Economics

THE WEEK AHEAD

October 31-November 4, 2022

If it gets ugly, how ugly will it get?

by **Avery Shenfeld** avery.shenfeld@cibc.com

For us, the Bank of Canada's call for a period of stagnation – growth of close to zero for a few quarters — had a familiar ring to it, because it's exactly what we have in our own forecast. That doesn't of course guarantee that outcome, but it's relevant because it reveals that the central bank doesn't think it *needs* an outright recession to bring inflation to heel, and isn't explicitly aiming to have one as it sets the path of interest rates.

But there's a band of uncertainty on how the economy will respond to a given level of interest rates, and room for new shocks to emerge; one certainly can't rule out that the combination of monetary tightening here and abroad ends up in an unintended recession. And so, the question we're being asked is, if it gets ugly, how ugly will it get? Just what kind of recession are we likely to see in Canada if it turns out that we're overdoing it on rate hikes?

It might not be a very short-lived downturn, because of where we are in this cycle. Unlike 2020, or 2007-08, when core inflation was reasonably well-contained when the recession hit, the Bank of Canada won't be rushing to the rescue with rate cuts at the first whiff of trouble, because it's actually looking to open up some economic slack. Economic data are reported with a lag, and a stall in growth might not look that different from an outright recession at first. As a result, many months could tick by before it's clear that the slowdown is more severe than intended, and that inflation is set to tumble below the Bank's 2% target.

Fiscal policy was the big weapon in fighting the COVID recession of 2020, both in the US and Canada. There too, the response this time might be delayed until it's clear we're getting more of an economic hit than we needed to cool inflation.

When it does come, fiscal relief could also be more limited. Stateside, if Republicans gain control of Congress in the midterms, they are likely to weigh in against new spending measures, as they tend to become more hawkish on deficits during a Democratic presidency. In Canada, while some provinces aren't in bad shape and the federal deficit is now melting away, the level of federal debt is obviously much higher than it was prior to 2020.

If there's a silver lining, it's that while monetary easing won't come quickly, and we could remain in a recession for several quarters, it's likely to offer a greater boost to Canada's economy than it could in 2020. Back then, overnight rates started from a peak of 1.75%, leaving very limited room to ease. There was much more easing in the offing in 2007, when rates could be slashed from 4.5% in 2007 down to 0.25% by 2009.

It would take a very deep recession to see that sort of response this time, but as in 2007-08, the Canadian economy is well placed to get a nice lift from any significant monetary easing. Back then, having not had a wave of mortgage defaults akin to what the US experienced, the Canadian economy enjoyed an earlier recovery, levered off of housing, when rate cuts were delivered on both sides of the border.

Prior to this year's spike in mortgage rates, there was again considerable pent-up demand for housing in Canada given brisk immigration and difficulties in keeping pace in homebuilding. That sector could turn from bust to boom again should we need a monetary easing to dig us out of a bigger economic hole than was intended to battle inflation. So while housing is feeling a disproportionate share of the pain from monetary tightening, it's waiting in the wings as the key to preventing what might be a protracted recession from turning into a very deep one.

Week Ahead Calendar And Forecast—Canada

H, M, L = High, Medium or Low Priority
SAAR = Seasonally Adjusted Annual Rate
Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Priority	CIBC	Consensus	Prior
Monday, October 31	-	AUCTION: 2-YR CANADAS $4B	-	-	-	-	-
Tuesday, November 1	6:30 PM	Speaker: Tiff Macklem (Governor) & Carolyn Rogers (Sr. Deputy Gov.)	-	-	-	-	-
Wednesday, November 2	-	-	-	-	-	-	-
Thursday, November 3	-	AUCTION: 10-YR CANADAS $4B	-	-	-	-	-
Thursday, November 3	8:30 AM	MERCHANDISE TRADE BALANCE	(Sep)	(H)	$1.2B	-	$1.52B
Thursday, November 3	8:30 AM	BUILDING PERMITS M/M	(Sep)	(M)	-	-	11.9%
Thursday, November 3	-	Federal Budget Update	-	-	-	-	-
Thursday, November 3	1:30 PM	Speaker: Paul Beaudry (Deputy Gov.)	-	-	-	-	-
Friday, November 4	8:30 AM	EMPLOYMENT CHANGE	(Oct)	(H)	5.0K	-	21.1K
Friday, November 4	8:30 AM	UNEMPLOYMENT RATE	(Oct)	(H)	5.3%	-	5.2%

