Economics

THE WEEK AHEAD

August 12 - 16, 2024

When the facts change

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

A wise economist famously said that “when the facts change, so do I.” But the challenge is always about whether the facts have, in fact, materially changed. That’s what we and our clients were grappling with after the US reported a succession of softer economic data. Is a recession imminent? Unavoidable? Will the Fed have to abandon a gradualist approach to easing policy? If so, what does all this mean for Canada?

Bayesian forecasting is a useful paradigm to apply to this task. It starts with a prior forecast and a given degree of confidence, and new information is weighed in against that prior view, rather than starting from scratch. In that regard, we need to remind ourselves that we just came off a stronger-than-expected Q2 for the US economy, and a hot June retail sales report. Q3 growth might settle back to the 1½% range, but that’s not a recession.

As for those citing Sahm’s recession rule, tied to a rise in the jobless rate, such rules are sometimes made to be broken. We should have already been in a North American recession if another rule-of-thumb, an inverted yield curve, had worked this time. What’s changed for Sahm’s rule is that the rising unemployment rate in Canada, and more recently in the US, has been tied to labour force growth. Both payrolls employment and the economy can be growing, and therefore defying the recession label, while not growing fast enough to absorb all those workers.

As for the stock market dive, Paul Samuelson’s quip about equity corrections predicting nine of the last five recessions is worth repeating. We’ve had a huge run up in valuations, one that may have baked in too much juice from growth in tech earnings and rate cuts, with not enough allowance for even a slowing in US economic growth. Its not that there wasn’t reason for the market to do a rethink, but as we saw in the much more dramatic 1987 crash, stock market declines don’t infallably signal a recession, or cause one.

Even if a recession isn’t in the cards, a case could be made for sharper rate cuts now. Given the progress already seen on underlying inflation, real rates are clearly higher than they need to be, just as they were clearly too low when the central banks started their hiking cycle. The BoC opted for some outsized hikes in the early stage of raising rates, before slowing the pace down to fine tune the landing. That same logic would open the door to moving 50 basis point cuts at time before slowing the easing pace or pausing.

But neither central bank seems likely to adopt that view without a dose of scarier economic news. The Fed and the Bank of Canada can also be thought of as Bayesian forecasters, adjusting their views as facts come in, while giving a good deal of weight to their prior forecasts. Those “priors” entailed a soft-landing outcome in which recessions were avoided and interest rate cuts were gradual. The Fed showed such gradualism in its “dot” forecasts and its decision to hold its fire in July, while the BoC did the same by starting with two quarter point cuts rather than something larger.

Still, the accumulated facts have changed enough in the past month to warrant the modest tweaks we made to our interest rate forecasts earlier this week. Disinflation in both countries looks sufficiently entrenched so that the focus of central banks can be on protecting against downside economic risks. There will be less reason to pause on the path to lower interest rates to judge how we’re doing on inflation, and more reason to get rates to less restrictive levels before taking such a pause.

As a result, we now see both the central banks cutting by a quarter point at each of their next three decision dates, ending this year (and 2025) a quarter point lower than we earlier projected. The facts haven’t changed enough, at least not yet, to change our minds or those of the central bankers more than that.

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, August 12	8:30 AM	BUILDING PERMITS M/M	(Jun)	(M)	-	-	-12.2%
Tuesday, August 13	-	AUCTION: 3-M BILLS $15.2B, 6-M BILLS $5.4B, 1-YR BILLS $5.4B	-	-	-	-	-
Wednesday, August 14	-	-	-	-	-	-	-
Thursday, August 15	8:30 AM	WHOLESALE SALES EX PETROLEUM M/M	(Jun)	(M)	-0.6%	-0.6%	-0.8%
Thursday, August 15	9:00 AM	EXISTING HOME SALES M/M	(Jul)	(M)	-	-	3.7%
Friday, August 16	8:15 AM	HOUSING STARTS SAAR	(Jul)	(M)	255.0K	245.0K	241.7K
Friday, August 16	8:30 AM	MANUFACTURING SHIPMENTS M/M	(Jun)	(M)	-2.6%	-2.6%	0.4%
Friday, August 16	8:30 AM	INT'L. SEC. TRANSACTIONS	(Jun)	(M)	-	-	$20.9B

