



Economics

Avery Shenfeld
(416) 594-7356
avery.shenfeld@cibc.com

Benjamin Tal
(416) 956-3698
benjamin.tal@cibc.com

Andrew Grantham
(416) 956-3219
andrew.grantham@cibc.com

Royce Mendes
(416) 594-7354
royce.mendes@cibc.com

Katherine Judge
(416) 956-6527
katherine.judge@cibc.com

<http://economics.cibccm.com>

THE WEEK AHEAD

August 17-21, 2020

Why Deficits Aren't Raising Alarm Bells

by Avery Shenfeld

One by one, Canada's provinces have unveiled adverse fiscal updates that markets took with surprising calm. This past week, for example, Ontario's larger-than-expected deficit caused barely a ripple in its borrowing spread. Are investors whistling in the dark, or as we would argue, are there good reasons for the lack of market concern?

In part, markets know that international issuance could absorb some of this supply. But market prices have also been distorted by the Bank of Canada's quantitative easing (QE) program, which is sopping up a lot of Canada's total supply across all levels of government. Indeed, suppressing yields is the *raison d'être* of QE. The naysayers would say since the BoC can't do this forever, we're simply deferring a huge spike in spreads. Others fret that bond buyers will see their investments melt away as inflation roars back from too much money printing.

But the very reason that the BoC can't do QE forever without triggering inflation is the same reason why we won't see these outsized deficits forever: the pandemic will pass and the economy will get better. The timing is uncertain, but the "fact" of the recovery isn't, because the downturn didn't arise from a shock to demand or competitiveness, but from spending restraints imposed by public health needs.

As that recovery comes, likely on a heels of a vaccine, the need to defend against inflation will have central banks end their QE programs. But at the very same time, the deficits will plunge, as will net issuance, and fall even faster as a share of GDP which now sits at a very weak level. The BoC is unlikely to resell a large part of its provincial holdings in a single year.

Unlike some past deficits, including the US federal deficit in 2019, much of the current red ink in Canada's three largest provinces is not structural. That's why in Ontario's case, they feel comfortable financing much of the increase in the money market rather than locking it in. It's not that the normal run rate of program spending and revenues was way out of line. Quebec and BC were in surplus, while Ontario had drawn up plans to move in the right direction. All have been blown off course, but not because they announced unaffordable tax cuts or instituted permanent new programs.

In Ontario, for example, nearly all of the \$13 bn increase in planned spending or contingencies added since March is on items that simply won't be necessary in a post-Covid world. All of the \$5.6 bn drop in the revenues left after federal government support since March is tied to a deep but temporary hole in economic activity, and even the March projection was based on a zero growth outlook for 2020. Together, these one-off dents account for more than half of this year's deficit. Unless you fear yet another virus is on the way soon, the path back to lower deficits will be quite steep beyond 2021 if a vaccine is distributed next year.

Finally, bonds are like American Idol contestants; you have to vote for one of the singers even if none seem destined for stardom, just as you've got to invest your fixed income funds somewhere. With deficits ballooning globally, and corporates more at risk in a period of depressed earnings, many bonds are singing some sour notes, and Canada's provinces don't sound that bad in comparison.



