

Economics

THE WEEK AHEAD

October 17-21, 2022

Changing composition of inflation strengthens central bankers

by Benjamin Tal benjamin.tal@cibc.com

As Bay Street economists, we often meet with CEOs from different corners of the Canadian economy. We share our thoughts du jour regarding the macro picture, and on occasion we ask questions to get a better sense of economic conditions on the ground in real time.

Recently, our questions have naturally focused on the labour shortage, profit margins, and supply chains. And almost universally, CEOs have indicated no improvement in their ability to attract low-wage labour (in some cases they actually have to pay candidates just to show up for an interview). Many also suggest that it's becoming more and more difficult to pass through higher costs to the consumer, which carries clear implications for the bottom line. As for supply chains, while far from perfect, there has been a notable improvement in recent months, mainly for shipments arriving from China.

Now that's important. Both the Fed and the Bank of Canada are helpless in controlling supply-driven inflation. And while it's true that when it comes to the effectiveness of monetary policy, the tiny Bank of Canada is more powerful than the mighty Fed, it is also true that that effectiveness is mostly relevant to the portion of inflation that is demand driven. As for the remainder, both central banks are basically price takers.

So where are we now on the supply/demand distribution of inflation? The San Francisco Fed did the hard work of deriving those measures. And while they are hardly perfect measures, it's the best we have. According to its estimates, just over 40% of the gap between current US core inflation and its 2019 pace is due to supply-driven inflation, 35% of the gap is explained by demand factors, and the rest is ambiguous. If we split the ambiguous portion, we can conclude that current inflation is driven almost evenly by demand and supply — more or less. More important here, however, is the fact that the contribution of supply factors to inflation is on a clear declining trajectory.

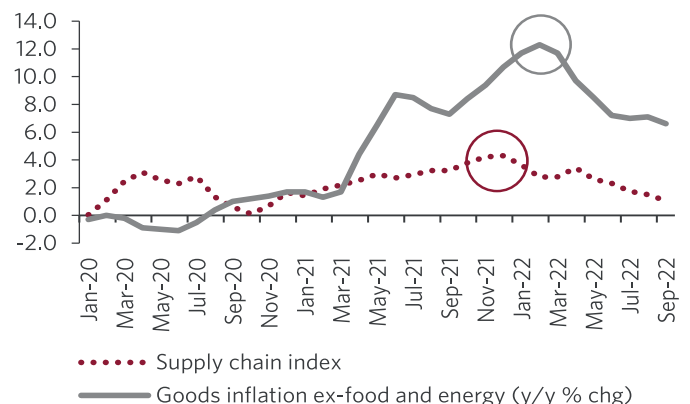
And there are many reasons to believe that that trend will continue in the coming quarters. CEOs are telling us that the supply chain situation is improving, and that sentiment is supported by the data. Freight rates have tumbled from their

late 2021 peaks, lockdown measures in North America have all but ceased, meaning manufacturers are able to produce at high capacity, the number of truck drivers in the US is now almost 20% higher than it was pre-Covid, and a substantial amount of capacity has been added to sea freight over the last two years.

The New York Fed's Global Capacity Pressure Index tries to capture those and other factors in one simple measure, and the trend is clear and encouraging (Chart). But what we find even more interesting is the lag between that index and core goods inflation (see circled areas). That means that the past and ongoing improvement in supply chain conditions will translate into a reduced contribution of supply-driven inflation over the coming quarters.

That changing composition of inflation might work to reduce the likelihood/magnitude of any overshooting by the Bank of Canada and the Fed. Every basis point decline in the contribution of supply-driven inflation leaves more control in the hands of central bankers to tamp down inflation, as it becomes more responsive to policy.

