Economics

THE WEEK AHEAD

August 23-27, 2021

Should the Bank of Canada ever reverse the QE engines?

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

Rate hikes still seem a long way off, but the Bank of Canada is actively paring back its other stimulus tool, quantitative easing, moving over the next few months to a pace that will simply reinvest its maturities of Government of Canada bonds. But then what?

Across the pond, the Bank of England announced that, once the economy has proven able to live with a 1% policy rate, it will also begin to sell bonds it purchased back to the market. Should the Bank of Canada ever think about reversing its own QE engines?

The benefits would be a reduction in the long term rollover risk on what is now a higher level of government debt outstanding. Under QE, the BoC removed government bonds from the public market, and in exchange, gave its financial sector counterparties settlement balances, which pay the overnight rate of interest. After stripping out the debt that the federal government owes to its wholly-owned central bank, but adding back the settlement balances, much more of Ottawa's debt is in the floating or under-1 year bucket (Chart).

For now, that's a huge win, since those balances pay a lower rate than the bonds that the BoC now holds. But if we ever entered a period of elevated overnight rates, the financial cost to Ottawa would also rise. Our outlook is for a very gradual climb in rates ahead. That should give BoC a few years to reverse QE, selling bonds back to the market, and lowering the levels of BoC liabilities in settlement balances. It could thereby lock in more of the government's debt at what will still be quite low rates by historical standards.

One downside is that the very act of selling those bonds could help speed up the return of higher longer term interest rates, and thereby act as a drag on growth. The BoC could, however, counterbalance that by choosing a slower pace to raising the overnight rate than it otherwise would have adopted.

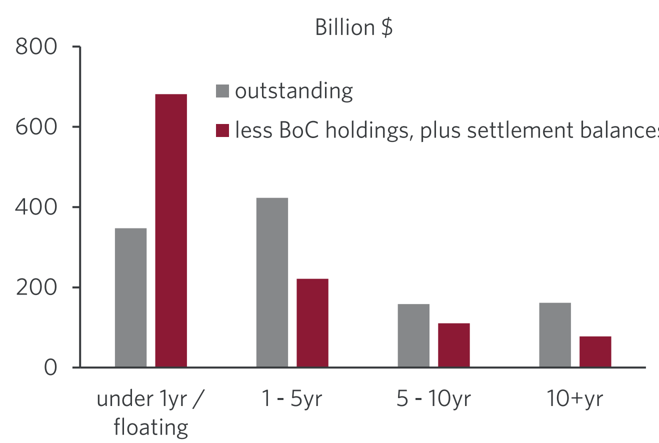
The other downside is what's true whenever a borrower locks in its debt for term in the face of an upward sloping yield curve. In the near term, such debt will entail a higher interest cost than short term or floating rate debt, something no finance minister is ever too happy about.

But that's no different than any time a government opts to issue, say, a 10-year bond when it could have instead put it all out in t-bills. You usually pay up for the safety of having more of your debt at fixed rates, but we still judge that doing so when rates are still low by historical standards can be prudent as a reduction in risk for future finance ministers.

One final consideration: if reversing QE becomes standard practice, it could dull the benefits of QE during a crisis. Should the market understand that bonds bought by the central bank today will be put back to the market a couple of years down the road, it could weaken the ability of such purchases to drag yields lower, and thereby help the economy recover.

Even now, if the BoC is even thinking about reversing QE, it should keep quiet about it, lest it push up long term interest rates before the economy is healthy enough to live with them. So for the good of the country, don't spread the word about this essay too far.

Chart: Government of Canada marketable debt outstanding



Source: Government of Canada, Bank of Canada, CIBC

Week Ahead Calendar And Forecast—Canada

H, M, L = High, Medium or Low Significance

SAAR = Seasonally Adjusted Annual Rate

Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Significance	CIBC	Consensus	Prior
Monday, August 23	-	Government Bond Purchase Program (GBPP): 10-YR	-	-	-	-	-
Tuesday, August 24	-	Government Bond Purchase Program (GBPP): 5-YR	-	-	-	-	-
Wednesday, August 25	-	Government Bond Purchase Program (GBPP): 2-YR	-	-	-	-	-
Wednesday, August 25	-	AUCTION: 3-YR CANADAS $3.5B	-	-	-	-	-
Thursday, August 26	-	Government Bond Purchase Program (GBPP): 30-YR	-	-	-	-	-
Thursday, August 26	-	AUCTION: 30-YR CANADAS $3B	-	-	-	-	-
Thursday, August 26	8:30 AM	PAYROLL EMPLOYMENT, EARNINGS & HRS	(Jun)	(L)	-	-	-258K
Friday, August 27	8:30 AM	INDUSTRIAL PROD. PRICES M/M	(Jul)	(M)	-	-	0.0%
Friday, August 27	8:30 AM	RAW MATERIALS M/M	(Jul)	(M)	-	-	3.9%

