Economics

THE WEEK AHEAD

January 8 - 12, 2024

Fast fashion

by Avery Shenfeld avery.shenfeld@cibc.com

Americans are speed demons, being fans of fast cars, fast food, and in recent years, fast fashion. Retailers like Shein and H&M offer up cheap clothing that mimics the latest runway trends, apparel that then get tossed when those cutting-edge styles are quickly yesterday's news. That here-today, gone-tomorrow world seems to have spread to the bond market, so investors need to be more careful about following the latest crazes too closely, lest they end up with the wrong portfolio in their closet.

Remember that "higher for longer" was all the rage in the US dollar rates market as recently as Halloween, when 10-year Treasuries yielded only a hair below 5%. Even if one accepted that the Fed would be slow to turn, that seemed to be excessively generous in a world in which, surely at some point, overnight rates would be closer to neutral, whether you think that's 2.75% or even 3.25%.

Then, in little over a month, the higher-for-longer fashion gave way to "lower rates sooner", as the market priced in Fed cuts as early as this spring. Coupled with a rejigged Treasury financing plan that put more weight on shorter term issuance, that briefly had 10 year rates more than 100 bps lower. Anyone talking about "higher for longer" in December might as well have been in skinny jeans (which TikTok knows are definitely out in the Gen-Z crowd).

There was, of course, some logic behind that fashion shift. US inflation has continued to melt away. Arguably, looking at 6-month annualized core PCE inflation, it's already in sight of the 2% target. On our part, that has us adding a further 50 basis points in second-half Fed rate cuts to the 50 bps we had previously.

That's not because the US economy is crying out for interest rate relief, as is the case in Canada, where we have an earlier and more aggressive forecast for 150 bps in cuts in this year. It's simply that Fed should now be less willing to tolerate any material slowing in growth and rising real interest rates given that inflation is less problematic, so some of the rate cuts we had penciled in for 2025 will arrive this year, if not as soon as the market is now counting on.

In fact, 10-year yields near 4% in the US, or 3.25% in Canada, actually aren't mispriced relative to their likely long-term equilibrium levels. That's a premium over what rolling over short-term securities would yield if, as we expect, they average somewhere close to the neutral rate over the next decade. Indeed, we'd expect US 10-year rates to have a fair bit of room below 4% down the road.

But what is problematic for investors is that they've reached that level a few quarters too early, because at this point, they're all risk with not enough reward. With overnight rates in 5% territory, there's a big negative carry for 10-year Canadas or Treasuries, or a foregone yield relative to T-bills.

In Canada, unless there's a material recession, there isn't much room for a further rally, because we'd need one to have the central bank take short rates into very stimulative territory. Canada is within a hair of a mild recession, but recession odds have been falling in the US, helped by lower bond yields, but also supported by the continued ability of the economy to grow in the face of a fed funds rate above 5%. Today's US jobs data continued to paint a picture of an economy that will eventually need an easing in policy, but isn't desperate for one. And Canada's inflation data has still been a bit too firm for the Bank of Canada to signal a near term easing.

Should inflation tick higher again, or the timing of the first cut be a few months later than markets are hoping, ten-year bonds in both countries could be today's skinny jeans, quickly out of fashion and generating capital losses as yields back up. So, investors should recognize that "higher for longer" was a fashion extreme that couldn't last, but the bond market has also become a bit too loaded up with an investment style that's overly dependent on a lot of rate cuts in a hurry.

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, January 8	-	-	-	-	-	-	-
Tuesday, January 9	8:30 AM	MERCHANDISE TRADE BALANCE	(Nov)	(H)	$3.0B	-	$3.0B
Tuesday, January 9	8:30 AM	BUILDING PERMITS M/M	(Nov)	(M)	-	-	2.3%
Wednesday, January 10	-	-	-	-	-	-	-
Thursday, January 11	-	AUCTION: 2-YR CANADAS $6.5B	-	-	-	-	-
Friday, January 12	-	-	-	-	-	-	-

