ON DECK FOR MONDAY, JANUARY 29

US	01/29	08:30	PCE Deflator (m/m)	Dec	0.1	0.1	0.2
US	01/29	08:30	PCE Deflator (y/y)	Dec	1.7	1.7	1.8
US	01/29	08:30	PCE ex. Food & Energy (m/m)	Dec	0.2	0.2	0.1
US	01/29	08:30	PCE ex. Food & Energy (y/y)	Dec	1.5	1.5	1.5
US	01/29	08:30	Personal Spending (m/m)	Dec	0.4	0.4	0.6
US	01/29	08:30	Personal Income (m/m)	Dec	0.3	0.3	0.3
US	01/29	10:30	Dallas Fed. Manufacturing Activity	Jan	--	25.4	29.7

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KEY POINTS:

- Bond sell-off driven by global central banks
- 4 reasons behind higher sovereign yields…
- …with the BoJ starting it…
- …ECB officials trading hawkish and dovish blows…
- …with the emphasis upon a candidate to replace Draghi…
- …ahead of whether US core PCE inflation is still rising…
- …and Wednesday's possibly more hawkish FOMC turn
- CAD and Canadian rates could be vulnerable to NAFTA headlines today
- BanRep expected to cut
- Global Week Ahead

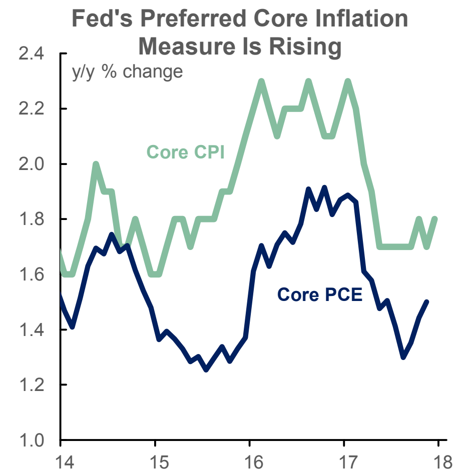
As a reminder, the Global Week Ahead was sent out on Friday and is available here. Key risk highlights will include:

- FOMC
- Inflation: US, EZ, Australia…
- …Thailand, South Korea, Indonesia, Peru
- GDP: Eurozone, Canada, Mexico, Taiwan
- Nonfarm payrolls
- NAFTA negotiations
- Trump's State of the Union
- Other CBs: Colombia, Chile
- China's PMIs
- Japan's macro dump
- US macro prints
- UK PMIs
- Earnings

The USD is broadly stronger while global sovereign yields are under significant upward pressure especially in the US and Germany. There are four factors that are probably driving this and they are summarized below. CAD and Canadian rates may be sensitive to how the US receives Canadian NAFTA proposals today. BanRep is expected to ease today.

- **The USD is broadly stronger against all major crosses and the also rans.** The weakest crosses are the rand, pound sterling, real and Mexican peso. The Euro lies in the middle of the pack on the back of mixed ECB comments. CAD is also a middle of the pack performer. The yen and won are outperforming but still down on the morning.

- **Sovereign bond yields are under upward pressure across all major markets this morning.** US Treasuries are leading the cheapening with the 10 year yield up 5-6bps to 2.72% in a slight bear steepener that has 2s up 3bps. The US 10 year yields is at its highest since April 2014. Canadas



Sources: Scotiabank Economics, Bloomberg.

are mildly outperforming with the 10 year yield up 3-4bps. Gilts are relatively little changed across the curve. Eurozone curves are also bear steepening and led by Germany and France. The German 10 year is up 4-5bps to 0.67% which is the highest in just over two years.

- Oil prices are a little lower with WTI at about US$65¾ as the flip side of a stronger greenback. There is nothing material by way of fresh developments in oil markets this morning. Gold is also lower.

- US equity futures are broadly lower across all benchmarks but by ¼% or less. TSX futures are down by a similar amount. European equities are flat across major bourses. Asian equities were mixed with Tokyo closing flat, HK declining ½%, mainland China down 1-1.5% but Seoul up by almost 1%.

There are four factors driving the bond sell off in my opinion and all three of them are related to the titans of central banking.

