Economics

THE WEEK AHEAD

July 24 - 28, 2023

A biased bank

by **Benjamin Tal** benjamin.tal@cibc.com

Give the Bank of Canada two choices: inflation or a recession, and the Bank will take a recession any day. The reason is that central banks have a lot of experience and effective tools to fight recessions, while rising inflation expectations are a central banker's worst nightmare.

The practical implication of this asymmetric game is that the Bank of Canada is biased. We have reached a point in the cycle in which for every bullish economic statistic, we can find one that is equally bearish. But given the Bank's bias, more weight is given to strong indicators — a fact that any investor must internalize. From here, the path to overshooting is clear.

In fact, it's not a stretch to suggest that the BoC started overshooting in June, consistent with its bias. So now we have reached a point in which you want to manage the size of the overshooting. And that's the context in which the latest relatively bullish BoC forecast should be viewed. The Bank's upwardly revised GDP growth projections for the coming quarters and the deferral of the timing to reach the inflation target is not really a forecast — it's strategic positioning. By upgrading your GDP forecast you limit the need to react to any strong indicator, while deferring the date that you reach price stability on is simply buying time with limited risk of increased long-term inflation expectations.

That is a good move. Buying time will allow the Bank to be less reactive to current/near-term strong numbers while allowing time for some important disinflationary forces to unfold. And there are no shortage of them. The ongoing improvement in supply chain conditions is working not only to enhance monetary policy effectiveness (less externally oriented inflation), but also to notably reduce retailers' gross margins. The US PPI is now in negative territory on a m/m and y/y basis. A big part of that weakness is due to the slowing in the trade-services component, which is a good proxy of gross margins for wholesalers and retailers. That measure rose dramatically during the pandemic as many retailers were able to hide behind the supply chain fog. Now, with supply chains improving, there is no place to hide. Margins are trending downward — an underrated disinflationary force on both sides of the border.

As for services inflation, the answers lie in the labour market. Here, the focus is of course on the recent decline in the number of job vacancies, but more importantly, on the fact that they are still 350K higher than the pre-Covid level. We also know that there is a clear negative correlation between wage level and the growth in vacancies since 2019. According to Economics 101, this shortage should be translated to a relatively strong wage performance amongst low-wage occupations. But a look at the wage ratio of the first and second quintiles to the third and forth quintiles doesn't show any significant upside trend that is consistent with the current level of low-wage vacancies.

There is no shortage of reasons for that: low margins, the cost of advertising a vacancy is minimal and recessionary fears resulting in businesses preferring higher turnover rates to higher wages. Add to that the fact that the official labour market statistics underestimate (mostly low-wage) labour supply due to a significant undercounting of non-permanent residents in the Labour Force Survey, and it seems that the labour market is not as tight as perceived.

The Bank of Canada might hike again in September, but soon enough the current disinflationary forces will be too noticeable to ignore, even for a biased bank.

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, July 24	-	-	-	-	-	-	-
Tuesday, July 25	-	-	-	-	-	-	-
Wednesday, July 26	1:30 PM	Publication: Summary of Deliberations	-	-	-	-	-
Thursday, July 27	-	AUCTION: 30-YR CANADAS $12.5B	-	-	-	-	-
Thursday, July 27	8:30 AM	PAYROLL EMPLOYMENT, EARNINGS & HRS	(May)	-	-	-	-140.3K
Friday, July 28	8:30 AM	GDP M/M	(May)	(H)	0.4%	-	0.0%
Friday, July 28	8:30 AM	GDP (annualized)	(May)	(H)	-	-	1.7%