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, January 8	3:00 PM	CONSUMER CREDIT	(Nov)	(L)	-	$9.5B	$5.1B
Monday, January 8	12:00 PM	Speaker: Raphael W. Bostic (Atlanta) (Non-Voter)	-	-	-	-	-
Tuesday, January 9	-	AUCTION: 3-YR TREASURIES $52B	-	-	-	-	-
Tueday, January 9	8:30 AM	GOODS & SERVICES TRADE BALANCE	(Nov)	(H)	-$66.0B	-$64.8B	-$64.3B
Tuesday, January 9	12:00 PM	Speaker: Michael S Barr (Governor) (Voter)	-	-	-	-	-
Wednesday, January 10	-	AUCTION: 10-YR TREASURIES $37B	-	-	-	-	-
Wednesday, January 10	7:00 AM	MBA-APPLICATIONS	(Jan 5)	(L)	-	-	-10.7%
Wednesday, January 10	10:00 AM	WHOLESALE INVENTORIES M/M	(Nov)	(L)	-	-0.2%	-0.2%
Wednesday, January 10	3:15 PM	Speaker: John C. Williams (Vice Chairman, New York) (Voter)	-	-	-	-	-
Thursday, January 11	-	AUCTION: 30-YR TREASURIES $21B	-	-	-	-	-
Thursday, January 11	8:30 AM	INITIAL CLAIMS	(Jan 6)	(M)	-	213K	202K
Thursday, January 11	8:30 AM	CONTINUING CLAIMS	(Dec 30)	(L)	-	1885K	1855K
Thursday, January 11	8:30 AM	CPI M/M	(Dec)	(H)	0.3%	0.2%	0.1%
Thursday, January 11	8:30 AM	CPI M/M (core)	(Dec)	(H)	0.3%	0.2%	0.3%
Thursday, January 11	8:30 AM	CPI Y/Y	(Dec)	(H)	3.3%	3.2%	3.1%
Thursday, January 11	8:30 AM	CPI Y/Y (core)	(Dec)	(H)	3.8%	3.8%	4.0%
Thursday, January 11	2:00 PM	TREASURY BUDGET	(Dec)	(L)	-	-	-$314.0B
Friday, January 12	8:30 AM	PPI M/M	(Dec)	(M)	0.3%	0.1%	0.0%
Friday, January 12	8:30 AM	PPI M/M (core)	(Dec)	(M)	0.3%	0.2%	0.0%
Friday, January 12	8:30 AM	PPI Y/Y	(Dec)	(M)	-	1.3%	0.9%
Friday, January 12	8:30 AM	PPI Y/Y (core)	(Dec)	(M)	-	1.9%	2.0%
Friday, January 12	10:00 AM	Speaker: Neel Kashkari (Minneapolis) (Voter)	-	-	-	-	-

Week Ahead's market call

by Avery Shenfeld

In the **US**, we're a bit above consensus in our calls for CPI data this month, but given the impressive progress made on inflation in the last half year, we don't see an extra decimal place in a single month as material to the Fed's outlook. The growth data are still sufficiently healthy to allow the FOMC to be patient in terms of when it actually starts cutting rates, while the trend in inflation is now favourable enough to have us moving forward the timing of the first cut into Q3, although that's still not as earlier as where market thinking lies. A few Fed speakers have the opportunity to put their own spin on recent developments. Trade and PPI data are also on tap but aren't likely to be market movers.

In **Canada**, it's a very light week ahead for data, and the trade balance could see offsetting impacts from volumes and prices (with lower oil prices weighing on nominal exports). So look for Canadian markets to take their cue from developments south of the border.