1. The BoJ Started It All On Friday

First is that a shift in thinking applied to global central banks began with the market confusion that was fed by BoJ Governor Kuroda's remarks at Davos on Friday when he sounded somewhat more hawkish. Kuroda said "There are some indications that wages are actually rising, and some prices have already started to rise and even medium- to long-term inflation expectations, which have been so weak in the last couple years, are slightly picking up. So, there are many factors which made achieving 2 percent inflation target or price stability target so difficult and time-consuming, but I think we are finally close to the target."

Shortly afterward BoJ officials attempted to tamp down the significance of the remarks by indicating that they do not represent new information relative to the BoJ's prior communications and forecasts, but I'm not so sure about that. The remarks seem pretty clear to me and indicate somewhat improved conviction at the top of the house that after a quarter century of blowing its targets in a deflationary or disinflationary environment that suddenly the BoJ thinks it is getting close.

2. The ECB Fanned The Flames This Morning

Second, hawks and doves continue to trade body blows this morning as the competition for President Draghi's job heats up. Draghi's term ends in October 2019 and the northern hawks are positioning themselves to be candidates. I would take many of the remarks by top officials this year in the context of jockeying for the job especially as the northern Eurozone economies state the case for one of them to be chosen including one of this morning's commentators.

ECB Governing Council Member and head of the Dutch central bank Klass Knot said that the ECB's QE program has to end "As soon as possible" and expanded upon that remark in a TV interview this morning. Because he is thought to be a candidate to replace Draghi, Knot's comments may be weighing particularly heavily upon markets this morning. He noted the following:

"The program has done what could realistically be expected of it. The program is fixed until September. We don't have to communicate yet that it will be over after September, but I think that's where we're headed."

ECB dove and Executive Board Member Peter Praet's term as chief economist expires in the Spring of 2019 and he note the following in a speech delivered in Brussels this morning:

"We are still some distance away from meeting all three criteria at the same time. Once the Governing Council judges that the three criteria for sustained adjustment have been met, net asset purchases will expire, in line with our guidance. The transition toward a normalization will begin once we have established that there is a sustained adjustment in the path of inflation. Despite the strong cyclical momentum, domestic price pressures remain subdued, as do measures of underlying inflation."

ECB Benoit Coeure, who heads the ECB's market operations, speaks at 11amET. His term expires in January 2020.

Will US Core Inflation Rise Again This Morning?

Third, we'll get fresh US data on core inflation this morning that will further inform the Fed's policy bias into Wednesday's FOMC meeting. Today's price deflator for personal consumption expenditures (8:30amET) in December will update the Fed's preferred metric and the issue is whether or not core PCE continues to rise. Consensus doesn't think so and expects it to hold flat at 1.5% y/y. Then again, core CPI did tick higher in December to 1.8% y/y. There are many differences between core CPI and core PCE (here) and about half of the difference in the latest CPI and PCE reports was explainable by different weights on several key components like gasoline and shelter. See the relative trend performances in the two measures in the accompanying chart. Consumer spending within the same report will offer no new information as it simply breaks out the December reading from the already known full quarter.

Wednesdays' FOMC Statement Could Be A Little More Hawkish

Fourth is that I expect Wednesday's FOMC meeting to take a mildly hawkish turn as outlined in Friday's Global Week Ahead. Briefly summarized, there are four main reasons. Since December's meeting, the Tax Cuts and Jobs Act was passed and the CBO's formal costing of the package was delivered in early January which should raise conviction across the FOMC on the mild near-term effects and quantifying them. Second is that core PCE inflation moved higher post-FOMC in December and pending today's January figures. Third is the decline in the USD and its implications for imported inflation. Fourth is that GDP growth has been quite strong on a sustained basis for the past three quarters.

Canada Could Be Vulnerable To NAFTA Headlines Today

Canadian rates are slightly outperforming Treasuries this morning, but will that last? CAD and rates may be vulnerable to comments at the conclusion of the sixth round of NAFTA negotiations in Montreal today. US Trade Representative Robert Lighthizer is expected to weigh in on whether Washington views the recent Canadian proposals on North American auto content as constructive enough to strike a more positive tone toward how negotiations are going. One of the key aspects of the Canadian proposal involves updating the content requirements through applying them across more components including software and other features that did not exist when NAFTA was originally implemented.

