Economics

THE WEEK AHEAD

August 15-19, 2022

Are central banks ready to bend over backwards?

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

Investors are hoping that central bankers are ready to bend over backwards to help them out, or will be next year. A look at the US futures curve, for example, sees markets expecting the Fed's target rate to get a bit above 3½%, but start to build in rate cuts over the latter half of 2023.

In the US, prospects for such cuts were seriously dimmed after the huge gains reported for July payrolls and the Q2 employment cost index, but they were revived somewhat after July's deceleration in core CPI. There was some visible good cheer in equity markets from the thought that the better news on inflation would let monetary policy bend back to a less restrictive stance next year, even though July's 0.3% monthly core CPI pace is still a bit too hot.

Sure, if we went into an outright recession with policy rates in the mid-3% range, there's little doubt that the central bankers would see enough of a further slide in inflation that they would have room to provide some rate relief. A significant recession could bring much sharper rate cuts than what's currently priced in, so fixed income players might be pricing-in a quarter of those cuts, for example, based on a 25% recession probability.

But the equity market can't really be cheering about an oncoming recession. Its hopes must rest on some combination of continued growth to support earnings, but lower inflation that convinces the central bankers to ease off.

From our perspective, that something-for-everyone combination looks implausible, at least for 2023. There is indeed a path to sharply lower inflation next year in the absence of a recession. But it's not 2023 inflation prospects that would prevent a rate-cut in that scenario. It's the 2024 CPI outlook.

As we saw in the latest US CPI data, inflation could begin to melt away, and quite sharply next year, if a narrow group of prices that have soared this year sees outright declines in the coming few quarters. By this time next year, slow global growth, coupled with supply chain improvements, could engender negative 12-month inflation rates in items like gasoline, passenger transportation, some vehicles, and basic foods, in both the US and Canada. But just as this year's inflation was exaggerated by supply shocks in those items, their downward pressure on inflation would likely prove to be a one-time story.

The Fed's concern during 2023, one shared by the Bank of Canada, will be whether the conditions will be in place to *keep* inflation low in 2024. Suppose we avoid a recession next year, and as in our forecast see a year of sluggish real growth in the 1% to 1½% range. That won't open up enough slack in North American labour and product markets to let the central banks step on the gas and ramp up growth in 2024, without generating some old fashioned inflation from excess demand, rather than supply shocks. We'll need a not-so-robust 2024 economy to bake in a longer run of 2% inflation.

That doesn't rule out eventual rate cuts back to neutral levels, but these will be aimed on nudging growth higher for 2025. Given the lags in policy, we'd look for the Fed, and the Bank of Canada, to have room to start trimming rates in 2024. Equity investors shouldn't cheer too loudly for interest rate relief at the front end of the curve much earlier than that, since the most likely route to that would be a recession that will dent earnings more than they expect. What equities need is an economic backdrop that is healthy enough that the central banks won't have to bend over backwards to help them out next year.

