Economics

THE WEEK AHEAD

February 12 - 16, 2024

Decoupling from China? Not so fast

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

The US election cycle is in full swing, and if we ever get around to discussing policies rather than scandals and court rulings, trade and protectionism could be a key area of focus. Trump favours further hikes to tariffs against a broader range of trading partners, but both he and Biden are closer aligned in having a protectionist bent when it comes to China. That includes restricting Chinese access to American technologies with potential military applications, and a desire to use both carrots (subsidies for goods with US or NAFTA content) and sticks, with Biden having retained Trump's tariffs, and Trump pledging further ones, to reduce imports from China.

The hazard is that the progress we've made on restoring supply chains and bringing down goods inflation could be put in jeopardy if the US moves too quickly on a path to decoupling from China. As a case in point, at a recent CIBC event for the renewable energy sector, we heard concerns among US players that elevated tariffs on key components imported from the Middle Kingdom would be a material cost headwind, even with the IRA encouraging the expansion of the domestic green-power manufacturing sector.

They aren't alone. While everyone understands that China is still an important manufacturing player and supplier to the US economy, even we were stunned by a recent report that documented the degree of its global dominance. The economist Richard Baldwin and his coauthors found that China now accounts for roughly 40% of the world's gross manufacturing output, and has surpassed the share of the next ten largest players combined (Chart). The US industrial sector is three times more reliant on Chinese inputs than China is on American suppliers.

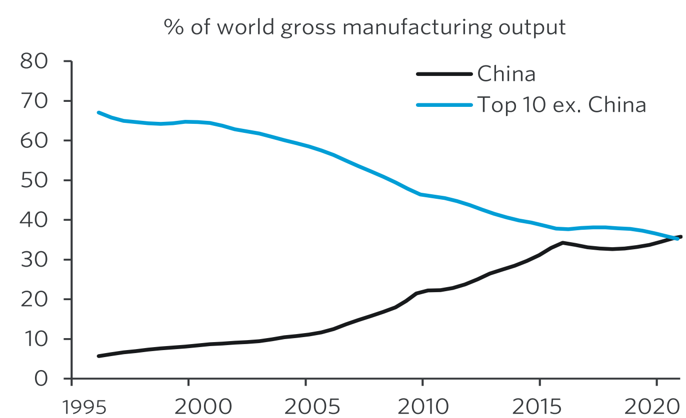
Industrial policies like the IRA and the CHIPS Act, as well as NAFTA provisions that favour Mexico and Canada over others, could alter that landscape over time. So too could political uncertainties over China-US relations, as American businesses fearing future disruptions seek to rejig supply chains and source products from countries with fewer perceived political risks.

The experience during the height of the COVID pandemic convinced many companies that a more diversified supplier base, alongside holding more inventories of parts and finished goods, might be worth the additional cost in terms of being less exposed to disruptions in one particular country. We wouldn't be surprised to see Mexico and other emerging markets pick up share under any likely US post-election policy stance.

But trying to force a quick divorce from China's manufacturing sector through a sharp increase in trade barriers would likely prove costly for the US economy, particularly at a time when sustaining low inflation in the goods sector will be key to an easing in monetary policy. Where substitutes from the US or other trading partners simply aren't available at a sufficient scale to replace Chinese goods, a heavier tariff on the latter would simply be passed on to American buyers, whether they are retailers or industrial companies using Chinese inputs.

Outright import bans would be even worse, snarling supply chains for a longer period. So before rushing into a quick divorce, American policymakers need to assess just how quickly its own suppliers or other trading partners could fill in the gap.

Chart: Chinese factory output tops next 10 largest countries



Source: OECD TiVA database, Baldwin (2024)

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, February 12	-	-	-	-	-	-	-
Tuesday, February 13	-	AUCTION: 3-M BILLS $14B, 6-M BILLS $5B, 1-YR BILLS $5B	-	-	-	-	-
Wednesday, February 14	9:00 AM	EXISTING HOME SALES M/M	(Jan)	(M)	-	-	8.7%
Wednesday, February 14	2:30 PM	Speaker: Rhys R. Mendes (Deputy Gov.)	-	-	-	-	-
Thursday, February 15	-	AUCTION: 5-YR CANADAS $5B	-	-	-	-	-
Thursday, February 15	8:15 AM	HOUSING STARTS SAAR	(Jan)	(M)	260K	-	249.3K
Thursday, February 15	8:30 AM	MANUFACTURING SHIPMENTS M/M	(Dec)	(M)	-0.6%	-	1.2%
Friday, February 16	8:30 AM	WHOLESALE SALES EX. PETROLEUM M/M	(Dec)	(M)	0.8%	-	0.9%
Friday, February 16	8:30 AM	INT'L. SEC. TRANSACTIONS	(Dec)	(M)	-	-	$11.4B