Chart: Supply chain index leads inflation



Source: New York Fed, BLS, CIBC

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 17	10:30 AM	BoC Business Outlook Survey	(Q3)	-	-	-	-
Monday, October 17	10:30 AM	BoC Canadian Survey of Consumer Expectations	(Q3)	-	-	-	-
Monday, October 17	4:00 PM	Speaker: 4:00 PM Carolyn Rogers (Sr. Deputy Gov.)	-	-	-	-	-
Tuesday, October 18	8:15 AM	HOUSING STARTS SAAR	(Sep)	(M)	255.0K	261.9K	267.4K
Tuesday, October 18	8:30 AM	INT'L. SEC. TRANSACTIONS	(Aug)	(M)	-	-	\$14.83B
Wednesday, October 19	-	AUCTION: 5-YR CANADAS \$4B	-	-	-	-	-
Wednesday, October 19	8:30 AM	INDUSTRIAL PROD. PRICES M/M	(Sep)	(M)	-	-	-1.2%
Wednesday, October 19	8:30 AM	RAW MATERIALS M/M	(Sep)	(M)	-	-	-4.2%
Wednesday, October 19	8:30 AM	CPI M/M	(Sep)	(H)	-0.2%	0.0%	-0.3%
Wednesday, October 19	8:30 AM	CPI Y/Y	(Sep)	(H)	6.5%	6.8%	7.0%
Wednesday, October 19	8:30 AM	CPI Core- Common Y/Y%	(Sep)	(M)	-	5.6%	5.7%
Wednesday, October 19	8:30 AM	CPI Core- Median Y/Y%	(Sep)	(M)	-	4.8%	4.8%
Wednesday, October 19	8:30 AM	CPI Core- Trim Y/Y%	(Sep)	(M)	-	5.1%	5.2%
Thursday, October 20	-	AUCTION: 3-YR CANADAS \$2.5B	-	-	-	-	-
Friday, October 21	8:30 AM	RETAIL TRADE TOTAL M/M	(Aug)	(H)	0.2%	0.1%	-2.5%
Friday, October 21	8:30 AM	RETAIL TRADE EX-AUTO M/M	(Aug)	(H)	0.0%	0.4%	-3.1%

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 17	8:30 AM	NEW YORK FED (EMPIRE)	(Oct)	(M)	-	-4.0	-1.5
Tuesday, October 18	9:15 AM	INDUSTRIAL PRODUCTION M/M	(Sep)	(H)	0.0%	0.1%	-0.2%
Tuesday, October 18	9:15 AM	CAPACITY UTILIZATION	(Sep)	(M)	80.0%	79.9%	80.0%
Tuesday, October 18	4:00 PM	NET LONG-TERM TIC FLOWS	(Aug)	(L)	-	-	\$21.4B
Tuesday, October 18	2:00 PM	Speaker: Raphael W. Bostic (Atlanta)	-	-	-	-	-
Tuesday, October 18	5:30 PM	Speaker: Neel Kashkari (Minneapolis) (Non-Voter)	-	-	-	-	-
Wednesday, October 19	-	20-YR AUCTION: \$12B	-	-	-	-	-
Wednesday, October 19	7:00 AM	MBA-APPLICATIONS	(Oct 14)	(L)	-	-	-
Wednesday, October 19	8:30 AM	HOUSING STARTS SAAR	(Sep)	(M)	1460K	1464K	1575K
Wednesday, October 19	8:30 AM	BUILDING PERMITS SAAR	(Sep)	(H)	1530K	1549K	1542K
Wednesday, October 19	2:00 PM	FED'S BEIGE BOOK	-	-	-	-	-
Wednesday, October 19	1:00 PM	Speaker: Neel Kashkari (Minneapolis) (Non-Voter)	-	-	-	-	-
Wednesday, October 19	6:30 PM	Speaker: Charles L. Evans (Chicago) (Non-Voter)	-	-	-	-	-
Wednesday, October 19	6:30 PM	Speaker: James Bullard (St Louis) (Voter)	-	-	-	-	-
Thursday, October 20	-	AUCTION: 5-YR TIPS \$21B	-	-	-	-	-
Thursday, October 20	8:30 AM	INITIAL CLAIMS	(Oct 15)	(M)	-	235K	228K
Thursday, October 20	8:30 AM	CONTINUING CLAIMS	(Oct 8)	(L)	-	-	1368K
Thursday, October 20	8:30 AM	PHILADELPHIA FED	(Oct)	(M)	-	-5.0	-9.9
Thursday, October 20	10:00 AM	EXISTING HOME SALES SAAR	(Sep)	(M)	-	4.7M	4.8M
Thursday, October 20	10:00 AM	EXISTING HOME SALES M/M	(Sep)	(M)	-	-2.3%	-0.4%
Thursday, October 20	10:00 AM	LEADING INDICATORS M/M	(Sep)	(M)	-	-0.3%	-0.3%
Thursday, October 20	1:30 PM	Speaker: Philip N Jefferson (Governor) (Voter)	-	-	-	-	-
Thursday, October 20	1:45 PM	Speaker: Lisa D Cook (Governor) (Voter)	-	-	-	-	-
Thursday, October 20	2:05 PM	Speaker: Michelle W Bowman (Governor) (Voter)	-	-	-	-	-
Friday, October 21	9:10 AM	Speaker: John C. Williams (Vice Chairman, New York) (Voter)	-	-	-	-	-

