BNY

iFlow

MACRO MORNING BRIEFING

October 28, 2024

US Macro Data Holds Up; CAD Still Vulnerable

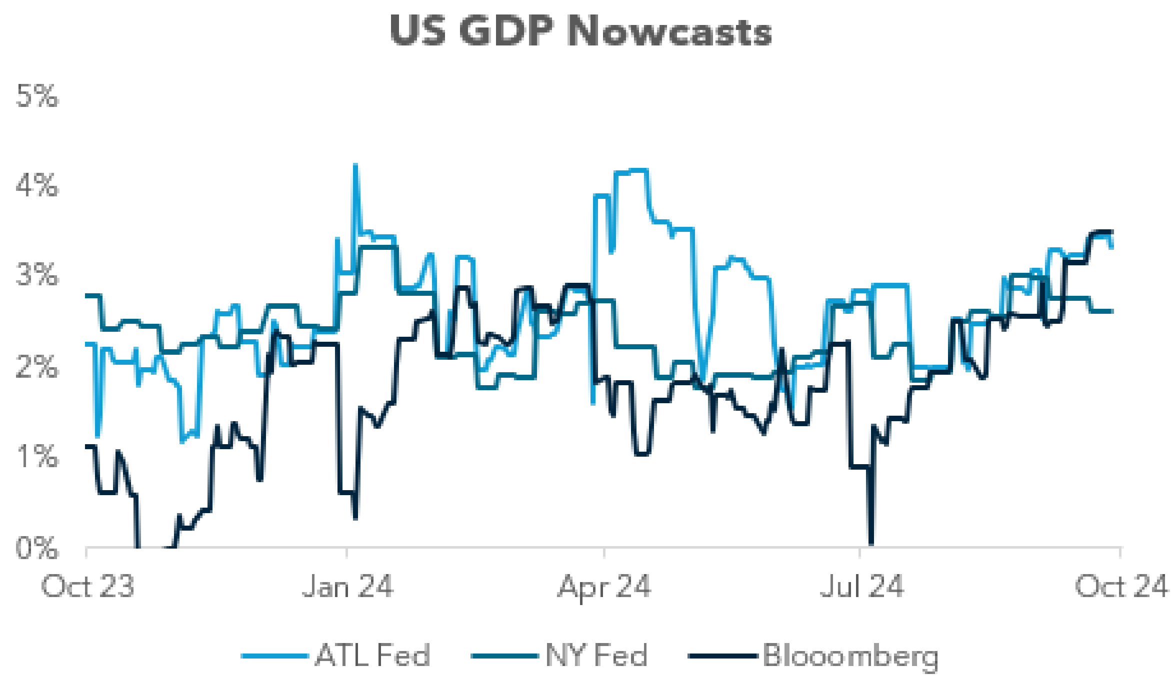
- US macro data remains quite solid; we still see the Fed cutting 25bp in November
- Election uncertainty results in investors taking few large macro positions
- We view USD/CAD as having more upside as we expect BoC to cut 50bp in December

US Macro Remains in a Good Place

Going into an election that we maintain is too close to call, we take this opportunity to assess the strength of the US economy going into the end of the year, after which a new administration – either red or blue – will be seated and its policy agenda starts to take shape. Much of the 2025 outlook will be determined not merely by who occupies the White House, but also by the makeup of both houses of Congress, the races for which are also on a razor's edge.

Economic data has held up quite well, displaying impressive resilience. Nowcasts from a variety of sources confirm the upbeat outlook. The Atlanta Fed's GDPNow estimates third quarter growth at 3.3% on the period, while the New York Fed sees 2.6%. Even the low end of these estimates would imply an economy running faster than trend, which is reckoned by most economists to be around 2% per year. Exhibit #1 underscores the strength of the quasi-real time estimates. Note that if these nowcasts are an accurate reflection of the actual GDP print due at the end of this week, we will have seen two strong quarter of above-trend growth.

