

Economics

THE WEEK AHEAD

March 20-24, 2023

The pain threshold

by Avery Shenfeld avery.shenfeld@cibc.com

When central banks raise rates, there's bound to be trouble. But when inflation is elevated, as it has been, you could say that the central bankers are out looking for trouble, as that's what it takes to slow the economy and cool those price pressures. So as the Federal Reserve's policy committee sits down next week, the key question for them isn't just whether issues in the banking system represent a potential hit to economic growth, which they surely do, but whether that hit is in fact greater than what they're looking to achieve to get back to a 2% inflation world.

Remember that barely more than a week ago, the message from the Fed leadership was that they weren't seeing enough of a growth and employment deceleration, and were therefore set to ramp up the pace of tightening and aim at a higher peak for interest rates. We were skeptics on that front, arguing that the resiliency of the economy to date was driven by factors that were fading, and that the lagged impacts of prior hikes were set to kick in (See "The Rise and Upcoming Fall of US Resilience" CIBC Economics, March 6).

While regional banks weren't our focus, the spark for recent events was the impact of rate hikes and falling bond values on one of them. Other issues from higher rates will become more visible over time, not just in the US, but in the global economy.

The Fed's balance sheet shows a significant jump in its lending to banks, giving them the liquidity they need to cover deposit outflows without selling assets at a discount or calling in loans. Some of that cash is in turn ending up on deposit at money center banks rather than leaving the banking system, but some may be ending up in money market funds or t-bills. So it's clear that wherever the FOMC members thought they had to take the funds rate to have a given impact on lending rates and volumes in the economy, they'll now be thinking of something less aggressive.

Markets are now assuming that the Fed will carry through on a quarter point hike either next week, or soon thereafter. Our forecast prior to all this turmoil was for a quarter point hike in each of March and May, and it's still our base case. There's a risk that if financial markets are in turmoil on the day the Fed meets, they would decide to push that hike off until May in order to avoid throwing fuel on the fire. But they would be in the awkward position of keeping rates on hold, while likely still giving a "dot" forecast that shows that rate hikes are still coming.

Where we really diverge from financial market pricing is on what comes after a rate hike or two this spring. The curve assumes a quick reversal with the Fed going on an easing spree this fall.

That's certainly possible, but we doubt that the central bank will come to such a conclusion that quickly. Remember the starting point: inflation is still too high, American labor markets are too tight, and the central bank wants to see the jobless rate head higher before it would think about providing economic relief. The "dot" forecast will likely include at least one more quarter point hike ahead and then a pause, since if the Fed really thought it would have to ease quickly, it wouldn't be hiking in March.

Perhaps what investors are doing isn't really pricing in strong odds of modest rate cuts this fall. Instead, one can think of a world in which everyone's base case is that the Fed hikes one or two times and then stays on hold for a couple of quarters, but that there's a non-negligible probability that the economy goes into a tailspin and requires a major tumble in interest rates. That's not unreasonable given the fog we're operating in today, but if the fog clears as we expect, bond yields will head higher as the rate cut story gets pushed into 2024.

Week Ahead Calendar And Forecast—Canada

H, M, L = High, Medium or Low Priority

SAAR = Seasonally Adjusted Annual Rate

Consensus Source: Bloomberg

Date	Time	Economic Releases, Auctions and Speakers	Month	Priority	CIBC	Consensus	Prior
Monday, March 20	-	AUCTION: 5-YR CANADAS \$3.5B	-	-	-	-	-
Tuesday, March 21	8:30 AM	CPI M/M	(Feb)	(H)	0.5%	0.5%	0.5%
Tuesday, March 21	8:30 AM	CPI Y/Y	(Feb)	(H)	5.4%	5.3%	5.9%
Tuesday, March 21	8:30 AM	Consumer Price Index	(Feb)	(M)	-	154.6	153.9
Tuesday, March 21	8:30 AM	CPI Core- Median Y/Y%	(Feb)	(M)	-	4.8%	5.0%
Tuesday, March 21	8:30 AM	CPI Core- Trim Y/Y%	(Feb)	(M)	-	4.9%	5.1%
Tuesday, March 21	-	New Brunswick Budget	-	-	-	-	-
Tuesday, March 21	-	Quebec Budget	-	-	-	-	-
Wednesday, March 22	1:30 PM	Publication: Summary of Deliberations	-	-	-	-	-
Wednesday, March 22	-	Saskatchewan Budget	-	-	-	-	-
Thursday, March 23	-	Nova Scotia Budget	-	-	-	-	-
Thursday, March 23	-	Ontario Budget	-	-	-	-	-
Thursday, March 23	-	Newfoundland & Labrador Budget	-	-	-	-	-
Friday, March 24	8:30 AM	RETAIL TRADE TOTAL M/M	(Jan)	(H)	0.9%	0.7%	0.5%
Friday, March 24	8:30 AM	RETAIL TRADE EX-AUTO M/M	(Jan)	(H)	0.5%	0.7%	-0.6%

