CIBC

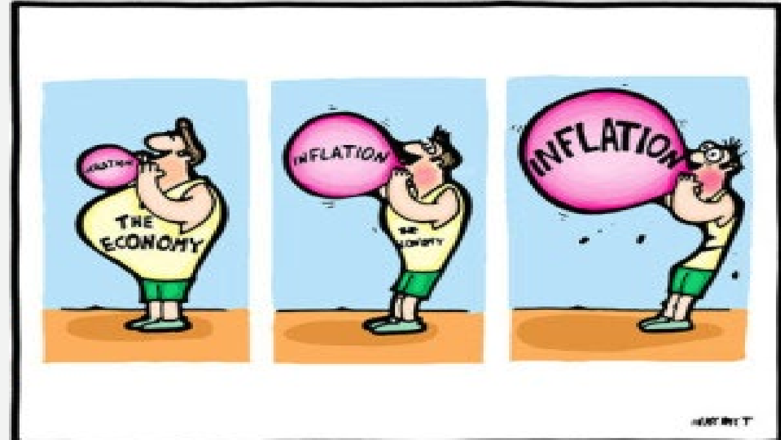
CIBC CAPITAL MARKETS

Global Outlook: Soft landing, hard landing, no landing?

Is the cup half empty, or the glass half full?

September 2023

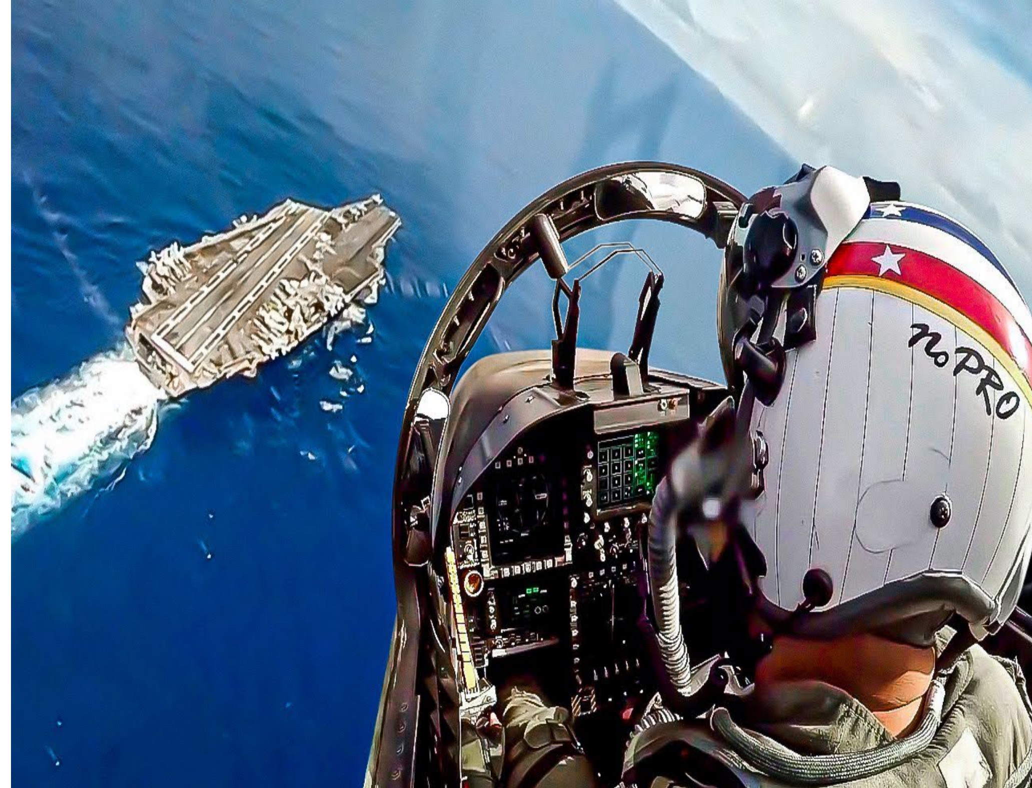
Jeremy Stretch
Chief International Strategist
jeremy.stretch@cibc.co.uk



Can the global economy find a landing zone?

