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Global Economics

September 12, 2014

The Global Week Ahead

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It Has Already Been 'A Considerable Time'

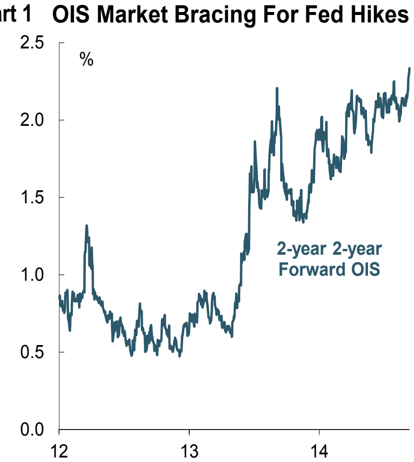
United States — Fed May Alter Time Reference To Lift-Off

Next week will be all about the Federal Reserve in terms of domestic and global market drivers. The statement and revised Summary of Economic Projections (SEP) will be available at 2pmET on Wednesday and Chair Yellen's press conference will begin a half hour later. Our broad takeaway is to expect shifts that tenuously signal a bias toward raising rates earlier than presently priced, but that it will signal a drawn out process with the break-out of longer run forecasts for the year 2017. We're entering a phase in which volatility will likely be as high on the way out of unprecedented stimulus as it was on the way in. There are at least three issues to address.

One will be the addition of 2017 forecasts. This matters more than possibly minor 2014 forecast revisions and we expect the 2015-16 view will remain largely intact. In a sense, the 2017 view is partially embedded within the transition from annual forecasts that currently end in 2016 and then give way to 'longer run' average forecasts', but the value will lie in getting the break-out of that particular year from the longer run. For instance, figure 2 in the last SEP shows no one forecasting the first hike to occur beyond 2016 and, if anything, the risk here lies in bringing forward some of the minority of officials who would prefer waiting that long for a first hike in 2016. The 2017 forecast risk therefore lies not in terms of signals over when to commence rate hikes, but rather signals on how quickly to move toward them over a three year horizon instead of the current 2015-16 break out of individual years. If the FOMC officials stick to their longer run average forecasts for the fed funds target rate beyond 2016 that are clustered between about 3.25-4.25%, then don't look for a massive jump in 2017 views off of 2016 perspectives since presumably officials wouldn't wish to get to that longer run view all in the transition from 2016 to 2017. **I would expect fed funds target rate guidance to therefore adhere to the party message regarding a lower longer run neutral rate with hikes starting next year but proceeding at a fairly modest pace over the next three years including spelling out 2017 this time.** Thus, the following line is likely to remain in the statement: "...economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run." **Ultimately over time I think this guidance will prove to be wrong** since I'm not a believer in 'new normal', 'this time is different' or 'secular stagnation' buzzwords versus pointing to the fact that we've heard this line about how potential GDP growth and neutral rates would be low for long in the past and that guidance has typically ended disastrously for bond markets (go here for our recent piece on this topic).

Another issue will center upon whether or not to amend or drop time-dependent reference reflected in the final paragraph of recent statements (June here) that states: ...it likely will be appropriate to maintain the current target range for the federal funds rate for a considerable time after the asset purchase program ends…" The Fed could leave this intact in that it fought that debate last meeting, Plosser was the only one to dissent, so stay the course and revisit later. If 'considerable time' goes, it is likely to be replaced by greater emphasis upon data dependency that is already in the Fed's communications anyway, or perhaps replaced with dredging up the pre-1994 'patience' language, or maybe kept but by adding in the statement a stronger signal about how if labour markets improve at a faster pace then hikes might come sooner and quicker. At issue is that market pricing remains so far misaligned with what the Fed has already been communicating by way of future policy actions; 2s, for instance, are still dear if the dot plot is anywhere close to what the Fed will ultimately do although the two-year two-year forward OIS rates have moved fairly dramatically over time (see chart).

Chart 1 OIS Market Bracing For Fed Hikes



Source: Bloomberg, Scotiabank Economics.

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As the US economy, labour markets and inflation readings have improved generally faster than the Fed anticipated not long ago, all of the FOMC officials who are currently in the 2015 first hike camp in the famous dot plot are likely to remain there, minus one (likely Plosser) who would prefer a hike this year. This then enters the realm of semantics by way of defining what exactly is 'a considerable time'? **I would think that a hike next Spring isn't really a considerable time, so the mere passage of time begets tightening up the time references, dropping them outright (less likely), or reverting back to an exclusive data-dependent reliance (more likely).**

Third will be the expectation that more detailed mechanics behind exit policy will be discussed in the press conference. How the Fed sees the rate corridor between the fed funds target, effective fed funds rate, interest rate on excess reserves, and repo rate evolving at the point of lift off but also well into it may be one such topic. We assume the rates converge upon one another at some point into the hiking cycle but the Fed might have other plans to maintain a different version of the ECB's rate corridor for a long time.