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, February 12	2:00 PM	TREASURY BUDGET	(Jan)	(L)	-	-	$129.4B
Monday, February 12	9:20 AM	Speaker: Michelle W Bowman (Governor) (Voter)	-	-	-	-	-
Monday, February 12	12:00 PM	Speaker: Thomas I. Barkin (Richmond) (Voter)	-	-	-	-	-
Monday, February 12	1:00 PM	Speaker: Neel Kashkari (Minneapolis) (Non-Voter)	-	-	-	-	-
Tuesday, February 13	8:30 AM	CPI M/M	(Jan)	(H)	0.2%	0.2%	0.3%
Tuesday, February 13	8:30 AM	CPI M/M (core)	(Jan)	(H)	0.3%	0.3%	0.3%
Tuesday, February 13	8:30 AM	CPI Y/Y	(Jan)	(H)	2.9%	2.9%	3.4%
Tuesday, February 13	8:30 AM	CPI Y/Y (core)	(Jan)	(H)	3.7%	3.7%	3.9%
Wednesday, February 14	7:00 AM	MBA-APPLICATIONS	(Feb 9)	(L)	-	-	3.7%
Wednesday, February 14	9:30 AM	Speaker: Austan D. Goolsbee, Chicago (Non-Voter)	-	-	-	-	-
Wednesday, February 14	4:00 PM	Speaker: Michael S Barr (Governor) (Voter)	-	-	-	-	-
Thursday, February 15	8:30 AM	INITIAL CLAIMS	(Feb 10)	(M)	-	-	218K
Thursday, February 15	8:30 AM	CONTINUING CLAIMS	(Feb 3)	(L)	-	-	1871K
Thursday, February 15	8:30 AM	NEW YORK FED (EMPIRE)	(Feb)	(M)	-	-10.0	-43.7
Thursday, February 15	8:30 AM	RETAIL SALES M/M	(Jan)	(H)	0.2%	-0.2%	0.6%
Thursday, February 15	8:30 AM	RETAIL SALES (X-AUTOS) M/M	(Jan)	(H)	0.2%	0.1%	0.4%
Thursday, February 15	8:30 AM	RETAIL SALES CONTROL GROUP M/M	(Jan)	(H)	0.3%	0.2%	0.8%
Thursday, February 15	8:30 AM	IMPORT PRICE INDEX M/M	(Jan)	(L)	-	-0.1%	0.0%
Thursday, February 15	8:30 AM	EXPORT PRICE INDEX M/M	(Jan)	(L)	-	-0.2%	-0.9%
Thursday, February 15	9:15 AM	INDUSTRIAL PRODUCTION M/M	(Jan)	(H)	0.2%	0.4%	0.1%
Thursday, February 15	9:15 AM	CAPACITY UTILIZATION	(Jan)	(M)	78.9%	79.0%	78.6%
Thursday, February 15	10:00 AM	BUSINESS INVENTORIES M/M	(Dec)	(L)	-	0.4%	-0.1%
Thursday, February 15	10:00 AM	NAHB HOUSING INDEX	(Feb)	(L)	-	-	44.0
Thursday, February 15	4:00 PM	NET CAPITAL INFLOWS (TICS)	(Dec)	(L)	-	-	$126.1B
Thursday, February 15	1:15 PM	Speaker: Christopher J. Waller (Governor) (Voter)	-	-	-	-	-
Thursday, February 15	7:00 PM	Speaker: Raphael W. Bostic (Atlanta) (Voter)	-	-	-	-	-
Friday, February 16	8:30 AM	BUILDING PERMITS SAAR	(Jan)	(H)	1525K	1515K	1493K
Friday, February 16	8:30 AM	HOUSING STARTS SAAR	(Jan)	(M)	1500K	1460K	1460K
Friday, February 16	8:30 AM	PPI M/M	(Jan)	(M)	0.2%	0.1%	-0.1%
Friday, February 16	8:30 AM	PPI M/M (core)	(Jan)	(M)	0.2%	0.1%	0.0%
Friday, February 16	8:30 AM	PPI Y/Y	(Jan)	(M)	-	-	1.0%
Friday, February 16	8:30 AM	PPI Y/Y (core)	(Jan)	(M)	-	-	1.8%
Friday, February 16	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Feb P)	(H)	-	79.0	79.0
Friday, February 16	9:10 AM	Speaker: Michael S Barr (Governor) (Voter)	-	-	-	-	-
Friday, February 16	12:10 PM	Speaker: Mary C. Daly (San Francisco) (Voter)	-	-	-	-	-