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, July 24	-	AUCTION: 2-YR TREASURIES $42B	-	-	-	-	-
Monday, July 24	8:30 AM	CHICAGO FED NAT.ACTIVITY INDEX	(Jun)	(M)	-	-	-0.15
Monday, July 24	9:45 AM	S&P GLOBAL US SERVICES PMI	(Jul P)	(L)	-	54.1	54.4
Monday, July 24	9:45 AM	S&P GLOBAL US COMPOSITE PMI	(Jul P)	(L)	-	-	53.2
Monday, July 24	9:45 AM	S&P GLOBAL US MANUFACTURING PMI	(Jul P)	(L)	-	46.1	46.3
Tuesday, July 25	-	AUCTION: 5-YR TREASURIES $43B	-	-	-	-	-
Tuesday, July 25	8:30 AM	PHILADELPHIA FED	(Jul)	(M)	-	-	-16.6
Tuesday, July 25	9:00 AM	S&P CORELOGIC CS Y/Y	(May)	(H)	-	-	-1.7%
Tuesday, July 25	10:00 AM	CONF.BOARD CONSUMER CONFIDENCE	(Jul)	(H)	111.0	112.0	109.7
Tuesday, July 25	10:00 AM	RICHMOND FED MANUF. INDEX	(Jul)	(M)	-	-10	-7
Wednesday, July 26	-	AUCTION: 2-YR FRN $24B	-	-	-	-	-
Wednesday, July 26	7:00 AM	MBA-APPLICATIONS	(Jul 21)	(L)	-	-	1.1%
Wednesday, July 26	10:00 AM	NEW HOME SALES SAAR	(Jun)	(M)	690K	722K	763K
Wednesday, July 26	10:00 AM	NEW HOME SALES M/M	(Jun)	(M)	-9.6%	-5.4%	12.2%
Wednesday, July 26	2:00 PM	FOMC RATE DECISION (UPPER BOUND)	(Jul 26)	(H)	5.50%	5.50%	5.25%
Wednesday, July 26	2:00 PM	FOMC RATE DECISION (LOWER BOUND)	(Jul 26)	(H)	5.25%	5.25%	5.00%
Wednesday, July 26	2:30 PM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Thursday, July 27	-	AUCTION: 7-YR TREASURIES $35B	-	-	-	-	-
Thursday, July 27	8:30 AM	INITIAL CLAIMS	(Jul 22)	(M)	-	-	228K
Thursday, July 27	8:30 AM	CONTINUING CLAIMS	(Jul 15)	(L)	-	-	1754K
Thursday, July 27	8:30 AM	WHOLESALE INVENTORIES M/M	(Jun P)	(L)	-	-	0.0%
Thursday, July 27	8:30 AM	DURABLE GOODS ORDERS M/M	(Jun P)	(H)	0.3%	1.0%	1.8%
Thursday, July 27	8:30 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Jun P)	(H)	0.2%	0.1%	0.7%
Thursday, July 27	8:30 AM	GDP (annualized)	(2Q A)	(H)	2.0%	1.8%	2.0%
Thursday, July 27	8:30 AM	GDP DEFLATOR (annualized)	(2Q A)	(H)	3.2%	3.0%	4.1%
Thursday, July 27	8:30 AM	ADVANCE GOODS TRADE BALANCE	(Jun)	(M)	-$92.3B	-$91.8B	-$91.1B
Thursday, July 27	8:30 AM	RETAIL INVENTORIES M/M	(Jun)	(H)	-	-	0.8%
Thursday, July 27	10:00 AM	PENDING HOME SALES M/M	(Jun)	(M)	-	0.3%	-2.7%
Friday, July 28	8:30 AM	EMPLOYMENT COST INDEX	(2Q)	(M)	-	1.1%	1.2%
Friday, July 28	8:30 AM	PCE DEFLATOR Y/Y	(Jun)	(H)	3.0%	3.1%	3.8%
Friday, July 28	8:30 AM	PCE DEFLATOR Y/Y (core)	(Jun)	(H)	4.1%	4.2%	4.6%
Friday, July 28	8:30 AM	PERSONAL INCOME M/M	(Jun)	(H)	0.5%	0.5%	0.4%
Friday, July 28	8:30 AM	PERSONAL SPENDING M/M	(Jun)	(H)	0.4%	0.4%	0.1%
Friday, July 28	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Jul)	(H)	-	72.6	72.6

Week Ahead's market call

by Katherine Judge and Andrew Grantham

In the **US**, the Fed is set to hike interest rates by 25bps and signal the probability of a final hike thereafter. Indeed, the lack of a deceleration in economic activity in the Q2 GDP report later in the week will likely validate the need for higher interest rates. The expected deceleration in annual core PCE price inflation in June will echo what was seen already in the CPI data, although that index is likely to see a more gradual deceleration over the rest of the year given the lower weighting of shelter in that index.

In **Canada**, the payrolls survey of employment will see a rebound as public administration workers ended their strike, but look for a further decline in vacancies as additional evidence of a cooling labour market. Monthly GDP will be strong in May, albeit driven by areas such as manufacturing and wholesale trade which could represent a further easing of supply chain disruptions — hardly bad news on the inflation front.