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, March 20	-	-	-	-	-	-	-
Tuesday, March 21	-	AUCTION: 1-YR TREASURIES \$34B	-	-	-	-	-
Tuesday, March 21	-	20-YR AUCTION \$12B	-	-	-	-	-
Tuesday, March 21	10:00 AM	EXISTING HOME SALES SAAR	(Feb)	(M)	-	\$4.16M	\$4.0M
Tuesday, March 21	10:00 AM	EXISTING HOME SALES M/M	(Feb)	(M)	-	4.0%	-0.7%
Wednesday, March 22	7:00 AM	MBA-APPLICATIONS	(Mar 17)	(L)	-	-	6.5%
Wednesday, March 22	2:00 PM	FOMC RATE DECISION (UPPER BOUND)	(Mar 22)	(H)	5.00%	5.00%	4.75%
Wednesday, March 22	2:00 PM	FOMC RATE DECISION (LOWER BOUND)	(Mar 22)	(H)	4.75%	4.75%	4.50%
Wednesday, March 22	2:30 PM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Thursday, March 23	-	AUCTION: 10-YR TIPS \$15B	-	-	-	-	-
Thursday, March 23	8:30 AM	CURRENT ACCOUNT BALANCE	(4Q)	(L)	-	-\$213.2B	-\$217.1 B
Thursday, March 23	8:30 AM	INITIAL CLAIMS	(Mar 18)	(M)	-	-	192K
Thursday, March 23	8:30 AM	CONTINUING CLAIMS	(Mar 11)	(L)	-	-	1684K
Thursday, March 23	8:30 AM	CHICAGO FED NAT.ACTIVITY INDEX	(Feb)	(M)	-	-	0.23
Thursday, March 23	10:00 AM	NEW HOME SALES SAAR	(Feb)	(M)	645K	650K	670K
Thursday, March 23	10:00 AM	NEW HOME SALES M/M	(Feb)	(M)	-3.7%	-3.0%	7.2%
Friday, March 24	8:30 AM	DURABLE GOODS ORDERS M/M	(Feb P)	(H)	1.5%	1.7%	- 4.5%
Friday, March 24	8:30 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Feb P)	(H)	0.2%	0.3%	0.8%
Friday, March 24	9:45 AM	S&P GLOBAL US SERVICES PMI	(Mar P)	(L)	-	50.3	50.6
Friday, March 24	9:45 AM	S&P GLOBAL US COMPOSITE PMI	(Mar P)	(L)	-	-	50.1
Friday, March 24	9:45 AM	S&P GLOBAL US MANUFACTURING PMI	(Mar P)	(L)	-	47.3	47.3

Week Ahead's market call

by Avery Shenfeld

In the **US**, the Fed has a very tricky decision, and we admit that if markets are in turmoil on the day they meet, they could just punt that decision into May by leaving rates on hold. But that would leave them in the awkward position of having to publish a "dot" forecast for interest rates that would in all likelihood still show some rate hikes ahead. Our base case is therefore that the Fed opts for a quarter point hike, dialing down what would have been a 50 bp move in the absence of the past week's banking events, but likely showing a follow up quarter point move in the "dots". Otherwise, it's a light week for data, so the focus for the market will remain squarely on developments at US banks.

In **Canada**, the CPI is likely to show a significant deceleration on a year over year basis as gasoline prices surged in the prior year's February. While core measures of inflation will moderate, the Bank of Canada's preferred measures will continue to pick up the inflation in food prices. We suspect that the three month annualized rates for core will still be in the 3 ½% range, not wildly above target, but not making a case for the easing in policy rates that the market is pricing in. The summary of Bank of Canada meeting deliberations will likely be seen as out of date, as it came before the recent turn of events in US banking. We also have January retail data due to show a decent bounce, and a boatload of budgets from Canadian provinces landing in the coming week.

