Economics

THE WEEK AHEAD

May 29 - June 2, 2023

Crunch time

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

Budget negotiations are like high school term papers; nobody but the class nerd gets them done before the due date. So it would come as no huge surprise if Washington pols pull an all-nighter next week and pass a debt ceiling deal of some sort. An extended failure to do so, with a sharp recession and market chaos, wasn't any forecaster's base case as far as we know.

That said, there are financial market implications coming from the drop in whatever slim odds of a stalemate were being priced in. Equities seem to like it for obvious reasons, the US dollar could lose a bit of any flight to safety bid, and nobody will count on the Fed having to ease policy to combat a fiscal-crisis recession.

But beyond pricing-out the small risks of chaos, how will markets price-in the actual deal and its impacts? To the extent that raising the debt ceiling comes with strings attached, in the form of actual spending restraint now or in the fiscal year beginning in a few months, it could work to reduce the pressure on the FOMC for further rate hikes.

As we showed earlier (See "The US debt ceiling debate: can anything good come of this" May 17), US fiscal policy was set to no longer be the drag on growth it was in 2022. Paring back spending plans (as long as we don't slash funds for the IRS so much that taxes-paid decline) could put that headwind back, providing an alternative to rate hikes as a means of slowing growth and inflation. We'll need to delve into the fine print of any deal to assess how real the proposed spending cuts really are, but Republicans are unlikely to approve an agreement that lacks some substance.

Even so, in the near term, a deal could actually send bond yields higher, and not just because the odds of an economic crisis diminished, but because of the impact on supply. The Treasury has been squeezed down to the point where there's only petty cash in the till at present. Replenishing the operating cash position at the Treasury General Account will necessitate a spurt of fresh issuance, requiring an additional $800 billion in bills and bonds in potentially as little as the next three months, over and above the normal funding pace.

That also takes a bit of pressure off the Fed to hike as early as June, a growing risk to our existing forecast in the wake of firmer-than-expected news on PCE inflation, personal consumption and durable goods orders today. Higher bond yields will impact mortgage rates and corporate borrowing costs.

Moreover, coupled with ongoing quantitative tightening, the public will have to drain its own deposits to take up the increased supply of government bonds and bills. Money market funds currently deposited at the Fed could take up some of the extra t-bills, but the added funding could also act as a drain on the banking sector's deposits, and in turn add to pressures on credit availability.

To be sure, all of these factors could take a back seat if the week ahead's US payrolls data deliver any significant upside surprises. With Q2 GDP forecasts being steadily marked upwards, a rate hike this summer is now a material risk, with the central bankers very divided at this point. Keeping the Fed on hold over the summer will require some evidence that job growth is still decelerating, that unemployment is starting to edge higher, and that job vacancies are continuing to decline.

That's not going to immediately show up in a deceleration in wages in the May data, given how tight the labour market is right now. The Fed economists will understand that point. But we need to see momentum towards a cooler labour market to give the FOMC confidence that they've done enough hiking for now. They can afford to be slackers for a while, as their own high school term paper, an essay on how they vanquished inflation, isn't due just yet.

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 29	-	-	-	-	-	-	-
Tuesday, May 30	8:30 AM	CURRENT ACCOUNT BAL.	(1Q)	(M)	-$10.0B	-$10.2B	-$10.6B
Wednesday, May 31	-	AUCTION: 2-YR CANADAS $4.8B	-	-	-	-	-
Wednesday, May 31	8:30 AM	GDP M/M	(Mar)	(H)	-0.1%	-0.1%	0.1%
Wednesday, May 31	8:30 AM	GDP (annualized)	(1Q)	(H)	2.6%	1.8%	0.0%
Thursday, June 1	-	AUCTION: 5-YR CANADAS $5B	-	-	-	-	-
Friday, June 2	-	-	-	-	-	-	-