- Pre-Covid investors were increasingly wary of a period of 'secular stagnation'. The definition of this is a period of prolonged low growth, low rates, and high unemployment.
  - Such a scenario is often associated with ineffective monetary policy and weak demand. Currently, we appear to be facing only the first criteria.

- Post-Covid investor worries centered around inflation. Supply shocks, re-opening dynamics, and energy price spikes, the combination of which prompted fears of a re-run of the 1970's.



CIBC

Can the global economy find a landing zone? (2)

- Spiking prices resulted in policymakers playing catch-up through 2022, in part due to policy adjustment being delayed……

  …….hindsight is a wonderful thing…..

- Central bank complacency was evident during 2021. The Fed led the way in terms of attempting to explain away supply-side inflationary pressures as being merely 'transitory'.
    - What is transitory in central bank terms?

- Markets are attempting to determine whether the global economy can find that smooth landing zone.

CIBC

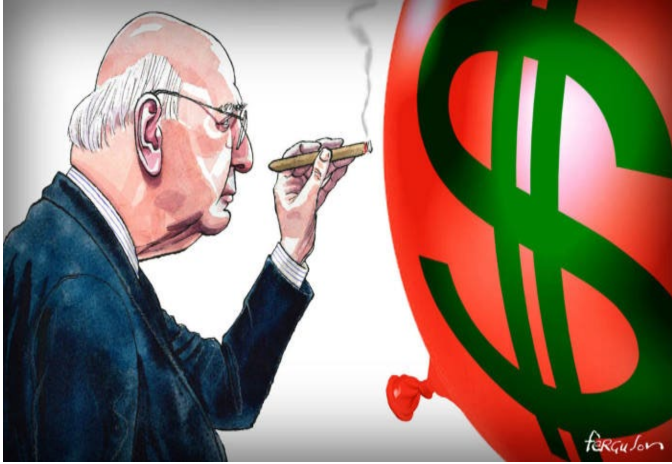
Past disinflations came with heavy economic pain –
Policy makers want to avoid repeating past mistakes

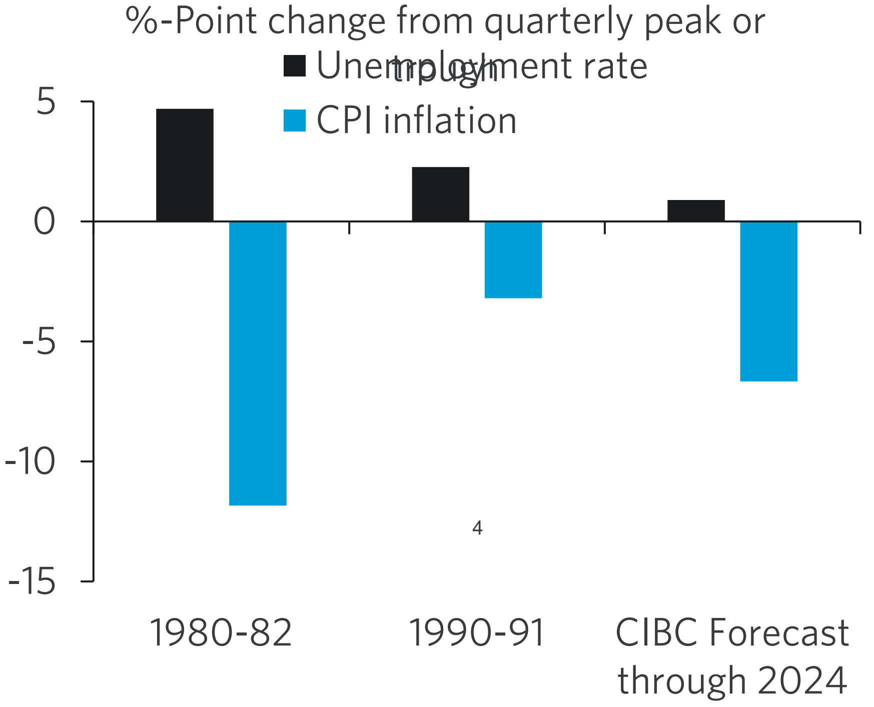
THE WALL STREET JOURNAL.