Data risk will be relatively modest and well behind the FOMC by way of significance to markets. CPI inflation is expected to remain near 2% y/y on Wednesday before the FOMC statement. Industrial production is expected to get a small boost in the August print, and industrial sector perspectives will be complemented by the latest prints for the Philly Fed and Empire gauges. Housing starts could slip somewhat from the large 16% m/m rise the prior month. Finally, while market significance is slight to non-existent, the Fed's flow of funds report will be released for Q2 and we will use it to track, among other things, who is buying US Treasuries and credit.

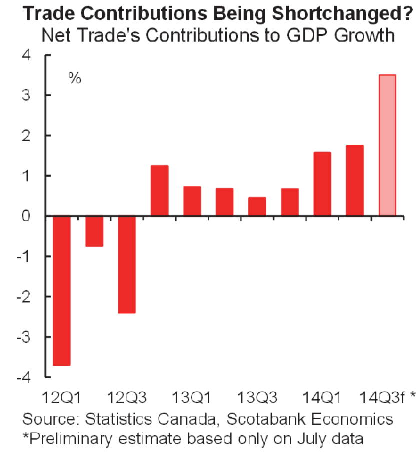
The US Treasury launches a 10 year TIPS reopening on Thursday.

Canada — Poloz Speech To Focus On The Currency

Bank of Canada Governor Stephen Poloz speaks on Tuesday ahead of the next day's Fed statement, ahead of the Scottish referendum, and before Friday's CPI print. Conceivably the rest of the week's events could be rather influential, but Governor Poloz is particularly focused upon full cycle views of the Canadian economy in a global context. His topic will be "The role of a floating exchange rate in the Canadian economy and in the Bank's policy framework." **The risk is therefore pointed toward the most direct references to the role of the currency in BoC policymaking that we've heard from Poloz thus far.** A press conference will follow and therefore anything may be fair game. Will the BoC update its estimates of currency pass-through into CPI? Will Poloz offer a more rigorous focus on lagged effects of currency moves on the trade account? Poloz is likely to continue to counsel looking through what the BoC views as temporary upsides on trade and inflation figures and the currency connections to both debates. They may prove to be correct on this over time, but the pressures are building in the direction of such guidance being viewed skeptically by markets. As the first chart shows, net exports have been making solid contributions to broad GDP growth for about two years now. As the second chart shows, this has sometimes been due to import weakness and sometimes due to export strength, but the trends in both import and export volumes remain pointed in the right direction. The current third quarter runs the risk of blowing the barn doors wide open by way of a massive contribution to GDP growth stemming from net trade although these are volatile and often-revised figures and we can thus far only evaluate the effects of the Q2 hand-off and the July print. Clearly the longer this stretch of trade improvements continues, the more it may cause many of us — the BoC possibly included — to re-think what we may have underestimated by way of trade strengths and their upside influences on GDP growth.

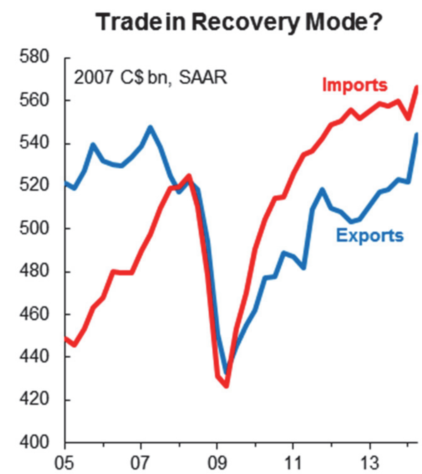
The same is true of developments on the inflation front. To that effect, we'll get another update in next Friday's CPI print. Here too, 'temporary' upsides to inflation may get tested further into year-end. Indeed, even at a tepid monthly pace of gains, CPI could

Chart 2



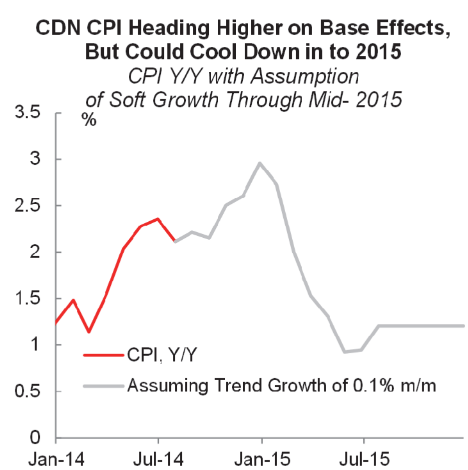
Source: Statistics Canada, Scotabank Economics
*Preliminary estimate based only on July data

Chart 3



Source: Statistics Canada, Scotiabank Economics.