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 29	-	-	-	-	-	-	-
Tuesday, May 30	9:00 AM	HOUSE PRICE INDEX M/M	(Mar)	(M)	-	0.2%	0.5%
Tuesday, May 30	9:00 AM	S&P CORELOGIC CS Y/Y	(Mar)	(H)	-	-	0.4%
Tuesday, May 30	10:00 AM	CONF.BOARD CONSUMER CONFIDENCE	(May)	(H)	99.2	99.5	101.3
Tuesday, May 30	1:00 PM	Speaker: Thomas I. Barkin (Richmond) (Non-Voter)	-	-	-	-	-
Wednesday, May 31	7:00 AM	MBA-APPLICATIONS	(May 26)	(L)	-	-	-4.6%
Wednesday, May 31	10:00 AM	JOLTS Job Openings	(Apr)	-	-	-	9590K
Wednesday, May 31	2:00 PM	FED'S BEIGE BOOK	-	-	-	-	-
Wednesday, May 31	8:50 AM	Speaker: Susan M. Collins (Boston) & Michelle W Bowman (Governor) (Voter)	-	-	-	-	-
Wednesday, May 31	12:20 PM	Speaker: Susan M. Collins (Boston)	-	-	-	-	-
Wednesday, May 31	12:30 PM	Speaker: Patrick Harker (Philadelphia) (Voter)	-	-	-	-	-
Wednesday, May 31	1:30 PM	Speaker: Philip N Jefferson (Governor) (Voter)	-	-	-	-	-
Thursday, June 1	8:15 AM	ADP EMPLOYMENT CHANGE	(May)	(M)	-	163K	296K
Thursday, June 1	8:30 AM	INITIAL CLAIMS	(May 27)	(M)	-	235K	229K
Thursday, June 1	8:30 AM	CONTINUING CLAIMS	(May 20)	(L)	-	-	1794K
Thursday, June 1	8:30 AM	NON-FARM PRODUCTIVITY	(1Q)	(M)	-	-2.7%	-2.7%
Thursday, June 1	9:45 AM	S&P GLOBAL US MANUFACTURING PMI	(May)	(L)	-	48.5	48.5
Thursday, June 1	10:00 AM	ISM - MANUFACTURING	(May)	(H)	46.6	47.1	47.1
Thursday, June 1	10:00 AM	CONSTRUCTION SPENDING M/M	(Apr)	(M)	-	0.2%	0.3%
Thursday, June 1	1:00 PM	Speaker: Patrick Harker (Philadelphia) (Voter)	-	-	-	-	-
Friday, June 2	8:30 AM	NON-FARM PAYROLLS	(May)	(H)	195K	188K	253K
Friday, June 2	8:30 AM	UNEMPLOYMENT RATE	(May)	(H)	3.5%	3.5%	3.4%
Friday, June 2	8:30 AM	AVERAGE HOURLY EARNINGS ALL EMPLOYEES M/M	(May)	(H)	0.4%	0.3%	0.5%
Friday, June 2	8:30 AM	AVERAGE WEEKLY HOURS ALL EMPLOYEES	(May)	(H)	-	34.4	34.4
Friday, June 2	8:30 AM	MANUFACTURING PAYROLLS	(May)	(H)	-	5K	11K

Week Ahead's market call

by Avery Shenfeld

In the **US**, we're expecting to see the ink on a deal to raise the debt ceiling early in the week (see cover). Fed speakers will show a degree of hawkishness in the wake of recent data. The signals ahead of the factory ISM are a bit puzzling, since we've seen a weakening in regional indexes, but firmness in durable orders. Our call for payrolls and wages on Friday isn't quite as soft as the consensus, and as always, the jobs data has the greatest potential to move the needle for markets.

In **Canada**, after trailing the US in the latter half of 2022, Q1 growth looks set to double the pace recorded in the US, but the two countries seem likely to swap places again in Q2. The weak end to Canada's first quarter, including a dip in March GDP, will be part of that story, alongside various disruptions that will plague the second quarter pace. That could be one key to keeping the Bank of Canada on hold if the Fed goes ahead with a rate hike in June or July.

Week Ahead's key Canadian number: GDP—March and Q1

(Wednesday, 8:30 am)

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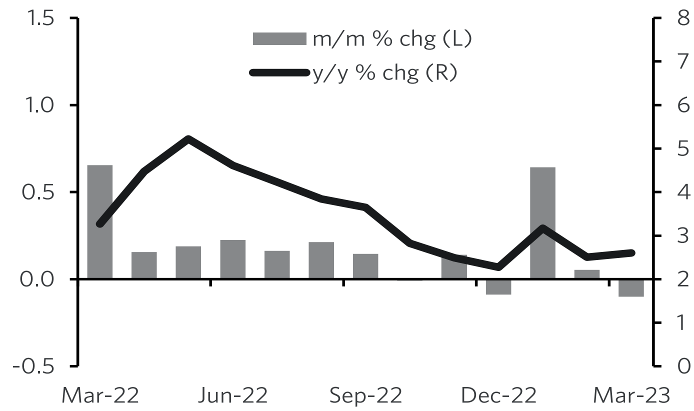
Variable (%)	CIBC	Mkt	Prior
GDP March (m/m)	-0.1	-0.1	0.1
GDP Q1 (annualized)	2.6	1.8	0.0

