Economics

THE WEEK AHEAD

June 3 - 7, 2024

The first cut isn't the deepest

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

The case for a rate cut in Canada next week is obvious. Inflation has decelerated sharply, and labour market slack, best captured by a plunging ratio of vacant jobs to unemployment, has widened further, even over a somewhat better first quarter for GDP. The fact that if you exclude mortgage interest, directly tied to higher interest rates, the CPI has run at only 1.6% in the past year, seems to be incontrovertible evidence that we no longer are in need for as much of an economic drag as six months ago. And importantly, in contrast to the Sheryl Crow song, the first cut isn't the deepest in terms of the economic liftoff, so there's no danger that this small quarter-point step will trigger an irreversible inflation upsurge.

On the other side of the ledger, the case for standing pat seems much weaker, particularly since the vast majority of forecasters, and market pricing, fully expects that taking a pass in June would only be about doing the same rate cut in July. But let's go through the contrarian arguments.

Those who say that the Governor seemed to have communicated that he'd wait a bit longer, and that he needs to stick to his word, are splitting hairs. With the market pricing-in more than a two-thirds chance of a cut, it would be a larger surprise at this point if rates aren't eased in June. Clearly, investors are looking at the big picture. Four months of very tame inflation readings, likely better than what the BoC thought would be possible, fully meet the conditions for starting to ease up on policy rates that the Bank had communicated back in April.

Fears that starting rate cuts now would fuel a massive and inflationary housing boom also lack foundation. Much of the recent mortgage activity has been in three-year fixed rates, which are already pricing-in a significant dose of overnight rate cuts in the next few years. Yes, variable rate mortgages will get a bit cheaper, but at current rates they might not attract that much interest.

Further out the yield curve, we doubt that five year bond yields, and therefore longer term borrowing costs for mortgages or corporates, will be much affected by the two possible outcomes of next week's BoC announcement. Should the Bank cut rates, the press conference will see it reiterate the warning that rate cuts are likely to be delivered at a moderate pace, and are still dependant on future inflation news. If it stands pat, it will surely increase its signaling that cuts are coming soon. So while rates out to two years should rally more on a ease, we don't see markets radically altering their views on where interest rates will sit three to five years out.

Those who want to wait for a more dovish Fed before dropping rates here are ignoring the fact that Canada isn't going it alone. The ECB, despite an inflation uptick, still seems to be signaling an impending cut. The Canadian dollar has been holding relatively steady even as markets started to anticipate that the BoC would cut ahead of the Fed, so a free-fall in the loonie seems unlikely on this first, and largely anticipated rate cut.

In the end, all of the risks feared by those counselling a wait-and-see stance until July aren't really associated with the first cut at all, which isn't going to trigger a sharp move in either term borrowing rates or economic activity. They're really about the risks of overdoing interest rate relief in a series of cuts that proves to be too much of a shift for an economy that doesn't have that much slack just yet.

But that's not at all tied to the first cut, but to what the Bank does in the quarters ahead. We expect a follow-up move in July, but the message from the Governor next week will be that the path thereafter is still very data dependent. A pause in September, to await a new forecast in October, could underscore that message. But if, as we expect, inflation stays in check, we may not see any deep cuts, but will need an extended series of small rate reductions through 2025 to keep the economy moving along.

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, June 3	-	-	-	-	-	-	-
Tuesday, June 4	-	AUCTION: 3-M BILLS $12.8B, 6-M BILLS $4.6B, 1-YR BILLS $4.6B	-	-	-	-	-
Wednesday, June 5	8:30 AM	LABOUR PRODUCTIVITY Q/Q	(1Q)	(M)	-	-	0.4%
Wednesday, June 5	9:45 AM	BANK OF CANADA RATE ANNOUNCE.	(Jun 5)	(H)	4.75%	4.75%	5.00%
Thursday, June 6	-	AUCTION: 5-YR CANADAS $5B	-	-	-	-	-
Thursday, June 6	8:30 AM	MERCHANDISE TRADE BALANCE	(Apr)	(H)	-$1.5B	-	-$2.3B
Thursday, June 6	10:00 AM	IVEY PMI	(May)	(L)	-	-	63.0
Friday, June 7	8:30 AM	EMPLOYMENT CHANGE	(May)	(H)	20.0K	-	90.4K
Friday, June 7	8:30 AM	UNEMPLOYMENT RATE	(May)	(H)	6.2%	-	6.1%
Friday, June 7	8:30 AM	CAPACITY UTILIZATION	(1Q)	(L)	-	-	78.7%

