

# PERSPECTIVES

Quarterly economic views and asset class outlook

Spring 2024



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Economic resilience has persisted in the US and green shoots of economic spring have emerged in other countries, including Canada.



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## Set fair

### Welcome to the 2024 spring edition of Perspectives.

2024 started with a flourish. Economic resilience has persisted in the US and green shoots of economic spring have emerged in other countries, including Canada. Thoughts of global recession, widespread at this time last year, are now relegated to a more distant possibility. A common thread is the collective health of consumers, who are navigating the higher interest rate environment more robustly than expected through a combination of higher real incomes, robust labour markets, and strong wealth effects. We expect this relatively good growth backdrop to persist through the remainder of 2024. Efforts to return inflation to central bank policy targets has also made substantial progress. But the last mile is proving the hardest, as expected, and service sector inflation has remained sticky, particularly in the US and parts of the emerging markets.

The combination of higher growth and sticky inflation has caused market participants to reign in exuberant rate cut expectations. Cuts are still being signaled by central bankers, even as economic resilience raises a question whether policy stimulus is actually needed, particularly in a world of still-plentiful liquidity. This resilience, allied to rising public indebtedness and various investment tailwinds discussed in our latest [Long-term Annualized Capital Market Expected Returns report](#), suggests that the equilibrium level of interest rates will remain higher than was common during the 2010s. This underscores the renewed attractiveness of a range of fixed income opportunities, from developed country sovereign to corporate and emerging market (EM) debt.

We also [remain cautiously optimistic](#) for equity markets. Investment sentiment has remained high and equity markets have looked through the pullback in rate cut expectations and instead responded positively to the improved growth outlook. Equity performance has also been encouraged by continued excitement around artificial intelligence. There are some warning signs on the horizon. Monthly inflation prints will be important in determining the extent and timing of policy easing; we doubt equity markets will shrug off another marked increase in bond yields as easily as they have in recent months. Valuations are stretched in some markets. Geopolitical risks remain elevated. And market volatility is expected to rise as we approach US elections. Investors will likely be rewarded for selectivity, and we continue to emphasize a focus on strong fundamentals and relatively attractive valuations. Canada and several emerging markets, excluding China, remain noteworthy in this regard.

We hope you find the insights in this edition of Perspectives additive to your continued efforts to navigate markets in 2024.

At [CIBC Asset Management](#), we're committed to providing market insights and investment research. We hope our quarterly market recap and economic outlook are helpful as you find the right investment strategies that align with your portfolio goals and expectations. If you have any questions or would like to discuss our insights and commentary, please contact your advisor or CIBC representative anytime.



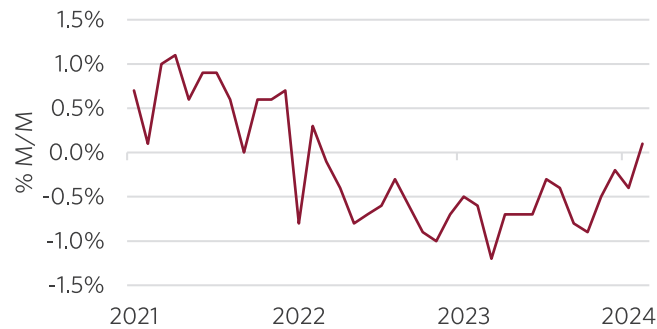
# Global markets strategy

## Central bank easing opens the possibility for a liquidity driven rally

In the [winter edition of Perspectives](#), we expressed our view on equities as one of cautious, and selective, optimism. We suggested that the outlook for markets would be dictated by how the recovery proceeds as the economic cycle moved out of its recent slowdown phase.

Since then, data suggest the US economy has continued to grow above its potential. In Canada, Q3 real gross domestic product (GDP) contracted, but Q4 data unexpectedly rebounded and economic data so far in 2024 appear consistent with a continued recovery. This pattern has been replicated in many other countries with purchasing manager sentiment surveys and other data generally consistent with green shoots of economic spring. In all developed economies, good progress has been made in returning inflation closer to central bank policy targets, although more still needs to be achieved before central banks can declare victory.

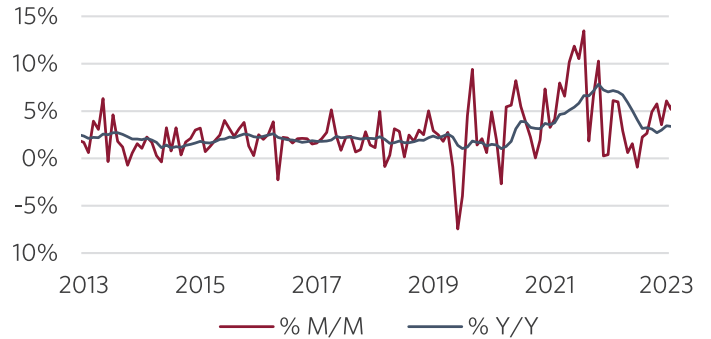
### Leading indicators point to an improving cyclical outlook Conference board US LEI



Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party providers: Bloomberg; LSEG Datastream. Data as at 29 February 2024.

A key risk identified in the winter edition of Perspectives was that resilient economic activity in the US, and tight labour markets elsewhere, would lead to a renewed upturn in inflation. This risk has increased recently with the release of stronger than expected data, particularly in service and rental sectors. This has caused market participants to scale back the extent and timing of expected interest rate cuts (at least for 2024) to be more consistent with the view we've held since the beginning of this year.

### Underlying inflation pressures still present US CPI services excluding shelter



Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party providers: Bloomberg; LSEG Datastream. Data as at 29 February 2024.

This change in interest rate outlook is important because the latest equity rally started in November 2023 when the US Federal Reserve (Fed) signaled the end of tightening, fueling hopes of a rapid and deep cycle of rate cuts. So far this year, the equity market has looked through the rate outlook and continues to be driven by the surprising strength of growth and the positive outlook for technology and artificial intelligence (AI).

