Economics

THE WEEK AHEAD

July 8 - 12, 2024

Political tides and the bond market

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

We're in the midst of shifting political tides as elections play out in major industrialized economies, but what they have in common isn't a swing to the left or the right. In the UK, the move was to the left, with Labour trouncing the Conservatives. A centre-left Biden government looks in danger of losing to a populist (and not traditionally conservative) Trump team, but that might also usher in a move to the right in Congressional seats. In contrast, elections on the European continent have seen the right gain ground at the expense of centrist parties.

So while it's not a unidirectional shift on the left-right spectrum, there are two elements that these elections do have in common. First, is a strong desire to, as they say, "throw the bums out". Incumbents of all stripes are taking the blame for the run-up in inflation. Price pressures have abated in terms of year-on-year increases, but that won't restore price levels, and the economic pain tied to the interest rate hikes needed to contain inflation still lingers.

The second theme is a desire to contain immigration. Some of that is tied to concerns over cultural shifts, but in other cases it's linked to economic costs of supporting or housing migrants, or the overwhelming of the capacity to do so as numbers soared. In Europe and the US, that's centred on undocumented border crossings, but earlier, in the UK's Brexit vote, it was also aimed at those coming under EU rules. In Canada, no major federal party has an anti-immigration platform, but the huge surge in temporary worker and student arrivals has taken some of the blame for soaring rental prices and other strains.

The bond market, for its part, has been focussed of late on a third issue that hasn't drawn sufficient attention from either voters or their political leaders: fiscal deficits. Fears of heavy borrowing are adding to risk premia in longer term sovereign debt. While the run-up in deficits made sense during the pandemic shock, in much of Europe and the US, debt levels are still climbing. Canada's federal deficits are generally lower, but a few provinces have run up the red ink this year, due in part to an inflation-catchup in public sector pay.

While some elections have called attention to the fiscal mess, voters have also protested against measures, like those launched by Macron over pensions, aimed at dealing with them. In the US, Republicans who back spending restraint favour tax cuts, while Democrats push for upper income or corporate tax hikes they can't pass while approving spending increases. No serious economists give any credence to the idea that tariff revenues will pay for major income tax cuts. The UK Labour government's platform was well short on measures aimed at deficit reduction, with their spending plans seen as swamping any savings or revenue increases.

But what's less recognized is that steps to dramatically curtail immigration could, in the long-run, lean towards lower yields. Slowing demographics, and the resulting impact on trend growth, were key factors in the drop in neutral interest rates in the prior cycle. The US got a pop in economic growth in the past year from immigration, and pulling back on that inflow will work towards the slowing that the Fed needs to see to ease up on rates. In Canada, recently announced measures to reduce the number of temporary workers and foreign students should begin to ease rent inflation in 2025, supporting further rate cuts from the central bank.

Rather than a general trend towards higher or lower yields in general, the political tides seem to be shifting towards a steeper curve. Continued deficits could leave larger risk premia in longer term rates, while a tightening in immigration slows growth and inflation in a way that supports lower short-term yields as central banks respond with policy rate cuts. Unless, of course, these new governments decide to diverge from the platforms that got them elected in the first place.

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 8	-	-	-	-	-	-	-
Tuesday, July 9	-	-	-	-	-	-	-
Wednesday, July 10	-	-	-	-	-	-	-
Thursday, July 11	-	AUCTION: 10-YR CANADAS $5B	-	-	-	-	-
Friday, July 12	8:30 AM	BUILDING PERMITS M/M	(May)	(M)	-	-5.2%	20.5%
Friday, July 12	9:00 AM	EXISTING HOME SALES M/M	(Jun)	(M)	-	-	-0.6%

