Week Ahead

19th - 23rd February 2024

Realised vol to stay high next week

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INTRODUCTION

Given a number of EM markets closed for the Lunar New Year holiday this week, with Chinese markets notably absent, the focus for FX traders was left squarely on developments across G10 currencies. In particular, it was data out of the US that once again stole the show, and left the broad dollar index to finish the week up by 0.4%. Key to this outperformance was Tuesday's CPI data, where core inflation numbers showed price growth of 0.4%MoM. Not only was this hot in isolation, but with other details of the inflation report also scanning as strong, this saw markets further paring back Fed rate cuts expectations. Our view on that data was a little more benign. While we note that inflation momentum is likely higher than markets were pricing just a week ago, mechanical and seasonal factors likely meant the pace of core CPI overstates the actual level of inflation. In this context, pricing of the Fed's easing path now looks too conservative and is prime for a retracement in the coming weeks, a view supported by January's weak retail sales data.

However, perhaps the biggest surprise of the week came from Swiss inflation data. Expected to print at 1.7% YoY in January, in line with December's reading, it instead fell to just 1.3%. As we have noted previously, franc strength in recent months should weigh on Swiss inflation, with this posing a significant downside risk to SNB price growth expectations. This is now showing up in the CPI data, fuelling speculation that the SNB would intervene to weaken the franc, and resulting in a six tenths rally for EURCHF. In our view this trend higher for the cross is likely to be sustained. Strong disinflation pressures should see the SNB easing in March, and low rates combined with a fading haven bid should, we think, see EURCHF back at parity by year end.

UK data was also a notable theme this week, not least because a fluke of scheduling meant that all major official economic data series were set for publication. As expected GDP figures pointed towards the UK entering recession, but Friday's retail sales indicated a better growth outlook for 2024. This met one half of our base case for improving growth to allow the Bank of England to keep rates high for longer than most other DM central banks. The other came from wage and inflation data earlier in the week, where signs of sticky inflation should similarly reinforce the need for no BoE rate cuts until the second half of the year. As such, sterling sold off this week as we predicted on recession headlines, this now leaves GBP looking cheap, especially when compared to the euro, heading into next week's flash PMI releases.

Realised volatility is likely to remain around 6-month averages next week, having been lifted by US data this month. The reopening of Chinese markets and their response to this week's move in US rates will likely keep volatility high at the start of the week, before attention turns to Swiss sight deposit data to determine whether the SNB intervened in markets following softer inflation data this week. Eurozone PMIs, potential PBoC easing, and Canadian core inflation are set to keep markets busy later in the week. In terms of predictions, we think rates are likely to be held by the PBoC, as any decision to cut may be viewed as negative on the economy's growth prospects and further undermine investor and consumer confidence. That said, we may see a 10bps cut in the market-determined 1-year loan prime rate instead, as banks cut short-term lending rates to stimulate demand following the improvement of their profit margins. The marquee event for the week is likely to be the release of flash PMI data for February, however, which we think holds the firepower to send EURUSD back below 1.07. In Canada, we argue that the data continues to overstate the strength of the economy, which could become clear in the inflation data on Tuesday, but given the US reading this week, we note that there is a risk that the data continues to present more noise than signal.

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ECONOMIC CALENDAR

All times in GMT

Sunday 18/02

Time	Country	Event	Period	Estimate	Prior
01:20	China	1-year Medium-term Lending Facility	Feb 18	2.5%	2.5%

Monday 19/02

Time	Country	Event	Period	Estimate	Prior
00:01	UK	Rightmove house prices MoM (YoY)	Feb		1.3% (-0.7%)
07:00	Sweden	CPI MoM (YoY)	Jan	-0.4%	0.7% (3.6%)
09:00	Switzerland	Domestic sight deposits CHF	Feb 16		473.8b
12:00	Brazil	Economic activity MoM (YoY)	Dec	0.7% (0.45%)	0.01% (2.19%)

Tuesday 20/02

Time	Country	Event	Period	Estimate	Prior
00:30	Australia	RBA minutes of Feb meeting			
01:15	China	1-year Loan Prime Rate		4.1%	4.2%
		5-year Loan Prime Rate		3.45%	3.45%
09:00	Eurozone	Current account	Dec		24.6b
	Poland	Average gross wages MoM (YoY)	Jan	0.4% (-0.2%)	0.0% (-0.1%)
09:30	South Africa	Unemployment	Q4	31.4%	31.9%
10:00	Eurozone	ECB publishes negotiated wages	Q2		
13:30	Canada	CPI MoM (YoY)	Jan	0.4% (3.3%)	-0.3% (3.4%)
		Core-median CPI YoY (Core-trim YoY)	Jan		3.6% (3.7%)
16:55	Sweden	Riksbank Governor Thedeen speaks at Swedbank event			
23:30	Australia	Westpac leading index MoM	Jan		-0.04%
23:50	Japan	Trade balance JPY	Jan	-1925.9b	68.9b