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 15	8:30 AM	MANUFACTURING SHIPMENTS M/M	(Jun)	(M)	-1.0%	-1.0%	-2.0%
Monday, August 15	8:30 AM	WHOLESALE TRADE M/M	(Jun)	(M)	0.5%	-	1.6%
Monday, August 15	9:00 AM	EXISTING HOME SALES M/M	(Jul)	(M)	-	-	-5.6%
Monday, August 15	10:30 AM	BoC Senior Loan Officer Survey	-	-	-	-	-
Tuesday, August 16	-	AUCTION: 3-M BILLS $9.2B, 6-M BILLS $3.4B, 1-YR BILLS $3.4B	-	-	-	-	-
Tuesday, August 16	8:15 AM	HOUSING STARTS SAAR	(Jul)	(M)	245.0K	265.0K	273.8K
Tuesday, August 16	8:30 AM	INT'L. SEC. TRANSACTIONS	(Jun)	(M)	-	-	$2.35B
Tuesday, August 16	8:30 AM	CPI M/M	(Jul)	(H)	0.2%	0.1%	0.7%
Tuesday, August 16	8:30 AM	CPI Y/Y	(Jul)	(H)	7.7%	7.6%	8.1%
Tuesday, August 16	8:30 AM	CPI Core- Common Y/Y%	(Jul)	(M)	-	-	4.6%
Tuesday, August 16	8:30 AM	CPI Core- Median Y/Y%	(Jul)	(M)	-	-	4.9%
Tuesday, August 16	8:30 AM	CPI Core- Trim Y/Y%	(Jul)	(M)	-	-	5.5%
Wednesday, August 17	-	-	-	-	-	-	-
Thursday, August 18	-	AUCTION: 3-YR CANADAS $2.5B	-	-	-	-	-
Thursday, August 18	8:30 AM	INDUSTRIAL PROD. PRICES M/M	(Jul)	(M)	-	-	-1.1%
Thursday, August 18	8:30 AM	RAW MATERIALS M/M	(Jul)	(M)	-	-	-0.1%
Friday, August 19	8:30 AM	RETAIL TRADE TOTAL M/M	(Jun)	(H)	0.3%	0.3%	2.2%
Friday, August 19	8:30 AM	RETAIL TRADE EX-AUTO M/M	(Jun)	(H)	1.0%	-	1.9%

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 15	8:30 AM	NEW YORK FED (EMPIRE)	(Aug)	(M)	-	5.0	11.1
Monday, August 15	10:00 AM	NAHB HOUSING INDEX	(Aug)	(L)	-	55.0	55.0
Monday, August 15	4:00 PM	NET CAPITAL INFLOWS (TICS)	(Jun)	(L)	-	-	$155.3B
Tuesday, August 16	8:30 AM	HOUSING STARTS SAAR	(Jul)	(M)	1540K	1537K	1559K
Tuesday, August 16	8:30 AM	BUILDING PERMITS SAAR	(Jul)	(H)	1610K	1645K	1696K
Tuesday, August 16	9:15 AM	INDUSTRIAL PRODUCTION M/M	(Jul)	(H)	0.5%	0.3%	-0.2%
Tuesday, August 16	9:15 AM	CAPACITY UTILIZATION	(Jul)	(M)	80.5%	80.2%	80.0%
Wednesday, August 17	-	20-YR AUCTION: $15B	-	-	-	-	-
Wednesday, August 17	7:00 AM	MBA-APPLICATIONS	(Aug 12)	(L)	-	-	0.2%
Wednesday, August 17	8:30 AM	RETAIL SALES M/M	(Jul)	(H)	0.2%	0.2%	1.0%
Wednesday, August 17	8:30 AM	RETAIL SALES (X-AUTOS) M/M	(Jul)	(H)	0.0%	0.1%	1.0%
Wednesday, August 17	8:30 AM	RETAIL SALES CONTROL GROUP M/M	(Jul)	(H)	0.5%	0.6%	0.8%
Wednesday, August 17	10:00 AM	BUSINESS INVENTORIES M/M	(Jun)	(L)	-	1.4%	1.4%
Wednesday, August 17	2:00 PM	FOMC Meeting Minutes	(Jul 27)	-	-	-	-
Thursday, August 18	-	AUCTION: 30-YR TIPS$8B	-	-	-	-	-
Thursday, August 18	8:30 AM	INITIAL CLAIMS	(Aug 13)	(M)	-	265K	262K
Thursday, August 18	8:30 AM	CONTINUING CLAIMS	(Aug 6)	(L)	-	-	1428K
Thursday, August 18	8:30 AM	PHILADELPHIA FED	(Aug)	(M)	-	-3.5	-12.3
Thursday, August 18	10:00 AM	EXISTING HOME SALES SAAR	(Jul)	(M)	-	4.86M	5.12M
Thursday, August 18	10:00 AM	EXISTING HOME SALES M/M	(Jul)	(M)	-	-5.1%	-5.4%
Thursday, August 18	10:00 AM	LEADING INDICATORS M/M	(Jul)	(M)	-	-0.5%	-0.8%
Thursday, August 18	1:20 PM	Speaker: Esther George (President, Kansas City) (Voter)	-	-	-	-	-
Thursday, August 18	1:45 PM	Speaker: Neel Kashkari (President, Minneapolis) (Non-Voter)	-	-	-	-	-
Friday,	-	-	-	-	-	-	-

