Economics

THE WEEK AHEAD

May 9-13, 2022

Do low rates beget low peak rates?

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

Those expecting central banks to hike by leaps and bounds were taken aback this past week as both the Fed, and the Bank of England pushed back against the hawkish end of market expectations for what comes next. The BoE delivered an unprecedented fourth hike in a row, while the Fed's 50 basis point step was the first of that scale in decades. But both cautioned about extrapolating that trend too far. The Bank of Canada had earlier put the kibosh on the likelihood of going by more than a half point at a time.

In part, the central bankers fear that if they did a 75 or 100 basis point move, or in the UK's case, too many smaller hikes in succession, the market would see that as a signal that the final destination is a 4% rate or even higher. The resulting climb in long rates could prove to be an excessive economic brake. But central banks also know that the final destination could prove to be not even as far as markets are already pricing in.

Remember that in successive rate hike cycles, the expectations of investors, and central banks that showed their hand, have tended to overshoot where rates ultimately settled. Neutral rates have fallen and surprised to the downside. Most explanations for that are tied to structural changes in the economy and slower trend growth that weakens capital spending at any given interest rate, or excess global savings.

But a paper from the BIS suggested another mechanism by which low interest rates beget low interest rates[1]. While its model offers a very particular example, the paper's broader point is that financial markets get accustomed to low interest rates, and economic actors take on leverage or build up asset valuations in a way that makes for financial booms in the low rate environment, and feeds into financial busts when rates move higher. In turn, that prevents rates from reaching the levels seen in prior cycles, and forces rates lower again when financial market woes spill over into the real economy.

At this point, central bankers aren't going to be too concerned about the negative implications for stocks or corporate debt markets associated with hiking rates. They're trying to cool growth, and if a shaky financial market raises the cost of capital to business, or pushes the weakest players into insolvency, that's just part of that process. But an abrupt sell off could be too much of a good thing, and Powell and his peers are attuned to that risk after the long bull run we had in asset valuations and credit markets.

Where might such vulnerabilities lie in this cycle? Investors don't tend to make the same error twice in a row, so we wouldn't expect it to show up in US subprime mortgages. Equity and asset valuations are showing some signs of fragility, and sub-investment grade debt markets, while functioning, are repricing. Both could be hit with further downside if rate hikes take that one step too far.

World Bank Chief Economist Carmen Reinhart sees a brewing crisis in private debt, one "hiding in plain sight" that will be visible as pandemic-period debt moratoriums end. While that might be more evident in less developed economies, it could ripple into a stall in overall global growth.

But truth be told, the financial market busts seen when liquidity dries up and interest rates move higher are never that easy to spot in advance, or they wouldn't happen. As Warren Buffet famously put it, "only when the tide goes out do you discover who's been swimming naked." Central banks are committed to taking some of the water away, but are trying to do so at a pace that lets forewarned investors reach for their bathing suits in time.

[1] Rungcharoenkitkul, P. et al. "Monetary policy, hysteresis, and the financial cycle' BIS working paper 817, May 2021.

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 9	-	AUCTION: 2-YR CANADAS $4.5B	-	-	-	-	-
Monday, May 9	8:30 AM	BUILDING PERMITS M/M	(Mar)	(M)	-	-	21.0%
Tuesday, May 10	-	AUCTION: 3-M BILLS $8.6B, 6-M BILLS $3.2B, 1-YR BILLS $3.2B	-	-	-	-	-
Wednesday, May 11	-	AUCTION: 5-YR CANADAS $4B	-	-	-	-	-
Thursday, May 12	11:50 AM	Speaker: Toni Gravelle (Deputy Governor)	-	-	-	-	-
Friday, May 13	8:30 AM	EXISTING HOME SALES M/M	(Apr)	(M)	-	-	-5.4%
Friday, May 13	10:30 AM	BoC Senior Loan Officer Survey	-	-	-	-	-