Wednesday 21/02

Time	Country	Event	Period	Estimate	Prior
00:30	Australia	Wage price index QoQ (YoY)	Q4	0.9% (4.1%)	1.3% (4.0%)
07:00	UK	Public Sector Net Borrowing ex banking groups	Jan		7.8b
08:00	South Africa	CPI MoM (YoY)	Jan	0.1% (5.3%)	0.0% (5.1%)
09:00	Poland	Real retail sales MoM (YoY)	Jan	-20.2% (1.7%)	11.0% (-2.3%)
12:00	US	MBA mortgage applications	Feb 16		-2.3%
	Mexico	Retail sales MoM (YoY)	Dec		0.1% (2.7%)

Time	Country	Event	Period	Estimate	Prior
14:00	UK	BoE's Dhingra speaks			
19:00	US	FOMC meeting minutes from Jan 31st decision			
21:45	New Zealand	Trade balance NZD	Jan		-323m
22:00	Australia	Judo Bank composite PMI	Feb P		49.0
		Judo Bank manufacturing PMI	Feb P		50.1
		Judo Bank services PMI	Feb		49.1

Thursday 22/02

Time	Country	Event	Period	Estimate	Prior
00:30	Japan	Jibun Bank composite PMI	Feb P		51.5
		Jibun Bank manufacturing PMI	Feb P		48.0
		Jibun Bank services PMI	Feb P		53.1
05:00	India	HSBC composite PMI	Feb P		61.2
		HSBC manufacturing PMI	Feb P		56.5
		HSBC services PMI	Feb P		61.8
06:30	UK	BoE's Green speaks			
07:30	Hungary	Average gross wages YoY	Dec	13.8%	13.9%
08:15	France	HCOB composite PMI	Feb P		44.6
		HCOB manufacturing PMI	Feb P	44.0	43.1
		HCOB services PMI	Feb P	45.5	45.4
08:30	Germany	HCOB composite PMI	Feb P	48.0	47.0
		HCOB manufacturing PMI	Feb P	46.3	45.5
		HCOB services PMI	Feb P	48.0	47.7
09:00	Eurozone	HCOB composite PMI	Feb P	48.3	47.9
		HCOB manufacturing PMI	Feb P	47.0	46.6
		HCOB services PMI	Feb P	48.7	48.4
	Norway	Norges Bank releases Q1 expectations survey data			
09:30	UK	S&P Global composite PMI	Feb P		52.9
		S&P Global manufacturing PMI	Feb P	47.2	47.0
		S&P Global services PMI	Feb P	54.1	54.3
10:00	Eurozone	CPI MoM (YoY)	Jan F	-0.4% (2.8%)	-0.4% (2.8%)
		Core CPI YoY	Jan F	3.3%	3.3%
11:00	Turkey	One-week repo rate		45.00%	45.00%
12:00	Mexico	GDP QoQ (YoY)	Q4 F		0.1% (2.4%)
		Full year GDP	2023		3.1%
		Bi-weekly CPI (YoY)	Feb 15	(4.8%)	0.32% (4.87%)
13:30	Canada	Retail sales MoM	Dec		-0.2%

Time	Country	Event	Period	Estimate	Prior
12:30	Eurozone	ECB publishes minutes of January meeting			
	US	Initial jobless claims	Feb 17		212k
14:45	US	S&P Global composite PMI	Feb P		52.0
		S&P Global manufacturing PMI	Feb P	50.1	50.7
		S&P Global services PMI	Feb P	52.0	52.5
15:00	Mexico	Banxico meeting minutes			
	US	Fed's Jefferson gives speech, Q&A			
21:45	New Zealand	Retail sales ex inflation QoQ	Q4	-0.2%	0.0%

Friday 23/02

Time	Country	Event	Period	Estimate	Prior
00:01	UK	GfK consumer confidence	Feb		-19
00:35	US	Fed's Waller speaks on economic outlook			
01:30	China	New home prices MoM	Jan		-0.45%
05:00	Singapore	CPI MoM (YoY)	Jan	(3.9%)	0.4% (3.7%)
07:00	Sweden	Total number of employees	Q4		0.1%
	Germany	GDP QoQ (YoY)	Q4 F	-0.3% (-0.2%)	-0.3% (-0.2%)
07:30	Hungary	Unemployment rate	Jan	4.3%	4.2%
	UK	BoE Green speaks			
09:00	Poland	Unemployment rate	Jan	5.4%	5.1%
	Germany	IFO expectations	Feb	84.0	83.5
	Eurozone	ECB 1-year (3-year) inflation expectations	Jan		3.2% (2.5%)
09:20	Eurozone	ECB's Schnabel speaks			
11:00	Brazil	FGV consumer confidence	Feb		90.8
13:00	Eurozone	ECB Schnabel speaks			
15:00	Mexico	Current account balance	Q4		$2628m