	CANADA			UNITED STATES		
		CIBC	Consensus	Prior		Prior
Monday August 17	Government Bond Purchase Program (GBPP): 30-YR BAPF REVERSE AUCTION: \$10B				AUCTION: 3-M BILLS \$54B, 6-M BILLS \$51B	
	8:30 AM INT'L SEC. TRANSACTIONS	(Jun) (M)	N/A	22.41B	8:30 AM NEW YORK FED (EMPIRE)	(Aug) (M)
	9:00 AM EXISTING HOME SALES M/M	(Jul) (M)	20.0%	63.0%	NET CAPITAL INFLOWS (TICS)	(Jun) (L)
	10:30 AM Senior Loan Officer Surveys					
Tuesday August 18	AUCTION: 3-M BILLS \$5.6B, 6-M BILLS \$2.2B, 1-YR BILLS \$2.2B Government Bond Purchase Program (GBPP): SHORT END BoC TERM REPO OPERATION: 182 Days \$3B BoC TERM REPO OPERATION: 539 Days \$6B				Speaker: 12:00 PM Raphael W. Bostic (President, Atlanta) (Dovish, Non-Voter*) CASH MGMT. 119-DAY: \$30B CASH MGMT. 42-DAY: \$30B	
Wednesday August 19	AUCTION: 5-YR CANADAS \$5B Government Bond Purchase Program (GBPP): 5-YR				8:30 AM HOUSING STARTS SAAR BUILDING PERMITS SAAR	(Jul) (M) (Jul) (H)
	8:30 AM WHOLESALE TRADE M/M CPI M/M CPI Y/Y CPI Core- Common Y/Y% CPI Core- Median Y/Y% CPI Core- Trim Y/Y%	(Jun) (M) (Jul) (H) (Jul) (H) (Jul) (M) (Jul) (M) (Jul) (M)	10.0% 0.4% 0.5% N/A	5.7% 0.8% 0.7% 1.5% 1.9% 1.8%	7:00 AM MBA-APPLICATIONS 2:00 PM Minutes of Jul 29th FOMC Meeting	(Aug 14) (L) (Jul 29)
Thursday August 20	AUCTION: 2-YR CANADAS \$6B Government Bond Purchase Program (GBPP): 2-YR				Speaker: 1:00 PM Mary C. Daly (President, San Francisco) (Dovish, Non-Voter*) AUCTION: 30-YR TIPS \$7B	
	8:30 AM ADP EMPLOYMENT CHANGE				8:30 AM INITIAL CLAIMS CONTINUING CLAIMS PHILADELPHIA FED LEADING INDICATORS M/M	(Aug 15) (M) (Aug 8) (L) (Aug) (M) (Jul) (M)
	Government Bond Purchase Program (GBPP): 10-YR IMPP: 5-YRS MBS PURCHASE				Speaker: 1:00 PM Mary C. Daly (President, San Francisco) (Dovish, Non-Voter*) 9:45 AM MARKT US SERVICES PMI MARKT US COMPOSITE PMI MARKT US MANUFACTURING PMI	(Aug P) (L) (Aug P) (L) (Aug P) (L)
Friday August 21	8:30 AM RETAIL TRADE TOTAL M/M RETAIL TRADE EX-AUTO M/M	(Jun) (H) (Jun) (H)	24.5% 16.0%	18.7% 10.6%	10:00 AM EXISTING HOME SALES SAAR EXISTING HOME SALES M/M	(Jul) (M) (Jul) (M)
					Note (*): Bloomberg	
		H, M, L = High, Medium or Low Significance	SAAR = Seasonally Adjusted Annual Rate	Consensus Source: Bloomberg		

Week Ahead's Market Call

by Avery Shenfeld

In the **US**, the weekend will see US trade negotiators agree that China is on track in meeting its Phase I trade deal commitments, while doing nothing to cool tempers on other issues. A light week for data will see further progress in the housing sector, but markets are looking for reassurance on progress on two other flanks: the coronavirus case counts, and getting Congress moving towards a deal to extend unemployment benefits, given that Trump's extension will run dry in less than six weeks.

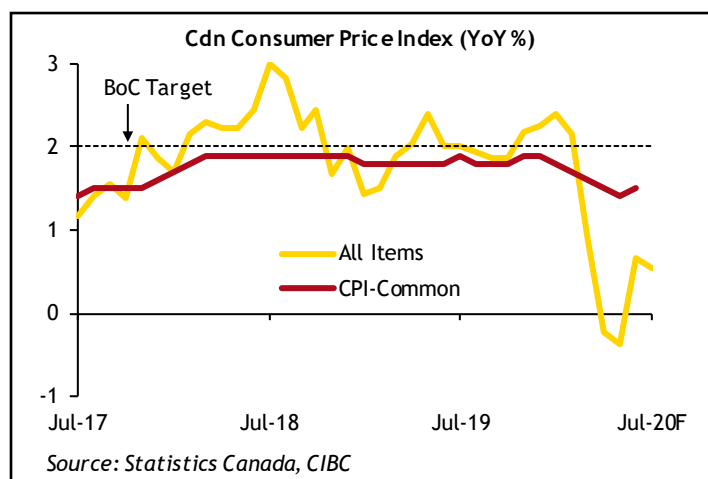
In **Canada**, inflation is likely to remain fairly quiet in terms of the year-on-year pace for core measures, and any upside surprise would be irrelevant to the Bank of Canada, as it would be viewed as unsustainable in the face of material economic slack. As was the case in the US, Canada likely saw a another big step forward in retail sales in June, but as is true stateside, it's in discretionary services that aren't in these data (concert halls, hotel rooms, airline tickets) where there's still major damage from the coronavirus to overall consumer spending.

Week Ahead's Key Canadian Number:**Consumer Price Index—July**

(Wednesday, 8:30 a.m.)