What's News

Inflation Hurtles to Highest Since '81

A 9.1% price rise adds pressure on the Fed as more investors expect a bigger rate boost in July

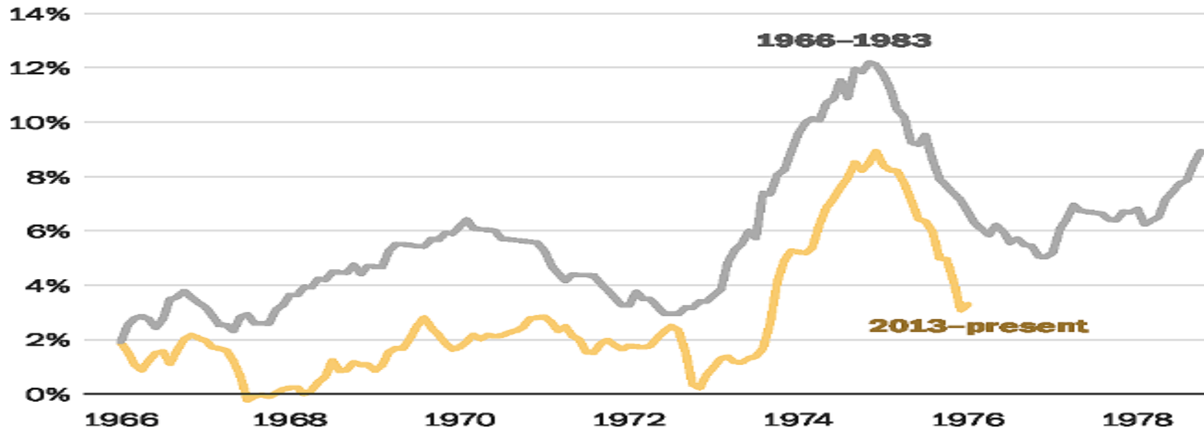




CIBC

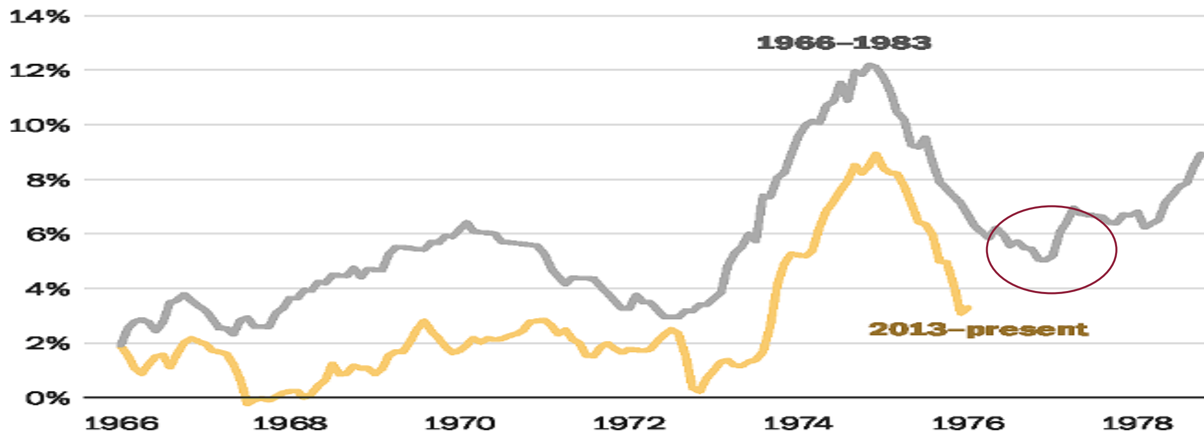
Source: BLS, CIBC

Inflation parallels from history – are we set for a re-run?



- The above chart was recently published by former US Treasury Secretary Larry Summers. In simple terms, the comparison looks compelling, not least as the recent uptick in oil price risks re-energizing headline price pressures.
- The similarities between past cycles and the current one relate to the impact of oil prices. The post-Ukraine invasion oil price spike is reminiscent of price reactions witnessed across the 1970s amidst regional conflicts and the Iranian Revolution.