Week Ahead's key Canadian number: GDP—May

(Friday, 8:30 am)

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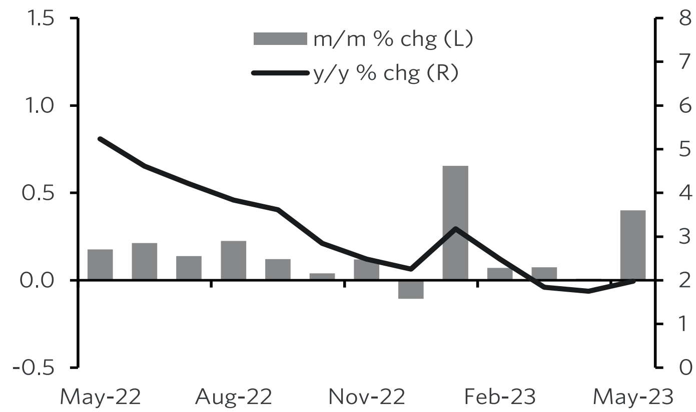
Variable (%)	CIBC	Mkt	Prior
GDP May (m/m)	0.4	-	0.0

Chart: Canadian real GDP at basic prices



Source: Statistics Canada, Haver Analytics, CIBC

The second quarter got off to a slow start in April, but economic growth is expected to have heated up in May. The 0.4% expected increase would be in line with the advance estimate, and is likely to be driven by large gains in manufacturing and wholesale, as well as a rebound in public administration following the end of the federal strike. A further, albeit slight, increase in activity during June should leave the advance estimate of Q2 GDP close to a 1½% annualized pace – in line with the Bank of Canada's MPR forecast.

Forecast implications — While GDP growth continues to hold up better than we, and others, anticipated at the start of the year, drivers such as manufacturing and wholesale suggest that this is in large part linked to an easing in supply chain disruptions. Modest growth in areas such as retail sales, air travel and restaurants suggests that consumer demand is waning due to the weight of higher interest rates.

Week Ahead's key US number: Real GDP—Q2 (Advance)

(Thursday, 8:30 am)

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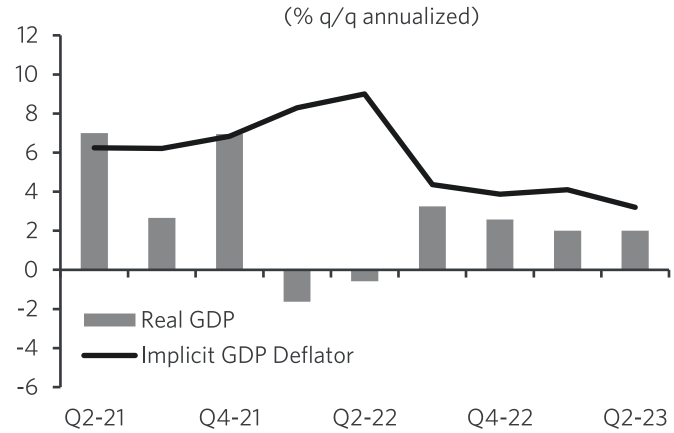
Variable (%)	CIBC	Mkt	Prior
GDP (q/q) annualized	2.0	1.8	2.0
GDP deflator	3.2	3.0	4.1

Chart: US GDP



Source: BEA, Haver Analytics, CIBC

The US economy hasn't shown the signs of cooling that the Fed was hoping to see after hiking interest rates aggressively. Indeed, GDP likely expanded by a healthy 2.0% annualized pace in the second quarter, supported by resilient consumption, a return to inventory investment, and growth in business investment. Household incomes were bolstered by the tight labor market, driving consumption growth in services, which will have masked softness in goods consumption. Demand growth could have supported a modest increase in business investment, while the drop in residential investment will have been limited by the surge in housing starts and new home sales halfway through the quarter. Excluding the expected weakness in net trade, along with inventories, final domestic demand likely looked even healthier at 2.7% annualized.

Forecast implications — The lack of a cooling in activity in Q2 clearly supports further Fed tightening, although there appears to be limited room for the consumer to drive further growth from here, as liquid excess savings are entirely held by the top 20% of income earners that have a low marginal propensity to consume, and credit card balances are now above their pre-pandemic trendline. A continued slowdown in the labor market and signs of inflation cooling will therefore leave the Fed on hold after hikes in July and September.

Market impact — We aren't far enough from the consensus to see a sustained market reaction.

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