.9	-0.5	-0.8	-4.3	4.1
Dow 30	33414	-250.9	-0.7	-0.6	-3.0	10.2
S&P 500	4278	-36.6	-0.8	-1.6	-2.8	16.7
Nasdaq	13186	-128.1	-1.0	-2.9	-2.1	24.2
DAX	14855	-190.2	-1.3	-2.2	-5.9	16.4
FTSE	7432	-67.5	-0.9	-2.2	-3.9	7.0
Nikkei	31259	-171.3	-0.5	-3.3	-5.3	15.7
Hang Seng	17172	-123.8	-0.7	-3.6	-4.0	5.5
CAC	6837	-84.0	-1.2	-2.4	-6.7	12.3

Commodities	Level		% change:			
WTI Crude	90.60	1.23	1.4	3.3	0.4	5.4
Natural Gas	2.95	-0.00	-0.1	-8.7	8.0	-44.9
Gold	1983.44	8.99	0.5	2.6	2.8	21.8
Silver	22.89	-0.33	-1.4	3.4	-1.9	24.1
CRB Index	287.34	1.51	0.5	3.3	-0.4	5.7

Currencies	Level		% change:			
USDCAD	1.3696	-0.0023	-0.2	0.3	1.7	-0.5
EURUSD	1.0586	0.0004	0.0	0.7	-0.7	8.2
USDJPY	149.94	0.1400	0.1	0.2	1.1	-0.1
AUDUSD	0.6314	-0.0015	-0.2	0.3	-2.1	0.5
GBPUSD	1.2126	-0.0018	-0.1	-0.1	-1.8	7.9
USDCHF	0.8913	-0.0001	-0.0	-1.2	-0.8	-11.2

Central Banks	Current Rate
Canada - BoC	**5.00**
US - Fed	**5.50**
England - BoE	**5.25**
Euro zone - ECB	**4.50**
Japan - BoJ	**-0.10**
Mexico - Banxico	**11.25**
Australia - RBA	**4.10**
New Zealand - RBNZ	**5.50**

Central Banks	Next Meeting Date
Canada - BoC	**Oct 25, 2023**
US - Fed	**Nov 01, 2023**
England - BoE	**Nov 02, 2023**
Euro zone - ECB	**Oct 26, 2023**
Japan - BoJ	**Oct 31, 2023**
Mexico - Banxico	**Nov 09, 2023**
Australia - RBA	**Nov 06, 2023**
New Zealand - RBNZ	**Nov 28, 2023**