Week Ahead's key Canadian number: Consumer price index—February

(Tuesday, 8:30am)

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Variable	CIBC	Mkt	Prior
CPI m/m (NSA)	0.5%	0.5%	0.5%
CPI yr/yr	5.4%	5.3%	5.9%

While the annual pace of inflation likely cooled further in February, the monthly increase excluding food/energy may look a little firmer than in the prior month. Gasoline will be the main driving force behind a deceleration in the headline rate of inflation to 5.4%, from 5.9% in the prior month, as pump prices were broadly unchanged this February, but saw a big jump in the same month a year ago. While another sharp monthly increase in food prices is likely to be seen, it isn't expected to be any stronger than the surge seen in February 2022.

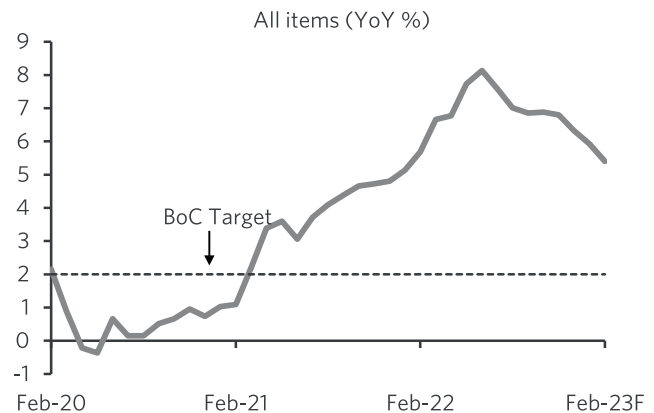
Excluding food and energy, prices are expected to increase by a seasonally adjusted 0.25%, which would be an acceleration from a 0.14% advance in January, due to increases in air fares, rents and other items. The BoC's core measures of inflation are expected to ease a little further on a year-over-year basis, but the three-month annualized rates will likely remain sticky around 3½% due to the impact that food prices can have on these measures.

Other Canadian releases: Retail sales—January

(Friday, 8:30am)

Retail sales likely started the year with a healthy looking 0.9% gain, although in volume terms that advance may look slightly less impressive given food and gasoline price increases during the month. With autos likely a driving force behind the overall increase, ex-auto sales may also post a less-impressive 0.5% gain. With household incomes being supported by a strong labour market and provincial stimulus, retail sales likely saw a further moderate increase in February's advance estimate.

Chart: Canadian consumer price index



Source: Statistics Canada, Haver Analytics, CIBC

Forecast implications — Underlying price pressures have already eased significantly since last spring/summer, and that should become more evident within the headline CPI figures once last year's largest monthly increases start to drop out of the annual calculation. Food price inflation is the one area of the CPI basket yet to see any easing, however, a decline in diesel costs and the impact that could have on transportation should bring relief later in the year.

Week Ahead's key US number: Durable goods orders—February

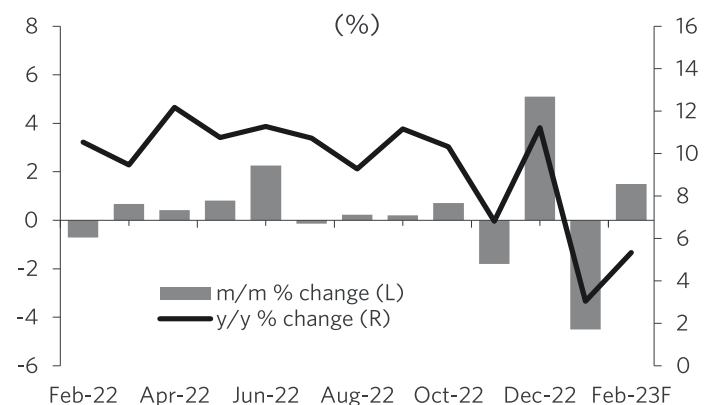
(Friday, 8:30am)

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Variable	CIBC	Mkt	Prior
Durable goods orders m/m	1.5%	1.7%	-4.5%
Ex. transportation m/m	0.2%	0.3%	0.8%

Durable goods orders likely rebounded in February, driven by stronger commercial aircraft orders after some turbulence at the start of the year, likely resulting in a 1.5% increase in total orders. Excluding the volatile transportation component, orders in other categories could have lost some momentum, decelerating to 0.2%, as capacity utilization in the industrial sector is off its peaks, which could have held back core capital goods orders (ex. transportation and defense), in line with demand uncertainty.

Chart: Durable goods orders



Source: Census Bureau, Haver Analytics, CIBC

Forecast implications — Durable goods orders ex. transportation are still close to pandemic-era peaks despite the deterioration in the ISM's manufacturing index, which has been in negative territory for several months, and weakening capacity utilization. Any softening in orders in the core capital goods group in February could portend an easing in business investment in equipment in the second quarter, when higher interest rates are set to weigh more on demand.

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