Inflation parallels from history – are set for a re-run? (2)

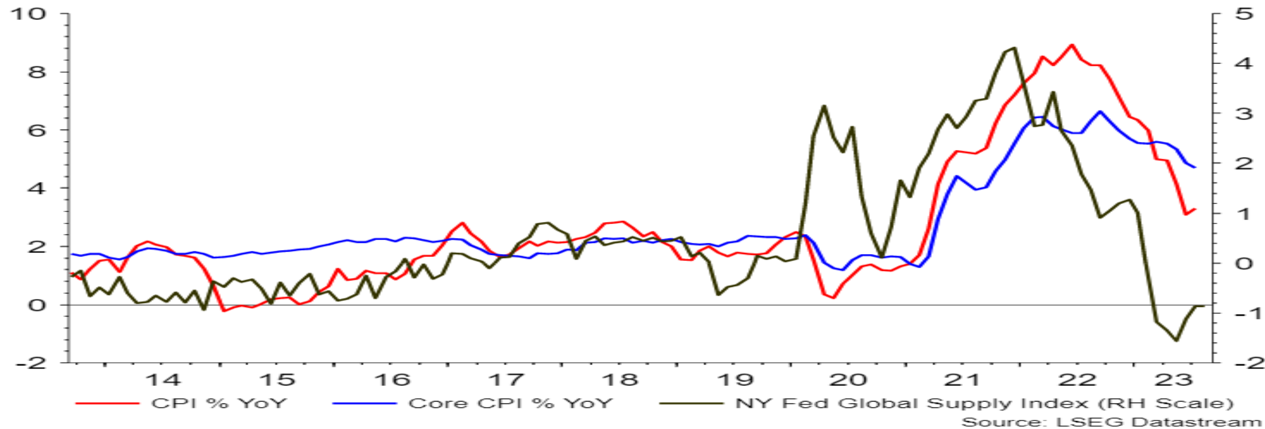


- The post-Covid period has been characterized by a number of specific criteria. Global macro re-opening, coincided with supply shortages, notably in key sectors such as computer chips, resulting in a material price squeeze.
- Should the extension in oil output reductions be seen through the prism of defensive efforts to sustain valuations or to drive prices higher, at the risk of compromising global growth? We would expect the former. The moderation in Chinese demand should help surely preclude fears of the return of US$100p/b oil.

CIBC

Inflation variables – supply concerns re-emerging?

Global Supply Chain Pressure Index

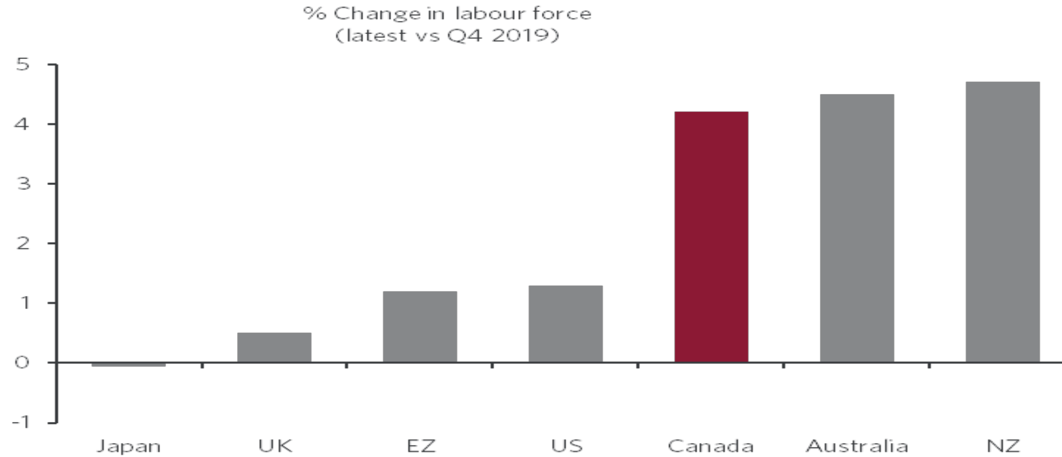


- After a material price spike, as we worked through the initial phase of Covid, we have witnessed broad supply-related price pressures falling back into negative territory.
- Geopolitical factors remain the main influence on supply-side price concerns.
- The correction in the NY Fed global supply index, the series dipped below zero for the first time since Aug 2019, indicated a moderation in supply chain price pressures.
- Beyond global good prices we can expect increasing scrutiny of second round price effects. Global central banks are increasingly focused on service-related price dynamics, notably wage growth.