Although we believe interest rates (along with relatively challenging valuations in some markets) will become more prominent drivers of returns, growth and AI have room to continue to dominate the narrative in the near term. What's missing so far is a catalyst to change this narrative. We thought the recent upside surprise in inflation had the potential to change sentiment, but this has not yet proven to be the case — and market sentiment has remained constructive. We also have to account for the possibility that we could be witnessing one of the few episodes of a Goldilocks soft landing—when inflation returns to policy targets without meaningful economic pain.

### Investor sentiment remains buoyant CIBC AM risk sentiment indicator



Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party providers: Bloomberg; LSEG Datastream. Data as at 28 March 2024.

Because of all these factors, we reaffirm our view on the fundamental outlook as one where a combination of resilient economic activity and sticky inflation means the extent of interest rate easing is likely to disappoint market expectations, even after the recent repricing. With challenging valuations, this is an environment where equity markets will likely experience higher volatility as well as periodic corrections. Upside appears limited and selectivity remains important.

Currently, this view isn't consistent with equity market behaviour. We believe it's better to be pragmatic than to stick to a strategy that isn't playing out. As such, we recently closed our tactical underweight positioning in equities versus overweight in fixed income and replaced it with intra-asset class relative tactical strategies that better express opportunities being created by current cyclical divergence between countries and regions. These include overweight Canada and emerging markets and underweight EAFE® and US small cap. Further details on the rationale for this positioning is provided below.

We also closed our previous tactical overweight position in Canadian short term and Universe bonds. We moved to an overweight position in global fixed income versus an underweight in Canadian fixed income. This relative position offers a small positive carry on a hedged yield basis and is in line with our valuation and cyclical indicators.

We also closed our tactical underweight position in non-investment grade fixed income. This was implemented to reflect the elevated recession risk we identified during 2023. This risk has subsequently diminished substantially. Although spreads have narrowed and are tight by historical standards, this position no longer has high conviction. Spread widening for non-investment grade could occur later in the year, if the cyclical economic outlook deteriorates. But for the foreseeable future economic conditions don't support this position.

### Multi-asset outlook

Asset class	Current 29-Mar-24	Most likely range for the next 12 months	
		Minimum	Maximum
Canada 3 Month T-Bills rate	5.00%	3.75%	5.00%
Canada 2 Year government bond yield	4.18%	3.00%	4.25%
Canada 10 Year government bond yield	3.47%	3.10%	4.25%
US 10 Year government bond yield	4.20%	3.50%	4.75%
Germany 10 Year government bond yield	2.30%	1.50%	3.00%
Japan 10 Year government bond yield	0.72%	0.40%	1.30%
Canada 10 Year Real Return government bond yield	1.63%	1.30%	1.85%
Canada Investment Grade corporate spreads	1.14%	0.90%	1.20%
US High-Yield corporate spreads	3.05%	2.60%	3.75%
EM Sovereign (USD dominated) bond spreads	287	250	500
S&P/TSX price index (basis points)	22,167	20,500	24,750
S&P 500 price index	5,254	4,600	5,650
Euro Stoxx 50 price index	5,083	4,400	5,450
Japan Topix price index	2,769	2,500	3,050
MSCI Emerging Markets	64,013	58,000	71,000
USD/CAD	1.3540	1.315	1.400
EUR/USD	1.0790	1.040	1.120
USD/JPY	151.35	142.00	158.00
USD/CNH	7.26	7.10	7.40
Gold (US dollars per fine troy ounce)	2,230	1,900	2,600
Oil price, WTI	83.17	65.00	100.00

Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party provider: Bloomberg. Data as at 29 March 2024.

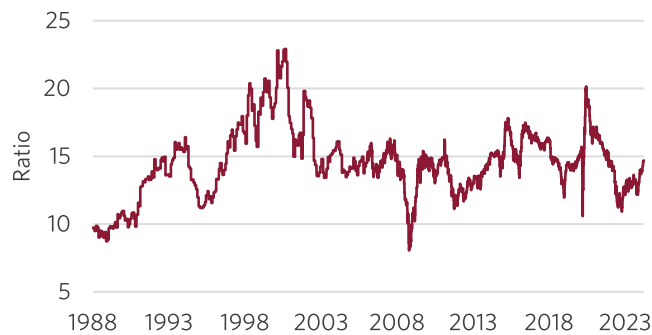
## Global equities: Relative opportunities arise from cyclical divergence

Equity markets started the year on a strong note. While the [Magnificent Seven](#) continue to do well, the rally became broader, with a pro-cyclical tilt. Over the long term, equities are expected to grow by 6.5% per year (10-year expected total return for MSCI All Country World in CAD). As such, the 11% return in the first quarter of this year is significant. Of course, equities are not expected to generate returns in a smooth and uniform fashion and by definition, above average returns cannot be sustained over long periods. When the market starts from a low base, as is usually the case after a period of sub-trend returns, it has room to catch up. But when it starts from a higher base, as is the case now, any above average return continues to push the market further above its trend. Therefore, we should expect the pace of increase to moderate. This expectation is consistent with our outlook for economic growth, which is resilient but no better than trend.

We recently introduced tactical overweight positions in Canadian and emerging equities. Both these markets have underperformed significantly over the last two years. As a result, valuation looks more attractive and momentum is not as overbought as in other regions. This sets the stage for a period of catch-up performance as economic activity and corporate earnings recover from the recent slowdown.

### Canada equity valuation is rising, but is not expensive

S&P/TSX forward PE

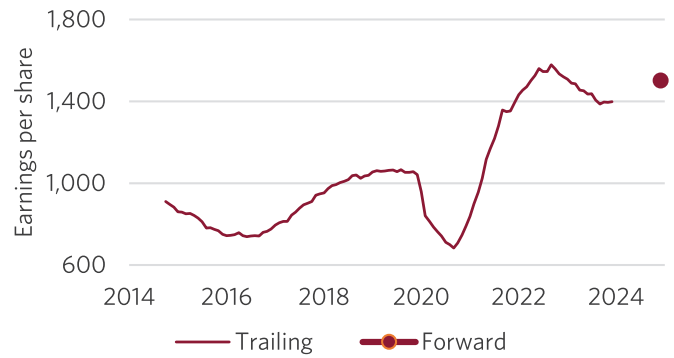


Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party providers: Bloomberg; LSEG Datastream. Data as at 29 March 2024.

