Economics

THE WEEK AHEAD

September 11 - 15, 2023

Will oil energize inflation again?

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

Declining energy prices were a major factor in quelling Canadian and US headline inflation in the past year, but in the case of oil and gasoline, we've reached a turning point. Already, its downward pull on 12-month inflation rates has started to diminish, a key reason why the headline inflation rate ticked higher in Canada in July. US EIA data shows that American gasoline prices in early September were now marginally above year-ago levels. And this past week, crude prices got a lift as Saudi and Russian production cuts were extended to the end of the year.

So could oil now be transitioning from a source of disinflation to a potential thorn in the side of central banks, by becoming a sustained and significant contributor to an acceleration? That seems unlikely, both in terms of where crude prices head from here, and in how gasoline or diesel prices play into the overall pace of inflation in the US and Canada.

One key is how to interpret the OPEC+ decision. Are that team's coaches pulling out all stops on offense as the market interpreted it this week, in an effort to drive prices sustainably higher. Or, as we see it, were they merely sending more defensive players onto the field, in a effort to prevent a decline in crude prices ahead?

The decision to extend production restraints clearly sent crude prices up for now, but it might just reflect a more pessimistic outlook for the global supply-demand balance, and a need to keep the reins on OPEC+ supply to sustain WTI prices in the $80/bbl range. China accounted for a sizeable majority of global oil demand increases earlier this year, but its economic growth appears to be melting away in a hurry, with exports diving and the property sector in crisis. Global growth has also decelerated, cutting into oil demand. On the supply side, non-OPEC countries, including Canada and the US, seem slated to add to output in the coming year.

If the OPEC move does manage to nudge prices through $90/bbl, that will increase the inflation contribution from gasoline and fuel oil. But the macro context suggests that, unlike what we saw in 2022, it might not be inflationary and could even be deflationary for other components of the CPI. True, diesel prices are up more than gasoline due to the type of oil being taken off the market. But for goods sellers to pass on the impact on their freight costs, consumers need enough spending power to not only fuel their own tanks, but cover those spillover impacts on other prices.

That's exactly what central banks are working to prevent. Higher interest rates have slowed job creation in both the US and Canada, and diminished job vacancies should show up in less aggressive wage offers from employers. Gasoline won't be a friendly component of the CPI the way it was earlier this year, but disinflation in other goods and services can take over the job if labour income gains and higher interest rates put enough of a squeeze on what consumers can afford to pay overall.

There's a broader lesson here in terms of how to think about inflation. Beyond a single month or two, one shouldn't dream of forecasting the CPI by adding up a view on gasoline, toothpaste, haircuts or cars. Any one item can get hit by a shock that sends its price higher or lower over the medium term. But the overall direction for inflation is best thought of as a product of those two ECO 100 standard bearers, supply and demand. Not the supply and demand for oil, or toothpaste, but rather the aggregate supply of total goods and services in the economy, relative to the aggregate demand that households' incomes, and their borrowing and savings decisions, will generate.

Supply improvements drove some of the disinflation in the past year. Now higher interest rates that reward saving and make borrowing more costly, and slowing job and wage growth that constrain incomes, should ease demand enough to cool inflation ahead, even if we end up paying a bit more at the pumps.

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, September 11	-	-	-	-	-	-	-
Tuesday, September 12	-	AUCTION: 3-M BILLS $14.6B, 6-M BILLS $5.2B, 1-YR BILLS $5.2B	-	-	-	-	-
Wednesday, September 13	-	AUCTION: 2-YR CANADAS $4.8B	-	-	-	-	-
Thursday, September 14	8:30 AM	WHOLESALE SALES EX. PETROLEUM M/M	(Jul)	(M)	1.4%	-	-2.8%
Friday, September 15	8:30 AM	INT'L. SEC. TRANSACTIONS	(Jul)	(M)	-	-	-2.8%
Friday, September 15	8:30 AM	MANUFACTURING SHIPMENTS M/M	(Jul)	(M)	0.7%	-	-1.7%
Friday, September 15	8:30 AM	EXISTING HOME SALES M/M	(Aug)	(M)	-	-	-0.7%

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, September 11	-	AUCTION: 3-YR TREASURIES $44B	-	-	-	-	-
Tuesday, September 12	-	AUCTION: 10-YR TREASURIES $35B	-	-	-	-	-
Wednesday, September 13	-	AUCTION: 30-YR TREASURIES $20B	-	-	-	-	-
Wednesday, September 13	7:00 AM	MBA-APPLICATIONS	(Sep 8)	(L)	-	-	-2.9%
Wednesday, September 13	8:30 AM	CPI M/M	(Aug)	(H)	0.4%	0.5%	0.2%
Wednesday, September 13	8:30 AM	CPI M/M (core)	(Aug)	(H)	0.1%	0.2%	0.2%
Wednesday, September 13	8:30 AM	CPI Y/Y	(Aug)	(H)	3.5%	3.6%	3.2%
Wednesday, September 13	8:30 AM	CPI Y/Y (core)	(Aug)	(H)	4.2%	4.3%	4.7%
Wednesday, September 13	2:00 PM	TREASURY BUDGET	(Aug)	(L)	-	-	-$220.8B
Thursday, September 14	8:30 AM	INITIAL CLAIMS	(Sep 9)	(M)	-	-	216K
Thursday, September 14	8:30 AM	CONTINUING CLAIMS	(Sep 2)	(L)	-	-	1679K
Thursday, September 14	8:30 AM	RETAIL SALES M/M	(Aug)	(H)	-0.1%	0.1%	0.7%
Thursday, September 14	8:30 AM	RETAIL SALES (X-AUTOS) M/M	(Aug)	(H)	0.3%	0.4%	1.0%
Thursday, September 14	8:30 AM	RETAIL SALES CONTROL GROUP M/M	(Aug)	(H)	-0.3%	-0.2%	1.0%
Thursday, September 14	8:30 AM	PPI M/M	(Aug)	(M)	0.3%	0.4%	0.3%
Thursday, September 14	8:30 AM	PPI M/M (core)	(Aug)	(M)	0.0%	0.2%	0.3%
Thursday, September 14	8:30 AM	PPI Y/Y	(Aug)	(M)	-	1.5%	0.8%
Thursday, September 14	8:30 AM	PPI Y/Y (core)	(Aug)	(M)	-	2.2%	2.4%
Thursday, September 14	10:00 AM	BUSINESS INVENTORIES M/M	(Jul)	(L)	-	0.1%	0.0%
Friday, September 15	8:30 AM	IMPORT PRICE INDEX M/M	(Aug)	(L)	-	0.3%	0.4%
Friday, September 15	8:30 AM	EXPORT PRICE INDEX M/M	(Aug)	(L)	-	0.3%	0.7%
Friday, September 15	8:30 AM	NEW YORK FED (EMPIRE)	(Sep)	(M)	-	-10.7	-19
Friday, September 15	9:15 AM	INDUSTRIAL PRODUCTION M/M	(Aug)	(H)	-0.1%	0.1%	1.0%
Friday, September 15	9:15 AM	CAPACITY UTILIZATION	(Aug)	(M)	79.2%	79.3%	79.3%
Friday, September 15	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Sep P)	(H)	-	69.4	69.5