Exhibit #1: Bullish Nowcasts

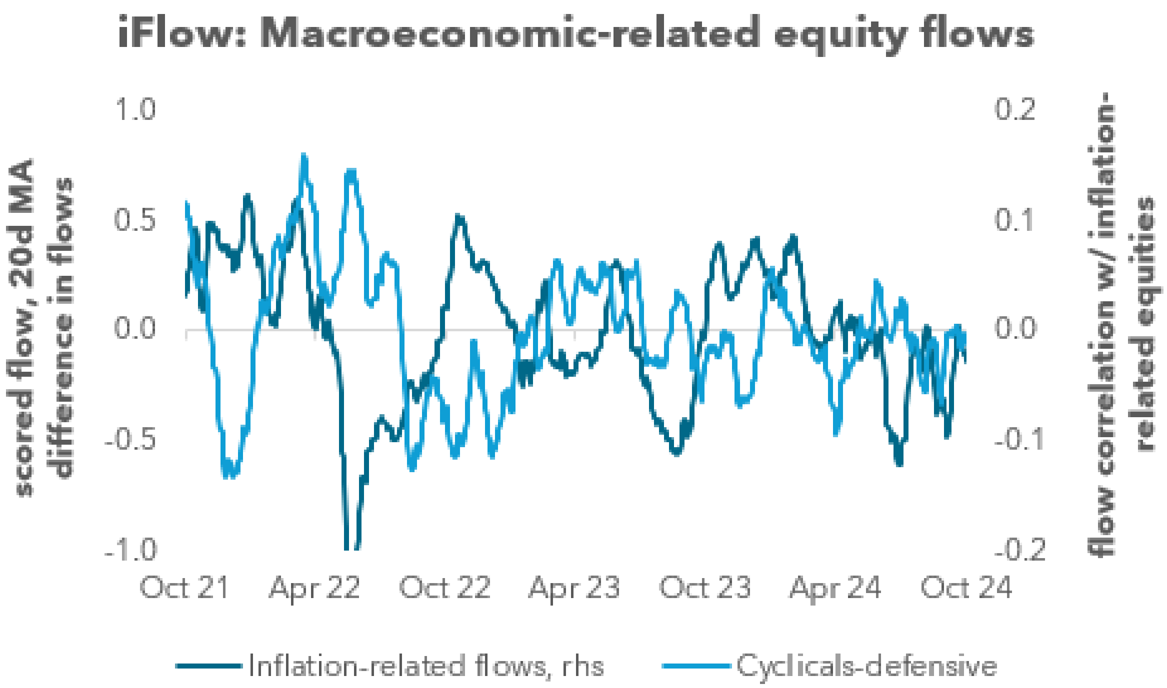


Source: BNY Markets, Bloomberg, Federal Reserve Bank of Atlanta, Federal Reserve Bank of New York

Going into the election, we see great uncertainty, and our macroeconomic-related equity flow indicators (shown in Exhibit #2 below) are almost flat. Investor preference for cyclical equity industries versus defensive ones is hovering right at zero and has been there since the spring of 2024. This measure can be viewed as a reflection of real money's view on the future of the economic cycle. We also measure inflation-related flows. If investors are concerned about rising inflation, we would expect them to pile into those GICS industries that tend to outperform during such a regime. Although it's moved around with the to-ing and fro-ing of inflation itself in recent years, it's also close to flat currently. In short, macroeconomic fundamentals are solid, investors are relatively neutral going into such an uncertain and important event as November 5.

This upcoming week will be choppy, a small appetizer for the following week which features the election, of course, as well as the November 7 FOMC meeting. But before that, markets have to navigate the US Treasury's quarterly refunding announcement this Monday morning, Q3 GDP and September PCE inflation (Wednesday and Thursday, respectively) and Friday's jobs data. This later release will be "dirty," in the sense that September hurricanes and the Boeing strike could lead to massively understated job creation. Fed Governor Waller warned us that the NFP data could be down by as many as 100k jobs. Going into a week with such key event risk, an opaque jobs print will only add to the uncertainty. Nevertheless, we feel confident that the Fed will continue to reduce its policy rate in November, cutting by 25bp – a move almost fully priced in by markets.

Exhibit #2: iFlow Shows Investor Indifference



Source: BNY Markets, iFlow

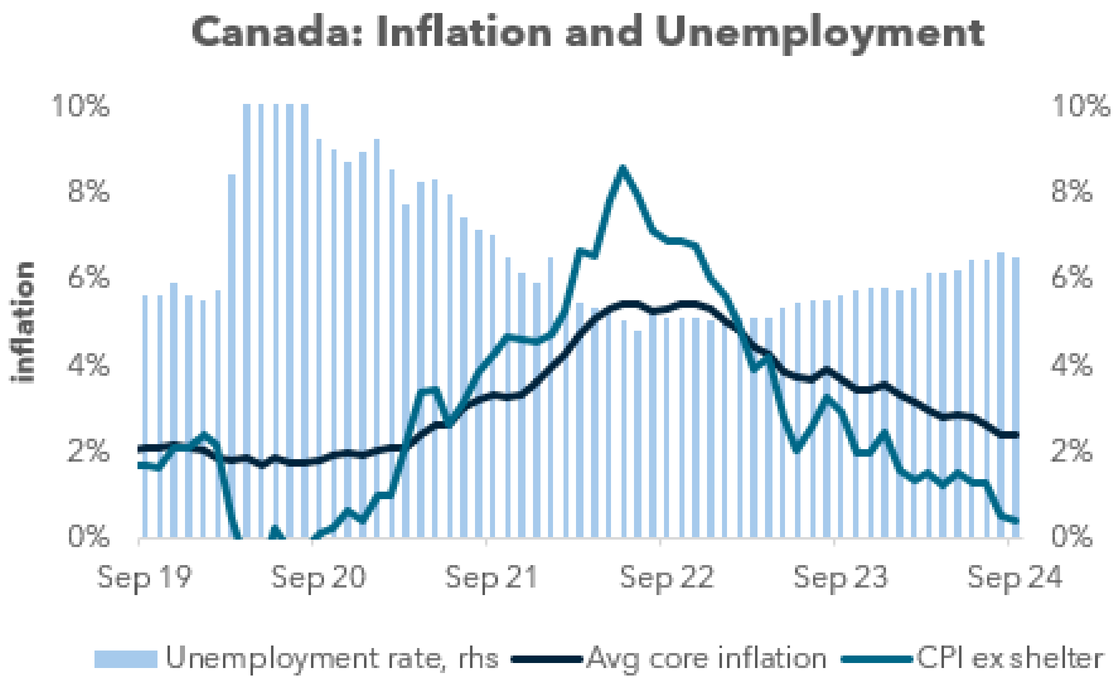
Canada – Faster Policy Easing Will Weigh on the Loonie