These overweight positions are expressed against a tactical underweight in EAFE® and US small cap. EAFE® equities have fared relatively well in recent months. Corporate profits in Europe have been more resilient than expected in the context of a weak economy. As such, the potential for further good performance is limited in relative terms. Japan offers a more constructive outlook based on structural reforms being implemented to improve corporate competitiveness. But with the Nikkei being up over 50% since early 2023, a lot is already in the price.

### After a contraction, Canadian earnings are expected to recover

S&P/TSX earnings per share



Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party providers: Bloomberg; LSEG Datastream. Data as at 29 March 2024.

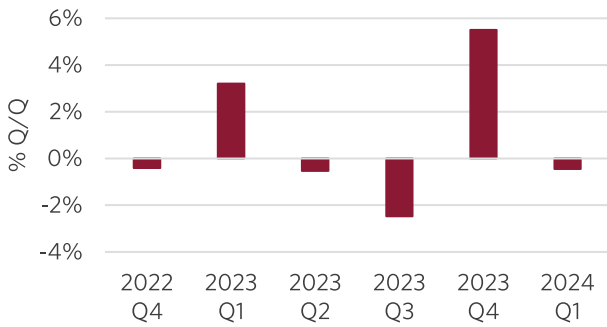
Most of our indicators point toward near-term relative underperformance of US equities. However, as mentioned previously, S&P 500 performance has become increasingly concentrated into a few companies that have displayed a lack of sensitivity to the cyclical economic outlook. The risk is that this situation persists for the foreseeable future. As such, US small cap provides a way to express our negative tactical relative fundamental view on US equities without exposure to technology and AI. The downside is that small caps are more sensitive to an improving economic outlook and are not as expensive as the rest of the US equity market. But they also stand to suffer more in an environment, captured in our baseline forecast scenario, where developed market (DM) central bank easing cycles are shallower and shorter than expected by the market consensus.

## Global bonds: Cautiously adding to duration

Global bond performance was slightly negative in the first quarter of 2024, with the [WGBI index](#) (Canadian dollars hedged) declining 0.44%. Bond yields were supported by positive economic growth surprises consistent with green shoots of global recovery and stickier inflation than expected by the consensus. Surging Treasury bond issuance is also likely consistent with higher yields than would otherwise be the case, via a rising term premium. Over the next twelve months, we expect the US Treasury 10-year bond yield to fluctuate between 3.50% to 4.75% with an equilibrium around 4.15%. Where we end up within that range will depend upon which of our three economic scenarios prevails.

**Global bond benchmark performance was slightly negative in the first quarter**

FTSE WGBI global bond performance



Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party providers: Bloomberg. Data as at 29 March 2024.

In our baseline scenario, inflation in the US is likely to prove stickier than currently expected by the market consensus. This outcome implies a much shallower and shorter policy easing cycle in the US (and other key DM countries) than is currently priced with policy rates staying higher for longer than expected. In this outcome, US 10-year bond yields should hover around 4.15%.

**Improving economic data supported bond yields**

Global economic surprises and US 10-year yield treasury yield



Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party provider: Bloomberg. Data as at 29 March 2024.

Alternatively, if global monetary policy proves to be insufficiently restrictive, the global economy could grow at a rate above its long-term non-inflationary trend rate. In this scenario, with inflation likely to turn higher once more, the Fed would likely keep its policy interest rate unchanged. In this scenario, we would expect 10-year Treasury yields to rise towards 4.75%. Less likely, if the impact of past policy tightening proves to be more restrictive than we assess, a global growth slowdown could unfold that encourages a safe haven bid in favour of DM bonds. This could eventually push US Treasuries yields towards the bottom of our forecast range, generating attractive returns for bonds.

In terms of portfolio strategy and with the 10-year Treasury yield currently in the top half of our expected range for the next 12-months, we have introduced an overweight duration position into portfolios. This exposure is currently small as the risk of yields moving higher in

the near term is non-negligible. We would become more aggressively positioned if 10-year US yields approach the top of our range.

For EM bonds, our strategy positioning has become more pro-cyclical over the last few months. Despite rich valuations for local and USD hard currency EM bonds, the global landscape has become more favourable, providing opportunities to increase the breadth of portfolio long positioning.

**Currencies**

**US dollar: Continued resilience**

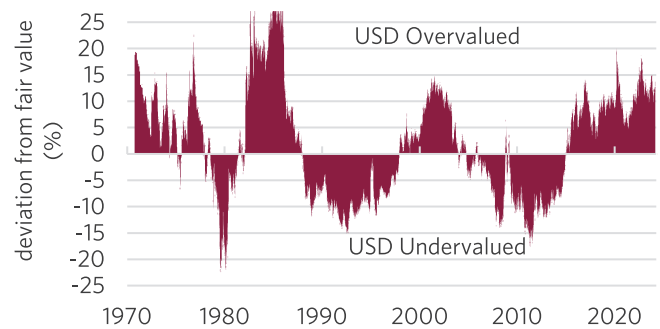
The US dollar (USD) remained on a solid footing in the first quarter of 2024 and appreciated a little more than 2.0% on a trade-weighted basis. USD strength was broad-based with noteworthy gains against the Japanese yen, Swiss franc and many other smaller DM currencies. A key driver of continued USD resilience was a repricing lower of market central bank rate cut expectations centered on the Fed. In addition, continued strong performance of US equities and heightened geopolitical risk likely also helped USD retain a bid.

With its recent strengthening, USD continues to screen as significantly overvalued. This isn't something new: USD has become increasingly overvalued over the course of almost a decade. USD strength hasn't helped US competitiveness and its trade deficit with the rest of the world has grown much bigger compared with 10 years ago.