Royce Mendes (416) 594-7354

	CIBC	Mkt	Prior
CPI m/m (NSA)	0.4%	0.3%	0.8%
CPI yr/yr	0.5%	0.5%	0.7%
CPI-common	1.4%	N/A	1.5%



The annual pace of inflation likely ceded some ground in July as a strong monthly print from a year ago was replaced by a slower advance in prices in the calculation. In recent years, the CPI has seen outsized gains in July as a result of a methodological change which boosted the readings for airline fares during the month. However, with many airline fares still suspended, Statistics Canada has been using the parent category for some sub-components of the airfares index. Prior years had seen higher summer airfares heavily tied to transatlantic travel, which was likely still excluded this July because of the suspension of flights. As a result, the boost from airfares seen in recent summers might be severely diminished in 2020.

Separately, gasoline prices were up again during the month, but August began with fuel costs slightly lower. That could persist if oil prices begin to feel more pain

from waning demand in the US, as its economy battles the effects of the recent surge in virus cases. While many other categories of the CPI basket likely also gained ground in July as government support has allowed consumers to continue spending despite the high unemployment rate, sectors that had seen a surge in demand during the worst of the pandemic will probably continue coming back down to earth.

Forecast Implications — As government support gradually becomes less generous, underlying inflation measures such as the Bank of Canada's core common component index could continue to weaken even further than the 1.4% we expect for July. Softer inflationary pressures should make it even clearer that the return to a sustainable 2% rate of inflation, on which a Bank of Canada rate hike is now predicated, is years away.

Other Canadian Releases:**Retail Sales—June**

(Friday, 8:30 a.m.)

Retail sales likely rose a whopping 24% in June, as the first full month of the economic reopening saw many more consumers out-and-about spending. Auto sales posted another solid monthly increase, and it seems other categories were also beneficiaries of the reopening. But, while it's tempting to get excited about the sharp turnaround, the bounce still leaves the seasonally-adjusted monthly pace of total retail sales below pre-COVID levels. It also likely reflects the satisfaction of some

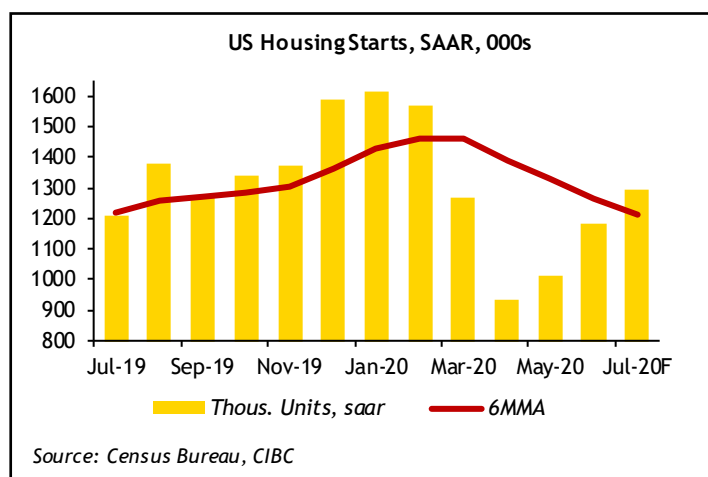
pent-up demand, as purchases that were supposed to take place in March, April or early May, ended up being delayed. That is best evidenced by the year-to-date retail sales figures which will be almost 10% lower than the pace at the halfway mark of 2019, representing the slowest opening half since 2016. As pent-up demand is satisfied and government support gradually becomes less generous, a stagnation in retailing is likely to appear, particularly with Canadian households already stretched in terms of debt loads.

Week Ahead's Key US Number:**Housing Starts—July**

(Tuesday, 8:30 a.m.)

Katherine Judge (416) 956-6527

	CIBC	Mkt	Prior
Housing Starts	1295K	1230K	1186K
Building Permits	1380K	1332K	1258K



The US housing market has proven to be one of the most resilient areas of the economy, as low mortgage rates have supported demand and homebuilder confidence, which was just shy of reaching its pre-pandemic peak as of July. Pent-up demand from the spring homebuying season that was delayed due to lockdowns is still apparent amidst slim inventories of homes for sale. That suggests an acceleration in housing starts to a 1295K pace in July, which is still 19% below the pre-virus high hit in January. Building permits should have accelerated to a 1380K pace, suggesting further strength in residential construction is in store ahead.

