

Economics

THE WEEK AHEAD

November 7-11, 2022

Midterms and the US Deficit: Que Sera, Sera

by Avery Shenfeld avery.shenfeld@cibc.com

A quote wrongly ascribed to Mark Twain wryly notes that “everybody talks about the weather, but nobody does anything about it.” Change “weather” to the “US budget deficit” and you would have an accurate depiction on where things stand on American fiscal policy, at least since Bill Clinton. Whatever the outcome, the week ahead’s midterm election is unlikely to change that.

The last 10-year projection from the Congressional Budget Office dates from May, and while nominal GDP and revenues will be helped by this year’s persistent inflation, the rest of the that CBO outlook looks too rosy. Not only does it assume only a very minor economic slowdown in 2023, but it allows the economy to sustain a jobless rate in the mid-3% range over the forecast horizon. Recent evidence suggests that might be inconsistent with a 2% inflation target, which would imply a lower potential growth rate, and therefore a less robust revenue trend.

Even in the CBO base case, the US debt/GDP ratio was projected to keep climbing. While nobody still buys into the idea that crossing through a 100% ratio spells an economic Armageddon, economists still pay attention to the debt service burden. The May CBO projection showed net interest doubling as a share of GDP over the coming decade.

None of that is necessarily alarming, but until we have a sense of where Treasury yields will descend to when the battle against inflation is won, we can’t be quite as comfortably nonchalant as when it looked like mid-2% rates or lower were the norm. Arguments about debt being less problematic when interest rates were below nominal GDP growth might one day be relevant again, but there are at least some doubts that we’ll again be there.

Republicans look likely to take control of the House, while the Senate could be a close call. While the GOP professes concern over deficits, and will once again use the debt ceiling to try to force spending cuts, recent history suggests that they are a party of big deficits, given their willingness to turn any savings on expenditures into quick tax cuts.

Moreover, with the White House likely to exercise veto power over attempts to trim key social programs like Medicare and Social Security, and do the same should the GOP take aim at spending on infrastructure and climate change, there’s not really that much scope for a divided Washington to slash expenditures. Tax hikes, including Biden’s threatened windfall tax on energy companies, will be a non-starter if Republicans have the reins in the House.

The Treasury recently announced their quarterly refunding, and it stood \$150 billion above their previous projections, citing fiscal policy as one the key reasons for that overshoot. That sort of pressure is likely to persist, and it can act to nudge up longer term yields from where they would otherwise sit.

It’s just one more reason why, when we look past the current spurt of inflation into 2024 and beyond, we’re unlikely to see a sustained return to the lows in bond yields that we got used to in the prior cycle. Perhaps that’s why the CBO assumed that while the fed funds rate would settle back to 2½% in the latter half of this decade, they allowed for 10-year Treasuries to average near 3½%. We still expect to see the long end rally in the next couple of years if inflation is vanquished, but fiscal policy might then create a push in the other direction if US politics continues along its current path.

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, November 7	-	-	-	-	-	-	-
Tuesday, November 8	-	AUCTION: 3-M BILLS \$9.2B, 6-M BILLS \$3.4B, 1-YR BILLS \$3.4B	-	-	-	-	-
Wednesday, November 9	-	AUCTION: 5-YR CANADAS \$3.5B	-	-	-	-	-
Thursday, November 10	12:05 PM	Speaker: Tiff Macklem (Governor)	-	-	-	-	-
Friday, November 11	-	Bond Market Closed (Remembrance Day)	-	-	-	-	-

