

Economics

THE WEEK AHEAD

October 18-22, 2021

Defending Macklem

by Avery Shenfeld avery.shenfeld@cibc.com

We would normally save our preview of the Bank of Canada's Monetary Policy Report for another week, but the volatility in the front end of Canada's yield curve in recent days behooves us to get our thoughts out now. Differences of opinion are said to be what makes a market, but count us on the side of Governor Macklem's view, or at least what we expect it to be when more fully fleshed out in the MPR.

Markets have taken cues from a more hawkish Bank of England, an upside surprise in Canadian employment, the jump in oil and gas prices and, of course, firming inflation. The resulting selling in BA futures had the market pricing in close to four rate hikes in 2022, starting in the spring, and significantly eclipsing what was assumed for the US Fed. But the Bank of Canada's take on these events is likely to differ, as not too subtly hinted in media remarks by Governor Macklem this week.

Employment is back to its pre-Covid level, but we were not quite at full employment when the pandemic hit. Nor does a restoration in the number of jobs get us back to the pre-pandemic jobless rate, given population growth. Hours worked look decidedly weaker than the jobs count, consistent with Canada's significant underperformance in real GDP growth versus the US over the Covid period. While there are issues with the available measures for wages, they collectively show no threatening acceleration.

Higher oil prices will fuel both inflation and some nominal GDP growth for Canada. But this isn't a return to the glory days for Canada's energy sector contribution to real GDP. Mega-projects are nowhere in sight, and we'll need a sustained period of firm prices to rekindle a capital spending boom.

As for inflation, Monday's business conditions survey will show that Canadian companies are feeling its sting on input costs and passing some of that on. But it's not a question of whether "transitory" means one quarter or one year. It's what's causing

it. If, as is the case, it's mostly from constraints on supply that are tied to Covid-related shutdowns, the cure will come from vaccines around the world and time to rebuild inventories, not from slowing the economy with higher interest rates. The time for rate hikes will come, but not until demand is overheated.

On that score, the Bank of Canada will be reminding markets what they seem to have forgotten. Canadian GDP fell in Q2, and its Q3 rebound will be in the range of 4% annualized. At annual rates, these two quarters will each be about 3% below the last Bank of Canada forecast, with Covid-19 hits to production, and to some extent services demand, being the story.

The result is that, as the Governor also hinted, the timetable for closing the output gap will likely be pushed a bit further away, not closer. While the Bank doesn't like to be too precise, look for the language to shift from it closing "late next year" or "before the end of next year" as opposed to "in the second half". We'll also be able to look at the estimate for the output gap at the end of Q3, and the growth forecast, to get a sense of that slight delay. If, as we expect, the Governor reiterates the view that rate hikes won't likely be needed until the output gap closes, that's also going to dampen expectations for an earlier, and more aggressive hiking cycle next year.

Our view aligns with what we heard from the Governor this past week. Of course, time will tell who's right, and upside surprises to growth could of course see 2022 play out differently. But in the near term, the market will have to decide how much its willing to take on the institution that does, after all, have the interest rate decision in its hands.

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, October 18	-	Government Bond Purchase Program (GBPP): 5-YR	-	-	-	-	-
Monday, October 18	8:15 AM	HOUSING STARTS SAAR	(Sep)	(M)	250K	-	260.2K
Monday, October 18	8:30 AM	INT'L. SEC. TRANSACTIONS	(Aug)	(M)	-	-	\$14.19B
Monday, October 18	10:30 AM	BoC Business Outlook Survey & Canadian Survey of Consumer Expectations	-	-	-	-	-
Monday, October 18	11:40 AM	Speaker: 11:40 AM Timothy Lane (Deputy Gov.)	-	-	-	-	-
Tuesday, October 19	-	Government Bond Purchase Program (GBPP): 30-YR	-	-	-	-	-
Tuesday, October 19	-	AUCTION: 3-M BILLS \$, 6-M BILLS \$, 1-YR BILLS \$	-	-	-	-	-
Wednesday, October 20	-	Government Bond Purchase Program (GBPP): 2-YR	-	-	-	-	-
Wednesday, October 20	-	AUCTION: 2-YR CANADAS \$3.5B	-	-	-	-	-
Wednesday, October 20	8:30 AM	CPI M/M	(Sep)	(H)	-0.2%	-	0.2%
Wednesday, October 20	8:30 AM	CPI Y/Y	(Sep)	(H)	4.0%	-	4.1%
Wednesday, October 20	8:30 AM	CPI Core- Common Y/Y%	(Sep)	(M)	2.0%	-	1.8%
Wednesday, October 20	8:30 AM	CPI Core- Median Y/Y%	(Sep)	(M)	-	-	2.6%
Wednesday, October 20	8:30 AM	CPI Core- Trim Y/Y%	(Sep)	(M)	-	-	3.3%
Thursday, October 21	-	Government Bond Purchase Program (GBPP): 10-YR	-	-	-	-	-
Thursday, October 21	-	AUCTION: 10-YR CANADAS \$4.5B	-	-	-	-	-
Thursday, October 21	8:30 AM	ADP EMPLOYMENT CHANGE	(Sep)	-	-	-	-
Friday, October 22	8:30 AM	RETAIL TRADE TOTAL M/M	(Aug)	(H)	1.7%	-	-0.6%
Friday, October 22	8:30 AM	RETAIL TRADE EX-AUTO M/M	(Aug)	(H)	2.9%	-	-1.0%

