February 25, 2020 @ 17:20 EST

KEY POINTS:

- **Stocks abruptly sell-off again on coronavirus concerns**
- **US nominal (but not real) 10 year yield hits record low**
- **Gold weakens with the USD**
- **Markets pricing two cuts from the Fed and BoC this year**
- **CDC warns it's "when" not "if" US cases pile up**
- **Why one shouldn't count upon the US economy being immune**
- **It's not clear COVID-19 will go away when the weather turns**
- **Fed's Clarida buys time to monitor**
- **US consumer confidence flat but expectations improve**
- **Richmond metric reinforces ISM downside**
- **US new home sales on tap tomorrow**
- **BoC's Lane does not comment on current policy**

Ouch. The best thing you can say about today is that stocks didn't fall by quite as much as the day before, though barely so. Coronavirus concerns dominated again with the CDC jumping in to warn Americans. Domestic US data didn't help while the Fed delivered a highly conditional assessment that basically just bought time.

- The S&P500 fell another 3.0% after declining by 3.35% on Monday. That takes the stock market back to its lowest since December 11th for a cumulative loss of 7.6% since the peak last Wednesday. The TSX sold off by 2.2% despite bank earnings beats that still saw banks down by 1.7%. European cash markets fell by around 2% on average.

- The US 10 year nominal Treasury yield hit the lowest on record all the way back to the 1870s and closed at 1.35% (chart 1). The real yield is by no means a record low. Yields began to marginally turn higher at about 3pmET onward. One measure of the real 10 year Treasury yield is to subtract the past year's headline CPI inflation rate; by this measure, the real yield was more negative in for much of the period from June 2011 to April 2013, and many other periods before that. See both measures on chart 2 all the way back to basically when Canada was born as a nation. Canada's curve underperformed Treasuries with the ten year bond yield around its lowest since early last September and not yet a record low. In fact, Canada's 10 year has another about another 24bps to go to hit the recent low in 2016.

- The USD weakened somewhat and mostly as the won, sterling, yen, Swiss franc and euro rallied. CAD slightly appreciated. The A$ and Mexican peso were flat.

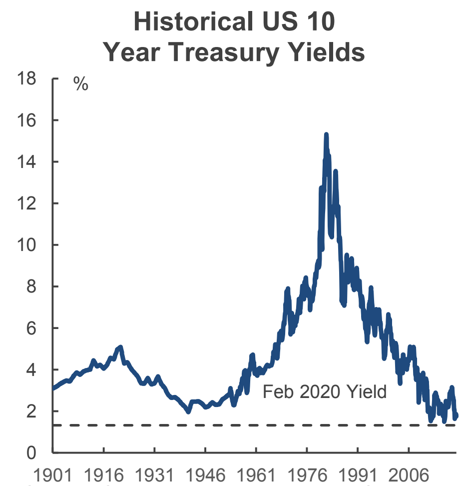
- Oil prices fell again. WTI sank to below US$50 before slightly rising and Brent fell to US$55 for declines of roughly 2½% in both. Western Canada Select fell by about another 70 cents to US$34.30. Gold also fell by another US$24 to US$1635 for a two day decline of about US$23. Why? Likely because the USD depreciated whereas the further decline in the real 10 year Treasury yield should have leaned in the opposite direction.

CONTACTS

Derek Holt, VP & Head of Capital Markets Economics
416.863.7707
Scotiabank Economics
derek.holt@scotiabank.com

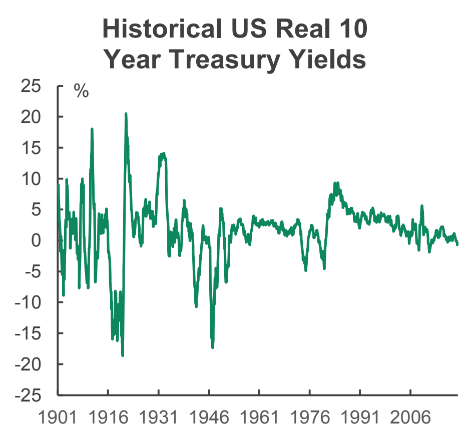
Evan Andrade, Research Analyst
416.862.3080
Scotiabank Economics
evan.andrade@scotiabank.com

Chart 1



Sources: Scotiabank Economics, Robert Shiller.

Chart 2



Note: Real Yields calculated by subtracting historical y/y headline CPI
Sources: Scotiabank Economics, Robert Shiller, US BLS.

- US fed funds futures are pricing a full cut by June and then another cut by September.
- OIS markets are pricing a full cut by the Bank of Canada by June, over half of a cut by the April meeting and about one-third of a cut by next week.

TODAY'S NORTH AMERICAN SESSION

US macro data generally disappointed a touch while coronavirus warnings intensified and the Fed sounded more guarded and conditional.

