Economics

THE WEEK AHEAD

May 13 - 17, 2024

A risk to the loonie, but not THAT one

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

We're getting a lot of questions about the risk of a plunge in the loonie if the Bank of Canada outguns the Fed on rate cuts this year. We see a couple of cents of weakening ahead, but not a sustained devaluation, because of a counterforce that could support the Canadian dollar against the greenback in 2025. But we're watching another development, across the pond in Europe, that could leave the Canadian dollar more exposed.

While monetary policy divergences can impact the Canadian dollar, its broadest movements against the greenback have more often been a reflection of whether the US dollar is generally weakening or strengthening against a basket of major currencies. The euro is the most heavily weighted developed-currency alternative to the greenback. As a result, in the past two decades, there's been an 85% correlation between monthly average levels for the euro's exchange rate versus the USD and the Canadian dollar's valuation against the greenback.

Hence our forecast for a recovery in the euro next year, and a general weakening in the US dollar, is key to our view that the loonie will reverse the weakness we'll see if the BoC eases more than markets now assume while the Fed stays closer to current expectations. The euro seems poised to rally because the greenback has been bid up aggressively on its usual safe-haven status during troubled economic times globally, to the point where it looks overvalued on trade fundamentals, and vulnerable to the mean reversion we typically see after long runs against the basket of other major currencies. We have both the Fed and the ECB easing more than market is currently pricing-in, with the extra rate cuts on the same order of magnitude, and therefore not having much sway over dollar-euro.

There's a risk to that call, however, and one that Canadian dollar traders may not be thinking about with all the focus on Canada-US interest rate differentials. Back in December, EU member states agreed to reimpose fiscal guidelines after setting such restraints aside when the pandemic and the Ukraine war hit growth prospects. That will require countries with deficits above 3% of GDP or debts over 60% of GDP to set a path back to those benchmarks, entailing varying degrees of fiscal belt tightening across the eurozone.

Of course, we've seen European countries claim that their budgets met earlier stability targets, only to beg for forgiveness when they fall short. Such slippage seems likely to repeat, and the EU doesn't have a lot of teeth on the enforcement side. That may be why the IMF sees the eurozone's cyclically-adjusted deficit falling by only 0.2% of GDP next year, not a big enough drag to really substitute for a lot of the central bank easing we expect to see. But if member states really do find religion on fiscal discipline, the resulting hit to growth could see the ECB forced to ease more than we expect.

In contrast, the IMF has the US cyclically-adjusted deficit actually widening, from 6.7% this year to 7.1% of GDP in 2025. That 0.4% of GDP move is not a huge dose of stimulus, but at this point, with an election in the offing, nobody can really be too sure about that prospect. Donald Trump seems to be pushing for further tax cuts, and Congress hasn't been able to pass much in the way of spending restraints.

Should US fiscal policy get even looser than we expect in 2025-26, and the EU crack down harder the other way, that could be enough to have the ECB surprising with more rate cuts than our current forecast, while the Fed has to ease less aggressively than our call. That's the sort of surprise that could prolong current US dollar strength. And as we noted, a strong dollar against the euro has gone hand in hand with gains for the greenback against the loonie. So odd as it might seem, keeping an eye on budget decisions in Germany, France, Italy and other major eurozone members is of importance for those with Canadian dollar risks to hedge.

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, May 13	8:30 AM	BUILDING PERMITS M/M	(Mar)	(M)	-	-5.0%	9.3%
Tuesday, May 14	8:30 AM	WHOLESALE SALES EX PETROLEUM M/M	(Mar)	(M)	-1.2%	-1.3%	0.0%
Wednesday, May 15	8:15 AM	HOUSING STARTS SAAR	(Apr)	(M)	225.0K	240.0K	242.2K
Wednesday, May 15	8:30 AM	MANUFACTURING SHIPMENTS M/M	(Mar)	(M)	-2.5%	-2.8%	0.7%
Wednesday, May 15	9:00 AM	EXISTING HOME SALES M/M	(Apr)	(M)	-	-	0.5%
Thursday, May 16	-	-	-	-	-	-	-
Friday, May 17	8:30 AM	INT'L. SEC. TRANSACTIONS	(Mar)	(M)	-	-	-$8.8B