The Bank of Canada adhered to expectations last Wednesday and cut its base rate by 50bp to 3.75%. The USD/CAD exchange rate had been strengthening into the meeting, up by nearly 3% (i.e., CAD weaker) between September 24 and October 22, the day before the rate announcement. In the days since the Governing Council met, CAD has remained on a weak footing. How much higher can the cross go, given that both central banks are likely to keep lowering rates at least over the next several months.

We think that additional CAD downside is possible, especially given an at least 50-50 possibility of a Trump victory next week. CAD (as well as the MXN) is highly exposed to US trade, and a movement to increase tariffs and potentially pursue other impediments to trade within North America is likely pricing some risk premium into the looney.

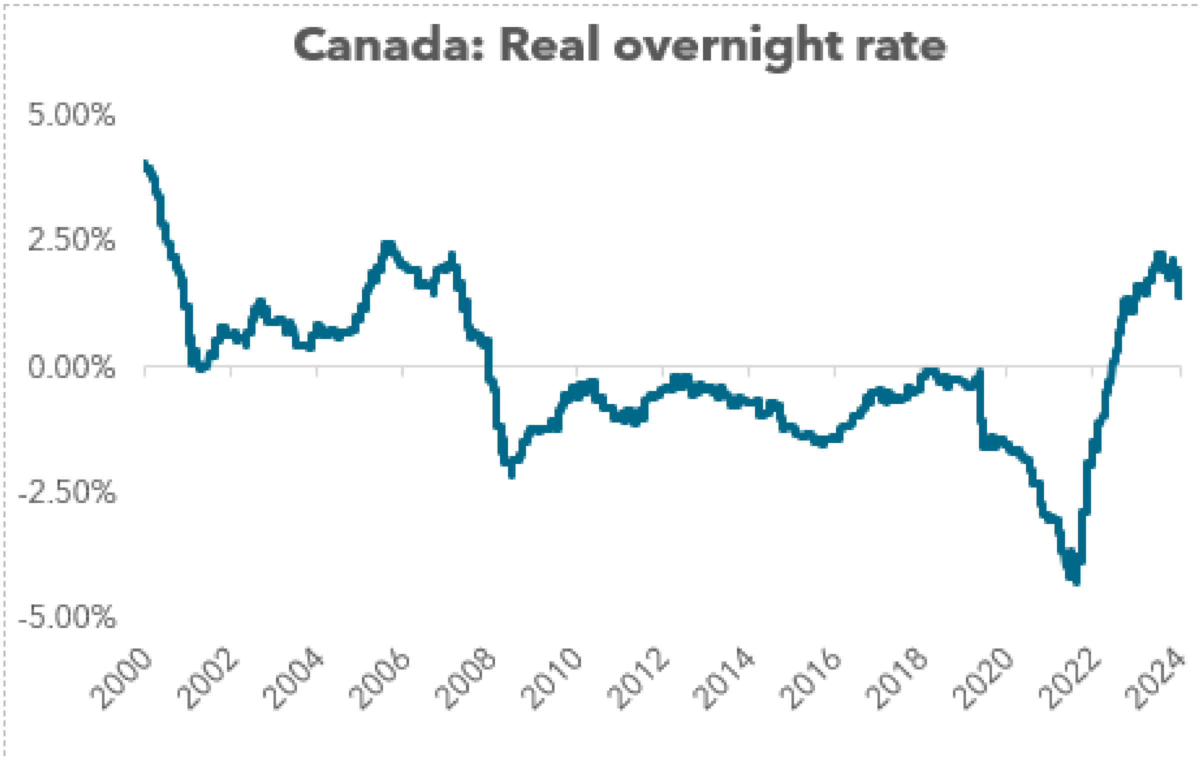
Exhibit #3 shows the impressive progress Canadian inflation has made, especially ex-shelter. At the same time, the labor market is weakening, as the rise in unemployment from 4.8% in the summer of 2022 to 6.5% now reveals. Exhibit #4 shows how high the real policy rate rose by midyear 2024. In excess of 2%, it was well above historical experience. The Bank's move to a jumbo cut last week is certainly justifiable given the prevailing degree of policy restrictiveness in the context of a weakening labor market and steady progress on inflation.