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, August 12	2:00 PM	TREASURY BUDGET	(Jul)	(L)	-	-	-$66.0B
Tuesday, August 13	8:30 AM	PPI M/M	(Jul)	(M)	0.2%	0.2%	0.2%
Tuesday, August 13	8:30 AM	PPI M/M (core)	(Jul)	(M)	0.2%	0.2%	0.4%
Tuesday, August 13	8:30 AM	PPI Y/Y	(Jul)	(M)	-	-	2.6%
Tuesday, August 13	8:30 AM	PPI Y/Y (core)	(Jul)	(M)	-	-	3.0%
Tuesday, August 13	1:15 PM	Speaker: Raphael W. Bostic (Atlanta) (Voter)	-	-	-	-	-
Wednesday, August 14	7:00 AM	MBA-APPLICATIONS	(Aug 9)	(L)	-	-	6.9%
Wednesday, August 14	8:30 AM	CPI M/M	(Jul)	(H)	0.2%	0.2%	-0.1%
Wednesday, August 14	8:30 AM	CPI M/M (core)	(Jul)	(H)	0.2%	0.2%	0.1%
Wednesday, August 14	8:30 AM	CPI Y/Y	(Jul)	(H)	3.0%	3.0%	3.0%
Wednesday, August 14	8:30 AM	CPI Y/Y (core)	(Jul)	(H)	3.2%	3.2%	3.3%
Thursday, August 15	8:30 AM	INITIAL CLAIMS	(Aug 10)	(M)	-	-	233K
Thursday, August 15	8:30 AM	CONTINUING CLAIMS	(Aug 3)	(L)	-	-	1875K
Thursday, August 15	8:30 AM	NEW YORK FED (EMPIRE)	(Aug)	(M)	-	-6.0	-6.6
Thursday, August 15	8:30 AM	RETAIL SALES M/M	(Jul)	(H)	0.2%	0.3%	0.0%
Thursday, August 15	8:30 AM	RETAIL SALES (X-AUTOS) M/M	(Jul)	(H)	0.0%	0.1%	0.4%
Thursday, August 15	8:30 AM	RETAIL SALES CONTROL GROUP M/M	(Jul)	(H)	-0.2%	0.1%	0.9%
Thursday, August 15	8:30 AM	IMPORT PRICE INDEX M/M	(Jul)	(L)	-	-0.1%	0.0%
Thursday, August 15	8:30 AM	EXPORT PRICE INDEX M/M	(Jul)	(L)	-	-	-0.5%
Thursday, August 15	9:15 AM	INDUSTRIAL PRODUCTION M/M	(Jul)	(H)	0.1%	0.0%	0.6%
Thursday, August 15	9:15 AM	CAPACITY UTILIZATION	(Jul)	(M)	78.8%	78.7%	78.8%
Thursday, August 15	10:00 AM	BUSINESS INVENTORIES M/M	(Jun)	(L)	-	0.3%	0.5%
Thursday, August 15	10:00 AM	NAHB HOUSING INDEX	(Aug)	(L)	-	42.0	42.0
Thursday, August 15	4:00 PM	NET CAPITAL INFLOWS (TICS)	(Jun)	(L)	-	-	-$54.6B
Thursday, August 15	9:10 AM	Speaker: Alberto G. Musalem (St Louis) (Non-Voter)	-	-	-	-	-
Thursday, August 15	1:10 PM	Speaker: Patrick Harker (Philadelphia) (Non-Voter)	-	-	-	-	-
Friday, August 16	8:30 AM	BUILDING PERMITS SAAR	(Jul)	(H)	1480K	1436K	1446K
Friday, August 16	8:30 AM	HOUSING STARTS SAAR	(Jul)	(M)	1400K	1342K	1353K
Friday, August 16	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Aug P)	(H)	-	67.2	66.4
Friday, August 16	1:25 PM	Speaker: Austan D. Goolsbee, Chicago (Non-Voter)	-	-	-	-	-

