MARKET INSIGHTS

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Mackenzie Fixed Income Team July 2, 2019

Global Macroeconomic Update

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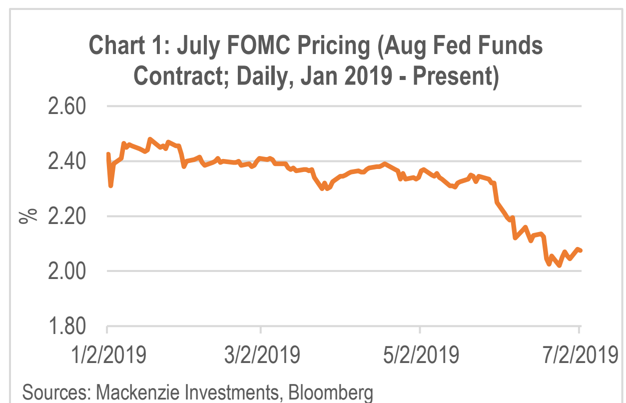
Key themes:

- The second-half of 2019 is likely to see several key macro themes and drivers for markets
- Fed outlook continues to be at or near the top of our list as does US-China trade
- US debt ceiling and sequester discussion is going to make for choppy markets
- The Bank of Canada may surprise some with its relative hawkish bias versus the Fed

Themes for the Second-Half

Fed Chair Powell likes to invoke the term "crosscurrents" when talking about the myriad of macro risks ahead the FOMC – so it's probably good enough for us. Indeed, the Chair is right: there are a lot of macro themes and risks ahead of us for the second-half of the year. Here, we thought it would be helpful to outline a few – although not all – of those risks and include some preliminary thoughts and views:

Chart 1: July FOMC Pricing (Aug Fed Funds Contract; Daily, Jan 2019 - Present)



Sources: Mackenzie Investments, Bloomberg

Fed: the Fed has effectively said that barring some significant upside surprise in either a) US-China trade; or, b) domestic inflation, it will ease at the July 31 FOMC. At time of writing, the market appears to be moving towards a 25bp cut (Chart 1) although no cut or a 50bp cut cannot be ruled out. As we write post-G20, we believe the Fed's view is the US economy isn't doing that badly, so if the Fed is more concerned about inflation then "insurance" cuts of 25bp are more likely, but if it looks like global trade is going to set the global economy into a tailspin (with second derivative effects on the US economy) then clips of 50bp are more likely. Regardless, rate cuts are highly likely in the second-half of the year and our view from late May of buying duration has worked out well (please see "Back to Your Corners, Gentlemen" – May 24, 2019).

China-US Trade: the Xi-Trump meeting in Osaka did not end acrimoniously, but the notion of a deal emerging soon is unlikely as the two sides remain far apart on key issues (IP theft, etc). The most likely scenario is for both sides to now resume earnest talks, trying to get a deal done before year-end - so this theme is likely to remain with us throughout the second-half of the year. We believe both the Americans and Chinese want to get a deal done as both want their economies humming along as the calendar turns into 2020. Trump simply wants to get reelected while Xi doesn't want a further economic slowdown or a deterioration in asset prices and the economy running at its peak for the 100th anniversary of the Communist Party.

Europe / ECB: the slowdown in Europe has been more pronounced than most had expected and the European Central Bank (ECB) is now in pivot mode, moving away from promises of unwinding negative interest rates to talking about adding additional stimulus in the coming meetings. ECB President Draghi, whose term ends on October 31, is probably going to leave his successor to either contemplate or work through another round of easing. The July meeting seems a bit early for an ECB pivot, but something is likely to happen no later than the September forecast round.

US Debt Ceiling: the US Treasury is currently using "extraordinary measures" to fund payments and those measures are likely to run out sometime between mid-September and mid-October when Congress will have to increase to the debt ceiling before said measures run out. Complicating matters is the so-called "sequester" that cuts spending to several programs, is also scheduled to kick-in later this year; although neither Republicans nor Democrats want that to happen, it will complicate the debt ceiling negotiations. We believe a last-minute deal will get done, but it will be choppy and it won't look good from a ratings agencies point-of-view (no downgrade on the event, just more fodder for the longer-term).

Bank of Canada: barring a total collapse in oil prices and global demand, we believe Governor Poloz will not follow the Fed in cutting rates – at least initially. We believe Poloz's reaction function to a global trade war will be different than most other central banks and the bar to easing rates is quite a bit higher than most would believe. This is not to say the BoC won't ease; rather there may be a bit of a lag and / or the size of the easing could be less notionally versus the Fed. Over the past few weeks we have amended our long-held view of a rangebound to higher USDCAD and are now looking for the pair to trade lower in the coming months.

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