Week Ahead's market call

by Avery Shenfeld

In the **US**, housing starts look to be little changed from the prior month, but industrial production will be helped by the power needed to run the AC at full blast, as well as any output associated with a brisk increase in hours worked in mining. July retail sales will look lacklustre in nominal terms due to the drop in gasoline prices.

In **Canada**, we'll get some of the inflation relief that the US enjoyed in its July data. But energy won't exert quite as much downward pressure on the monthly change due to fixed taxes (i.e. not set as a percentage of the selling price) imposed on gasoline that make it less sensitive to crude price changes, as well as some increases in household natural gas prices. For growth indicators, flash estimates earlier suggested that June saw weakness in manufacturing activity but inflation-boosted gains in ex-auto retailing, with the combination part of a lacklustre pace for monthly GDP at the end of Q2. So the focus will be on the preliminary figures for July, and whether the softness we've seen in employment in the last two months also extended to activity measures.

Week Ahead's key Canadian number: Consumer price index—July

(Tuesday, 8:30 am)

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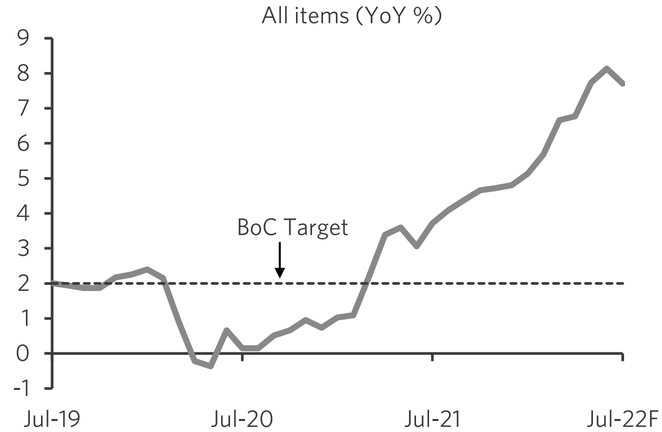
Variable (%)	CIBC	Mkt	Prior
CPI NSA (m/m)	0.2	0.1	0.7
CPI (y/y)	7.7	7.6	8.1

Chart: Canadian consumer price index



Source: Statistics Canada, Haver Analytics, CIBC

The slump in gasoline prices will be the major driver of a softer inflation reading for July, although increases in natural gas rates will offset part of that decline within the overall energy bucket. Food price inflation has been lagging the US numbers in recent months, but could see a slight acceleration in July.

Excluding food and energy, monthly price increases should continue to moderate, with goods price inflation not as strong as it was earlier in the year. "Other" owned accommodation costs (mainly real estate agent fees) fell for the first time since 2019 in June, and will likely see a larger drop in July as the housing market continues to cool rapidly. Mortgage interest costs will, however, continue to rise quickly owing to the brisk nature of Bank of Canada rate hikes. Overall ex food/energy prices are expected to rise 0.25% for an annual rate of 5.0%, down from 5.3% in the prior month. Due to big revisions in monthly readings for the Bank of Canada's three core measures (particularly core-common), policymakers are likely keeping an even closer eye on ex food/energy inflation these days.