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, June 3	9:45 AM	S&P GLOBAL US MANUFACTURING PMI	(May)	(L)	-	-	50.9
Monday, June 3	10:00 AM	ISM - MANUFACTURING	(May)	(H)	50.0	49.6	49.2
Monday, June 3	10:00 AM	CONSTRUCTION SPENDING M/M	(Apr)	(M)	-	0.2%	-0.2%
Tuesday, June 4	10:00 AM	JOLTS Job Openings	(Apr)	-	8400K	8400K	8488K
Tuesday, June 4	10:00 AM	FACTORY ORDERS M/M	(Apr)	(M)	-	0.7%	0.8%
Tuesday, June 4	10:00 AM	DURABLE GOODS ORDERS M/M	(Apr)	(H)	-	0.7%	0.7%
Tuesday, June 4	10:00 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Apr)	(H)	-	-	0.4%
Wednesday, June 5	7:00 AM	MBA-APPLICATIONS	(May 31)	(L)	-	-	-5.7%
Wednesday, June 5	8:15 AM	ADP EMPLOYMENT CHANGE	(May)	(M)	-	175K	192K
Wednesday, June 5	9:45 AM	S&P GLOBAL US SERVICES PMI	(May)	(L)	-	-	54.8
Wednesday, June 5	9:45 AM	S&P GLOBAL US COMPOSITE PMI	(May)	(L)	-	-	54.4
Wednesday, June 5	10:00 AM	ISM - SERVICES	(May)	(M)	50.5	51.0	49.4
Thursday, June 6	8:30 AM	INITIAL CLAIMS	(Jun 1)	(M)	-	-	219K
Thursday, June 6	8:30 AM	CONTINUING CLAIMS	(May 25)	(L)	-	-	1791K
Thursday, June 6	8:30 AM	NON-FARM PRODUCTIVITY	(1Q)	(M)	0.2%	0.3%	0.3%
Thursday, June 6	8:30 AM	GOODS & SERVICES TRADE BALANCE	(Apr)	(H)	-$68.0B	-$69.8B	-$69.4B
Friday, June 7	8:30 AM	NON-FARM PAYROLLS	(May)	(H)	210K	185K	175K
Friday, June 7	8:30 AM	UNEMPLOYMENT RATE	(May)	(H)	3.9%	3.9%	3.9%
Friday, June 7	8:30 AM	AVERAGE HOURLY EARNINGS ALL EMPLOYEES M/M	(May)	(H)	0.3%	0.3%	0.2%
Friday, June 7	8:30 AM	AVERAGE WEEKLY HOURS ALL EMPLOYEES	(May)	(H)	-	34.3	34.3
Friday, June 7	8:30 AM	MANUFACTURING PAYROLLS	(May)	(H)	-	8K	8K
Friday, June 7	10:00 AM	WHOLESALE INVENTORIES M/M	(Apr)	(L)	-	-	0.2%
Friday, June 7	3:00 PM	CONSUMER CREDIT	(Apr)	(L)	-	$10.2B	$6.3B
Friday, June 7	12:00 PM	Speaker: Lisa D Cook (Governor) (Voter)	-	-	-	-	-

Week Ahead's market call

by Avery Shenfeld

In the **US**, we're surprised to see that our payrolls forecast lies above the consensus, given the low readings we've seen on jobless claims. But even with that, we're expecting the jobless rate to hold steady, and wages, with a 0.3% monthly gain, only a tad warm for the Fed's liking. Earlier in the week, the JOLTS data could show a modest further drop in job vacancies, which for larger firms have already normalized back to pre-COVID levels. Regional Fed surveys suggest that the ISM manufacturing could nudge up a bit, but only to a mediocre 50 reading.

In **Canada**, we expect the central bank to deliver a 25 basis point rate cut, a call we've had in place for a long while. The Bank will cite tamer trends in underlying inflation as the key to its decision, but will underscore that the pace of further easing will be likely be gradual and will be dependent on further evidence that we're on course for its 2% target. That move will put some downward pressure on short term yields. But we're still more dovish than street pricing at this point, expecting three further quarter point moves over July to December, and that won't yet become the consensus view after just this first small step. On the data front, the household labour force survey could report another uptick in the unemployment rate, but just how much employment will increase will depend more on what Statistics Canada assumes about population growth, and whether those estimates are still playing catchup to last year's surge of temporary immigrants.

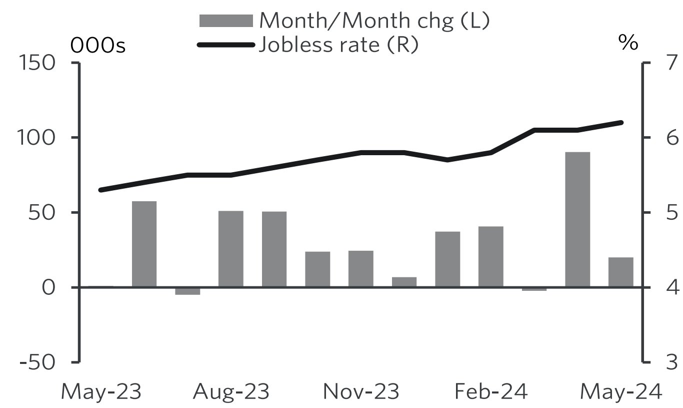
Week Ahead's key Canadian number: Employment—May