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, October 18	9:15 AM	INDUSTRIAL PRODUCTION M/M	(Sep)	(H)	0.1%	0.2%	0.4%
Monday, October 18	9:15 AM	CAPACITY UTILIZATION	(Sep)	(M)	76.5%	76.5%	76.4%
Monday, October 18	10:00 AM	NAHB HOUSING INDEX	(Oct)	(L)	-	75.0	76.0
Monday, October 18	4:00 PM	NET CAPITAL INFLOWS (TICS)	(Aug)	(L)	-	-	\$2.0B
Monday, October 18	4:00 PM	TREASURY BUDGET	(Aug)	(L)	-	-\$180.0B	-\$124.6B
Monday, October 18	5:30 AM	Speaker: Randal Keith Quarles (Governor) (Voter)	-	-	-	-	-
Monday, October 19	2:15 PM	Speaker: PM Neel Kashkari (President, Minneapolis)	-	-	-	-	-
Tuesday, October 19	8:30 AM	HOUSING STARTS SAAR	(Sep)	(M)	1600K	1610K	1615K
Tuesday, October 19	8:30 AM	BUILDING PERMITS SAAR	(Sep)	(H)	1650K	1675K	1721K
Tuesday, October 19	11:00 AM	Speaker: Mary C. Daly (President, San Francisco) (Voter)	-	-	-	-	-
Tuesday, October 19	2:50 PM	Speaker: Raphael W. Bostic (President, Atlanta) (Voter)	-	-	-	-	-
Tuesday, October 19	3:00 PM	Speaker: Christopher J. Waller (Governor) (Voter)	-	-	-	-	-
Wednesday, October 20	-	20-YR AUCTION: \$24B	-	-	-	-	-
Wednesday, October 20	7:00 AM	MBA-APPLICATIONS	(Oct 15)	(L)	-	-	0.2%
Wednesday, October 20	2:00 PM	FED'S BEIGE BOOK	-	-	-	-	-
Wednesday, October 20	12:00 PM	Speaker: Raphael W. Bostic (President, Atlanta) (Voter), Neel Kashkari (President, Minneapolis), Charles L. Evans (President, Chicago) (Voter), James Bullard (President, St Louis) (Non-Voter)	-	-	-	-	-
Wednesday, October 20	1:00 PM	Speaker: Randal Keith Quarles (Governor) (Voter)	-	-	-	-	-
Thursday, October 21	-	AUCTION: 5-YR TIPS \$19B	-	-	-	-	-
Thursday, October 21	8:30 AM	INITIAL CLAIMS	(Oct 16)	(M)	-	302K	293K
Thursday, October 21	8:30 AM	CONTINUING CLAIMS	(Oct 9)	(L)	-	-	2593K
Thursday, October 21	8:30 AM	PHILADELPHIA FED	(Oct)	(M)	-	24.5	30.7
Thursday, October 21	10:00 AM	LEADING INDICATORS M/M	(Sep)	(M)	-	0.5%	0.9%
Thursday, October 21	10:00 AM	EXISTING HOME SALES SAAR	(Sep)	(M)	-	6.00M	5.88M
Thursday, October 21	10:00 AM	EXISTING HOME SALES M/M	(Sep)	(M)	-	2.0%	-2.0%
Thursday, October 21	9:00 AM	Speaker: Christopher J. Waller (Governor) (Voter)	-	-	-	-	-
Friday, October 22	9:45 AM	MARKIT US SERVICES PMI	(Oct P)	(L)	-	55.1	54.9
Friday, October 22	9:45 AM	MARKIT US COMPOSITE PMI	(Oct P)	(L)	-	-	55.0
Friday, October 22	9:45 AM	MARKIT US MANUFACTURING PMI	(Oct P)	(L)	-	60.5	60.7
Friday, October 22	10:00 AM	Speaker: Mary C. Daly (President, San Francisco) (Voter)	-	-	-	-	-