Week Ahead's market call

by Avery Shenfeld

In the **US**, we're in line with the consensus on CPI, with inflation being well enough behaved to leave market views on the Fed little changed. Inflation is tame enough for the Fed to start cutting in September, and the choice between a 25 or 50 bp move will come down to how scary the employment picture looks. We're softer than consensus on control group retail sales, as barring revisions (always a big risk with these advance readings), the prior month was a strong outlier that leaves room for a bit of a give back in July. Fed speakers don't seem inclined to question their July decision or fan fears of a sharper economic slowdown.

In **Canada**, manufacturing shipments look to drop given advance readings, while we look for a bit of an uptick in housing starts. Looking ahead, starts will be held back by sluggish preconstruction sales of condos, so there will be a fairly long lag between rate cuts and a revival in building activity. Markets seem reasonably priced for a steady dose of quarter point cut cuts over the balance of the year, so we don't expect to see much volatility tied to the macro data until we get fresh news on CPI and GDP.

There are no major Canadian data releases next week.

Week Ahead's key US number: CPI—July

(Wednesday, 8:30 am)

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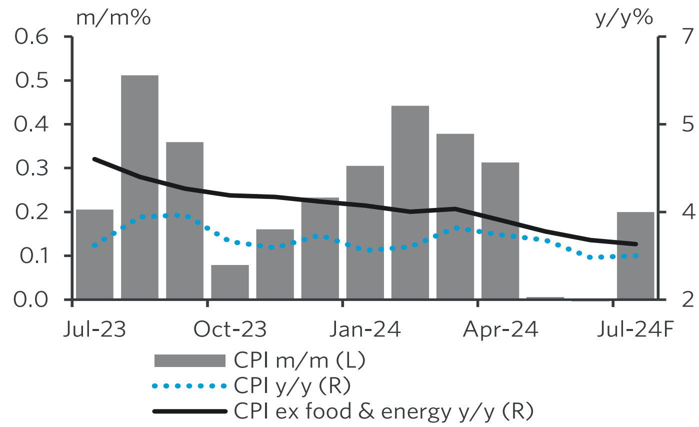
Variable (%)	CIBC	Mkt	Prior
Headline CPI (m/m)	0.2	0.2	-0.1
Headline CPI (yr/yr)	3.0	3.0	3.0
Core CPI (m/m)	0.2	0.2	0.1
Core CPI (yr/yr)	3.2	3.2	3.3

Chart: US Consumer price index



Source: BLS, Haver Analytics, CIBC

It almost feels like next week's July CPI report doesn't matter, with the Fed on lock to cut rates in September in large part because of the risk to its labor mandate. But the CPI report will reassure everyone that victory is insight on the Fed's price stability mandate, as headline and core CPI should come in broadly consistent with target, at 0.2% m/m for both. Last month's report saw shelter inflation finally come down a couple of pegs and we expect that to gradually become a trend, making the last mile fairly smooth. Price pressures in goods should remain muted, helping to offset a pickup in non-housing services prices.

Forecast implications — The Fed is on a clear course to cut rates and we recently upgraded our call from two cuts this year to three straight cuts to end the year, as the Fed plays a bit of catch up to labor market softness.

Market implications — Our views on inflation are aligned with the consensus, and that outcome will mean markets will continue to walk back their views of larger-than-normal cut in September.

Other US Releases: Retail sales—July

(Thursday, 8:30 am)

The consumer should pullback in July after hot start to the summer in June. Total retail sales will increase by 0.1% but spending in the control group should contract by 0.2% in the month. Car sales will bounce back after last month's software glitch depressed sales, slightly flattering the overall number. But the underlying trend in consumer spending is softer given labor income growth is slowing.

Industrial production—July

(Thursday, 9:15 am)

Industrial production should decrease by 0.2% in the month, as manufacturing production should slow, weighed down by worsening sentiment and a pullback from strong growth in the prior month. Utilities production should also soften as July temperatures were broadly in line with historical norms.

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