Week Ahead Calendar And Forecast—United States

H, M, L = High, Medium or Low Significance

SAAR = Seasonally Adjusted Annual Rate

Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Significance	CIBC	Consensus	Prior
Monday, August 23	-	AUCTION: 3-M BILLS $51B, 6-M BILLS $48B	-	-	-	-	-
Monday, August 23	8:30 AM	CHICAGO FED NAT.ACTIVITY INDEX	(Jul)	(M)	-	-	0.09
Monday, August 23	9:45 AM	MARKIT US SERVICES PMI	(Aug P)	(L)	-	59.0	59.9
Monday, August 23	9:45 AM	MARKIT US COMPOSITE PMI	(Aug P)	(L)	-	-	59.9
Monday, August 23	9:45 AM	MARKIT US MANUFACTURING PMI	(Aug P)	(L)	-	62.8	63.4
Monday, August 23	10:00 AM	EXISTING HOME SALES SAAR	(Jul)	(M)	-	5.84M	5.86M
Monday, August 23	10:00 AM	EXISTING HOME SALES M/M	(Jul)	(M)	-	-0.3%	1.4%
Tuesday, August 24	-	CASH MGMT. 67-DAY $40B	-	-	-	-	-
Tuesday, August 24	-	AUCTION: 2-YR TREASURIES $60B	-	-	-	-	-
Tuesday, August 24	10:00 AM	NEW HOME SALES SAAR	(Jul)	(M)	670K	700K	676K
Tuesday, August 24	10:00 AM	NEW HOME SALES M/M	(Jul)	(M)	-	3.6%	-6.6%
Tuesday, August 24	10:00 AM	RICHMOND FED MANUF. INDEX	(Aug)	(M)	-	25.0	27
Wednesday, August 25	-	AUCTION: 5-YR TREASURIES $61B	-	-	-	-	-
Wednesday, August 25	-	AUCTION: 7-YR TREASURIES $62B	-	-	-	-	-
Wednesday, August 25	-	AUCTION: 2-YR FRN $26B	-	-	-	-	-
Wednesday, August 25	7:00 AM	MBA-APPLICATIONS	(Aug 20)	(L)	-	-	-3.9%
Wednesday, August 25	8:30 AM	DURABLE GOODS ORDERS M/M	(Jul P)	(H)	-0.3%	-0.4%	0.9%
Wednesday, August 25	8:30 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Jul P)	(H)	0.5%	0.3%	0.5%
Thursday, August 26	8:30 AM	INITIAL CLAIMS	(Aug 21)	(M)	-	-	348K
Thursday, August 26	8:30 AM	CONTINUING CLAIMS	(Aug 14)	(L)	-	-	2820K
Thursday, August 26	8:30 AM	GDP (annualized)	(Q2S)	(H)	6.6%	6.6%	6.5%
Thursday, August 26	8:30 AM	GDP DEFLATOR (annualized)	(Q2S)	(H)	-	6.0%	6.0%
Thursday, August 26	-	FED'S ANNUAL JACKSON HOLE POLICY RETREAT	-	-	-	-	-
Friday, August 27	8:30 AM	ADVANCE GOODS TRADE BALANCE	(Jul)	(M)	-$91.6B	-$90.0B	-$91.2B
Friday, August 27	8:30 AM	RETAIL INVENTORIES M/M	(Jul)	(H)	-	-	0.3%
Friday, August 27	8:30 AM	WHOLESALE INVENTORIES M/M	(Jul P)	(L)	-	1.0%	1.1%
Friday, August 27	8:30 AM	PCE DEFLATOR Y/Y	(Jul)	(H)	4.2%	4.1%	4.0%
Friday, August 27	8:30 AM	PCE DEFLATOR Y/Y (core)	(Jul)	(H)	3.6%	3.6%	3.5%
Friday, August 27	8:30 AM	PERSONAL INCOME M/M	(Jul)	(H)	-0.3%	0.2%	0.1%
Friday, August 27	8:30 AM	PERSONAL SPENDING M/M	(Jul)	(H)	0.7%	0.4%	1.0%
Friday, August 27	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Aug F)	(H)	-	70.8	70.2
Friday, August 27	10:00 AM	FED'S ANNUAL JACKSON HOLE POLICY RETREAT	-	-	-	-	-