The CDC issued this early this afternoon on the coronavirus that has been noted as a cause of accelerated stock selling. They warned of the risk of community spread in the US and offered guidance on managing the risk. The verbal teleconference that went with the release of the report stated more bluntly that "we expect we will see community spread. It is not a matter of if, but a question of when, this will exactly happen."

Markets are sparking somewhat of a reassessment of risks to the US economy which should not be assumed to be immune to the effects. For one thing, the disease experts are saying that the domestic case count is expected to materially rise. That might drive more avoidance activity with dampening implications to growth in discretionary spending. **If they're warning about this, markets have cause to listen and economists have cause to begin factoring the effects into their base case outlook.**

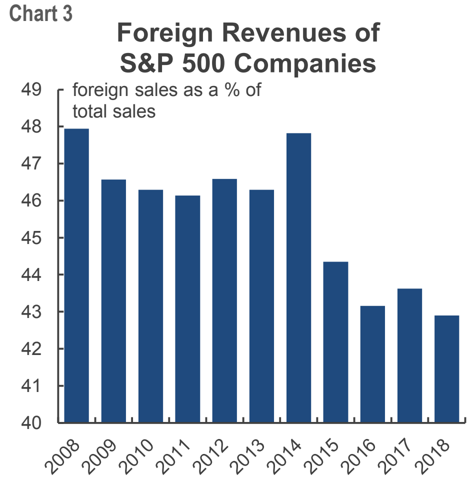
Further, US supply chains are being hit. Given the extent of offshoring activity over the decades and integrated supply chains, the feedback effect could be negative upon domestic production and product availability.

Third, a profit crunch—and its aftermath—is in the midst of unfolding. What stock markets are heavily reassessing is the risk to foreign earnings given that over 40% of the earnings of S&P500 companies comes from abroad (chart 3). Thus, risks to supply chains—further amplifying the effects of Trump's trade wars and still present tariffs—coupled with a potential profit shock could well motivate reduced investment, tightened expense controls and lessened hiring activity that will heighten the focus upon measures like nonfarm payrolls over coming months. This emerging profit shock is occurring in the context of concern toward corporate debt markets and stretched financing behaviour.

Last, **it's not clear that the assumption advanced by many that the virus will go away when Spring arrives will be valid.** To this effect, I'm repeating chart 4 that shows how the precedent whereby the 2009 Swine Flu did not go away by Spring and the case count kept climbing throughout the year.

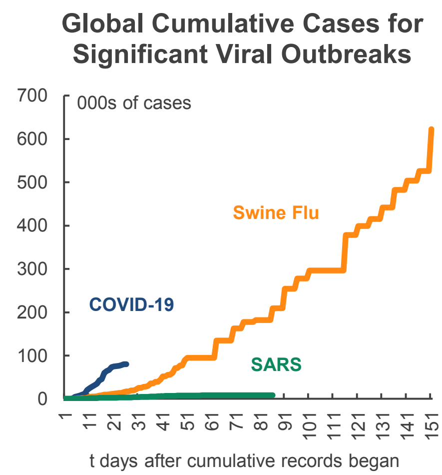
Federal Reserve Vice Chair Richard Clarida delivered a speech on the outlook today and perhaps the most telling feature was its brevity (here). It was probably planned that way because he had to go into a moderated discussion after delivering the speech, but it worked out rather conveniently to not have to say very much at this uncertain juncture. Clarida walked the line between staunchly defended potentially stale forecasts and not reacting in an overly hasty fashion to recent market and coronavirus developments. Clarida's remarks were heavily conditional. Policy is appropriate "as long as incoming information about the economy remains broadly consistent with" their prior outlook. He said it's 'too soon to tell' what the coronavirus may mean. He also repeated that inflation is beneath their target but expected to rise. The key was his risks paragraph as follows:

Chart 3



Sources: Scotiabank Economics, S&P Dow Jones Indices LLC.

Chart 4



Sources: Scotiabank Economics, CDC, WHO.

> "However, risks to the outlook remain. In particular, we are closely monitoring the emergence of the coronavirus, which is likely to have a noticeable impact on Chinese growth, at least in the first quarter of this year. The disruption there could spill over to the rest of the global economy. But it is still too soon to even speculate about either the size or the persistence of these effects, or whether they will lead to a material change in the outlook. In addition, U.S. inflation remains muted. And inflation expectations—those measured by surveys, market prices, and econometric models—reside at the low end of a range I consider consistent with our price-stability mandate."

The two year Treasury yield cheapened somewhat after Clarida's remarks. Even though his comments were guarded and conditional as per what script from 2019H1 on the path to eventually cutting, positioning may have expected him to be more direct given that his speech last March was the first serious effort to open the door to possible easing.

The 20-city composite S&P Case Shiller Home Price Index rose 2.9% y/y in December. The US housing market continues its stable growth trend. The rebound from the small dip in 2019 growth is being supported by last year's rate cuts and lowering housing inventory levels.