QUESTIONS FROM THE FLOOR

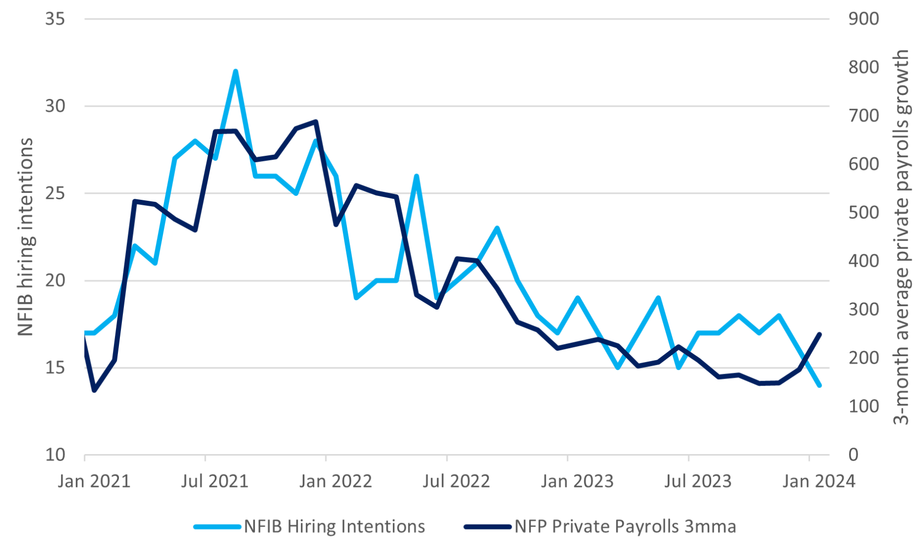
Markets are now pricing fewer rate cuts than our forecast, does our base case still stand?

Heading into the new year, one of our highest conviction calls was that pricing of the Fed's easing cycle this year would be reined in as the US economy continued to grow at an above-consensus rate. Over the past six weeks, this has materialised: the cumulative amount of rate cuts priced into the December 2024 OIS contract has fallen from 152bps to just shy of 100bps, while the start date for the Fed's first cut has now been pushed back well into Q2. As pointed out, the readjustment in market pricing has now overshot our base case forecast of a rate cut in May, followed by three more successive rate cuts before a deceleration to one cut per quarter in Q4, culminating in 125bps of easing this year. Despite this, we aren't inclined to revise down our easing expectations for year just yet, especially as the data that has moved market expectations is producing a lot of noise and doesn't yet suggest the disinflation trend has shifted in our view.

While Chair Powell's message at the January 31st meeting that a March rate cut was unlikely set the hawkish trend for US rates in motion, it wasn't until January's data began to print substantially above expectations that market pricing began to seriously shift. This started with the payrolls data, which less than 48 hours after Powell's warning about the March meeting, showed the US economy adding 353k jobs at the start of the year. The details of the jobs report read firm as well: the unemployment rate held steady at 3.7%, average hourly earnings growth doubled expectations to record the fastest growth since the full re-opening at 0.6%, while job gains were concentrated in cyclical sectors such as retail trade and professional and business services. On the surface, the data suggested that the US labour market remained tight with labour demand elevated. This not only pointed to strong underlying growth rates, but also a labour market that remains inflationary just days after Q4's employment cost index argued otherwise.