CIBC

Labour force dynamics

Change in Labour Force (% vs Q4 2019)



Source: Statistics Canada, CIBC

- Increases in the size of labour force have benefitted the ‘New World’ Dollar Bloc.
- The lack of Japanese migration flows and the impact of Brexit, impacting EU workers, has resulted in the UK and Japan witnessing labour force challenges. Limited labour supply risks increased and more protracted wage pressures in regions/countries where supply remains constrained.
- Such considerations point towards potentially profound implications for Japanese policy normalization.

CIBC

Central banks have repeated cycles last practiced in the ‘80’s

- The scale of global policy tightening, allied to increasingly long and variable policy lags, demonstrates the policy difficulties faced by global central banks.

- Friedman created the metaphor of the “fool in the shower.”

  - The fool tinkers with the policy controls while failing to realize the lag between adjusting the temperature and the impact of the change.

- The metaphor suggests policymakers are prone to overshooting.

  - This applies both on the way up and in terms of keeping rates too low for too long, as per post-2008 and the end of the DOT.com bubble.

“The Fool in the shower”

CIBC

A return to the ‘70’s?- Bursting inflation or the economy

- Virtually all the major global central banks, bar the BoJ, have attempted to front-load policy tightening.
  - The list includes those who insisted their situations were different and didn’t initially warrant immediate action such as the RBA and the Riksbank. Of course, both have been forced to materially adjust course.
- The Fed moved relatively expeditiously. The Fed continues to attempt to engineer a soft rather than a hard landing, is that still possible or feasible? We suspect that we have reached peak Fed hawkishness. We favour a soft landing. Recession risks are overstated.

  - However, should we really expect Fed easing before the end of Q1 2024? We remain mindful of the post-SVB tightening in financial conditions. That tightening, post the SVB debacle, has fully unwound, have sectoral pressures truly passed?
- Does the inverted yield curve guarantee a recession?
  - Back in early 2020, prior to the virus, we viewed the flattening of the US yield curve as a false flag and did not signal an imminent recession.
- Growth will continue to decelerate through this year and remain subpar into 2024. Global growth looks set to remain well below the 3% threshold through 2025. This level marks the effective tipping point for global living standards to be improving or deteriorating.
- Are demographics causing investors to increase rather than decrease saving?

CIBC

US Curve and Recession Risks

US Curve and Recession Bands

- Does the yield curve inversion signal imminent recession? Currently, the market is assuming a 60% probability of a US recession, versus around 65% three months ago. The Cleveland Fed's yield curve model peaked at 79% in April, this marked the highest reading since 1982.
- We would view such assumptions as too high. That being said the US economy risks moderating towards the stall speed. Nevertheless, we do not expect rates to be cut quickly.
- Can the Fed engineer a slowdown without risking a material unemployment spike? Larry Summers has suggested that the Fed needs an unemployment spike. We do not anticipate needing to see the u/e rate spiking toward 5%, we assume a peak below 4.5%.

  - Back in early 2020, we viewed the flattening of the US yield curve as a false flag. Previous oil price spikes in the last decade did not result in a recession. The rationale comes via the fact that oil is less important within the consumer/industrial spectrum than in earlier decades.

CIBC

Recession or weak GDP across most of the globe in 2023/24

GDP – still sub-par into 2025

	2019A	2020A	2021A	2022A	2023F	2024F	2025F
World*	2.8	-2.8	6.3	3.5	2.6	2.3	2.8
US	2.3	-2.8	5.9	2.1	2.0	0.8	1.6
Canada	1.9	-5.1	5.0	3.4	1.2	0.7	2.1
Eurozone	1.6	-6.3	5.6	3.4	0.5	0.2	1.0
UK	1.6	-10.4	8.7	4.3	0.4	0.1	1.2
Australia	1.9	-1.8	5.2	3.7	1.8	1.0	1.8
Japan	-0.4	-4.3	2.3	1.0	1.9	1.0	1.2
China	6.0	2.2	8.4	3.0	4.8	4.2	4.4