The Richmond Fed manufacturing index —which measures activity the central Atlantic region— fell to -2 points in February from 20 points the month prior. Shipments, new orders, and employment index components moved lower. This print comes after substantial improvement in the New York and Philadelphia Fed indices. Strictly looking at the regional surveys suggests that the US manufacturing slowdown could be bottoming out for the time being. However, caution should be used in anticipating the bounce to be reflected in February's ISM manufacturing reading next week. The coronavirus is likely to disrupt the global supply chains and further hurt export heavy manufacturing regions while Boeing's suspended production of the 737Max in January will impact the full month of February and is likely to be underrepresented in the regional manufacturing reports..

The US Conference Board Consumer Confidence Index rose a touch by 0.3 points to 130.7. The present situation component of the index fell significantly due to Coronavirus fears. However, consumers seem to be increasingly optimistic about the future as the expectations component rose for the second straight month. This measure considers labour market conditions more than the University of Michigan index. Strong job creation, wage growth, and personal savings rate suggest consumers will be resilient for a good while longer.

BoC Deputy Governor Lane did not remark upon current monetary policy considerations today.

OVERNIGHT

There are no notable releases due out overnight.

TOMORROW'S NORTH AMERICAN RELEASES

Only US new home sales are due out tomorrow (10amET). A significant rise is expected for the month of January following three consecutive declines.

Canada's calendar will be quiet tomorrow with just a bond auction.

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.	1.22	1.25	1.41	1.18	1.21	1.40	1.35	1.37	1.56	1.83	1.84	2.01
CANADA	1.34	1.34	1.47	1.22	1.21	1.34	1.21	1.20	1.33	1.34	1.31	1.45
GERMANY	-0.69	-0.67	-0.65	-0.69	-0.66	-0.62	-0.51	-0.48	-0.41	-0.03	0.00	0.11
JAPAN	-0.19	-0.16	-0.15	-0.21	-0.16	-0.15	-0.10	-0.06	-0.06	0.34	0.35	0.35
U.K.	0.39	0.41	0.53	0.41	0.43	0.48	0.52	0.54	0.61	0.96	0.98	1.10
	Spreads vs. U.S. (bps):											
CANADA	12	9	5	3	0	-6	-14	-17	-23	-49	-52	-56
GERMANY	-191	-192	-206	-187	-187	-201	-186	-185	-197	-186	-183	-190
JAPAN	-142	-141	-157	-139	-137	-155	-146	-143	-162	-149	-148	-166
U.K.	-84	-84	-88	-78	-78	-92	-83	-83	-95	-86	-86	-91

Equities	Level		% change:			
	Last	Change	1 Day	1-wk	1-mo	1-yr
S&P/TSX	17177	-385.4	-2.2	-3.8	-2.2	7.0
Dow 30	27081	-879.4	-3.1	-7.4	-6.6	3.8
S&P 500	3128	-97.7	-3.0	-7.2	-5.1	11.9
Nasdaq	8966	-255.7	-2.8	-7.9	-3.7	18.7
DAX	12790	-244.8	-1.9	-6.5	-5.8	11.2
FTSE	7018	-139.0	-1.9	-4.9	-7.5	-2.3
Nikkei	22605	-781.3	-3.3	-3.9	-5.1	5.4
Hang Seng	26893	72.3	0.3	-2.3	-3.8	-6.5
CAC	5792	-237.9	-3.9	-4.4	-3.9	10.7
Commodities	Level		% change:			
WTI Crude	50.10	-1.33	-2.6	-3.7	-7.5	-9.7
Natural Gas	1.84	0.01	0.6	-7.2	-2.9	-35.2
Gold	1634.87	-0.27	-0.0	1.4	4.0	23.0
Silver	18.78	0.22	1.2	5.5	5.3	18.3
CRB Index	168.49	-2.08	-1.2	-3.1	-4.1	-7.3
Currencies	Level		% change:			
USDCAD	1.3284	0.0005	0.0	0.5	0.7	0.9
EURUSD	1.0883	0.0001	0.0	0.7	-1.2	-4.4
USDJPY	110.18	-0.0200	-0.0	-1.1	1.2	-0.4
AUDUSD	0.6602	-0.0002	-0.0	-1.1	-2.4	-8.1
GBPUSD	1.3001	-0.0004	-0.0	0.6	-0.4	-1.9
USDCHF	0.9761	0.0000	0.0	-0.8	0.7	-2.4

Central Banks	
Current Rate	
Canada - BoC	1.75
US - Fed	1.75
England - BoE	0.75
Euro zone - ECB	0.00
Japan - BoJ	-0.10
Mexico - Banxico	7.00
Australia - RBA	0.75
New Zealand - RBNZ	1.00
Next Meeting Date	
Canada - BoC	Mar 04, 2020
US - Fed	Mar 18, 2020
England - BoE	Mar 26, 2020
Euro zone - ECB	Mar 12, 2020
Japan - BoJ	Mar 19, 2020
Mexico - Banxico	Mar 26, 2020
Australia - RBA	Mar 02, 2020
New Zealand - RBNZ	Mar 24, 2020

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.