

DAILY POINTS

December 15, 2023 @ 7:15 EST

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On Deck for Friday, December 15

Country	Date	Time	Indicator	Period	BNS	Consensus	Latest
CA	12-15	08:15	Housing Starts (000s a.r.)	Nov	255	260.0	274.7
CA	12-15	08:30	International Securities Transactions (C\$ bn)	Oct	--	--	-15.1
CA	12-15	08:30	Wholesale Trade (m/m)	Oct	-1.1	-1.1	0.4
US	12-15	08:30	Empire State Manufacturing Index	Dec	--	2.1	9.1
CA	12-15	09:00	Existing Home Sales (m/m)	Nov	--	--	-0.9
US	12-15	09:15	Capacity Utilization (%)	Nov	--	79.1	78.9
US	12-15	09:15	Industrial Production (m/m)	Nov	0.3	0.3	-0.6
US	12-15	16:00	Total Net TIC Flows (US\$ bn)	Oct	--	--	-67.4
US	12-15	16:00	Net Long-term TIC Flows (US\$ bn)	Oct	--	--	-1.7

KEY POINTS:

- **Markets are stabilizing after the Fed**
- **Will the BoC join other central banks...**
- **...in departing from how markets perceived the Fed's actions?**
- **UK PMIs improve, driving gilts underperformance**
- **Eurozone PMIs weaken, driving richer EGBs**
- **Aussie & Japanese PMIs rise, US on tap**
- **PBOC leaves policy rate unchanged, ramps up liquidity**
- **China macro data was mixed**
- **Russia's central bank hikes again because of wartime pressures**

So far, the Fed is the lone central bank to have caused a stir with speculation on rate cuts this week—despite only showing -75bps next year that implies starting later in the year (recap [here](#))—as the ECB and BoE pushed back while others offered mixed perspectives including Norges Bank's surprise hike. Next up is the BoC when Governor Macklem speaks and that is a main focus of the rest of this note. There is little to no differentiation across relative central bank risks in terms of market pricing and I think that's a mistake.

Let's get other more minor matters out of the way first though. Equities are mostly higher, albeit modestly, and excluding London. The US S&P has a dividend yield of 1.5% with a 23 times trailing p/e and 21.2 times price to one-year forward earnings ratio whilst the Nasdaq's forward P/E is 31.1 times. Treasuries seem to have stabilized while better UK data is driving a slightly cheaper gilts front-end and Eurozone PMIs are driving slightly dearer EGBs. The dollar is stabilizing. So are oil prices that are in the US\$72–77 range.

We got a round of global PMIs out overnight. All of them improved a bit except for the Eurozone. The UK was the standout. Here's the round up:

- Australia's composite PMI increased to 47.4 from 46.2 which is still in contraction but by a lesser extent. The improvement was driven by services.
- Japan's composite PMI also improved to 50.4 from 49.6 entirely due to services as manufacturing cooled.
- the UK's composite PMI moved a full point higher to 51.7 entirely due to services as manufacturing slipped. This is one of the few upbeat readings of late.
- the Eurozone's composite PMI slipped 0.6 points to 47 entirely due to services.

The PBOC left its 1-year Medium-Term Lending Facility Rate unchanged at 2.5% as widely expected. It increased liquidity and there was a slight relaxation of restrictions against home buying in some cities that also garnered attention.

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China macro data was mixed. Industrial output accelerated by 6.6% y/y and was above consensus. Retail sales also picked up but by less than consensus. Fixed investment was soft.

The Russian central bank hiked 100bps this morning.

**** SPEECH BY BOC'S MACKLEM****

On tap into the N.A. session is a speech by BoC Governor Macklem that should garner attention amid otherwise relatively minor US and Canadian data like Canadian housing starts for November (8:15amET), the US Empire manufacturing gauge (8:30amET), US industrial output for November (9:15amET) and the US S&P PMIs for December (9:45amET).

The speech arrives at 12:25pmET and there will be a full press conference at about 2pmET that tends to last 20–30 minutes or so. There is no speech title or topic available but the Governor's pre-holiday speech can be impactful at times.