Forecast Implications — While residential investment is still expected to lead the recovery, risks remain in the coming months, given the escalation in Covid cases seen lately. If social distancing measures have to be tightened in the construction industry, or the employment backdrop weakens materially, that could be a temporary barrier to the recovery in the housing market. At this point, the MBA mortgage purchase index remains elevated, however, suggesting that activity isn't yet being materially impacted.

Market Impact — We are more optimistic than the consensus, but given that housing starts capture decisions made at least a month prior, markets will likely remain focused on the next fiscal package being discussed by Congress and the trajectory of the virus.

CANADIAN RELEASE AND EVENT DATES

August/September 2020



MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
10	11	12	13	14
	HOUSING STARTS 8:15 AM 000's (AR) TOTAL SINGLES MAY 196 44 JUN 212 42 JUL 246 48			SURVEY OF MANUFACTURING 8:30 AM SHIPMENTS M Y APR -28.3 -37.4 MAY 11.6 -31.3 JUN 20.7 -15.6
17	18	19	20	21
INT'L TRANSACTIONS IN SECURITIES C\$BN, NET 8:30 AM BONDS MONEY STOCKS TOT MARKET APR 46.9 7.0 -4.9 49.0 MAY 25.0 7.4 -10.0 22.4 JUN		CPI 8:30 AM M Y MAY 0.3 -0.4 JUN 0.8 0.7 JUL WHOLESALE TRADE 8:30 AM	ADP EMPLOYMENT SURVEY 8:30 AM	RETAIL TRADE 8:30 AM (Current\$) M Y APR -25.0 -31.2 MAY 18.7 -18.4 JUN
24	25	26	27	28
			PAYROLL EMPLOYMENT, EARNINGS & HOURS 8:30 AM BALANCE OF INT'L PAYMENTS 8:30 AM CURR. ACCT. BAL. \$BN(QR) \$BN(AR) 19:Q4 -9.3 -37.2 20:Q1 -11.1 -44.4 20:Q2	NATIONAL ACCTS 8:30 AM REAL PRICE GDP DEFLATOR %ch AR %ch AR 19:Q4 0.6 3.3 20:Q1 -8.2 2.2 20:Q2 GDP BY INDUSTRY 8:30 AM (2002\$) GDP IND.PROD. M M APR -11.7 -16.1 MAY 4.5 4.8 JUN
31	1	2	3	4
INDUSTRIAL PRICES 8:30 AM M (NSA) Y MAY 1.2 -4.9 JUN 0.4 -3.1 JUL BUILDING PERMITS (\$) 8:30 AM M M (RE) (NON-RES) MAY 21.7 21.4 JUN 7.0 4.6 JUL		LABOUR PRODUCTIVITY 8:30 AM	MERCHANDISE TRADE 8:30 AM \$MN 12 MO. BALANCE MAY -1,329 -22,520 JUN -3,189 -24,851 JUL	LABOUR FORCE SURVEY 8:30 AM AVG EMPLOY UNEMP HRLY (HSHOLD) RATE EARN M Y % Y JUN 5.8 -8.5 12.3 6.8 JUL 2.4 -6.3 10.9 5.7 AUG IVEY PURCHASING MANAGERS' INDEX 10:00 AM
7	8	9	10	11
LABOUR DAY (HOLIDAY) (Markets Closed)		HOUSING STARTS 8:15 AM 000's (AR) TOTAL SINGLES JUN 212 42 JUL 246 48 AUG Bank of Canada Interest Rate Announcement	CANADA'S INTERNATIONAL INVESTMENT POSITION 8:30 AM	CAPACITY UTILIZATION 8:30 AM LEVEL (%) TOTAL MANUF. 19:Q4 81.4 77.9 20:Q1 79.8 74.4 20:Q2

All data seasonally adjusted except where noted "NSA". M: per cent change from previous month. Q: per cent change from previous quarter at annual rates. Y: per cent change from year earlier. AR: Annual Rate. YTD: Year to date. Release dates are provided by sources outside CIBC World Markets Inc. Dates are subject to change. Sources for historical data: Statistics Canada, CMHC, Human Resources Development Canada and the Bank of Canada.