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, May 13	9:00 AM	Speaker: Loretta Mester (Cleveland) (Voter)	-	-	-	-	-
Tuesday, May 14	-	AUCTION: 1-YR TREASURIES $46B	-	-	-	-	-
Tuesday, May 14	8:30 AM	PPI M/M	(Apr)	(M)	0.2%	0.3%	0.2%
Tuesday, May 14	8:30 AM	PPI M/M (core)	(Apr)	(M)	0.2%	0.2%	0.2%
Tuesday, May 14	8:30 AM	PPI Y/Y	(Apr)	(M)	-	2.2%	2.1%
Tuesday, May 14	8:30 AM	PPI Y/Y (core)	(Apr)	(M)	-	2.3%	2.4%
Tuesday, May 14	10:00 AM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Wednesday, May 15	7:00 AM	MBA-APPLICATIONS	(May 10)	(L)	-	-	2.6%
Wednesday, May 15	8:30 AM	NEW YORK FED (EMPIRE)	(May)	(M)	-	-10.7	-14.3
Wednesday, May 15	8:30 AM	CPI M/M	(Apr)	(H)	0.3%	0.4%	0.4%
Wednesday, May 15	8:30 AM	CPI M/M (core)	(Apr)	(H)	0.2%	0.3%	0.4%
Wednesday, May 15	8:30 AM	CPI Y/Y	(Apr)	(H)	3.3%	3.4%	3.5%
Wednesday, May 15	8:30 AM	CPI Y/Y (core)	(Apr)	(H)	3.5%	3.6%	3.8%
Wednesday, May 15	8:30 AM	RETAIL SALES M/M	(Apr)	(H)	0.0%	0.4%	0.7%
Wednesday, May 15	8:30 AM	RETAIL SALES (X-AUTOS) M/M	(Apr)	(H)	-0.1%	0.2%	1.1%
Wednesday, May 15	8:30 AM	RETAIL SALES CONTROL GROUP M/M	(Apr)	(H)	-0.3%	0.2%	1.1%
Wednesday, May 15	10:00 AM	BUSINESS INVENTORIES M/M	(Mar)	(L)	-	0.0%	0.4%
Wednesday, May 15	10:00 AM	NAHB HOUSING INDEX	(May)	(L)	-	51.0	51.0
Wednesday, May 15	4:00 PM	NET CAPITAL INFLOWS (TICS)	(Mar)	(L)	-	-	$71.5B
Wednesday, May 15	12:00 PM	Speaker: Neel Kashkari (Minneapolis) (Non-Voter)	-	-	-	-	-
Thursday, May 16	8:30 AM	INITIAL CLAIMS	(May 11)	(M)	-	-	231K
Thursday, May 16	8:30 AM	CONTINUING CLAIMS	(May 4)	(L)	-	-	1785K
Thursday, May 16	8:30 AM	BUILDING PERMITS SAAR	(Apr)	(H)	1450K	1488K	1467K
Thursday, May 16	8:30 AM	HOUSING STARTS SAAR	(Apr)	(M)	1350K	1433K	1321K
Thursday, May 16	8:30 AM	IMPORT PRICE INDEX M/M	(Apr)	(L)	-	0.2%	0.4%
Thursday, May 16	8:30 AM	EXPORT PRICE INDEX M/M	(Apr)	(L)	-	0.2%	0.3%
Thursday, May 16	9:15 AM	INDUSTRIAL PRODUCTION M/M	(Apr)	(H)	0.1%	0.2%	0.4%
Thursday, May 16	9:15 AM	CAPACITY UTILIZATION	(Apr)	(M)	78.5%	78.4%	78.4%
Thursday, May 16	12:00 PM	Speaker: Loretta Mester (Cleveland) (Voter)	-	-	-	-	-
Thursday, May 16	10:30 AM	Speaker: Patrick Harker (Philadelphia) (Non-Voter)	-	-	-	-	-
Thursday, May 16	3:50 PM	Speaker: Raphael W. Bostic (Atlanta) (Voter)	-	-	-	-	-
Friday, May 17	10:00 AM	LEADING INDICATORS M/M	(Apr)	(M)	-	-0.3%	-0.3%

Week Ahead's market call

by Avery Shenfeld

In the **US**, the week in economics will be largely compressed into a single day, as both the CPI and retail sales hit the tape on Wednesday. We're a tad below consensus on both, which if on the mark, should add a bit to Fed cut expectations. Some of the Fed speakers have been warning that a further rate hike can't be ruled out, but that's based on a scenario in which we see further disappointing news on inflation. One month isn't a trend, but a lighter core CPI reading this month would be the first step back in the right direction.