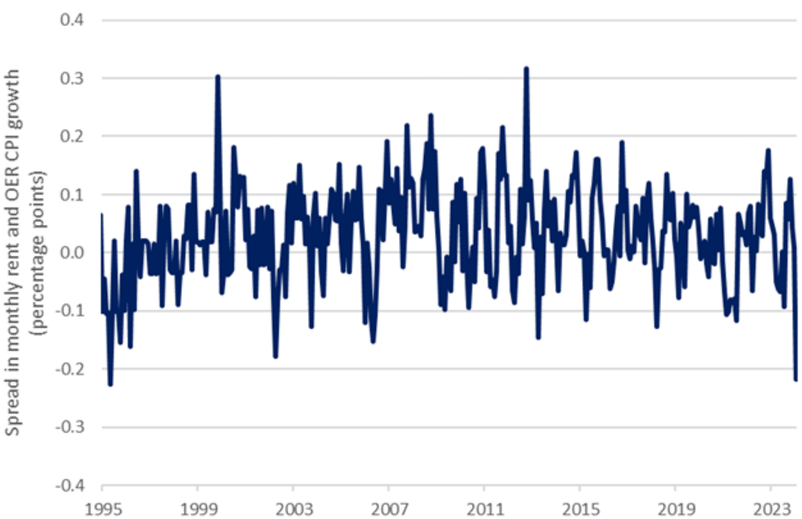
At the time, we were somewhat sceptical of extrapolating too much from this singular data point, noting that January 2023 also saw a blowout jobs report due to the seasonal adjuster being tainted by lockdown effects. Upon closer inspection, a similar argument can be made about this year's data. The details of the report are also less concerning than the top-line measures suggest. Take average hourly earnings, for example. Stronger wage growth largely reflects fewer hours worked in weather-sensitive sectors—construction (-0.4), mining (-0.9), retail trade (-0.5) and hospitality (-0.5)—as opposed to much stronger pay settlements. This is reflected in flat average weekly earnings (-0.033% MoM), which is unaffected by changes in hours. Now this isn't to say the US labour market isn't strong. After all, the trend in employment was elevated even before January with job growth continuing to track supply, leading the employment-to-population ratio to trend broadly sideways over the past year. Nevertheless, the labour market isn't as hot as the headline jobs and wage measures suggest, and forward-looking indicators such as the NFIB's hiring intentions suggest that capacity pressures in the labour market should continue to normalise in the coming months.

Forward looking indicators, such as the NFIB's hiring intentions, suggest the labour market should continue to normalise



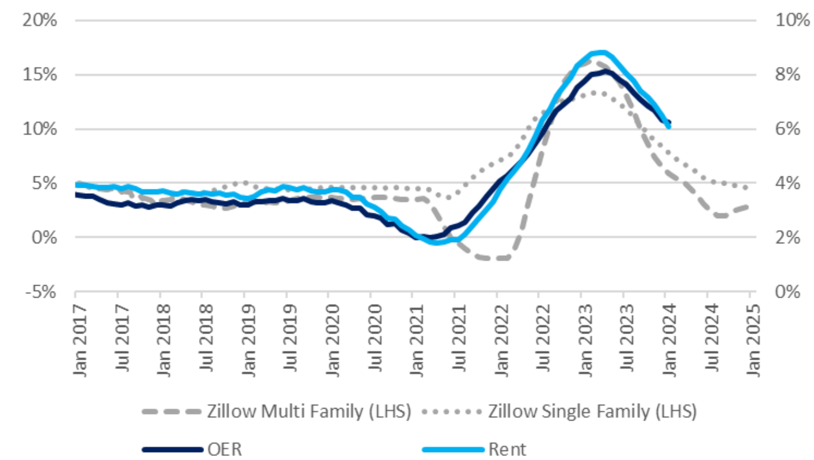
Similar caveats can be applied to this week's inflation report, where methodological changes, start-of-year price adjustments and an anomalous spike in the calculated owners' equivalent rent measure of shelter inflation led the acceleration in core inflation to overstate the capacity pressures in the economy. As we noted in this week's data response, the strength in core inflation largely reflected the increased share of OER within the shelter category, which in total contributed over two-thirds to headline inflation. However, OER is a synthetic measure of shelter inflation and has multiple flaws. Beyond the difficulties in matching rented units to comparable owned residences, the BLS also estimates what the contribution of utilities is within rent and then strips it out in the OER measure. This means there are two areas where measurement error can arise; 1) how much utility costs account for within overall rent, 2) how quickly an increase in utilities is passed on. The scope for error means the source data, primary rents, better reflects shelter inflation. That isn't necessarily reflected in overall shelter CPI, however, as the relative importance of OER on overall inflation has risen by 0.751pp this year, while the share of rent has declined by -0.043pp. This means the significant divergence in the composition of shelter inflation, the largest since May 1995, boosted inflation.

Measures of shelter inflation diverge the most since 1995



"Focusing specifically on rent inflation, shelter costs are considerably cooler and should continue to ease in the coming months as new lease agreements are being struck with fewer inflation adjustments. This is visible in more recent rent measures."

Leading indicators such as the Zillow index suggest that shelter costs are cooling faster than official measures suggest



The questionable developments in shelter inflation aren't the only reason to discount the latest CPI report. Labour-reliant categories also saw sharp price increases at the beginning of 2024, likely reflecting start-of-year price resetting. Medical care services (+7.02%), transport services (+8.73%) and daycare (+5.75%) all exhibited outsized increases, likely due to high levels of wage growth last year, but these should revert in the coming months. The downtrend in airline passenger growth and hotel occupancy rates also suggests that the significant increases in airline fares (+8.73%) and lodging away from home (+6.17%) should soon reset to a lower pace of growth too. All told, the overall level of strength in the US data confirms our view that the Fed's easing path will begin later and will be shallower than markets anticipated at the start of the year. However, given the sheer level of noise in the January data, we think it is too early to completely write off a cut in May. Should signs of inflation persistence remain visible in February's data, we are likely to revise our overall view on Fed easing, but in the interim, we are inclined to maintain our view, focusing on the trend of inflation pressures through this noisy period.