Week Ahead's market call

by Avery Shenfeld

In the **US**, our forecasts are one or two ticks lower than the consensus on the various CPI and retail sales figures that top the data calendar for the coming week. If that's on the mark, it will help cement the case for the Fed to stay on hold in September, which in any event seems to be where FOMC members are already lining up. Where they diverge is on their views on whether this is another one meeting skip, or a plateau at the peak rate for this cycle. We'll need to see a bit more labour market slack and the associated downward pressure on core inflation to get everyone on board with the latter view, so it will likely still be a few months before markets can price out all risks of another hike, let alone begin to make the case for an easing in policy.

In **Canada**, there are no major data releases for the coming week. Manufacturing and wholesale sales reports for July aren't likely to diverge much from their advance readings, although there is perhaps some downside risk for the factory sales number, given that the earlier reported sales gain didn't translate into an increase in subsequently reported real GDP for the industry. August advance figures for both factories and wholesalers will give us a first look at that month's activity measures. We are expecting a return to real GDP growth in Q3 after a slight negative in Q2, but at a sluggish pace that still adds to economic slack.

There are no major Canadian data releases next week.

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

(Wednesday, 8:30 am)

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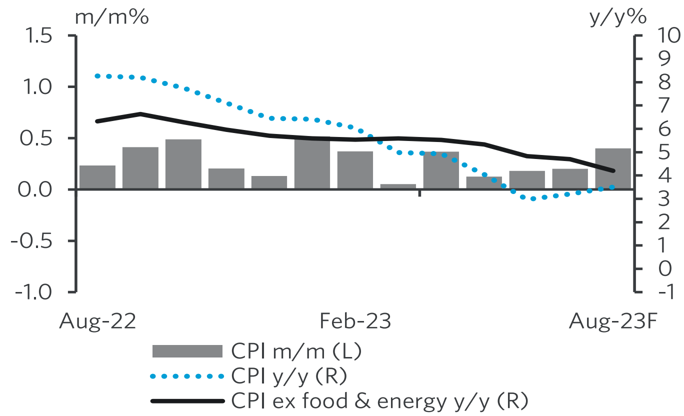
Variable (%)	CIBC	Mkt	Prior
Headline CPI (m/m)	0.4	0.5	0.2
Headline CPI (y/y)	3.5	3.6	3.2
Core CPI (m/m)	0.1	0.2	0.2
Core CPI (y/y)	4.2	4.3	4.7

Chart: US consumer price index



Source: BLS, Haver Analytics, CIBC

The August CPI will be the final piece of the puzzle for the Fed ahead of its September meeting. We expect the last few soft readings to start to form a trend, with core CPI in August expected to come in at a meagre 0.1% m/m as the easing supply chains will weigh further on core goods prices. We look for service prices to remain firm given solid demand but will be around the pace in recent months. Favourable base effects will also help push the 12-month change in core inflation down meaningfully to 4.2%. Headline CPI will tick up on higher gasoline prices to 3.5%.

Forecast implications — A third straight month of soft inflation readings, combined with the gradually weakening trend in the labour market will be enough for the Fed to throw in the towel on its September meeting and signal data dependence the rest of the year.

Market impact — We expect disinflation in core goods will pick up pace in August reflecting weakness in auto sales and the gradual feed through of the supply chains. That leaves our view on both core and headline inflation weaker than the market. Given the Fed is sitting in a data dependent position and will continue to weigh risk management considerations heavily, a downside surprise should be slightly bullish for fixed income markets.

Other US Releases: Retail sales—August

(Thursday, 8:30 am)

Consumers will pullback after last month's spending spree, sending headline retail and the important control group that feeds into GDP into negative territory. Vehicle sales data in August point to slower auto sales already, a signal that other interest-sensitive categories likely also show weakness. But the broader context of weak income growth and restrictive monetary policy portends more a subdued outlook for the US consumer this fall.

Forecast implications — Forecasters, both human and machine, will dial back their rosy outlooks for Q3 from a very strong to a more moderate outlook. This will be further comfort for the Fed that while demand is strong, it doesn't appear to necessarily heating up either.

Market impact — We expect a weaker reading than the market, which should be supportive for fixed income and not too worrisome for equities, as it will solidify the view that the Fed is done.

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