Macklem's speech may have been complicated by the Fed's messages, or at least the market's interpretation of the Fed's messages but I wouldn't be the least bit surprised if he pushed back on market pricing for future rate cuts. He'll no doubt be asked about market pricing and while he'll largely dodge it, I'd watch for the nuanced messages around how comfortable they are with it, or not.

For one thing, any experienced BoC observer knows that they couldn't care less about what markets are pricing. If they go into March/April with a cut priced and felt it would be the wrong thing to do then they'd have no problem stuffing markets. They've surprised markets on countless occasions under multiple Governors over time.

I don't care about market pricing either. It's one input, but not a dominant one. Markets have routinely misunderstood the BoC throughout the pandemic and handed opportunity after opportunity. We've seen cuts priced before and with enormous confidence among their proponents, only for reversals to kick in.

What is likely catching their eye is the net easing of financial conditions. CAD is firmer, but probably still undervalued and the magnitude of the movement of late has been trivial relative to what's needed to have any significant and sustained impact upon inflation. Oil has dipped but remains supportive to output and relative to break evens.

On the other hand, the TSX is at the high for the year and what dominates all of that are developments across the rates complex.

The 5-year GoC yield has now rallied by about 115bps to 3¼%. There is little to no term premium built in above a probably higher neutral rate. The market has pulled forward the full normalization of the BoC's policy rate.

That is making mortgage resets look more and more like what I've been describing in metaphorical terms as an economic mirage in addition to the tail wagging the dog in a broader macroeconomic outlook. From a great distance in the desert, it looks like a shimmering, ominous threat. As we get closer and closer, it fades into nothingness as we get closer to easing, as incomes rise alongside what I think is a buoyant outlook for house prices and as amortizations, LTVs and household behaviour adapt. The perceived shock will lessen in significance with the passage of time and circumstances.

The issue isn't rate cuts or no rate cuts. It's when to optimally time them. Emboldening market pricing for early cuts would light up the same imbalances that got us here in the first place and with totally different idiosyncratic drivers of Canadian inflation than in the US. Cut too early and future cuts are imperiled. The dumbest thing the BoC could do would be to fan easing into the Spring housing market when they just delivered a speech that put strong emphasis upon shelter within CPI and immigration pressures and ahead of the Winter round of government budgets. I strongly think that would be a policy error versus being patient, and possibly delivering more meaningful easing later. If they cut early, I'd raise the inflation outlook thereafter.

If the Governor follows Powell and/or the market's interpretation of Powell, then he'll thoroughly contradict what he has recently said back on November 22nd (recap [here](#)). Read the whole set of comments as opposed to the cherry-picking that I've seen. He said "We need to see a number of months that we're on a path to 2% inflation. When we are on that path we will begin to think about when to cut interest rates. Right now, we're still assessing whether they are high enough. The lesson from the 1970s is not to be half-hearted in getting inflation back to target."

A sudden Macklem pivot would also conflict with what one of his Deputies said just last week (recap [here](#)) that the central bank didn't see enough disinflationary evidence as of yet. Gravelle said that if they did come to see enough such evidence, then the BoC would need to have confidence that the forces are sustainable, and only then would it consider when to begin easing. Macklem himself recently said they've only seen one month of softer inflation. We'll get another update next week when headline will be soft but key will be the core gauges.

And as for following the Fed, why should they? They are already 50bps below the Fed with an undervalued CAD. They've had plenty of times when they've been above the Fed. They've also had times when their cutting has lagged the Fed's, like the early 2000s and they lagged the Fed on the upswing from 2016 to 2018.

Today's circumstances are different anyway with higher inflation risk north of the border than south and so I'm dismissive toward comparing today to past cycles. The surge of immigration into no housing supply is unprecedented in modern times. Soaring wages relative to productivity have no precedent. Fiscal policy continues to prime the pump. Their survey-based measures of inflation expectations remain too high across all time horizons. Behaviour is changing as evidenced in collective bargaining exercises within a totally different labour market than stateside including the fact that one-in-three Canadian workers are unionized versus one-in-ten in the US. Commodities remain broadly supportive and the BoC does not have the Fed's issue of a strong dollar.