(Friday, 8:30 am)

Katherine Judge katherine.judge@cibc.com

Variable	CIBC	Mkt	Prior
Employment change	20.0K	-	90.4K
Unemployment rate	6.2%	-	6.1%

Chart: Canadian employment



Source: Statistics Canada, Haver Analytics, CIBC

Canada's labour market likely continued to gradually loosen in May, with the unemployment rate ticking up to 6.2% on a 20K increase in jobs. An easing in job creation would be in line with sluggish domestic demand towards the end of the first quarter and the more reliable payrolls survey of employment that is tracking weaker over the past twelve months, as well as the increase in business bankruptcies seen so far this year. Wage growth for permanent employees likely remained around the 4.8% y/y pace seen in April.

Forecast implications — Further evidence of labour market slack opening up should validate the Bank of Canada's likely interest rate cut next week, ahead of the release of this data. The unemployment rate is likely close to peaking as lower interest rates will put a floor under demand and labour market activity in the months ahead.

Other Canadian releases: Merchandise trade—April

(Thursday, 8:30 am)

Canada's goods trade deficit likely narrowed slightly to start the second quarter, as higher activity in the transportation manufacturing sector could have supported exports. In the energy category, export volumes of crude to the US were a little lower, offsetting the boost to outbound shipments from higher prices. With the inventory-to-sales ratio still well above pre-pandemic norms, imports could have lagged, leaving the overall goods trade deficit at $1.5bn.

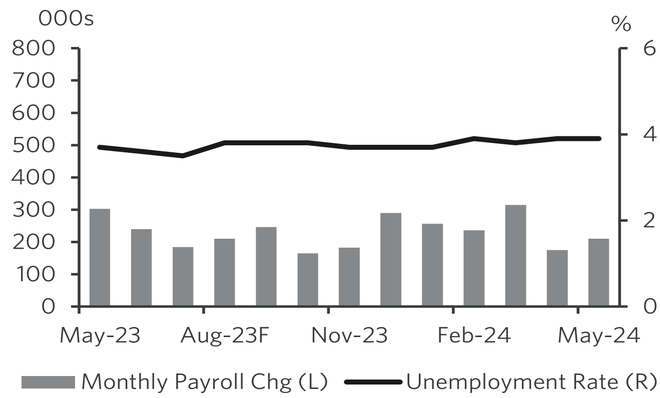
Week Ahead's key US number: Employment situation—May

(Friday, 8:30 am)

Ali Jaffery ali.jaffery@cibc.com

Variable	CIBC	Mkt	Prior
Employment (m/m)	210K	185K	175K
Unemployment rate	3.9%	3.9%	3.9%
Avg hourly earnings (m/m)	0.3%	0.3%	0.2%

Chart: US payroll employment



Source: BLS, Haver Analytics, CIBC

We expect job gains to pick up in May to 210K in the month. Government hiring slowed to crawl last month, pushing payroll jobs below consensus. Public sector hiring should pick up again in May but stay below the pace we saw in 2023. Job growth in healthcare should continue at a robust pace and anchor the overall employment picture. The unemployment rate and the participation rate will remain unchanged in the month at 3.9% and 62.7% respectively, and wage growth will accelerate a tick to 0.3% in the month.

Forecast implications — Solid hiring, wage growth and steady average hours worked will mean labor income should accelerate in May providing more fuel for consumer spending to grow at a healthy pace around 2% annualized in Q2.

Market impact — We are currently above consensus on payrolls, but 210K is not far from break-even estimates of job growth with the current surge of immigration. An average of April and May is a good reflection of an economy that is running in slight excess demand. The latest Fed speak suggests the FOMC probably holds that view, so we don't expect large market moves in response to an upside surprise.

Other US Releases: ISM Manufacturing—May

(Monday, 10:00 am)

We expect the ISM Manufacturing survey to be close to 50, consistent with mixed regional surveys. The manufacturing sector will stay on hold in no-to-low growth regime until monetary policy easing in the US becomes more certain. Firms have limited incentive to further expand production until they have better insight into whether we are at a turning point for the cost of capital.

JOLTS Job Openings—April

(Tuesday, 10:00 am)

We expect job openings to edge down slightly to 8400 and the openings to unemployment ratio to stay at 1.3. That would be consistent with the slight moderation seen in other March labor market measures. But more broadly, we think JOLTS is indicating a labor market fairly close to balance with only small businesses showing vacancy levels above where they were before the pandemic.

Contacts:

Avery Shenfeld
avery.shenfeld@cibc.com

Benjamin Tal
benjamin.tal@cibc.com

Andrew Grantham
andrew.grantham@cibc.com

Ali Jaffery
ali.jaffery@cibc.com

Katherine Judge
katherine.judge@cibc.com

CIBC Capital Markets
PO Box 500
161 Bay Street, Brookfield Place
Toronto, Canada, M5J 2S8
Bloomberg @ CIBC

economics.cibccm.com