Week Ahead's market call

by Katherine Judge

In the **US**, a range of second tier data will be released, with the household spending data for July set to confirm the shift in spending towards services that is underway. The Fed's preferred inflation measure, core PCE prices, will accelerate by a tick, further validating that the price stability goal has been reached. The most important event of the week will be Powell's remarks at the annual Jackson Hole Symposium in which investors will be parsing his speech for clues that substantial further progress has been made towards the full employment part of the dual mandate. That would set the stage for officials to announce a tapering of QE at the September meeting, poised to begin as early as later this year.

In **Canada**, it's a quiet week with no major economic events on the calendar. Markets will therefore be focused on developments stateside.

There are no major Canadian data releases next week.

Week Ahead's key US number:
Personal income and spending—July

(Friday, 8:30 am)

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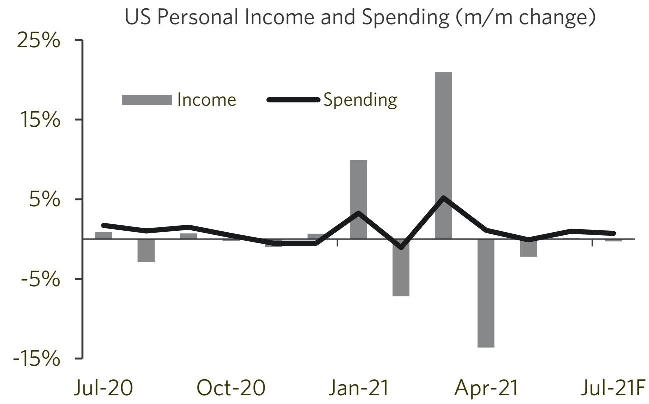
Variable (% change)	CIBC	Mkt	Prior
Personal income (m/m)	-0.3	0.2	0.1
Personal spending (m/m)	0.7	0.4	1.0
PCE price index (y/y)	4.2	4.1	4.0
Core PCE price index (y/y)	3.6	3.6	3.5

Chart: US personal income and spending



Source: Haver Analytics, CIBC

Spending swung towards services at the end of Q2 while spending on goods tapered off, something that looks to have continued in July. Total personal spending likely rose by 0.7% on the month while incomes likely fell by 0.3% as labor income gains could have been offset by a drop in government transfers as many states moved to end unemployment benefit top-ups in late June, which would result in lower average incomes over July.

Price pressures likely heated up, reflecting the transitory impact of higher energy prices on headline PCE inflation, which is set to rise to 4.2%, while higher wages along with strong demand for services could have boosted core PCE inflation to 3.6%. When stripping out base effects by comparing the latter measure to its pre-pandemic level, inflation would still be above target at 2.6% annualized.

Forecast Implications— With ample savings accumulated throughout the pandemic from deferred spending and fiscal stimulus, services should continue to see healthy demand ahead, helped by continued strong employment gains. Still, the spread of the Delta variant poses a growing downside risk to services consumption. With the Fed having acknowledged that the price stability goal has been reached, focus is solely on labor market progress.

Market Impact— We are above the consensus on spending which could be supportive of yields and the USD.

Other US Releases:
Durable goods orders—July

(Wednesday, 8:30 am)

Commercial aircraft orders rose in July, but cancellations of previous orders could have offset that progress, resulting in a 0.3% decline in total durable goods orders. Excluding transportation, durable goods orders likely rose by 0.5%, supported by a cyclical improvement in demand for capital goods as capacity utilization surpassed its pre-pandemic level in the manufacturing sector during the month. That would extend the positive trend in orders seen over the second quarter, suggesting that capital spending will remain a driver of growth in the third quarter.

Advance goods trade balance—July

(Friday, 8:30 am)

The US trade deficit in goods ended the second quarter at a record wide level on strong imports of industrial supplies. While inventory rebuilding, particularly of auto dealerships, will produce a bounce in imports ahead, the timing is uncertain given supply chain bottlenecks, logistics issues, and rising transportation costs, along with the resurgence of the virus that has prompted activity curtailments in some supplier markets. Still, China's trade surplus with the US increased in July, suggesting that the US goods deficit could have widened slightly to $91.6bn, with the jump in export prices limiting the widening.

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