Week Ahead Calendar And Forecast—United States

H, M, L = High, Medium or Low Priority
SAAR = Seasonally Adjusted Annual Rate
Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Priority	CIBC	Consensus	Prior
Monday, October 31	9:45 AM	CHICAGO PMI	(Oct)	(M)	-	47.2	45.7
Tuesday, November 1	-	AUCTION: 1-YR TREASURIES $34B	-	-	-	-	-
Tuesday, November 1	10:00 AM	ISM - MANUFACTURING	(Oct)	(H)	49.8	50.0	50.9
Tuesday, November 1	10:00 AM	CONSTRUCTION SPENDING M/M	(Sep)	(M)	-	-0.5%	-0.7%
Tuesday, November 1	10:00 AM	JOLTS Job Openings	(Sep)	-	-	9750K	10053K
Tuesday, November 1	-	NEW VEHICLE SALES	(Oct)	(M)	-	14.25M	13.49M
Wednesday, November 2	7:00 AM	MBA-APPLICATIONS	(Oct 28)	(L)	-	-	-1.7%
Wednesday, November 2	8:15 AM	ADP EMPLOYMENT CHANGE	(Oct)	(M)	-	200K	208K
Wednesday, November 2	2:00 PM	FOMC RATE DECISION (UPPER BOUND)	(Nov 2)	(H)	4.00%	4.00%	3.25%
Wednesday, November 2	2:00 PM	FOMC RATE DECISION (LOWER BOUND)	(Nov 2)	(H)	3.75%	3.75%	3.00%
Wednesday, November 2	2:30 PM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Thursday, November 3	8:30 AM	INITIAL CLAIMS	(Oct 29)	(M)	-	-	217K
Thursday, November 3	8:30 AM	CONTINUING CLAIMS	(Oct 22)	(L)	-	-	1438K
Thursday, November 3	8:30 AM	GOODS & SERVICES TRADE BALANCE	(Sep)	(H)	-$72.3B	-$70.2B	-$67.4B
Thursday, November 3	8:30 AM	NON-FARM PRODUCTIVITY	(3Q P)	(M)	0.4%	-0.1%	-4.1%
Thursday, November 3	10:00 AM	FACTORY ORDERS M/M	(Sep)	(M)	0.2%	0.4%	0.0%
Thursday, November 3	10:00 AM	ISM - SERVICES	(Oct)	(M)	55.4	55.5	56.70
Friday, November 4	8:30 AM	NON-FARM PAYROLLS	(Oct)	(H)	175K	200K	263K
Friday, November 4	8:30 AM	UNEMPLOYMENT RATE	(Oct)	(H)	3.6%	3.6%	3.5%
Friday, November 4	8:30 AM	AVERAGE HOURLY EARNINGS ALL EMPLOYEES M/M	(Oct)	(H)	0.3%	0.3%	0.3%
Friday, November 4	8:30 AM	AVERAGE WEEKLY HOURS ALL EMPLOYEES	(Oct)	(H)	-	34.5	34.5
Friday, November 4	8:30 AM	MANUFACTURING PAYROLLS	(Oct)	(H)	-	10K	22K
Friday, November 4	8:30 AM	Speaker: Susan M. Collins (Boston) (Voter)	-	-	-	-	-

Week Ahead's market call

by Avery Shenfeld

In the **US**, the message in the data looks to be that we're getting there, but that we're not there yet, "there" being enough of a slowdown that the Fed can put away its rate hike weapon. We see the Fed moving by 75 basis points, and while that only leaves a further 50 basis points to reach our projected ceiling, we wouldn't expect the central bankers to drop any dovish hints on a day they are moving that aggressively. For that sort of talk, employment growth has to decelerate enough to have the jobless rate gradually heading higher, and although our payrolls call is a bit below consensus, it's still not quite weak enough to provide much of an upward push to the unemployment rate. That said, a possible dip in the ISM manufacturing index below 50, and hopefully a further drop in job openings, could provide the Fed some comfort that the required deceleration is underway.

In **Canada**, as always, the statistical noise in the labour force survey data prevents anyone from being too confident about any one month's reading. The trend has been towards lacklustre job gains in recent months, and after a bit of a bounce-back in the last reading, we're looking for a quite tepid jobs gain in October. That would certainly be consistent with the fact that the latest three months of GDP data showed the economy advancing at a slim 0.1% per month. Softer oil prices but volume gains in agricultural products might combine to produce a modest narrowing in the latest data on Canada's trade surplus. The Bank of Canada Governor and his Senior Deputy will make an appearance, but there's little room to add to what they said this past week. We also don't expect any major new announcements in the federal fiscal update on Thursday.