* At Purchasing power parity

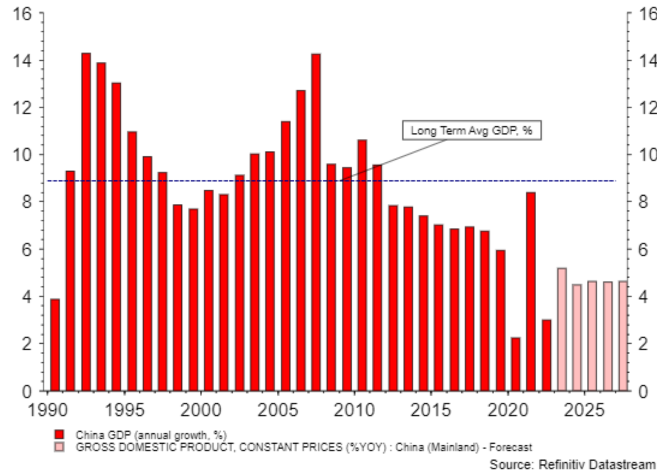
Source: CIBC Economics/FICC Strategy

- Global GDP peaked back in ‘17. The Covid downdraft proved more aggressive in the US than the slide post the GFC, US GDP merely declined by 2.6% in 2009.
- Global activity is set to remain below-trend levels in most instances in 2024. The question is whether the scale of policy tightening, risks triggering a material recession.
- The Eurozone remains exposed to external events including weak Chinese demand and Ukraine-related concerns. Europe needs another benign winter in order to preclude fresh energy price concerns. Fears of the real economy being impacted by gas supply restrictions have materially eased, for now.
- China’s growth challenges were initially amplified by the zero Covid strategy. Post the strategy reversal we are now in a scenario where consumer confidence and or spending remains fragile, underlining ongoing growth challenges. Even the new moderate growth target seems increasingly out of reach.

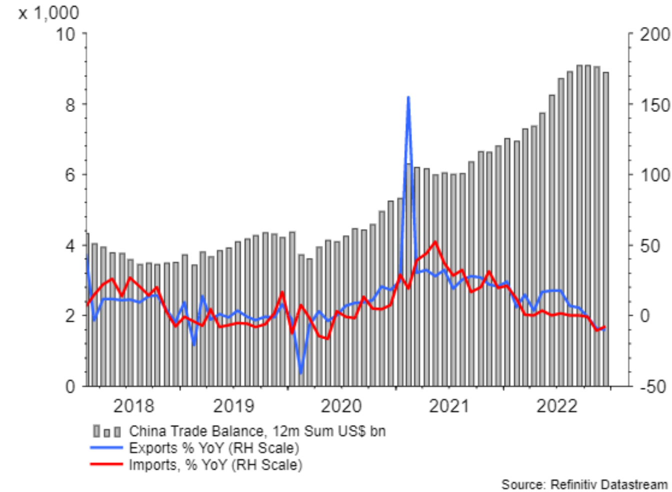
CIBC

China: growth trends still matter

China GDP a new paradigm



China nominal trade remains elevated



- The key question for the Chinese authorities is can they create a smooth landing most notably in terms of real estate. We would expect policy to remain easy in order to ease pressures in the sector.
- Despite the moderation in global growth the nominal trade surplus has continued to broadly advance. Such a scenario has important implications in the FX space.
- The ending of the zero Covid strategy has potentially profound implications. The rebound in domestic demand will see an increasing degree of growth proving to be domestically generated.

CIBC

What could go wrong?....... Still quite a lot, actually…..

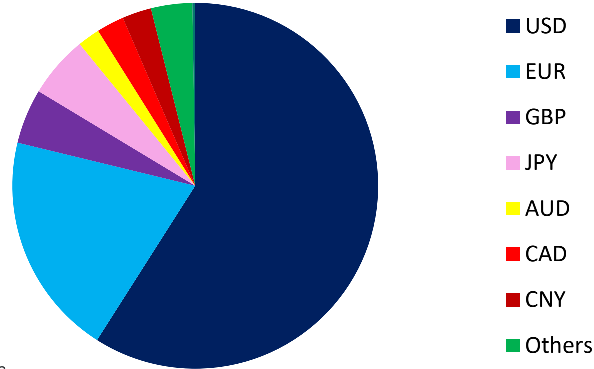
- Excessive rate hikes by central banks. Should US terminal rates push higher (oil price pressures remain an existential risk) expect global recession risks to extend. - We've seen that movie.
  - Does the Fed risk a policy mistake? Is the Fed alone in such risks?
  - Have the central banks understood the impact/implications of broad credit tightening?
- The market is not priced for a material escalation in events in Ukraine.
- Financial markets and wealth effects. Extending policy tightening risks undermining consumer confidence and spending.
- Political risks remain real as we move towards a 2024 election cycle.
- Demographics – ageing populations and changing spending habits are set to materially impact the investment landscape

CIBC

Summing up: a cup half empty, or the glass half full?