Week Ahead's market call

by Avery Shenfeld

In the **US**, a week of second-tier indicators will leave room for a host of Fed speakers to catch market attention. Industrial production will be distorted by lingering energy sector disruptions from the prior month's hurricane, as well as the headwinds to auto and other manufacturing from supply shortfalls. Housing starts could be fairly steady, with permits coming down from an outsized prior month. Washington politics remain focused on finding a common ground within the Democrats in Congress.

In **Canada**, remember that the upcoming Bank of Canada Outlook Survey will have been taken in the latter part of August, so it won't quite pick up the peak in Delta wave concerns on the growth side, or all of the jitters over inflation. But we still expect to see a fair dose of optimism on growth ahead, and a lot of discussion on rising production costs. The CPI has some heat ahead of it, but this monthly reading will include a dip in gasoline prices that didn't last, as well as a drop in Alberta power costs, so we'll be waiting another month to catch the latest upsurge in the energy component. Food bears watching given what we saw in the US data for the same month, but also the common component core CPI, which we still expect to be a comforting signal for the Bank of Canada. Retail sales should post a solid rebound, if a bit below the prior flash estimate, with the flash figure for September likely on the soft side.

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

(Wednesday, 8:30 am)

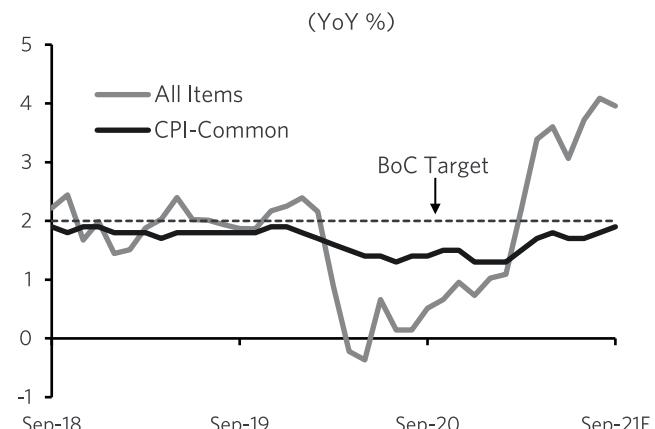
Royce Mendes royce.mendes@cibc.com

Variable (%)	CIBC	Mkt	Prior
CPI NSA (m/m)	-0.2%	-	0.2%
CPI (y/y)	4.0%	-	4.1%
CPI-common (y/y)	2.0%	-	1.8%

Other than the pandemic, inflation is all anyone wants to talk about these days. Unfortunately, it's unlikely that the upcoming CPI report will do anything to change that, with price pressures from supply chain disruptions remaining evident across a host of goods prices. That said, there will be some offset from gasoline prices, which were stagnant in September, and falling electricity prices in Alberta after the summer heatwave.

While that will still leave the headline inflation rate tracking 4.0%, measures of underlying inflationary trends should continue to look weaker. Excluding food and energy, inflation looks likely to have continued tracking 2.9%. Moreover, the Bank of Canada's common component indicator is expected to sit at only 2%.

Chart: Consumer price index (YoY %)



Source: Statistics Canada, Haver Analytics, CIBC

Forecast implications — The September CPI data won't do much to quell concerns surrounding the pace of headline inflation, but we expect the details will still point to much of the current price pressures simply being the transitory effects of the pandemic on certain goods. As a result, we still see inflation cooling down next year.