In **Canada**, the April jobs report threw a bit of a wrench into our call for a rate cut in June by hinting that a weak March GDP figure will give way to better news again in April. But we were still left with a 6.1% jobless rate, up from a 4.9% low. The week ahead's numbers will mostly look back to that soft March, other than April housing starts, where we expect a dip. The next real market mover, the April CPI report, isn't yet on tap for the coming week, and we'll need another moderate reading for core prices to keep the June cut alive.

There are no major Canadian data releases next week.

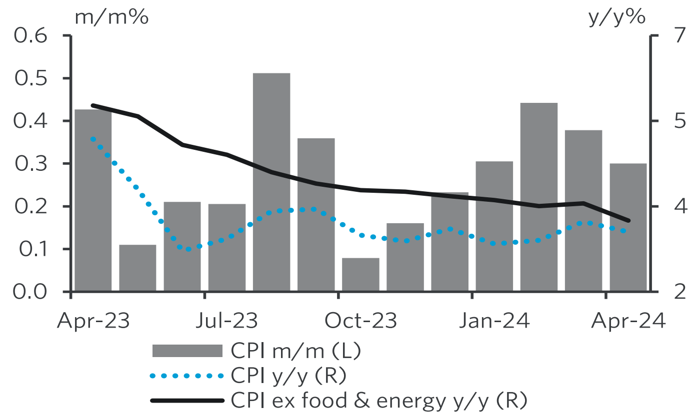
Week Ahead's key US number: CPI—April

(Wednesday, 8:30 am)

Ali Jaffery ali.jaffery@cibc.com

Variable (%)	CIBC	Mkt	Prior
Headline CPI (m/m)	0.3	0.4	0.4
Headline CPI (y/y)	3.3	3.4	3.5
Core CPI (m/m)	0.2	0.3	0.4
Core CPI (y/y)	3.5	3.6	3.8

Chart: US consumer price index



Source: BLS, Haver Analytics, CIBC

It is more than an understatement to say the April CPI will be the main event next week. The heavens could open up and deliver a one-tick below consensus core CPI reading of 0.2% m/m, and headline inflation should come in at 0.3% in the month. Rising car insurance premiums and auto maintenance costs have played no small part in uptick in inflation to start the year. These costs surged in March and we expect a more moderate increase in April, which will pare back some of the strength in non-housing services inflation. That combined with another soft core goods print, and roughly stable shelter costs, will push core inflation down a couple of notches from the 0.4% reading last month. But don't count on more miracles, as more mild April price pressures could be a momentary reprieve. Insurance premiums and motor vehicle maintenance costs are still catching up with the surge in car prices, and with some major car insurers still not back to profitability, these costs will likely continue to rise at an elevated pace in the coming months.

Forecast implications — While some elements of inflation could remain sticky, the Fed will feel more comfortable easing later this year as it sees further signs of an improving demand-supply balance. The supply of labor and goods remains very healthy, the dollar is strong, wage growth is slowing and GDP growth is shifting into a slightly lower gear.

Market implications — Fed pricing has been all over the place, in large part because Powell has kept a dovish bias, with the market pricing in just under two cuts for the year. If our forecast is right, it could prompt an overreaction from markets.

Other US Releases: Retail sales—April

(Wednesday, 8:30 am)

After the sharp increase in sales last month, we expect consumer spending to pull back in April. The control group of retail sales should come in at -0.3%, after rising above 1% in March. We expect headline retail sales to be flat in the month. But momentum from March and still solid demand for services will keep consumption growth at a very strong pace in Q2.

Industrial production—April

(Thursday, 9:15 am)

We expect industrial production to grow modestly in April at 0.1% as manufacturing slows. Sentiment has turned sour a little, likely as a result of the higher-for-longer narrative coming out of the Fed. The broader trend for industrial production has been a sideways trend, which should remain intact until monetary policy eases and global trade picks up.

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