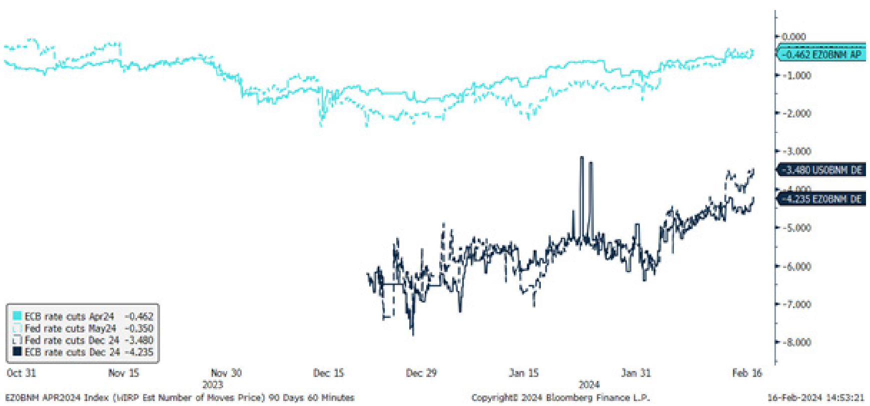
Eurozone data remains weak, when will the euro start to reflect this?

Eurozone data continues to suggest that the economy not only stalled by the end of 2023 at best, but that risks of this being a prolonged stagnation are high. Even so, this has not been enough to convince markets to take a more dovish on ECB rate cuts just yet. So, while EURUSD has fallen 1.65% since the start of the year, this is largely due to US data highlighting continued American economic strength. This outperformance has in turn led markets to trim expectations for the Fed's easing cycle, which had seen a first full rate cut priced for March as recently as two months ago. But the evolution of US data over recent weeks has now seen this pushed back to June. The impact has not just been limited to Fed expectations, however. Despite, incoming eurozone data continuing to argue for earlier rate cuts in the Eurozone, market pricing for the ECB has trended in the opposite direction, but in concert with the anticipated Fed easing path. This process has been encouraged by ECB policymakers who continue to emphasise the importance of April wage data in determining when to start cutting.

"We, however, are doubtful. Given our dim view of the eurozone economy, we think this view of a later easing path is likely to be short lived, and that the fall in EURUSD has further to run."

For this to happen though, it would now require markets to take a more dovish view on eurozone rates, with Fed expectations now looking somewhat stretched to us (see question above on the Fed's rate path).

Pricing of the ECB continues to track that of the Fed's, even as the data continues to diverge



Preliminary eurozone PMI data, due next Thursday, may cause this dynamic to break. After January's data added further weight to our view that the bloc is unlikely to escape contraction soon, we expect February's release to show that growth conditions are yet again failing to improve, despite the continued strengthening of forward-looking confidence indicators. Admittedly, last month's report tried to suggest signs of recovery were beginning to show. If they are, it is by the barest of margins in our view, not least given that the composite measure only rose 0.3pp to 47.9. Our reading of that data, in contrast, was somewhat different. Notably, whilst employment stabilised in January, this followed on from declines in November and December. Combined with firms continuing to clear backlogs of work and new business orders falling, this suggests to us that labour market conditions are likely continuing to deteriorate under the surface. Rising unemployment is combining with weak aggregate demand conditions too, which continue to weigh on services activity in particular. To us this suggests both that there is little scope for pass through from wage to inflation and that weak consumer demand should hinder any economic recovery. As such, we expect to see a further weakening in the employment sub-indices next week, meaning that stickiness in prices charged should not overly trouble policymakers.

More interesting will be if there is a renewed downturn in both input and output cost indictors, a dynamic that should ultimately materialise given the weaknesses elsewhere in the data. There is a distinct possibility that this happens next week, albeit risks are that this may take another release or two to become fully apparent. When it does though, this should remove the final upside risk to the inflation outlook other than wages. With headline inflation already below the Bank's forecasts, further declines in cost indicators combined with an economy in contraction and further softening in the labour market, risks would begin to skew sharply to the downside and push against holding rates until Q1's wage data is released.

"In any case, assuming our view for next weeks data plays out as we expect, this should add yet more evidence that the Eurozone economy is slowing faster than ECB officials are willing to publicly acknowledge, and that the inflation profile is likely to be weaker than many project. As such, if the ECB is as data dependent as it claims to be, then next week's data should argue in favour of cuts coming in April, and in advance of official wage data being published."