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 8	3:00 PM	CONSUMER CREDIT	(May)	(L)	-	$11.0B	$6.4B
Tuesday, July 9	-	AUCTION: 1-YR TREASURIES $46B	-	-	-	-	-
Tuesday, July 9	-	AUCTION: 3-YR TREASURIES $58B	-	-	-	-	-
Tuesday, July 9	10:00 AM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Wednesday, July 10	-	AUCTION: 10-YR TREASURIES $39B	-	-	-	-	-
Wednesday, July 10	7:00 AM	MBA-APPLICATIONS	(Jul 5)	(L)			-2.6%
Wednesday, July 10	10:00 AM	WHOLESALE INVENTORIES M/M	(May)	(L)	-	-	0.6%
Wednesday, July 10	10:00 AM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Wednesday, July 10	2:30 PM	Speaker: Austan D. Goolsbee, Chicago (Non-Voter) & Michelle W Bowman (Governor) (Voter)	-	-	-	-	-
Thursday, July 11	-	AUCTION: 30-YR TREASURIES $22B	-	-	-	-	-
Thursday, July 11	8:30 AM	INITIAL CLAIMS	(Jul 6)	(M)	-	-	238K
Thursday, July 11	8:30 AM	CONTINUING CLAIMS	(Jun 29)	(L)	-	-	1858K
Thursday, July 11	8:30 AM	CPI M/M	(Jun)	(H)	0.2%	0.1%	0.0%
Thursday, July 11	8:30 AM	CPI M/M (core)	(Jun)	(H)	0.3%	0.2%	0.2%
Thursday, July 11	8:30 AM	CPI Y/Y	(Jun)	(H)	3.3%	3.1%	3.3%
Thursday, July 11	8:30 AM	CPI Y/Y (core)	(Jun)	(H)	3.5%	3.4%	3.4%
Thursday, July 11	2:00 PM	TREASURY BUDGET	(Jun)	(L)	-	-	-$347.1B
Thursday, July 11	11:30 AM	Speaker: Raphael W. Bostic (Atlanta) (Voter)	-	-	-	-	-
Thursday, July 11	1:00 PM	Speaker: Alberto G. Musalem (St Louis)(Non-Voter)	-	-	-	-	-
Friday, July 12	8:30 AM	PPI M/M	(Jun)	(M)	0.2%	0.1%	-0.2%
Friday, July 12	8:30 AM	PPI M/M (core)	(Jun)	(M)	0.3%	0.1%	0.0%
Friday, July 12	8:30 AM	PPI Y/Y	(Jun)	(M)	-	-	2.2%
Friday, July 12	8:30 AM	PPI Y/Y (core)	(Jun)	(M)	-	-	2.3%
Friday, July 12	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Jul P)	(H)	-	67.0	68.2

Week Ahead's market call

by Avery Shenfeld

In the **US**, inflation reports top the data calendar, and while we see price pressures on a broadly moderating trend, we might be reminded that monthly data are choppy and rarely run in a straight line. The result is that core CPI prices, coming off a very tame increase last month, risk printing a less friendly 0.3% advance this time, and giving the bond market some temporary angst. Fed speakers aren't yet ready to give clear signals at this point, so their remarks are less likely to be market moving. Politics will be the other focal point, as Biden's candidacy is still under a cloud.

In **Canada**, we get a week off from economic news, with nothing on the calendar of note. The fallout from the weaker jobs data this past week will still be resonating in markets, but the reality is that cementing the July rate cut we have in our forecast, and which the economy very much needs, will have to await the next CPI reading, after May's 0.3% core price increases created some risks to the 3-month trend.

There are no major Canadian data releases next week.

Week Ahead's key US number: CPI—June

(Thursday, 8:30 am)

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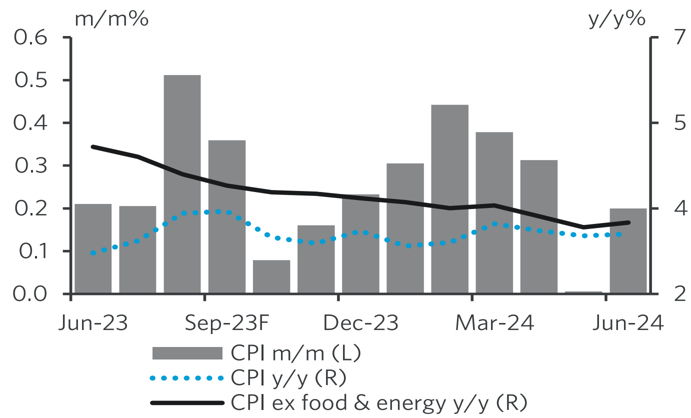
Variable (%)	CIBC	Mkt	Prior
Headline CPI m/m	0.2	0.1	0.0
Headline CPI y/y	3.3	3.1	3.3
Core CPI m/m	0.3	0.2	0.2
Core CPI y/y	3.5	3.4	3.4

Chart: US Consumer price index



Source: BLS, Haver Analytics, CIBC

We expect less progress against inflation in June, with core CPI expected at 0.3% m/m and headline at 0.2%. Most of the softness seen in the May report was due to transportation services, and particularly car insurance inflation, coming back down to earth. But we are don't expect that type of softness to continue in June, resulting in non-housing service inflation picking up again. We also believe the pass-through of market rents into shelter inflation will remain slow and overall shelter inflation we likely not look very different from what we have seen since the start of the year. While goods deflation should continue, it won't be enough to offset a pick up in service inflation in the month, pushing the monthly reading a bit higher.

Forecast implications — A 0.3% core CPI reading translates into a 0.2-0.3% m/m reading in the core PCE price index depending on the compositional details, as well as the PPI. The Fed will be looking through the monthly volatility and has every right to continue to view Q2 as progress. On a Q/Q SAAR basis, our expectation implies core CPI inflation will ease from slightly above 4% in Q1 to 3% in Q2, which is only modestly above target in PCE space because of the outsized role of shelter in CPI. Combined with a cooler trend in the labor market, that broader picture will keep the Fed in play for a first cut in September.

Market implications — We are a tick above consensus for this release, and the initial reaction to an above consensus reading on inflation will likely generate some jitters about a September cut, but overall, the market may still be somewhat patient after Powell's confident tone about inflation progress this week.

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