Week Ahead's key Canadian number: Labour force survey—October

(Friday, 8:30 am)

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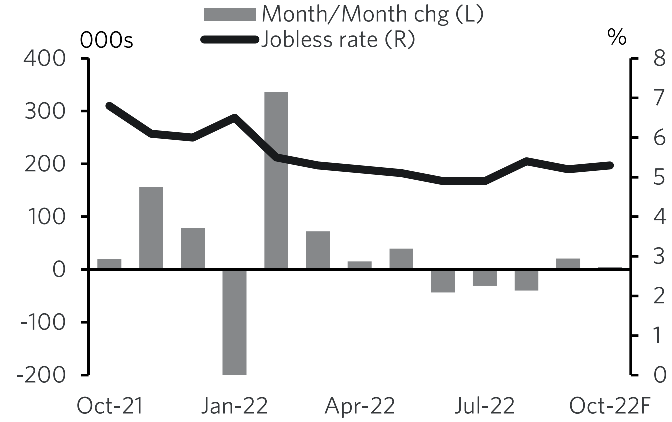
Variable	CIBC	Mkt	Prior
Employment (m/m)	5.0K	-	21.1K
Unemployment rate	5.3%	-	5.2%

Chart: Canadian employment



Source: Statistics Canada, Haver Analytics, CIBC

Through the volatility caused by a decline in the labour force and swings in education employment, it appears that the job market has weakened noticeably relative to where it was six months or so ago. Much like overall economic activity, growth seems to have slowed to a crawl and dropped below the long-run potential for the economy. As such, we expect to see only a very slim 5K increase in employment during October, which would be far enough below the pace of population growth to see the jobless rate tick up to 5.3%. Monthly movements in average wages have been softer in recent months, although the annual rate is expected to remain close to 5% in October before easing more meaningfully next spring.

Forecast implications — A further, modest, rise in the unemployment rate combined with additional evidence that wage inflation is close to peaking should convince the Bank of Canada to slow and eventually halt its current rate hiking cycle.

Other Canadian releases: Merchandise trade balance—September

(Thursday, 8:30 am)

Despite stabilizing as the month went on, oil prices were once again lower on average in September than they were in the month before. That should result in a modest narrowing of the goods trade surplus to $1.2bn. A potential rebound in agricultural exports following a decline in the prior month could partly offset the drag on nominal exports from lower oil prices.

Week Ahead's key US number: Employment situation—October

(Friday, 8:30 am)

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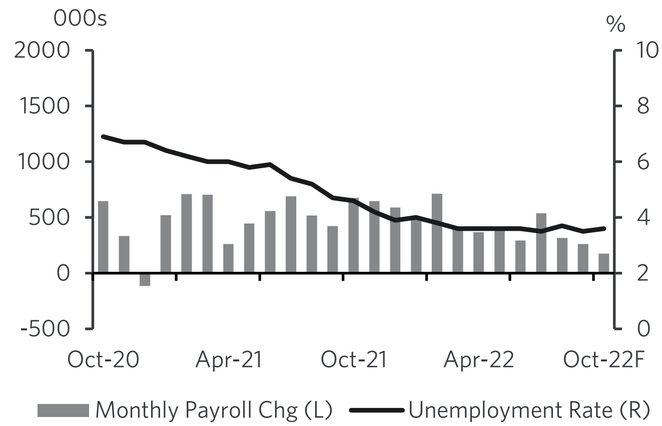
Variable	CIBC	Mkt	Prior
Employment (m/m)	175K	200K	263K
Unemployment rate	3.6%	3.6%	3.5%
Avg hourly earnings (m/m)	0.3%	0.3%	0.3%

Chart: US payroll employment



Source: BLS, Haver Analytics, CIBC

The jump in initial jobless claims early in October included the impact of Hurricane Ian, and claims remained elevated into the payrolls survey reference week, suggesting that hiring could have cooled to a 175K pace. That's also consistent with the deterioration seen in the Conference Board's labor differential, the softening in job openings in recent months, and caution amongst businesses as the demand outlook has dimmed. Moreover, with the prime-age participation rate hovering around its pre-pandemic level, there is little room for continued, outsized job gains. That would likely leave the unemployment rate a tick higher at 3.6%.

Forecast implications — The Fed is looking for weaker hiring in order to add some slack to the labor market, and October will likely be a modest step in the right direction on that front. Aggregate household income growth will be limited by slower hiring ahead, causing demand to cool in Q4. We still expect another 75bp hike at next week's FOMC, but there could be enough evidence of a cooling in the labor market by December to make that month's 50bp hike the last move for this cycle.

Market impact — We're slightly below the consensus, which could nudge bond yields and the USD lower.

Other US Releases: ISM Manufacturing—October

(Tuesday, 10:00 am)

The ISM's gauge of manufacturing activity likely fell slightly into contractionary territory in October, at 49.8. That's consistent with declines seen in regional indices, and reflects the slowdown in demand that is underway, which could have pushed the new orders sub-index further into negative territory. The ongoing alleviation of supply chain issues could have also weighed on the headline index.

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