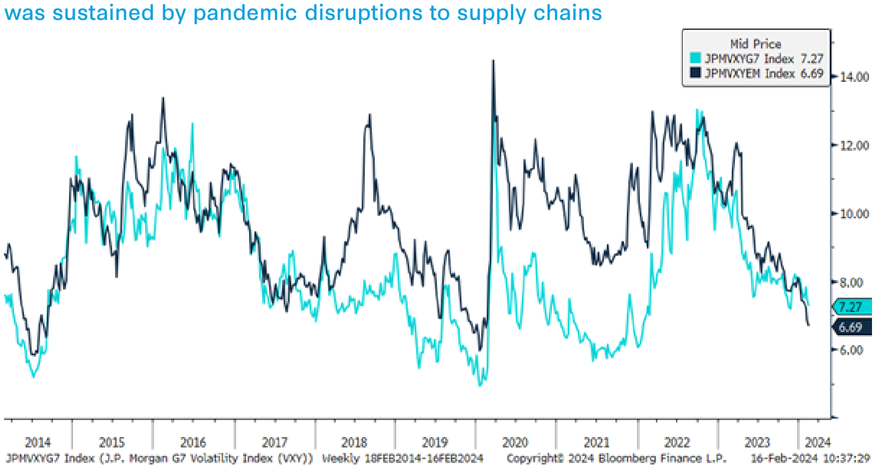
If this is accompanied by a strong signal that prices charged are definitively falling too, this should spark a sharp EURUSD selloff on speculation that this could be confirmed in the February inflation data released the following week in advance of the March meeting. Absent this, then an acceleration in ECB rate cut expectations could take a little longer to play out, with policymakers likely to try and keep their options open. Even so, we would still anticipate expectations between the US and eurozone widening on a weak eurozone outturn, which should see EURUSD breaking back below the key psychological barrier of 1.07 as a result.

Why has FX volatility for EM currencies fallen below that for G10, and how long will this last?

First off, it is worth noting that after remaining largely stable for the second half of last year, broad currency volatility including both EM and G10 currencies has taken another leg lower in the early part of 2024. As alluded to however, this have been more pronounced for EM currencies than for G10, to the extent that the composite implied FX volatility for EM currencies has now fallen below that of G10 FX when looking at JP Morgan's indices at shorter tenors.

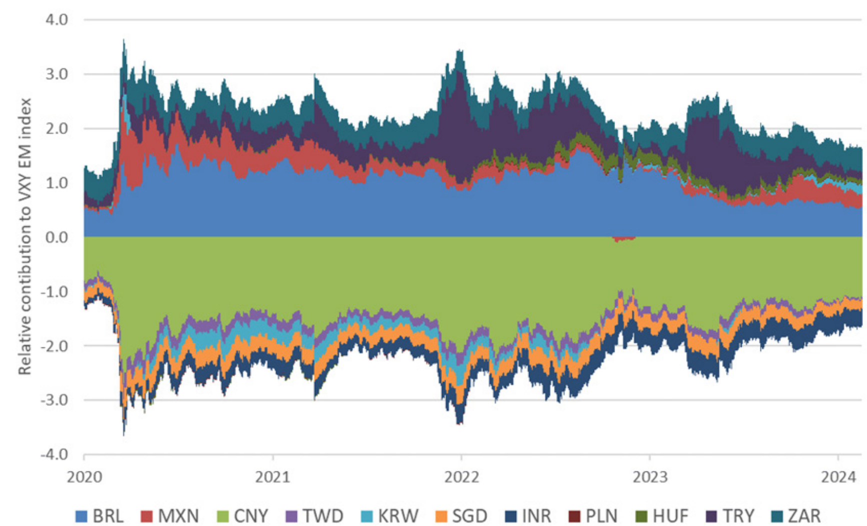
In part this represents a return to more normal market behaviour. Looking at 3m implied measures, EM FX volatility has historically tracked G10 volatility relatively closely. In this sense, it is the period post-2018 that is an outlier when placed, with EM volatility notably more elevated when compared to that for G10 FX. Significantly though, this coincided with a souring in US-China relations, sparking a trade war between the two countries which led EM currencies trade with greater volatility than seen across broad G10 FX. Moreover, just as these tensions began to subside in late 2019 and early 2020, the Covid-19 pandemic then emerged to stoke further disruption to global trade. As such, it was only in 2022 with the normalisation of global supply chains that volatility across G10 and EM FX broadly realigned. But this was a return to old patterns of behaviour rather than anything new and special.