With US elections fast approaching and the odds of another trade war increasing, the US trade imbalance will likely take center stage again. In the meantime, USD (just like the US economy) is expected to stay resilient, particularly against other DM currencies.

**US dollar: Still overvalued after all these years**

US dollar trade-weighted index deviation from CIBC AM fair value estimate



Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party providers: Bloomberg; LSEG Datastream. Data as at 28 March 2024.

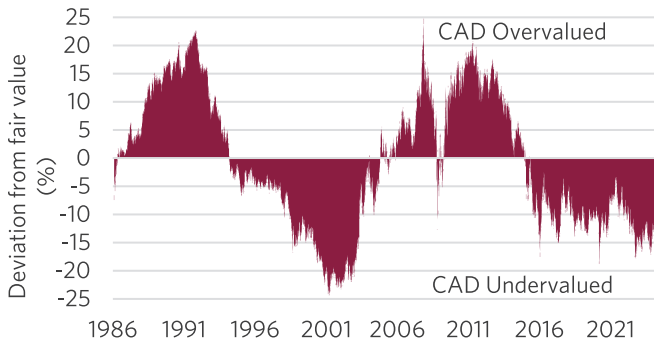
**Canadian dollar: Sideways against USD and weaker against fundamentally strong EM currencies**

The behaviour of the Canadian dollar (CAD) so far in 2024 has been a mirror image of USD. While it lost some ground on a bilateral basis against USD in Q1, this wasn't enough to move CAD outside of the relatively narrow range that has prevailed since late 2022. CAD/USD volatility also remains at unusually low levels. What has been relatively unique is that this continued sideways consolidation against USD has occurred with CAD deep in undervalued territory.

We don't expect CAD to revert back to fair value over our 12-month forecast period because none of its key drivers are expected to make significant moves. We see little upside for energy prices from current levels. Relative monetary policy expectations between the Bank of Canada (BoC) and the Fed aren't projected to change much from current levels. And Canada will likely continue to grapple with the negative productivity implications of the current population boom. Consequently, we expect CAD to continue trading against USD between \$1.315 and \$1.40 over the current 12-month forecast period.

**CAD remains deeply undervalued against USD**

CAD/USD bilateral rate deviation from CIBC AM fair value estimate



Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party providers: Bloomberg; LSEG Datastream. Data as at 28 March 2024.

**Euro: No significant moves against USD, unless ECB jumps ahead of the Fed**

USD's decade-long overvaluation hasn't just been observed against CAD. The same holds for the euro too, due in large part to the substantial easing efforts deployed during much of this period by the European Central Bank (ECB). For a long time, the ECB's implicit weak-euro policy facilitated an increase in eurozone exporters' US market share and a widening in the eurozone's bilateral trade surplus.

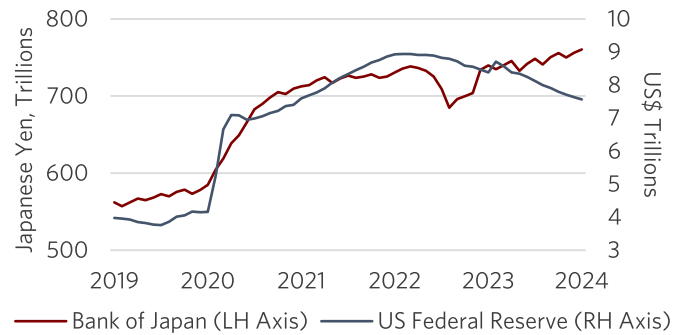
Currency-wise, the ECB would likely prefer to take a dovish turn earlier than the Fed in an effort to keep the euro in undervalued territory against USD by widening US-EU short-term interest rate differentials. However, developments on the inflation front have to be sufficiently supportive to allow for this course of action. Judging by its latest economic assessment, the ECB seems persuaded that the fight on inflation will soon be won and that the stage is set to deliver multiple rate cuts. We're not as convinced, and accordingly look for a more volatile EURUSD bilateral exchange rate trading between US\$1.04 and US\$1.12 over the forecast period.

**Japanese Yen: No catalyst yet for persistent yen strength**

As has often been the case, the Bank of Japan (BoJ) continues to march to a different beat. In March, as other DM central banks approached the start of policy easing cycles, the BoJ implemented a dovish policy tightening. Years of ultra-loose policy, implemented in an effort to lift the Japanese economy sustainably away from its toxic affair with deflation, have driven the yen to extreme levels of undervaluation against many currencies, including USD. Allied to subdued Japanese domestic demand, currency weakness has widened Japan's trade surplus with the US to its highest level in sixteen years.

**The BoJ and Fed have been on different policy paths**

Central bank balance sheets



Source: Information calculated by CIBC Asset Management Inc. using data from the following third-party provider: Bloomberg. Data as at March 24, 2024.

Despite the start of BoJ policy normalization, it remains difficult to identify a catalyst that will drive a sustained period of yen strength. The BoJ is aware that moving too aggressively will likely jeopardize the broader reform effort underway in Japan to break the deflationary cycle of the last three decades. This suggests policy normalization will proceed slowly and is unlikely to trigger significant capital repatriation by domestic Japanese investors or change the broader macroeconomic outlook for the yen. More likely, the yen has transitioned into consolidation mode against USD. We expect it to trade between ¥142 and ¥158 over the forecast period.