Forecast implications — With gasoline prices continuing to fall rapidly into mid-August, the annual rate of inflation could see an even larger deceleration next month. If energy prices remain at current levels, headline inflation could fall below 2% before the middle of next year, as the peak in oil and other commodity prices following the start to Russia's war in Ukraine fall out of the calculation. Ex food/energy inflation will, however, take longer to return to target due to ongoing supply constraints, such as labour availability in services and supply bottlenecks for goods.

Other Canadian releases: Retail sales—June

(Friday, 8:30 am)

Retail sales are expected to have risen by 0.3% in June, which in inflation-adjusted terms would likely represent a modest decline. After a rebound in May, auto sales likely shifted into a lower gear again in June. Ex autos retail sales is forecast to have risen 1%, although much of that reflects higher prices at the pump during the month. A decline in gasoline prices and still struggling auto sales could mean that the advance estimate for July shows a modest drop in nominal sales.

Housing starts—July

(Tuesday, 8:15 am)

Housing starts have been strong relative to permit applications in recent months, with the latter cooling potentially due to the rapidly rising interest rate environment. Starts are expected to slow to a 245K pace, from 274K in the prior month and driven largely by the sometimes volatile multiples segment.

Week Ahead's key US number: Retail sales—July

(Wednesday, 8:30 am)

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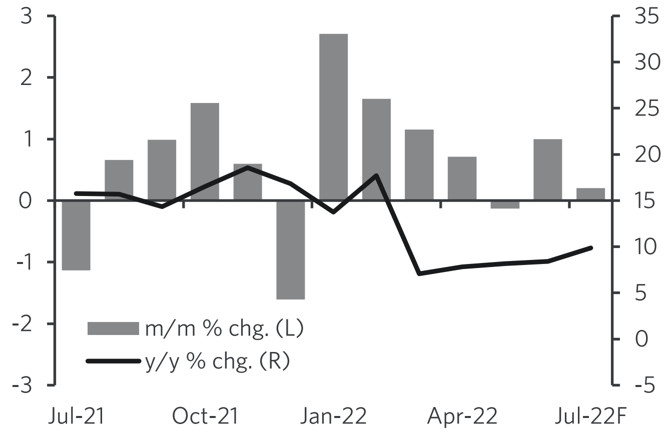
Variable (%)	CIBC	Mkt	Prior
Retail sales	0.2	0.2	1.0
- ex auto	0.0	0.1	1.0
- control group	0.5	0.6	0.8

Chart: US retail sales



Source: Census Bureau, Haver Analytics, CIBC

Total retail sales growth appears to have weakened in July as prices at the pump eased, while building material sales likely fell further along with the cooling in housing market activity. With some offset from higher unit vehicle sales and restaurant receipts, total retail sales likely eked out a 0.2% advance. The 0.5% growth expected in the control group (ex. gasoline, building materials, autos, and restaurants) will largely reflect higher prices, with sales volumes limited by consumer resistance to higher prices and the erosion in real incomes, consistent with reports from some major retailers lately.

Forecast implications — There is room for spending on autos to increase as supply chain issues fade in that area. But spending in other discretionary goods categories is likely to continue to wane ahead in favor of services.

Other US Releases: Housing starts—July

(Tuesday, 8:30 am)

Plummeting homebuilder confidence, an easing in building permit issuance in the second quarter, and the drop in mortgage applications all portend a slowdown in the pace of housing starts to 1540K in July. Residential investment is likely to remain a drag on growth over the rest of the year as higher interest rates constrain demand, consistent with a likely easing in building permit issuance to a 1610K pace in July.

Industrial production—July

(Tuesday, 9:15 am)

Hours worked rebounded in manufacturing in July, while producers in the semiconductor and electric component area increased headcounts, indicating that an easing of supply chain issues could have supported production. Along with a solid rise in hours worked in the mining sector and unseasonably hot temperatures, total industrial production likely rebounded by a solid 0.5% in July. However, looking further ahead, a global slowdown in demand is set to limit growth in industrial production.

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