Despite ordinarily tracking broadly in line with G10 currency volatility, implied EM volatility began to exhibit an upwards spread on US-China trade tensions in 2018, and was sustained by pandemic disruptions to supply chains



For EM volatility to drop below that for G10 FX is unusual, however, particularly for it to do so on a more sustained basis as we have seen since the beginning of 2024. At first glance, the obvious explanation would seem to be the behaviour of USDCNY, which is by far the largest component of the VXY EM basket at 35.3%. After the pair rallied sharply in the first half of 2023, the PBoC implemented what was in effect a soft peg between, leading realised volatility to collapse. Moreover, following a modest depreciation for USDCNY in November the PBoC did not choose to drop their stance, but instead appear to have reset it at a lower level. This is not however the full story as to why EM currency volatility has dropped below G10. In fact, despite remaining the single largest downward contributor the 3m EM currency volatility index, CNY has actually become less of drag in recent months as the index as a whole declined.

As the VXY EM index ground lower, CNY volatility became less of a drag. Instead, declining volatility across CNY-sensitive currencies, plus some idiosyncratic stories, have been responsible for the recent volatility decline.



This is not to say that CNY is not having an effect in depressing volatility across the EM index as a whole. Rather, we think that it is now doing so more indirectly. It is notable that the recent volatility declines have largely been concentrated in currencies with significant exposure to CNY and to Chinese growth. Accordingly, just the PBoCs actions have contained USDCNY volatility, it appears that the lack of CNY movement is now weighing on volatility across other China exposed FX, notably BRL. A similar though less pronounced effect is also apparent for USDINR, where the RBI similarly instituted a soft dollar peg since late-2022.

That said, some idiosyncratic stories are also at play too. This is most obvious for TRY, where bouts of rapid depreciation combined with domestic political risks have given it an outsized upward impact on the index historically. The transition to a more orthodox monetary policy framework in mid-2023 has done much to stabilise the currency, however, not to mention instil confidence that this is set to continue. As such, TRY is the largest contributor to the fall in volatility since the start of 2023. But with markets now having digested the CBRT's change in approach, this is unlikely to drag the index much lower going forwards.

"All told, we think this trend of EM volatility tracking below that of G10 FX could persist temporarily for several more months."

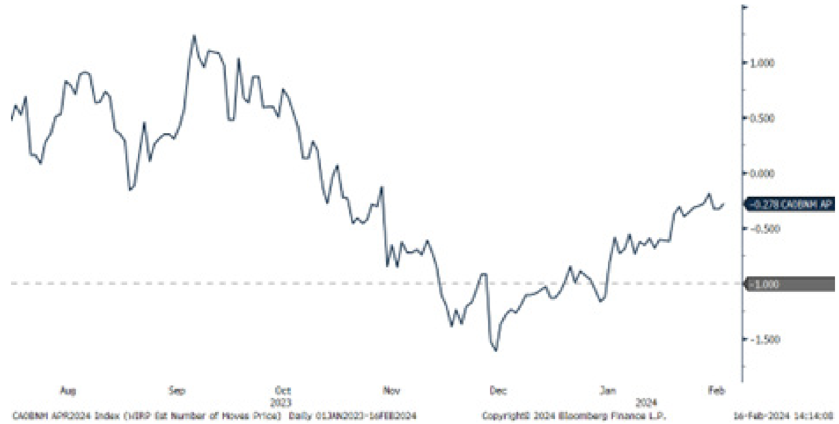
Whilst the impact of soft pegs across EMs are unlikely to depress realised volatility much further in the short term, the already subdued levels of price action for key EM currencies should continue to drag implied volatility lower at the margin. This, along with reduced rates volatility, should see implied vols grind lower across the complex. That said, we see this as a temporary phenomenon as central bank policy across the expanded majors is set to become more active. In G10 markets, the "will they won't they" speculation is likely to turn towards the magnitude of rate cuts and the risk of late cycle dynamics, with some central banks likely facing the risk of a more pronounced downturn due to holding rates for too long. On the contrary, re-emergence of inflation pressures is also possible for some of the early easers, meaning two-directional policy risks should arise. This is especially the case for EM central banks, but cannot be ruled out indefinitely for DM economies either. As the 3-month window starts to cover this period, which we expect to begin in mid-to-late Q2, implied volatility should rise across the board, with riskier EM currencies likely to command a higher premium than G10 counterparts.

The number of rate cuts priced for the BoC this year have nearly halved, is it time to turn bullish on CAD?

The US isn't unique in terms of noisy data. Macroeconomic variables out of Canada have been displaying conflicting signals for months now, and even the mostly reliable jobs data isn't insulated from this. As a result, distinguishing the noise from the signal is becoming harder, and that itself is a reason for the Bank of Canada to take a more cautious approach in easing policy.