- We have had tailwinds in terms of getting headline inflation down, namely base effects, at least into H2 2023.
- But we still need a stall in growth and higher jobless rates to sustainably reach 2% CPI.
- High inflation remains the number one tail risk.
- Central banks are nearly done with hikes. The lagged impacts of prior hikes are set to kick in.
- In order to avoid the mistakes of the past rates will have to stay high for a period. Those hoping for early easing are set to be disappointed.
- Equities will benefit from assumptions of lower rates into H2 2024 alongside a lower inflation trajectory.
- Stronger growth prospects and an easing bias favours the high beta currencies into H2 next year.

Global FX Diversification- Too early to call the demise of the USD



Source: BIS COFER FX Data

- At the turn of the century USD holdings accounted for more than 70% of allocated global FX reserves, this compares with just 59% at the end of Q1 2023 according to the latest IMF data.
- EUR holdings peaked ahead of the euro crisis near 28% in '09. Negative EUR rates saw holdings slip below 20%. Although holdings rebounded to 20.5% at the end of 2022 holdings moderated in Q1 to 19.77%. Positive rates have yet to materially impact reserve managers.
- That EUR reserves remain only around a third of those of the USD Dollar underlines that the Dollar's "exorbitant privilege" of being the international reserve currency looks set to remain in place.
- The proportion held in CNH has effectively doubled since the start of 2018. Chinese FX reserve holdings equate to around USD289bn or more accurately just over 2.5% of total allocated global reserves. A lack of convertibility suggests we are unlikely to witness a substantive increase in CNY reserves.

CIBC

Disclaimer

CIBC Capital Markets is a trademark brand name under which Canadian Imperial Bank of Commerce ("**CIBC**"), its subsidiaries and affiliates (including, without limitation, CIBC World Markets Inc., CIBC World Markets Corp. and CIBC Capital Markets (Europe) S.A.) provide products and services to our customers around the world. Securities and other products offered or sold by CIBC Capital Markets are subject to investment risks, including possible loss of the principal invested. Nothing contained herein is an offer or solicitation to transact in any product or financial instrument, nor a confirmation of any transaction. Each subsidiary or affiliate of CIBC is solely responsible for its own contractual obligations and commitments. Unless stated otherwise in writing CIBC Capital Markets products and services are not insured by the Canada Deposit Insurance Corporation, the Federal Deposit Insurance Corporation, or other similar deposit insurance and are not endorsed or guaranteed by any bank.

The materials described herein are provided "as is" without warranty of any kind, either express or implied, to the fullest extent permissible pursuant to applicable law, including but not limited to the implied warranties of merchantability, operation, usefulness, completeness, accuracy, timeliness, reliability, fitness for a particular purpose or non-infringement. The information and data contained herein has been obtained or derived from sources believed to be reliable, without independent verification by CIBC Capital Markets, and we do not represent or warrant that any such information or data is accurate or complete. CIBC Capital Markets assumes no obligation to update any information, assumptions, opinions, data or statements contained herein for any reason or to notify any person in respect thereof. Nothing contained herein is an offer or solicitation to transact in any product or financial instrument, nor a confirmation of any transaction.

This communication is provided, for informational purposes only, to institutional investor and retail clients of CIBC World Markets Inc. in Canada, and does not constitute an offer or solicitation to buy or sell any securities discussed herein in any jurisdiction where such offer or solicitation would be prohibited. This document and any of the products and information contained herein are not intended for the use of private investors in the United Kingdom. Such investors will not be able to enter into agreements or purchase products mentioned herein from CIBC World Markets plc. The comments and views expressed in this document are meant for the general interests of wholesale clients of CIBC Australia Limited.