Last, Canada is not on the same political cycle as the US. I do think US politics matters to the outlook. A cratering US economy into November 2024 could pave the way for Trump and that, I think, would be a total disaster for the US and world economies without even getting into what's good for democracy.

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			
	4.37	4.39	4.72	3.88	3.91	4.24	3.91	3.92	4.23	4.04	4.04	4.30	Canada - BoC	5.00	
	3.90	3.91	4.15	3.21	3.24	3.49	3.12	3.15	3.37	2.95	2.97	3.18	US - Fed	5.50	
	2.52	2.57	2.69	2.02	2.08	2.23	2.04	2.12	2.28	2.23	2.33	2.47			
	0.08	0.06	0.09	0.30	0.28	0.36	0.70	0.67	0.77	1.63	1.62	1.74			
	4.35	4.36	4.59	3.81	3.82	4.11	3.74	3.79	4.04	4.22	4.29	4.53	England - BoE	5.25	
	Spreads vs. U.S. (bps):														
	CANADA	-47	-48	-57	-67	-66	-75	-79	-77	-86	-108	-107	-112	Euro zone - ECB	4.50
	GERMANY	-185	-182	-203	-186	-183	-201	-187	-180	-195	-181	-171	-184	Japan - BoJ	-0.10
JAPAN	-429	-433	-463	-358	-363	-389	-321	-325	-346	-241	-241	-256			
U.K.	-2	-3	-13	-7	-9	-13	-17	-13	-19	18	26	22			
Equities	Level					% change:									
	Last	Change			1 Day	1-wk	1-mo	1-yr							
S&P/TSX	20779	149.3			0.7	2.5	3.6	6.0			Australia - RBA	4.35			
Dow 30	37248	158.1			0.4	3.1	6.5	12.2							
S&P 500	4720	12.5			0.3	2.9	4.8	21.1			New Zealand - RBNZ	5.50			
Nasdaq	14762	27.6			0.2	2.9	4.7	36.5							
DAX	16820	67.7			0.4	0.4	6.8	20.3			Next Meeting Date				
FTSE	7612	-37.3			-0.5	0.8	1.7	2.5			Canada - BoC	Jan 24, 2024			
Nikkei	32971	284.3			0.9	2.1	-1.6	17.5			US - Fed	Jan 31, 2024			
Hang Seng	16792	390.0			2.4	2.8	-3.8	-13.7							
CAC	7623	47.1			0.6	1.3	5.7	16.9			England - BoE	Feb 01, 2024			
Commodities	Level					% change:									
WTI Crude	71.87	0.29			0.4	0.9	-6.2	-5.6			Euro zone - ECB	Jan 25, 2024			
Natural Gas	2.40	0.01			0.4	-7.0	-24.7	-65.6			Japan - BoJ	Dec 19, 2023			
Gold	2043.15	6.79			0.3	1.9	4.3	15.0							
Silver	23.99	1.27			5.6	0.3	7.3	1.6							
CRB Index	264.31	5.20			2.0	1.4	-4.5	-3.8							
Currencies	Level					% change:									
USDCAD	1.3381	-0.0026			-0.2	-1.5	-2.2	-2.0			Mexico - Banxico	Feb 08, 2024			
EURUSD	1.0960	-0.0033			-0.3	1.8	1.0	3.1							
USDJPY	141.60	-0.2900			-0.2	-2.3	-6.4	2.8			Australia - RBA	Feb 05, 2024			
AUDUSD	0.6718	0.0019			0.3	2.1	3.2	0.2							
GBPUSD	1.2767	0.0000			0.0	1.7	2.8	4.8			New Zealand - RBNZ	Feb 27, 2024			
USDCHF	0.8659	-0.0017			-0.2	-1.6	-2.5	-6.7							

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