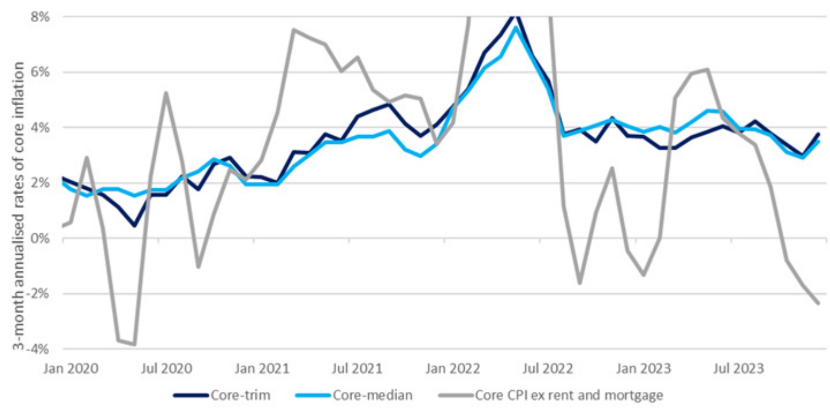
This arguably poses the biggest risk to our long-held forecast that the BoC will begin cutting rates in April. Nevertheless, despite the headline noise, we think the underlying trend within key data continues to support our base case of an April cut.

Markets have effectively priced out a BoC rate cut in April as the data comes in choppy, having previously seen it as a done deal



Turning first to the inflation data, which arguably poses the strongest counterargument on a surface level. While the average of the BoC's core measures of inflation continues to show limited progress on disinflation, suggesting that progress on the annual measures is set to stall in the coming months, we note that a lot of the inflation is still coming from housing components and directly reflects the BoC's hiking cycle accordingly. For example, simply stripping out rent and mortgage components from the standard core CPI measure (CPI ex food and energy), the trend in core inflation is actually deflationary. The same can be said when excluding shelter entirely, but we prefer concentrating primarily on rent and mortgage payments for two reasons. First, the more you exclude from the inflation basket, the less inflation you're likely to get. Second, rent and mortgage payments represent the feedback loop from the BoC's tightening cycle. The former through the impact higher interest rates have had on exacerbating the structural under-supply, the latter directly through yields and mortgage rates.

Canada's inflation rate isn't as hot as the BoC's preferred measures suggest once removing some shelter components



Beneath the surface, the labour market has been softening too. While the economy added 37.3k jobs in January, all of these were within part-time positions. While seasonally adjusted industry breakdowns aren't provided, we believe most of the part-time increases were concentrated within consumer discretionary industries, which tend to have a high monthly turnover and should retrace in February. Not only was the composition of job gains weak, but it also dovetails on the more stable Q4 data that highlighted weak growth conditions filtering through into more cyclical industries. Additionally, strength in the wage data should also be heavily caveated. Not only have the BoC warned against overinterpreting the lagged data, but more accurate measures of pay growth, such as that within the SEPH report, are tracking at rates more consistent with 2% inflation. Furthermore, we have argued that if both wage growth is north of 5% as the data suggests, and core inflation pressures remain hot, labour supply growth should increase considerably as individuals are either attracted or forced into the labour market. It was interesting then that January saw the overall population grow by 126k people but the unemployment rate drop for the first time since December 2022. This inconsistency suggests to us that measures of either inflation or wage growth, but most likely both, are providing a false signal. Nevertheless, over time we suspect those inactive workers will join the labour market, loosening conditions at the margin. In conjunction with firms reporting significantly easier hiring conditions, it is only a matter of time before the headline wage measure drops to around 3% per annum.

Cooling wage growth and rising unemployment poses a risk to growth, which on a monthly basis has also been overstating the strength of the Canadian economy due to high levels of immigration and inventory rebuilding. This should become clearer in the much richer quarterly growth data for Q4, released at the end of the month. Nevertheless, the fact that practically every single Canadian macro data point needs to be carefully explained suggests the BoC may take a more patient stance than our base case expects – the virtues of being a central bank! That said, with two more inflation, jobs, and monthly GDP reports, one more quarterly GDP report, and another round of Business Outlook Surveys set to be released before the BoC's April 10th meeting, we think it is too early to give up hope on an April cut. The market seemingly thinks differently and is grossly underpricing the risk of a cut at just 27.8%. Should the data, starting next week with January's inflation data, start to better reflect the cyclical weaknesses within the economy that can be seen in the underlying data, we think pricing of cuts should sharply rise, weighing on CAD in the short-term. In the event that the data continues to be noisy, we don't think a delayed start to the BoC's easing cycle warrants a changed view on CAD given that the risk of a BoC induced recession and larger rate cuts in the middle of the year merely increases.

"If anything, we think this scenario would increase our bearishness on the Canadian economy over the medium-term."

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