U.S. RELEASE AND EVENT DATES August/September 2020



MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
10	11	12	13	14
	PPI 8:30 AM M (SA) Y (SA) MAY 0.4 -0.8 JUN -0.2 -0.8 JUL 0.3 -0.4	CPI 8:30 AM M(SA) Y (NSA) MAY -0.1 0.1 JUN 0.6 0.6 JUL 0.6 1.0 TREASURY BUDGET 2:00 PM		RETAIL SALES 8:30 AM M Y MAY 18.3 -5.6 JUN 8.4 2.1 JUL 1.2 2.7 NON-FARM PRODUCTIVITY 8:30 AM Q/Q (AR) Y/Y 19:Q4 1.6 1.9 20:Q1 -0.3 0.9 20:Q2 7.3 2.2 CAPACITY UTIL/IND. PROD. 9:15 AM LEV M Y MAY 64.8 0.9 -15.8 JUN 68.5 5.7 -11.1 JUL 70.6 3.0 -8.2 BUSINESS INVENTORIES 10:00 AM MICHIGAN SENTIMENT (P) 10:00 AM
	BOT (9:00) REDBOOK (8:55)		INITIAL JOBLESS CLAIMS (8:30)	
17	18	19	20	21
NET CAPITAL INFLOWS TICS 4:00 PM	HOUSING STARTS 8:30 AM Mn. M/M MAY 0.908 8.2 JUN 0.881 17.3 JUL BOT (9:00) REDBOOK (8:55)	FOMC Minutes	PHILADELPHIA FED INDEX 8:30 PM LEADING INDICATOR 10:00 AM INITIAL JOBLESS CLAIMS (8:30)	EXISTING HOME SALES 10:00 AM
24	25	26	27	28
	S&P/CASE-SHILLER HOUSE PRICE INDEX 9:00 AM NEW HOME SALES 10:00 AM CONSUMER CONFIDENCE 10:00 AM BOT (9:00) REDBOOK (8:55)	DURABLE GOODS ORDERS 8:30 AM M Y MAY 15.1 -18.5 JUN 7.3 -12.7 JUL FACTORY ORDERS 10:00 AM M(SA) Y(NSA) MAY 7.7 -16.1 JUN 6.2 -10.6 JUL	GDP 8:30 AM (AR) REAL IMPLICIT GDP DEFLATOR 19:Q4 2.1 1.3 20:Q1 -5.0 1.4 20:Q2 (2nd) INITIAL JOBLESS CLAIMS (8:30)	PERS. INC & OUT. 8:30 AM SAVING INCOME CONS RATE M M AR MAY -4.4 8.5 24.2 JUN -1.1 5.6 19.0 JUL ADV. TRADE IN INTERNATIONAL GOODS 8:30 AM MICHIGAN SENTIMENT (F) 10:00 AM
31	1	2	3	4
CHICAGO PMI 9:45 AM	ISM MFG SURVEY 10:00 AM COMP. PRICES INDEX INDEX JUN 52.6 51.3 JUL 54.2 53.2 AUG LIGHT VEHICLES SALES MIL (AR) Y JUN 13.069 -24.0 JUL 14.520 -14.4 AUG BOT (9:00) REDBOOK (8:55)	ADP SURVEY 8:15 AM FACTORY ORDERS 10:00 AM M(SA) Y(NSA) MAY 7.7 -16.1 JUN 6.2 -10.6 JUL	GOODS & SERV. BALANCE (BOP) \$B 8:30 AM GDS SERV TOT MAY -76.2 21.4 -54.8 JUN -72.2 21.5 -50.7 JUL NON-FARM PRODUCTIVITY 8:30 AM Q/Q (AR) Y/Y 19:Q4 1.6 1.9 20:Q1 -0.3 0.9 20:Q2 ISM NON-MFG SURVEY 10:00 AM INITIAL JOBLESS CLAIMS (8:30)	EMPLOY. SITUATION 8:30 AM NON- CIV AVG FARM UNEMP HRLY PAYROLL RATE EARN JUN 4791 11.1 5.4 JUL 1763 10.2 4.6 AUG
7	8	9	10	11
LABOR DAY (HOLIDAY) (Markets Closed)	CONSUMER CREDIT 3:00PM BOT (9:00) REDBOOK (8:55)		PPI 8:30 AM M (SA) Y (SA) JUN -0.2 -0.8 JUL 0.3 -0.4 AUG WHOLESALE TRADE 10:00 PM INITIAL JOBLESS CLAIMS (8:30)	CPI 8:30 AM M(SA) Y (NSA) JUN 0.6 0.6 JUL 0.6 1.0 AUG TREASURY BUDGET 2:00 PM

All data seasonally adjusted except where noted "NSA". M: per cent change from previous month. Q: per cent change from previous quarter at annual rates. Y: per cent change from year earlier. AR: Annual Rate. YTD: Year to date. Release dates are provided by sources outside CIBC World Markets Inc. Dates are subject to change. Sources for historical data: U.S. Department of Commerce, U.S. Department of Labor and U.S. Federal Reserve Board.

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