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 9	10:00 AM	WHOLESALE INVENTORIES M/M	(Mar F)	(L)	-	2.3%	2.3%
Tuesday, May 10	-	AUCTION: 3-YR TREASURIES $45B	-	-	-	-	-
Tuesday, May 10	7:40 AM	Speaker: Williams (Vice Chair, New York) (Voter)	-	-	-	-	-
Tuesday, May 10	9:15 AM	Speaker: Barkin (President, Richmond)	-	-	-	-	-
Tuesday, May 10	1:00 PM	Speaker: Waller (Governor) (Voter) & Kashkari (President, Minneapolis) (Non-Voter)	-	-	-	-	-
Tuesday, May 10	3:00 PM	Speaker: Mester (President, Cleveland) (Voter)	-	-	-	-	-
Tuesday, May 10	7:00 PM	Speaker: Bostic (President, Atlanta)	-	-	-	-	-
Wednesday, May 11	-	AUCTION: 10-YR TREASURIES $36B	-	-	-	-	-
Wednesday, May 11	7:00 AM	MBA-APPLICATIONS	(May 6)	(L)	-	-	2.5%
Wednesday, May 11	8:30 AM	CPI M/M	(Apr)	(H)	0.2%	0.2%	1.2%
Wednesday, May 11	8:30 AM	CPI M/M (core)	(Apr)	(H)	0.4%	0.4%	0.3%
Wednesday, May 11	8:30 AM	CPI Y/Y	(Apr)	(H)	8.1%	8.1%	8.5%
Wednesday, May 11	8:30 AM	CPI Y/Y (core)	(Apr)	(H)	6.0%	6.0%	6.5%
Wednesday, May 11	2:00 PM	TREASURY BUDGET	(Apr)	(L)	-	-	-$192.7B
Wednesday, May 11	12:00 PM	Speaker: Bostic (President, Atlanta)	-	-	-	-	-
Thursday, May 12	-	30-YR AUCTION: $22B	-	-	-	-	-
Thursday, May 12	8:30 AM	INITIAL CLAIMS	(May 7)	(M)	-	180K	200K
Thursday, May 12	8:30 AM	CONTINUING CLAIMS	(Apr 30)	(L)	-	1400K	1384K
Thursday, May 12	8:30 AM	PPI M/M	(Apr)	(M)	0.5%	0.5%	1.4%
Thursday, May 12	8:30 AM	PPI M/M (core)	(Apr)	(M)	0.6%	0.6%	1.0%
Thursday, May 12	8:30 AM	PPI Y/Y	(Apr)	(M)	-	10.7%	11.2%
Thursday, May 12	8:30 AM	PPI Y/Y (core)	(Apr)	(M)	-	8.9%	9.2%
Thursday, May 12	4:00 PM	Speaker: Daly (President, San Francisco)	-	-	-	-	-
Friday, May 13	8:30 AM	IMPORT PRICE INDEX M/M	(Apr)	(L)	-	0.6%	2.6%
Friday, May 13	8:30 AM	EXPORT PRICE INDEX M/M	(Apr)	(L)	-	0.7%	4.5%
Friday, May 13	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(May P)	(H)	-	63.7	65.2
Friday, May 13	11:00 AM	Speaker: Kashkari (President, Minneapolis) (Non-Voter)	-	-	-	-	-
Friday, May 13	12:00 PM	Speaker: Mester (President, Cleveland) (Voter)	-	-	-	-	-

Week Ahead's market call

by Avery Shenfeld

In the **US**, although the 12-month CPI will actually get a bit of a breather due to both base effects and softer energy prices, that will be cold comfort if, as we expect, monthly core prices comes in at a firm 0.4%. That would be in line with the consensus, but firm enough to keep inflation fears at the top of market concerns. It's much the same story for producer prices. A host of Fed speakers will at this point be singing from the same song sheet, with another 50 bps hike highly likely at the next meeting.

In **Canada**, there's no market moving economic reports on the calendar, so financial market volatility will be following along for the ride with what happens in the US and abroad. Earnings reports are now a very mixed bag, with a lot depending on which companies are in a position to pass on cost increases.

There are no major Canadian data releases next week.

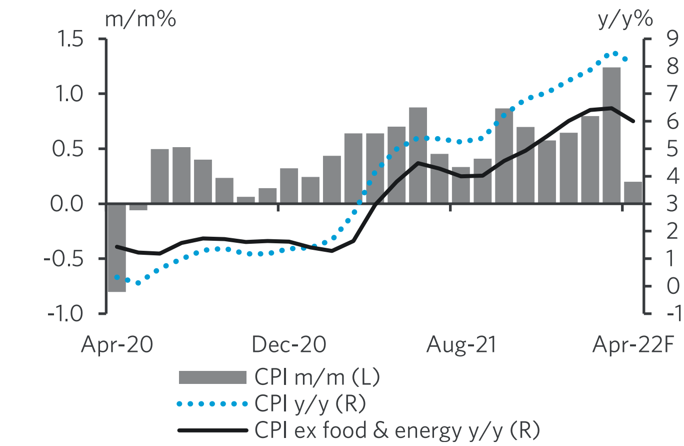
Week Ahead's key US number: Consumer price index—April

(Wednesday, 8:30 am)

Katherine Judge katherine.judge@cibc.com

Consumer price index (%)	CIBC	Mkt	Prior
Headline CPI m/m	0.2	0.2	1.2
Headline CPI (y/y)	8.1	8.1	8.5
Core CPI m/m	0.4	0.4	0.3
Core CPI y/y	6.0	6.0	6.5

Chart: US Consumer price index



Source: BLS, Haver Analytics, CIBC

With gasoline prices easing off in April, and strong year-ago prints from last year's reopening being lapped, inflation is set to decelerate in April, while still remaining sky high. The 0.2% monthly advance expected for total CPI would mask a strong gain in food prices, reflecting fresh supply chain issues linked to the war in Ukraine. That would also include an acceleration in monthly ex. food and energy prices to 0.4%, attributable to renewed supply chain disruptions for goods tied to widespread lockdowns in China, and continued upwards pressure from the cost of shelter and the tightening in the labor market.

Forecast Implications— Inflation will likely continue to decelerate in the months ahead due to base effects, but that will be limited by supply chain disruptions in goods sectors tied to lockdowns in China, strong underlying demand for services, and the tightening in the labor market. Those forces will compel the Fed to raise rates by 50bps at each of the next two FOMC meetings, before slowing the pace of tightening to observe the slowdown expected in growth.

Market Impact— We are in line with the consensus which should limit any market reaction.

Contacts:

Avery Shenfeld
416 594-7356
avery.shenfeld@cibc.com

Benjamin Tal
416 956-3698
benjamin.tal@cibc.com

Andrew Grantham
416 956-3219
andrew.grantham@cibc.com

Karyne Charbonneau
613 552-1341
karyne.charbonneau@cibc.com

Katherine Judge
416 956-6527
katherine.judge@cibc.com

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

economics.cibccm.com