Chart 4



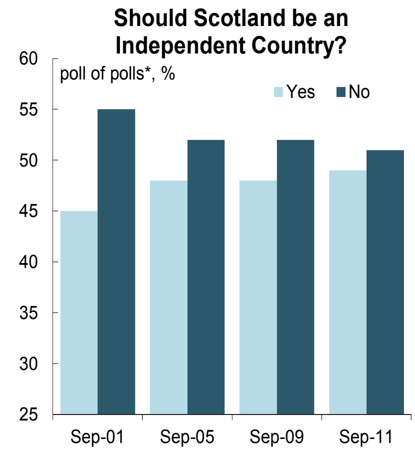
Source: Scotiabank Economics, Statistics Canada well not only hang in around the 2% target but could face upward pressure to the 2.5-3% y/y pace over the closing months of 2014 (chart 3). There are still good arguments on why trade and inflation upsides might not persist, but if something is unanticipated and faces considerable uncertainty then it's reasonable for this to be communicated by way of not only a neutral bias in the shorter run but perhaps by reining in long-pause arguments.

Home resales for August, and both manufacturing shipments and wholesale trade in July will further advance our tracking of Q3 economic growth forecasts as quarterly macro data trickles in with the usual lag. A solid gain in manufacturing shipments is likely on the back of a solid 1% m/m rise in the volume of exports that month coupled with momentum in the new orders book.

Europe — Could 16 year-old Scots Knock Carney Off Course?

I'm not sure that lowering the voting age to 16 is the best public policy, but Scotland did it and we'll see if it bought the separatists enough support. Voting starts at 7am and ends at 10pm on Thursday and we'll get the results by Friday morning London time unless signals of a runaway outcome hit the wires sooner. Poll results (see chart) are all over the map with a large undecided factor that will either stay home — which is unusual in referendums like this — or determine the outcome.

Chart 5



* Latest based on two polls by YouGov, one by ICM, one by Survation, one by TNS BMRB and one by Panelbase. Source: WhatScotlandThinks.org Poll of Polls.

France may actually be the sleeper risk that few are talking about. A vote of confidence in the government will be held in the French parliament on Tuesday and our European strategists note that the government's thin one-vote majority may present a challenge to the outcome.

The UK will also be the prime focal point for data risk. CPI inflation is expected to remain around 1 1/2% and thus will remain around the lowest readings since the depths of the global crisis in 2009. Low inflation supports BoE Governor Carney's guidance that rate hikes starting in Spring would be consistent with BoE policy goals in a statement that probably motivates the relative minority of individuals forecasting rate hikes next quarter to push out their views. The statement may have been an effort to front run next week's minutes to the September 4th BoE meeting. Whether a 'yes' vote in Scotland triggers BoE contingency plans, or a 'no' vote clears the way toward lift-off hangs in the balance. The unemployment rate and retail sales round out the UK hits.

German investor confidence, the European add-up on trade figures, and an expected policy hold by Norges Bank will complete the line-up. Sweden's general election on Sunday may be worth watching for Riksbank followers given that the Social Democrats lead in the polls and threaten to alter the central bank's mandate in future to place greater emphasis upon the job market. The return of the Social Democrats is expected to give rise to an emphasis upon restoring past cuts to social welfare programs.

Asia — Eye On China's Property Markets

Asian markets will play judge and jury on developments at the Fed while otherwise facing few domestic or regional drivers.

Chinese macro data will focus on evidence of a further deceleration in property prices, as well as releases for retail sales and industrial output. Chief among these potential risk factors will be the extent to which a softening property market is coinciding with a weakening credit cycle. A rebound in aggregate financing figures for Chinese companies in August allayed some of the fears that the plunge in new financing during the prior month would harken a new and more disturbing trend. That said, the breadth in the August rebound was not great as it was mostly focused upon just the new yuan loans category. The magnitude of the rebound was also somewhat disappointing since it still fell shy of the average monthly case of the post-crisis era. Should next Wednesday's property prices report point toward further weakness then it would keep alive concerns about a cooling credit and property cycle and what that might do to growth in China's economy. Remember that the prior month's report showed that property prices were falling in month-over-month terms across all but a couple of China's over 60 major cities that are captured in the figures. That still leaves the year-ago pace of price changes in the black, but at a decelerating pace that is being pulled down by month-over-month declines.

Central banks will figure into the equation with two speeches by BoJ Governor Kuroda on Tuesday and Thursday, and rate decisions by the Bank of Thailand and Bank Negara Malaysia around mid-week.

New Zealand GDP for Q2, and trade figures for India and Japan will be monitored for regional market effects.