**Commodities**

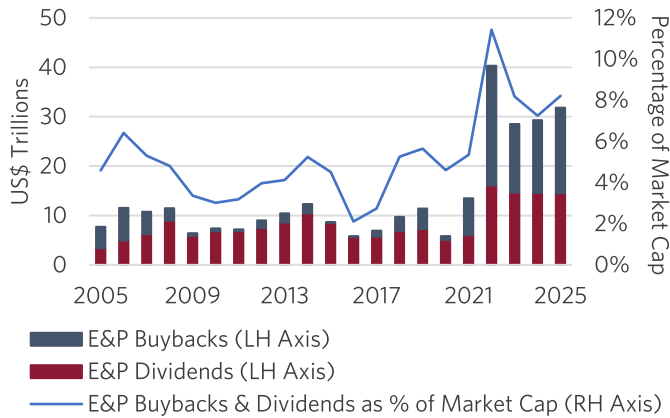
**Crude Oil: Rangebound**

So far in 2024, the price of oil has been on the rise, trading from a low of US\$70/bbl at the start of the year to US\$80/bbl as we move into Q2. There have been several supportive factors. First, producer discipline has generally held, limiting supply. OPEC+ continues to limit output and publicly traded North American producers continue to prioritize shareholder returns over an expansion of output. Second, the global economy is proving to be more resilient than expected, helping support demand for energy. Third, heightened geopolitical risks, including the wars in Ukraine and the Middle East, helped support crude oil prices.

Looking forward, we expect supply side discipline to persist. North American producers continue to operate within their means. Shareholders remain focused on balance sheet deleveraging, dividends and buybacks, and so far, the producers are sticking to the script.



**Shareholders of North American oil producers remain focused on balance sheet deleveraging and dividends and buybacks**  
E&P dividends & buybacks



Source: Information calculated by CIBC Asset Management Inc. using data from the following third-party providers: Peters & Co.; Bloomberg. Data as at April 4, 2024.

We're also seeing limited investment in supply growth by publicly traded producers and OPEC+ continues to provide price support by limiting output from its member states.

In addition, geopolitical risks remain elevated. In particular, the risk of an escalation in the war in Gaza to a wider regional conflict remains real. Should this happen there is potential for material supply side implications for the oil market, as well as upside price risk.

On the demand side, although inflation is proving to be sticky in some areas, it has likely already fallen enough to for several central banks to embark on at least a limited rate cutting cycle. To the extent this leads to a renewed fall in bond yields, it could be bullish for oil demand during the remainder of 2024.

We expect oil to largely trade between US\$75 and US\$85/bbl for the rest of 2024. There will likely be temporary periods where it trades outside of this range as geopolitical risks and macroeconomic data ebb and flow. This outcome would represent a healthy price for Canadian producers as they generate meaningful free cash flow at these levels that can be used to support further deleveraging efforts and capital returns to shareholders.

**Limited investment in new supply is expected to support crude oil prices**

Global oil & gas upstream capital expenditure



Source: Information calculated by CIBC Asset Management Inc. using data from the following third-party provider: International Energy Agency (IEA); LSEG Datastream. Data as at April 4, 2024.

**Copper: Tight supply to drive copper price higher**

Copper broke out of its recent trading range in March and moved up through US\$4/lb. On the demand side, global industrial production and manufacturing data are looking more positive. China, a key end user of copper, reported an expansion in manufacturing output in March for the first time in six months. While we're certainly not expecting a sharp upturn in global demand indicators, continued incremental improvement will likely support the outlook for copper in 2024.

The supply side continues to underwhelm. 2024 operating plans indicate a significant shift lower in output expectations for a number of copper producers. And a continued mine closure in Panama is keeping 1% of supply off the market with no resolution likely in the near term.

The treatment charge smelters levy on miners to process copper concentrate is a key leading indicator of the price of copper. This charge reflects transactions within the industry between participants in the copper supply chain, rather than financial market participants. As such it provides a bellwether of underlying market conditions. A higher treatment charge signals a well-supplied concentrate market, allowing smelters to charge miners a higher fee to process material. A lower treatment charge signals that smelters are competing for limited supply. This describes current tight market conditions. We expect this dynamic to be supportive of the copper price for the remainder of 2024.

**Low copper treatment charges signal tight copper supply**

Copper treatment charges



Source: Information calculated by CIBC Asset Management Inc. using data from the following third-party providers: Scotiabank; Wood Mackenzie. Data as at April 4, 2024.

Over the medium term, we continue to see a compelling case for copper price appreciation. The transition to a lower carbon economy will be copper intensive as a result of its use in the manufacture of renewable energy producing assets and in the distribution networks necessary to deliver low carbon electricity to end users. The impact of this transition demand will outweigh slowing demand from traditional sources, including Chinese housing. As a result, copper prices will have to move higher to incentivize the next generation of copper supply projects and to satisfy demand.



### Gold: Continued near-term support

The price of gold strengthened significantly in early 2024, running up from approximately US\$2,000/oz at the start of the year to an all-time high of US\$2,325/oz by early April. The traditional inverse relationship between gold and USD recently broke down. Support for gold has come from continued elevated geopolitical risks and relatively dovish commentary from the Fed.

### The price of gold has continued to rise despite recent USD strength

#### Gold versus USD



Source: Information calculated by CIBC Asset Management Inc. using data from the following third-party provider: Bloomberg. Data as at April 4, 2024.

In the near term, the risk of a wider conflict in the Middle East could lend further support to gold. Recent events in Syria and Lebanon support this narrative. Should cooler heads prevail and the situation in the region stabilize, some of the risk premium currently built into gold could start to come out.

Fundamentally, we expect moderating inflation to drive expectations of at least some rate cuts, which we expect to be supportive for gold in the coming quarters. Falling interest rates reduce the opportunity cost of holding gold. And we continue to see a case for a strategic portfolio allocation to gold as a relatively consistent hedge against a range of tail risks that include heightened geopolitical and inflation risk, an expectation of higher financial and economic volatility and a residual risk of recession.

# Economic analysis

## US: Higher for longer

Since the start of 2024, market participants have reigned in expectations of the extent of Fed policy easing over the next 12 months. Approximately two quarter point rate cuts are now priced. This makes the consensus broadly consistent with the baseline scenario we've held since the beginning of the year. This shift in market expectations reflects developments on both growth and inflation.