Other Canadian releases: Housing starts—September

(Monday, 8:15 am)

Demand for housing remained strong across Canada in September, but building permits suggest that homebuilding continued to cool off from the historically fast pace seen earlier this year. While the 250K housing starts we're forecasting would still be elevated compared to the pre-pandemic trend, it would represent the slowest monthly pace since last year. Shrinking supplies and rising prices of labour and materials are keeping a lid on new construction despite signs of a reacceleration in the resale market recently. The good news is that, if as we expect starts remain elevated for some months to come, it would help alleviate some housing supply pressures as immigration ramps back up.

Retail sales—August

(Friday, 8:30 am)

Given how badly auto sales performed during the month of August, Statistics Canada's flash estimate for an increase of more than 2% in total retail sales looks too lofty. Even after taking into account that nominal retail sales would have been buoyed by higher car prices, the drop in unit auto sales leaves us forecasting a lesser gain of 1.7%. That said, excluding autos, expect a solid increase of 2.9%. While that would still leave the level of sales ex-autos below the peak in March, during the worst of the shutdowns when Canadians didn't have much else to spend on other than retail goods, it shows that outside of supply chain disruptions demand has remained strong. With the auto industry still plagued by a shortage of semiconductors, expect any gains seen in the flash estimate of September retail sales to look relatively muted given that ex-auto sales were already heading into the month at an elevated level.

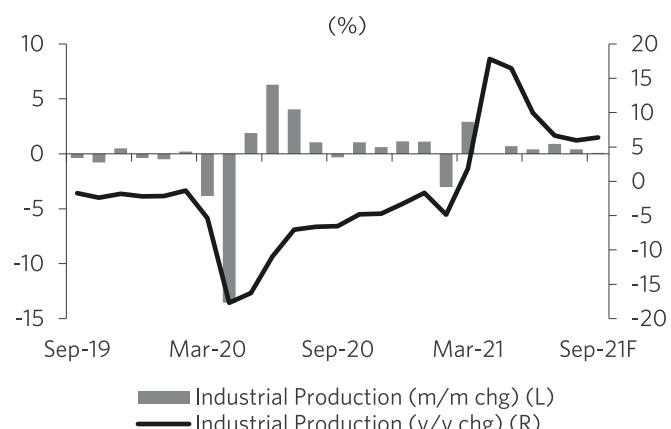
Week Ahead's key US number: Industrial production—September

(Monday, 9:15 am)

Katherine Judge katherine.judge@cibc.com

Variable (%)	CIBC	Mkt	Prior
Industrial production (m/m)	0.1	0.2	0.4
Capacity utilization	76.5	76.5	76.4

Chart: US Industrial production



Source: FRB, Haver Analytics, CIBC

Hours worked by production employees in manufacturing flatlined in September, but the ISM's production sub-index suggests that manufacturing output still could have grown. However, a large portion of oil production in the Gulf of Mexico remained offline in the aftermath of hurricane Ida, and that could have offset most of the gains in factory activity. Moreover, utilities output likely offered little support as the weather returned closer to seasonal norms. Total industrial production therefore likely inched forward by 0.1% to end the third quarter.

Forecast implications — Our forecast implies 7.0% annualized growth in industrial production over the third quarter, an acceleration from the previous quarter. However, momentum has faded lately and the fourth quarter is likely to see a material slowdown in growth as supply chain issues weigh on production and inventory replenishment.

Market impact — We are below the consensus forecast, but not by enough to suggest a market response.

Other US Releases: Housing starts—September

(Tuesday, 8:30 am)

The gap between housing starts and permits suggests an acceleration in building ahead, but supply and labor shortages continue to pose challenges for builders. Homebuilding could have therefore eased off to a 1600K pace in September, while building permit issuance could have fallen to a more sustainable pace of 1650K. With housing starts making no progress over the third quarter, and construction spending losing considerable momentum, residential investment looks to have subtracted from growth in the third quarter.

Contacts:

Avery Shenfeld

416 594-7356

avery.shenfeld@cibc.com

Benjamin Tal

416 956-3698

benjamin.tal@cibc.com

Andrew Grantham

416 956-3219

andrew.grantham@cibc.com

Royce Mendes

416 594-7354

royce.mendes@cibc.com

Katherine Judge

416 956-6527

katherine.judge@cibc.com

CIBC Capital Markets

PO Box 500

161 Bay Street, Brookfield Place

Toronto, Canada, M5J 2S8

Bloomberg @ CIBC

economics.cibccm.com

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