Week Ahead's market call

by Avery Shenfeld

In the **US**, of the two heavyweight indicators due in the coming week, retail sales is likely of greater importance than the CPI. Inflation is now sufficiently quiescent to allow the Fed to start easing when it becomes convinced that the economy needs it, and we don't see the upcoming CPI data, or the subsequent PCE price index figures, as changing that picture. The issue is that the need for rate cuts hasn't been apparent, and even a moderate gain in retail sales will keep Q1 on track for a healthy pace for consumer spending. That's consistent with our call for 100 bps in cuts in 2024 not getting delivered until the back half of the year. Industrial production should be helped by utilities this month, offsetting softness in ex-auto manufacturing.

In **Canada**, what looks to have been a modestly better Q4 economic pace than the Bank of Canada projected, and a dip in the jobless rate in January, suggested that our prior call for 150 bps in rate cuts this year was too aggressive, and we'll be paring that back to 125 bps as a result. Even then, with the Bank looking for more signs of decelerating prices and wages, the first cut isn't likely to be seen until June, and Deputy Governor Mendes has a chance to hint at that sort of patience in remarks in the week ahead. The data calendar is light, with gains for wholesalers and housing potentially offset by tepid data from manufacturing shipments.

There are no major Canadian data releases next week.

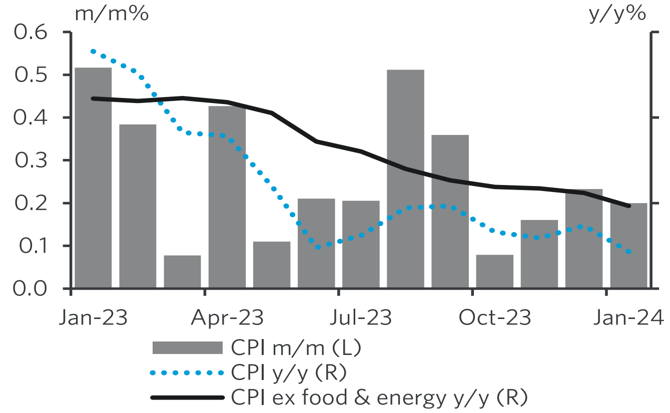
Week Ahead's key US number: Consumer price index—January

(Tuesday, 8:30 am)

Ali Jaffery ali.jaffery@cibc.com

Variable (%)	CIBC	Mkt	Prior
Headline CPI (m/m)	0.2	0.2	0.3
Headline CPI (y/y)	2.9	2.9	3.4
Core CPI (m/m)	0.3	0.3	0.3
Core CPI (y/y)	3.7	3.7	3.9

Chart: US consumer price index



Source: BLS, Haver Analytics, CIBC

Much to the Fed's delight, CPI is becoming boring again. We expect more of the same in next week's January CPI report. Core inflation will remain in a range broadly consistent with target, coming in at 0.3% m/m, and headline inflation should come in a touch softer at 0.2% m/m. The Fed will be paying close attention to the composition, looking for more progress from service inflation. But they do not need to see a lot of progress in that rotation in this release as time continues to be on their side. Rebalancing in the used car market and pass-through from weak Chinese import prices should keep a lid on core goods prices, mitigating the influence of higher shipping costs.

Forecast implications — The feeling from the last FOMC meeting was that the Fed believes inflation momentum should remain at target but that the FOMC just wanted to see it happen to be sure they can ease policy later this year. The forecasts risks to Fed policy from this release appear to be low.

Market implications — Our views on inflation are aligned with the consensus. Powell emphasized the employment side of the mandate at the last FOMC meeting and at this point the risk of faster easing likely will stem from weakness in the labor market rather than weaker than expected CPI. We also suspect that given the wedge between CPI and PCE due to shelter costs, the Fed will reserve judgement on inflation progress until seeing the PCE release.

Other US Releases: Retail sales—January

(Thursday, 8:30 am)

Will the US consumer take a break? We aren't betting on it. We expect the control group of retail sales to moderate but remain solid with growth of 0.3% m/m and the headline advanced reading should be 0.2%. The underlying strength in the labor market combined to normalizing inflation has meant real income growth has accelerated. Other forces are a foot too to support consumption. Housing unaffordability, work-from-home and rising household wealth could be pushing consumers to spend more on durables.

Forecast implications — The strength in December goods consumption implies that goods consumption growth in 24Q1 would be just under 4% annualized if growth was flat in each month of the quarter. The level of consumption is very high and absent a large pullback in January and February, it is going to be difficult to see a weak consumption reading in 24Q1.

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