Economic activity has remained resilient in recent quarters. The main contributor has been private consumption, which has been spurred on by a combination of robust growth in real household disposable income and plentiful liquidity that has fostered a strong rise in equity valuations and a resurgence in home prices. For the year as a whole, we expect an average GDP growth rate of 2.1% compared to 1.5% in 2023. This is a relatively favourable outcome that likely provides support to corporate earnings and equity markets. It also raises a question as to how tight Fed policy actually is and whether interest rate cuts are needed by the US economy. This is a question that several Fed Board members have recently started to ponder in public fora.

### Fed liquidity remains a plentiful support to growth and financial markets

#### US Fed Holdings of domestic securities (SOMA)

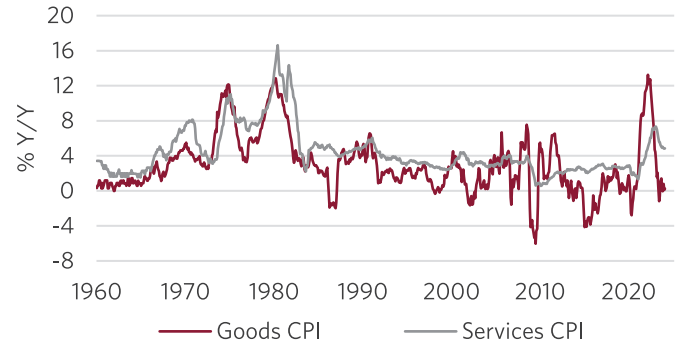


Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party providers: US Federal Reserve; LSEG Datastream. Data as at 28 March 2024.

Increasingly sticky inflation prompts the same question. In 2023 we saw a substantial fall in inflation back towards the Fed's 2% target. Much of this progress was realized through a fall in goods prices as previous supply bottlenecks eased. Service sector inflation, particularly housing rental, has been more problematic, and re-accelerated in recent months. Our baseline scenario expects the core Personal Consumption Expenditure Price (PCE) Index (the Fed's favoured measure of inflation) to stabilize at 2.6% Y/Y at the end of 2024. Core PCE inflation is typically 0.4% lower than the core Consumer Price Index.

### Service sector inflation has remained sticky

#### US Goods & services inflation



Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party providers: Bloomberg; LSEG Datastream. Data as at 28 March 2024.

As a result, the Fed finds itself in a catch-22 situation. It has indicated a desire to cut its policy interest rate while keeping economy-wide liquidity plentiful. Starting rate cutting too soon comes with the risk of enabling excessive growth that prevents inflation from completing its return to the Fed's 2.0% target. This outcome would likely be accompanied by widening US economic and financial imbalances. Within this quandary, housing and fiscal imbalances appear particularly problematic. Housing affordability continues to be challenging, forcing an increasing number of households into the rental market. This trend is fueling sticky shelter inflation. Strong US household formation is likely to persist, suggesting this problem won't disappear any time soon.

Fiscal spending is also complicating the Fed's task. When growth is above trend, fiscal deficits tend to narrow. In the US, by contrast, the deficit has widened and been an important contributor to resilient growth. It's projected by the [Congressional Budget Office](#) to remain wide for the foreseeable future. This puts upward pressure on bond yields via a rising term premium and suggests equilibrium interest rates will be higher in the long term than would otherwise be the case. We also note the risk of renewed inflation pressures stemming from a more hawkish US trade policy regardless of who wins the presidential election in November.

As a result of these themes supporting growth and inflation over the next 12 months, we think the Fed will be forced to err on the side of caution—at least in terms of interest rate policy. This means delivering fewer rate cuts in the coming year than implied by downwardly revised expectations currently priced by market participants. This will likely be a relatively benign environment for equities and other risky assets. It means that rental inflation will continue to be a thorn in the Fed's side. But this appears to be the lesser of two evils. Convergence to the neutral policy interest rate—at which inflation is neither increasing nor decreasing—will likely take several years to achieve.

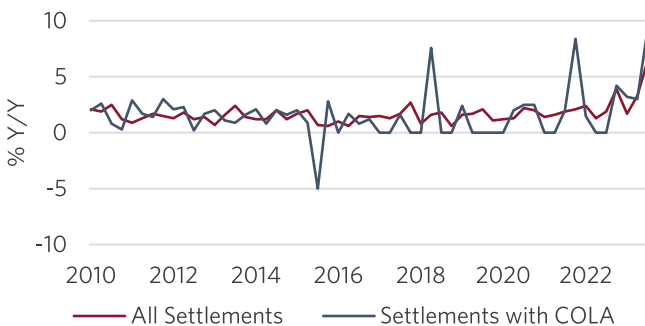
## Canada: Resilient households and sticky inflation complicate policy outlook

Robust real disposable income (which increased by 1.6% in 2023), rising consumer credit and strengthening balance sheets have helped Canadian households navigate the current high interest rate environment with more resilience than expected. Household consumption rose by 1.7% last year and remained robust in the first quarter of 2024, despite substantially higher mortgage interest payments. As a result, the Canadian economy has grown at a faster pace than expected, including by the BoC.

By adding to aggregate demand, the resilience of household consumption is complicating BoC efforts to return inflation to its 2% policy target. This likely means that we'll see fewer rate cuts in the next 12 months than currently priced by the market consensus—even though this consensus assessment became less ebullient in the last quarter. It's a similar story in the labour market, for which the past six months have been characterized by a gentle increase in the unemployment rate, which is now running close to 6% compared to 5% in the first half of 2023, but also a continued rise in employment and strong wage growth.

Two factors in particular have contributed to recent wage stickiness. First, the labour force has expanded rapidly in recent years due to strong population growth. This has created an additional pool of potential employees, although many newcomers have first to retrain before integrating into the labour market. It has also created additional consumers. Over the past 12 months, for each addition to the workforce there has been approximately two additional consumers. The resulting increase in demand for goods and services will likely provide a further boost to labour demand. Higher labour demand will make it less likely that wage inflation will slow sufficiently for the BoC. Second, the relatively high proportion of unionized workers in Canada plays a role in sustaining faster wage growth. The latest data on wage settlements with cost of living allowances (COLA) reports pay increases well above the 3% pace consistent with achievement of the BoC's inflation target, assuming positive productivity growth.