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, November 7	3:00 PM	CONSUMER CREDIT	(Sep)	(L)	-	\$32.00B	\$32.24B
Monday, November 7	3:40 PM	Speaker: Susan M. Collins (Boston) (Voter), Loretta Mester (Cleveland) (Voter)	-	-	-	-	-
Monday, November 7	6:00 PM	Speaker: Thomas I. Barkin (Richmond)	-	-	-	-	-
Tuesday, November 8	-	AUCTION: 3-YR TREASURIES \$40B	-	-	-	-	-
Tuesday, November 8	-	US Midterm Elections	-	-	-	-	-
Tuesday, November 8	3:00 PM	Speaker: John C. Williams (Vice Chairman, New York) (Voter)	-	-	-	-	-
Tuesday, November 8	11:00 AM	Speaker: Thomas I. Barkin (Richmond)	-	-	-	-	-
Wednesday, November 9	-	10-YR AUCTION: \$35B	-	-	-	-	-
Wednesday, November 9	7:00 AM	MBA-APPLICATIONS	(Nov 4)	(L)	-	-	-0.5%
Wednesday, November 9	2:00 AM	Speaker: Christopher J. Waller (Governor) (Voter)	-	-	-	-	-
Wednesday, November 9	9:35 AM	Speaker: Lorie K. Logan (Dallas) (Non-Voter)	-	-	-	-	-
Wednesday, November 9	12:30 PM	Speaker: Loretta Mester (Cleveland) (Voter)	-	-	-	-	-
Wednesday, November 9	1:30 PM	Speaker: Esther George (Kansas City) (Voter)	-	-	-	-	-
Thursday, November 10	-	30-YR AUCTION: \$21B	-	-	-	-	-
Thursday, November 10	8:30 AM	INITIAL CLAIMS	(Nov 5)	(M)	-	-	217K
Thursday, November 10	8:30 AM	CONTINUING CLAIMS	(Oct 29)	(L)	-	-	1485K
Thursday, November 10	8:30 AM	CPI M/M	(Oct)	(H)	0.7%	0.7%	0.4%
Thursday, November 10	8:30 AM	CPI M/M (core)	(Oct)	(H)	0.5%	0.5%	0.6%
Thursday, November 10	8:30 AM	CPI Y/Y	(Oct)	(H)	8.0%	8.0%	8.2%
Thursday, November 10	8:30 AM	CPI Y/Y (core)	(Oct)	(H)	6.6%	6.6%	6.6%
Thursday, November 10	2:00 PM	TREASURY BUDGET	(Oct)	(L)	-	-	-\$429.7B
Thursday, November 10	12:30 PM	Speaker: Loretta Mester (Cleveland) (Voter)	-	-	-	-	-
Friday, November 11	-	Treasury Markets Closed (Veteran's Day)	-	-	-	-	-
Friday, November 11	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Nov P)	(H)	-	59.6	59.9

Week Ahead's market call

by Avery Shenfeld

In the **US**, midterm elections look likely to swing at least the House into Republican hands. That sets the stage for yet another battle over the debt ceiling down the road, but could also have implications for tax and regulatory policies in a number of sectors. See our Week Ahead cover on the deficit outlook, as well the detailed look at implications for energy, climate and trade policy recently published by Ian de Verteuil and his portfolio strategy team in CIBC Equity Research. On the data front, we're not counting on better news from the US CPI, but neither is the market at this point. Fed speakers are likely to line up with a quite unified voice behind Powell's recent hawkish comments.

Canada's bond market will take a one-day breather for Remembrance Day (Friday), but the week will also get a breather from major economic news. Bank of Canada Governor Macklem said some of what he had to say after the last rate hike, but will add colour on what they expect to see in the labour market if inflation is to decelerate. It's also worth watching whether he reacts at all to the rebound seen in October jobs figures.

There are no major Canadian data releases next week.

Week Ahead's key US number: Consumer price index—October

(Thursday, 8:30 am)

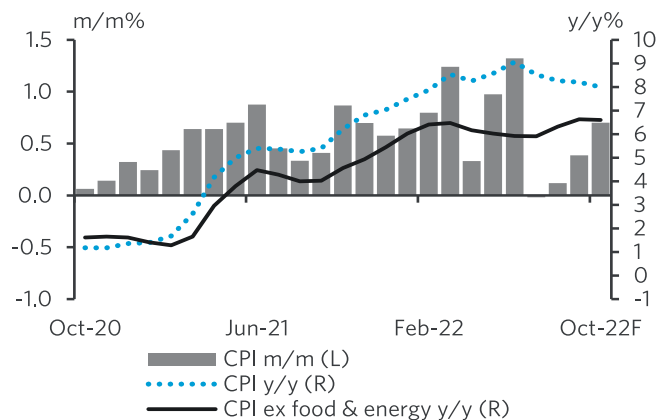
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Variable (%)	CIBC	Mkt	Prior
Headline CPI m/m	0.7	0.7	0.4
Headline CPI (y/y)	8.0	8.0	8.2
Core CPI m/m	0.5	0.5	0.6
Core CPI y/y	6.6	6.6	6.6

The relief from higher prices at the pump ended in October, as prices climbed into mid-month, with OPEC+ announcing supply curtailments. Combined with broad price pressures in other categories, the total CPI likely accelerated to 0.7% on the month, leaving the annual rate of inflation lower at 8.0%.

Excluding food and energy, core prices likely remained heated with a 0.5% gain on the month, reflecting continued pressure in the shelter price index as leases reset at higher rates, lagging housing market developments. High demand for other services likely added to that pressure, however, some easing in core goods prices could have been masked by the headline, as industry gauges of used car prices have fallen along with the fading of supply chain issues in that sector.

Chart: US Consumer price index



Source: BLS, Haver Analytics, CIBC

Forecast implications — Oil prices appear to have a floor under them, as OPEC+ has started to cut production, but there is scope for food inflation to ease off in the months ahead, in line with the drop in global food commodity price indices. Core prices could also decelerate ahead if supply chain improvements and the impact of past interest rate hikes on demand start to materialize in the index. With inflation still set to remain elevated into 2023, the Fed will likely hike rates by another 100bps in order to contain inflation expectations and cool the labor market.

Market impact — We are in line with the consensus and market reaction should therefore be limited.

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