Week Ahead's key Canadian number: Merchandise trade balance—November

(Tuesday, 8:30 am)

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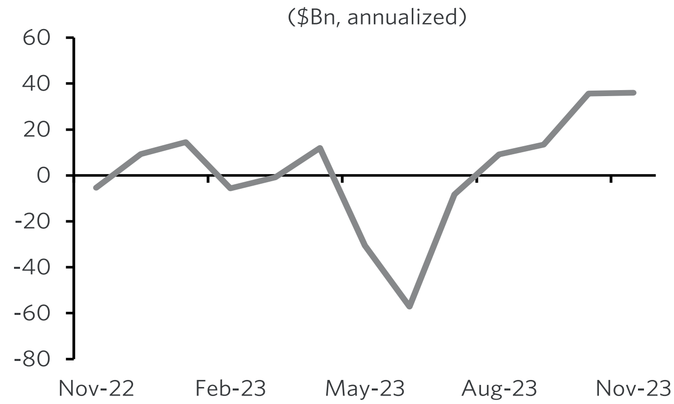
Variable	CIBC	Mkt	Prior
Trade balance	$3.0B	-	$3.0B

Chart: Canadian merchandise trade balance



Source: Statistics Canada, Haver Analytics, CIBC

Auto workers on strike in the US drove Canada's goods trade balance higher in October, as imports plummeted. And while US auto workers returned to factories in November, that didn't translate into a boost in two-way trade of autos for the US in that month, even as Canadian wholesale and manufacturing activity in the auto sector picked up. A further retrenchment in auto imports from the US, combined with a sinking of oil prices and therefore nominal energy exports, suggests that Canada's trade surplus could have been largely unchanged in November, at $3.0bn.

Forecast implications — Shipments of oil will have looked better in volume terms, and that adds to the evidence that trade will have been supportive for GDP growth in the fourth quarter. However, the weakness in imports implies some offset from softer inventory accumulation, which could also be a signpost of weak domestic demand. Looking further ahead, Canada's trade balance should swing back into deficit territory as auto imports from the US normalize, and international demand for Canadian exports is hampered by high interest rates globally.

Week Ahead's key US number: CPI—December

(Thursday, 8:30 am)

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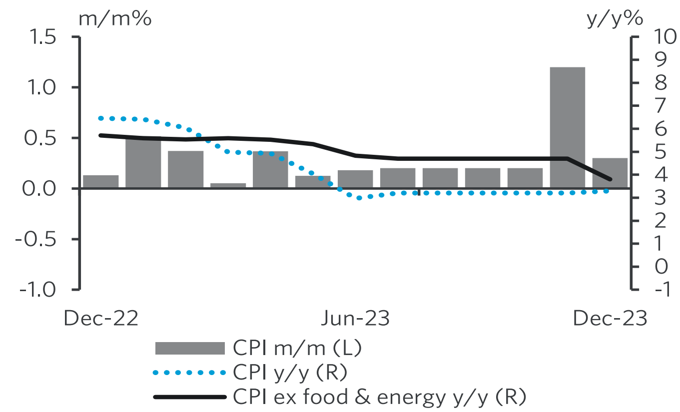
Variable (%)	CIBC	Mkt	Prior
Headline CPI (m/m)	0.3	0.2	0.1
Headline CPI (yr/yr)	3.3	3.2	3.1
Core CPI (m/m)	0.3	0.2	0.3
Core CPI (yr/yr)	3.8	3.8	4.0

Chart: US consumer price index



Source: BLS, Haver Analytics, CIBC

Next week's December CPI report will be the main data point in what will otherwise be a fairly light week. We expect headline and core prices both to rise by 0.3% m/m in the month. Core goods prices should show a somewhat weaker disinflationary impulse but services inflation will edge down to keep core inflation very close to the Fed's target on a monthly basis. The New York Fed's Supply Chain Index has shown supply chain pressures have normalized and the speed of disinflation in the Manheim Used Car index has slowed in recent months — suggesting we may have seen the majority of price level reversion in the goods sector play out.

Forecast implications — The main upside risk to CPI in recent months has been the stickiness in shelter inflation, which has not moderated as much as other rental and house price indices might have predicted by this time. However, even if this persists, it is unlikely to be a major impediment to the Fed sustainably reaching target. The FOMC's preferred price gauge, PCE inflation, puts less than half the weight on housing costs (15%) than is reported in the CPI survey (35%).

Market implications — Our views on core inflation are slightly above consensus but it's getting harder to get excited about CPI surprises given the progress observed on inflation over the past six months. We are now out of the territory where one report could change the FOMC's thinking about near-term policy choices and markets understand this.

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