### Canadian wage inflation is running too hot for the Bank of Canada Wage settlements - first year adjustment



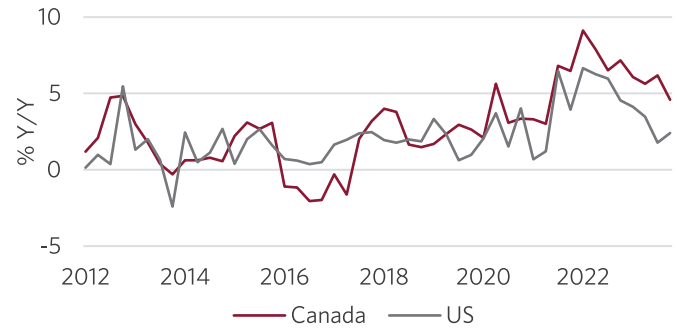
Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party provider: Statistics Canada. Data as at 28 March 2024.

The assumption of positive productivity growth is an important one — and is challenged by the data. Accentuated by rapid population growth, labour productivity has now declined for several quarters, prompting [BoC Senior Deputy Governor Carolyn Rogers](#) to discuss

the “pressing need for Canada to increase productivity”. A sustained deterioration in productivity increases unit labour costs (ULCs). In turn, high ULCs drive up inflationary pressures as firms seek to pass through at least some of this additional cost to customers in an effort to maintain profit margins.

### Wage inflation and deteriorating productivity contribute to high unit labour costs

#### Unit labour costs



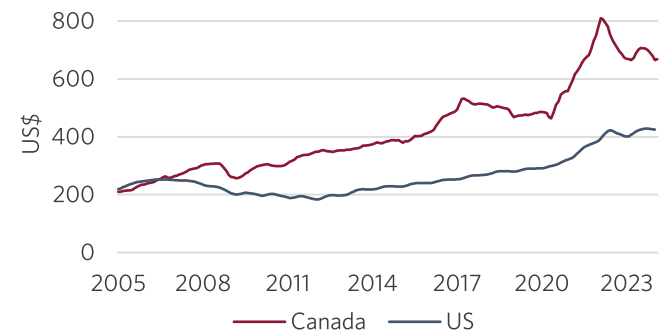
Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party providers: LSEG Datastream. Data as at 28 March 2024.

The complexity of the challenge faced by the BoC is increased by two further issues. First, the Canadian housing market remains far out of balance. Second, fiscal budgets projected by provincial governments are anything but contractionary.

Green shoots of economic spring and sticky inflation likely mean the BoC delivers less rate cuts than expected in the coming policy easing cycle.

### Canadian house prices remain far above estimates of long-term equilibrium

#### Price of single family home



Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party providers: Canadian Real Estate Association (CREA); LSEG Datastream. Data as at 28 March 2024.

## Eurozone: The ECB is setting the stage for rate cuts

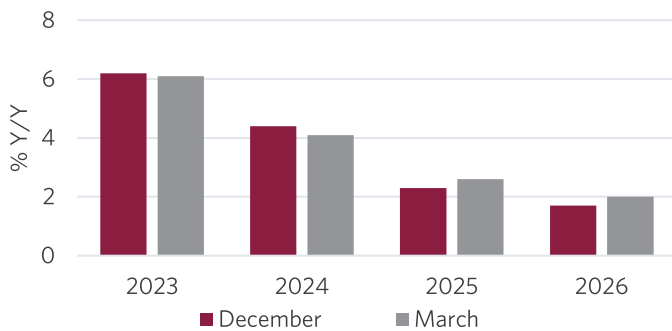
Similar to the Fed, the ECB is priced by the market consensus to ease its monetary policy stance over the next 12 months. This expectation is consistent with the ECB’s latest growth and inflation projections. On growth, the ECB suggests the eurozone will experience a recovery in 2024 fueled by rising real disposable income that encourages stronger private consumption. We agree. The recovery is likely to be modest—the ECB projects only a 0.6% increase in GDP, which is two tenths lower than its previous forecast in December—as headwinds from tight financial conditions, a large fiscal drag and declining private investment spending remain strong. This weak projected recovery also masks marked differences in outlook between tepid growth in Germany and France on the one hand, and stronger activity in southern member states on the other.

The ECB also projects a continued relatively rapid deceleration in inflation to continue. The core Harmonized Index of Consumer Prices (HICP) is expected to reach 2.5% Y/Y in the fourth quarter of 2024—driven lower by previous monetary policy tightening and an end of any remaining upside impact from previous supply bottlenecks and food and energy price increases—followed by a further decline back to the ECB’s 2% policy target in 2025.

By projecting a combination of sluggish recovery and weaker inflation the ECB is setting the stage for policy rate cuts over the course of 2024. We see risks to this view, particularly from inflation. Wage growth remains high at 5.6% Y/Y, and labour productivity is contracting by 1.6% Y/Y. As a result, ULCs are rising at 7.2% Y/Y, far above the rate consistent with the ECB’s inflation target. It also exceeds selling price inflation and represents a hit to profit margins. Even so, firms will likely be hesitant to shed employment due to labour shortages and market rigidity. In turn, labour market conditions may well contribute to stickier inflation than the ECB expects.

### The ECB has a benign view of ULCs

ECB projections for Unit Labour Cost inflation



Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party providers: Bloomberg; LSEG Datastream. Data as at 28 March 2024.

The ECB also has to contend with continued wide housing imbalances. Similar to other DMs, eurozone home prices surged following the pandemic shock and have subsequently proved relatively resilient in the face of aggressive policy tightening. With affordability deteriorating and stronger-than-usual population growth, housing imbalances will likely keep rental inflation elevated.

We estimate that protracted shipping disruptions in the Red Sea and the Gulf of Aden could add 0.25% to the ECB’s baseline inflation scenario in both 2024 and 2025. By contrast, the ECB assumes a negligible impact from this source. With the maximum disinflationary impact from imported goods price inflation behind us, any upside surprise from this source likely won’t encounter offsetting mitigants.