Exhibit #3: Progress on Inflation, Problems on Employment



Source: BNY Markets, Statistics Canada

Exhibit #4: Real Overnight Rate Historically High



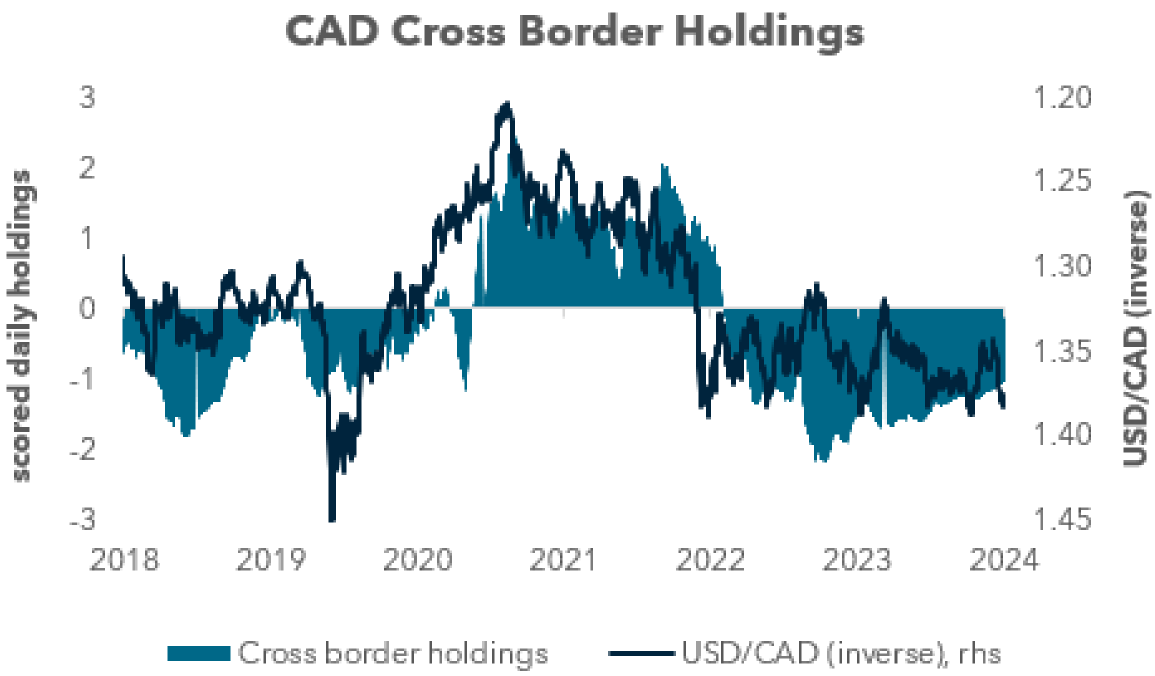
Source: BNY Markets, Bank of Canada, Statistics Canada

Consulting iFlow, our custody clients have been slight sellers of the currency, although cross-border purchases have been steady. Exhibit #5 (below) shows that cross-border holdings remain quite underweight, although these shorts have been gradually getting smaller. The data in the chart go back to 2018, and we can see that large, infrequent changes in holdings correspond to similarly large movements in the USD/CAD exchange rate. We don't see much risk of a major move in the currency absent a significant sentiment change towards the currency.

Although the spread between the US federal funds rate and the Canadian overnight rate is now 125bp, there have been episodes in the last few decades in which this difference has been even wider. We don't put a great deal of stock in the argument that the BoC's monetary policy can't diverge from US too much. In addition to historical precedent, we feel that as long as both central banks are easing – i.e., policy is moving in the same direction – the divergence in rates is not problematic for Ottawa.

As for further easing, we think that further progress on inflation and additional cooling in the labor market will allow – if not compel – the Bank to pursue another 50bp cut at its next meeting in December. The market currently sees a coin flip between a 25bp and 50bp cut at that time, and we feel the odds will only increase over the next several weeks, driving CAD further weaker.

Exhibit #5: Underweight Cross-Border Investors



Source: BNY Markets, iFlow

Disclaimer & Disclosures

Please direct questions or comments to: iFlow@BNY.com

John Velis
AMERICAS MACRO STRATEGIST

CONTACT JOHN

Can't see the email? View online

This message was sent from an unmonitored email box. Please do not reply to this message.

.