Aside from such developments, the only other one worth observing across our clients' footprint will come from Colombia. **BanRep issues a policy decision today and a slim majority of 19 out of 36 forecasters expect the overnight lending rate to be cut by 25bps to 4.5%.** If one removes the more stale forecasts from the Bloomberg sample, then the balance turns more decidedly toward a cut.

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.	2.14	2.12	2.06	2.52	2.47	2.45	2.72	2.66	2.65	2.96	2.91	2.91
CANADA	1.84	1.81	1.80	2.10	2.06	2.03	2.30	2.26	2.24	2.36	2.33	2.36
GERMANY	-0.53	-0.54	-0.61	0.00	-0.04	-0.15	0.68	0.63	0.57	1.32	1.28	1.31
JAPAN	-0.12	-0.13	-0.13	-0.07	-0.08	-0.08	0.09	0.08	0.08	0.81	0.83	0.83
U.K.	0.63	0.63	0.57	0.98	0.97	0.87	1.46	1.44	1.36	1.89	1.90	1.87
	Spreads vs. U.S. (bps):											
CANADA	-31	-30	-26	-43	-41	-41	-42	-40	-41	-60	-58	-55
GERMANY	-267	-266	-267	-252	-251	-259	-204	-203	-208	-164	-163	-160
JAPAN	-227	-224	-219	-259	-255	-252	-263	-258	-257	-215	-209	-209
U.K.	-152	-149	-149	-154	-150	-157	-126	-122	-129	-107	-101	-105

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	16239	35.2	0.2	-0.7	0.2	4.3
Dow 30	26617	223.9	0.8	2.1	7.7	32.5
S&P 500	2873	33.6	1.2	2.2	7.5	25.2
Nasdaq	7506	94.6	1.3	2.3	8.7	32.6
DAX	13331	-9.4	-0.1	-1.0	3.2	12.8
FTSE	7682	16.7	0.2	-0.4	-0.1	6.9
Nikkei	23629	-2.5	-0.0	-0.8	3.8	21.4
Hang Seng	32967	-187.2	-0.6	1.8	10.2	41.1
CAC	5533	3.4	0.1	-0.2	4.1	14.3
Commodities	Level		% change:			
WTI Crude	65.69	-0.45	-0.7	3.5	8.7	23.5
Natural Gas	3.36	-0.14	-4.1	4.3	13.9	-0.9
Gold	1342.76	-6.94	-0.5	0.7	3.0	12.7
Silver	17.34	-0.07	-0.4	1.8	2.8	3.8
CRB Index	200.52	1.18	0.6	2.6	3.4	3.7
Currencies	Level		% change:			
USDCAD	1.2349	0.0041	0.3	-0.8	-1.8	-5.9
EURUSD	1.2382	-0.0045	-0.4	1.0	3.1	15.8
USDJPY	108.81	0.2300	0.2	-1.9	-3.4	-4.4
AUDUSD	0.8085	-0.0025	-0.3	0.8	3.5	7.0
GBPUSD	1.4067	-0.0093	-0.7	0.6	4.1	12.7
USDCHF	0.9358	0.0034	0.4	-2.7	-4.0	-6.0

Central Banks	
Current Rate	
Canada - BoC	1.25
US - Fed	1.50
England - BoE	0.50
Euro zone - ECB	0.00
Japan - BoJ	-0.10
Mexico - Banxico	7.25
Australia - RBA	1.50
New Zealand - RBNZ	1.75
Next Meeting Date	
Canada - BoC	Mar 07, 2018
US - Fed	Jan 31, 2018
England - BoE	Feb 08, 2018
Euro zone - ECB	Mar 08, 2018
Japan - BoJ	Mar 09, 2018
Mexico - Banxico	Feb 08, 2018
Australia - RBA	Feb 05, 2018
New Zealand - RBNZ	Feb 07, 2018

Source: Bloomberg. All quotes reflect Bloomberg data as at the time of publishing. While this source is believed to be reliable, Scotiabank cannot guarantee its accuracy.