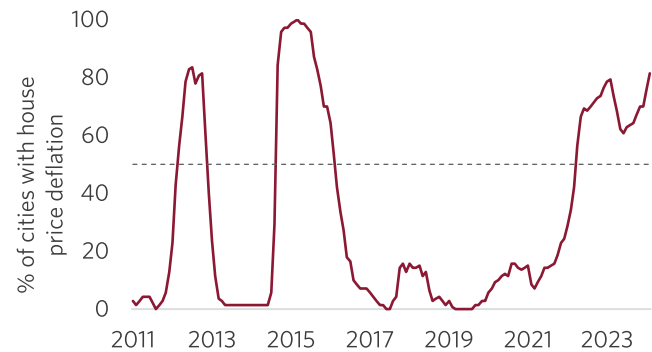
Putting all these factors together—as with the Fed—we see the risk for ECB policy easing tilted towards a shorter and shallower cycle than currently expected by the market consensus.

## China: Weak growth will persist

After experiencing another year of disappointing growth in 2023, the Chinese economy has shown tentative signs of stabilization in the early months of 2024. This has primarily reflected a modest recovery in external demand for Chinese output. Progress in other sectors has been less promising and a V-shaped recovery for the aggregate economy appears unlikely. Prospects remain particularly bleak for the housing sector, as well as private investment. Domestic confidence remains low contributing to lackluster consumer spending. And geopolitical tensions appear to have dampened foreign investment inflows—these have been particularly weak recently.

### Many Chinese cities are grappling with house price deflation

House price deflation diffusion index  
(higher = more cities reporting deflation)



Source: The information is provided by CIBC Asset Management Inc. using data from the following third-party provider: Bloomberg. Data as at 4 April, 2024.

In this environment, China will likely have no choice but to launch more stimulus. These efforts won’t resemble previous largescale infrastructure programs; adopting this approach will likely worsen excess supply and intensify financial risks the authorities are working to solve. Instead, stimulus measures will likely be smaller and more targeted with a focus on mitigating downside economic risks. Recently announced stimulus packages have included additional measures intended to accelerate the energy transition and technology investment. These sectors have been heavily financed by the public sector since 2022 and the marginal impact of this additional stimulus on GDP growth is expected to be modest. In addition, we expect the government will also introduce stimulus equivalent to approximately 1% of GDP to renovate and upgrade older housing units in second and third-tier cities. The positive impact of this stimulus will likely be hindered by local government fiscal consolidation which is necessary



in response to revenue shortfalls caused by the ongoing housing correction.

We expect the Chinese economy will continue to grow at a weak pace. GDP growth is likely to average 4.6% over the next four quarters. This is close to our estimate of current trend growth, but is notably lower than the 6%-7% norm of only a few years ago—and will be insufficient to absorb existing excess supply. This means downward pressure will continue on inflation.

In this context, we expect the People's Bank of China (PBoC) to become less averse to allowing the yuan to depreciate more freely against a broad range of currencies. Over time, a weaker currency more aligned with supply and demand forces should aid in restoring China's competitiveness. Nonetheless, a weaker currency isn't a panacea. A fading fiscal impulse later this year is expected to exert a negative impact on economic activity and suggests Chinese GDP growth will likely be at its best in the near term.

### Economic forecasts (next 12 months)

Region	Current GDP	GDP - consensus	GDP - CAM view	Current inflation	Inflation - consensus	Inflation - CAM view	Policy rate - CAM view
Canada	1.1%	1.0%	1.3%	2.8%	2.3%	3.0%	-0.75%
United States	3.0%	1.9%	2.1%	3.2%	2.8%	2.9%	-0.75%
Eurozone	0.1%	0.9%	0.7%	2.6%	2.3%	2.5%	-0.50%
China	5.2%	4.7%	4.6%	0.7%	1.0%	0.8%	
Japan	1.2%	0.8%	0.9%	2.8%	2.1%	2.4%	
World	2.8%	2.8%	2.9%	3.5%	2.9%	3.0%	

Source: The information is provided by CIBC Asset Management Inc.. Inflation refers to CPI.

# Alternative economic scenarios

## Higher for longer (55% probability)

In our baseline scenario, inflation is projected to continue decelerating allowing major DM central banks to deliver their first rate cuts. However, we also project that these central banks will be forced to move to the sidelines earlier than generally expected as efforts to control inflation prove to be more challenging than initially believed.

This scenario would have limited impact on markets since it's mostly already priced. A renewed, hawkish pivot by central banks would likely cause bond yields to stay at the high-end of our trading range, but wouldn't push them above it. Equities would be supported by decent growth, yet upside would be limited by higher interest rates. The pace of increase would likely moderate compared to the recent past, with occasional pullbacks.

## Second wave inflation (25% probability)

In this scenario, global monetary policy is insufficiently restrictive and allows the world economy to grow above potential over our 12-month forecast horizon. US real GDP growth would remain elevated in Q1 2025 at 2.5% Y/Y, with global growth at more than 3.0%. Abundant central bank liquidity and the lack of fiscal discipline would allow inflation to reaccelerate and force central bankers to delay their plans to cut rates.

This scenario would be very path dependent for markets. Initially this is a good environment for risky assets because abundant liquidity and dovish central banks would fuel risk appetite, leading to strong returns. However, as evidence grows that inflation is not only above targets but also showing no signs of coming back down, central banks would take away the punch bowl and financial conditions would tighten. As this realization sinks into market expectations, risky assets would face a more challenging environment.

## Global slowdown (20% probability)

In this scenario, global monetary policy turns out to be too restrictive. Combined with a bigger drag from fiscal policy, the global economy downshifts into a lower gear and inflation sharply decelerates. With inflation back to target rates, central banks will have the leeway to cut rates more aggressively to cushion the economic downturn. In the context of renewed global economic weakness and deeper policy rate cuts, global bond markets would be expected to rally, but risky assets would be hit hard with equity prices experiencing a price correction.

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