Chart: Canadian real GDP at basic prices



Source: Statistics Canada, Haver Analytics, CIBC

The first quarter was a solid one for the Canadian economy, albeit one that ended on a weaker footing. The 2.6% annualized pace of growth we forecast was driven in large part by net trade, as export volumes surged but imports floundered. However, weak imports likely mean a slower pace of inventory building as well, which will be a drag on overall GDP. Final domestic demand, and in particular consumer spending, will look much more solid in Q1 than it was during the second half of 2022. However, much of that will be driven by autos, which reflects the easing of supply chains in fulfilling orders placed earlier, rather than new demand.

Monthly data suggest that momentum faded noticeably as the quarter wore on, with a 0.1% decline in monthly GDP anticipated for March. With power outages in Quebec and a strike by Federal workers both disrupting the economy during April, the advance estimate for that month could point to another slight decline in GDP to start Q2.

Forecast implications — The strength in consumer spending during Q1 will be partly misleading, as a large chunk will represent the delivery of auto orders that were placed in 2022. Weak momentum to end the quarter could raise the possibility of a Q2 contraction, particularly with wildfires in BC and Alberta hampering commodity production in May, adding to the temporary disruptions expected to impact the quarter as a whole.

Other Canadian releases: Current account balance—Q1

(Tuesday, 8:30 am)

A surge in export volumes meant that the goods trade surplus was little changed in Q1 relative to the prior quarter, despite a continued slump in commodity prices. A wider deficit on the services side, as travel patterns continued to normalize closer to 2019 levels, could have been countered by a slimmer primary income deficit. Summing up, we expect a $10bn current account deficit – little changed from the prior quarter.

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

(Friday, 8:30 am)

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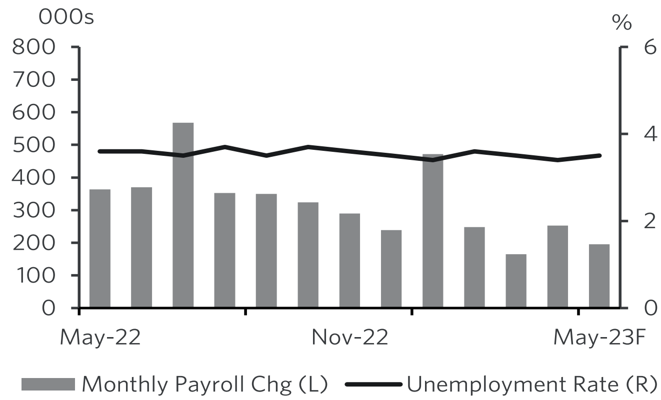
Variable	CIBC	Mkt	Prior
Employment (m/m)	195K	188K	253K
Unemployment rate	3.5%	3.5%	3.4%
Avg hourly earnings (m/m)	0.4%	0.3%	0.5%

Chart: US payroll employment



Source: BLS, Haver Analytics, CIBC

The previously reported jump in initial jobless claims was revised away, and the May payrolls survey reference period now shows a slight improvement in claims. That suggests that hiring was likely still a robust 195K in May, although that represents a deceleration from the recent 3-month average trend, in line with the softening in job openings seen so far this year. It appears that workers who have lost jobs in interest-sensitive sectors or those that have announced layoffs are still being re-absorbed into the labor market, as continuing jobless claims also eased slightly over the survey reference period. The unemployment rate likely ticked up to 3.5%, while wage growth could have slowed, but remained hot, at 0.4%.

Forecast implications — We continue to expect past rate hikes to put the brakes on economic activity and hiring ahead. While strong wage growth continues to support household incomes, the easing in job openings suggests that labor is becoming less scarce, which will cap wage gains ahead. The Fed could stay on the sidelines in June as the trend is still towards a cooling in hiring, but we'll need to see enough of a slowing in the subsequent data to prevent the Fed from hiking any further thereafter.

Market impact — We're more optimistic than the consensus on hiring and wages, which could lift bond yields.

Other US Releases: ISM Manufacturing—May

(Thursday, 10:00 am)

The ISM's manufacturing index likely fell to 46.6 in May, in line with the deterioration seen in regional indices, although the strength in durable goods orders for April suggests that these surveys are picking up pessimism for what lies ahead rather than just weakness on the ground.

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