CIBC's Foreign Exchange Disclosure Statement relating to guidelines contained in the FX Global Code can be found at www.cibccm.com/fxdisclosure. For important disclosures concerning U.S. swap trading, see the Dodd-Frank Disclosures at http://www.cibccm.com/cibc-eportal-web/portal/wm?pageId=dodd_frank_disclosures&language=en_CA.

This communication should not be construed as a research report. The information contained in this communication is not intended to constitute a "research report, statement or opinion of an expert" for the purposes of the securities legislation of any province or territory of Canada or "research" as defined in FINRA Rule 2241 by the Financial Industry Regulatory Authority (FINRA).

CIBC World Markets Inc. is a member of the Canadian Investor Protection Fund and the Investment Industry Regulatory Organization of Canada. In the United States, CIBC World Markets Corp. is a member of the Financial Industry Regulatory Authority and the Securities Investor Protection Fund. In Luxembourg, CIBC Capital Markets (Europe) S.A. (RCS Luxembourg: B236326) is authorised by the European Central Bank (the "ECB") and supervised by the Luxembourg Financial Supervisory Authority (Commission de Surveillance du Sector Financier) under the oversight of the ECB. CIBC Australia Ltd (AFSL No: 240603) is regulated by the Australian Securities and Investment Commission ("ASIC"). CIBC World Markets (Japan) Inc. is a member of the Japanese Securities Dealer Association. CIBC (TSX/NYSE: CM) is a bank chartered under the Bank Act (Canada) having its registered office in Toronto, Ontario, Canada, and regulated by the Office of the Superintendent of Financial Institutions. CIBC New York Branch is licensed and supervised by the New York State Department of Financial Services. In the UK, CIBC London Branch is authorised by the Prudential Regulation Authority and subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Canadian Imperial Bank of Commerce Sydney Branch (ABN: 33 608 235 847) is an authorized foreign bank branch regulated by the Australian Prudential Regulation Authority (APRA). Canadian Imperial Bank of Commerce Hong Kong Branch is a registered institution under the Securities and Futures Ordinance, Cap 571 and a limited liability foreign company registered with the Hong Kong Companies Registry. Canadian Imperial Bank of Commerce Singapore Branch is a wholesale bank licensed and regulated by the Monetary Authority of Singapore.

CIBC London Branch is authorised by the Prudential Regulation Authority and subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority.

This communication is distributed solely to institutional clients and not retail clients as defined by the applicable securities legislation and regulation to which CIBC Capital Markets may be subject in any jurisdiction. All values are expressed in Canadian dollars, unless otherwise noted.

CIBC does not (and shall not be deemed to) provide, and has not provided, any investment or financial advice or recommendation to you in relation to any securities, products or financial instruments described herein or any transaction. You may not rely on any communication (written or oral) from CIBC as investment or financial advice or as a recommendation relating the securities, products or financial instruments or to any transaction.

The services, securities and investments discussed in this document may not be available to, nor suitable for, all investors. These materials do not (nor do they purport to) disclose all the risks and other significant issues relating to any of the securities, products or financial instruments described herein or any transaction related thereto. Nothing contained herein constitutes financial, business, legal, tax, investment, regulatory or accounting advice. Prior to making any investment in a product or financial instrument described herein, you should make your own appraisal of the risks from a financial, business, legal, tax, investment, regulatory and accounting perspective, without relying on the information contained herein, by consulting, if you deem it necessary, your own advisors in these matters or any other professional advisors. Since the levels and bases of taxation can change, any reference in this communication to the impact of taxation should not be construed as offering tax advice on the tax consequences of investments. As with any investment having potential tax implications, clients should consult with their own tax advisors. This communication may provide addresses of, or contain hyperlinks to, Internet web sites. CIBC Capital Markets has not reviewed the linked Internet web site of any third party and takes no responsibility for the contents thereof. Each such address or hyperlink is provided solely for the recipient's convenience and information, and the content of linked third-party web sites is not in any way incorporated into this document. Recipients who choose to access such third-party web sites or follow such hyperlinks do so at their own risk.

CIBC Capital Markets and the CIBC Logo are trademarks of CIBC in Canada, the United States and other countries, and is used under license.

© 2023 CIBC Capital Markets. All rights reserved. Unauthorized use, distribution, duplication or disclosure without the prior written permission of CIBC Capital is prohibited by law and may result in prosecution.