Week Ahead's market call

by Katherine Judge and Andrew Grantham

In the **US**, it's a quiet week, with a slim selection of second tier economic indicators on tap. An expected slowdown in housing starts and building permit issuance will reflect the impact of higher mortgage rates, while any improvement in supply chains will likely be masked in the industrial production data by hurricane-related disruptions and demand fears in the mining sector. Multiple Fed speakers will round the week out, and that leaves equity earnings reports as the other main focus.

In **Canada**, inflation is expected to take a step back owing to lower gasoline prices and the differing treatment of shelter costs here relative to the US. Business and consumer expectations for future inflation, released as part of the BoC's quarterly surveys on Monday, will also be key in determining how much higher policymakers push interest rates. Retail sales data is expected to show only a modest rebound in August following the prior month's drop, as consumers have become more cautious in the current high inflation and interest rate environment.

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

(Wednesday, 8:30 am)

Andrew Grantham andrew.grantham@cibc.com

Variable (%)	CIBC	Mkt	Prior
CPI NSA (m/m)	-0.2	0.0	-0.3
CPI (y/y)	6.5	6.8	7.0

Despite rising toward month-end, gasoline prices were once again lower on average than in the prior month and will be the main driving force behind a deceleration in Canadian inflation in September. Unadjusted prices are expected to drop by 0.2% month-over-month with the annual rate easing to 6.5%, from 7.0% in the prior month. Food prices, including another rise in dairy prices, will partly offset the decline in energy costs.

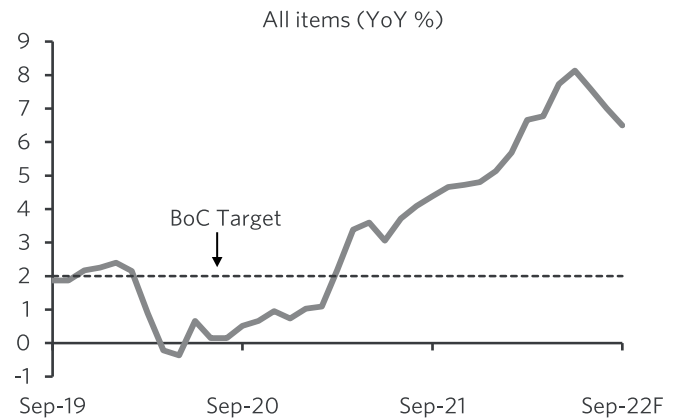
The trend in ex food/energy prices is once again likely to be more subdued in Canada than in the US, thanks largely to the differing treatment of shelter costs. With house prices continuing to fall and building costs no longer escalating, the homeowner replacement and other housing components of CPI will remain weak month-over-month. These components combined account for roughly 11% of the overall CPI basket. While mortgage interest costs will continue to escalate, this area is a smaller 3% of the basket and tends to be looked past by the Bank of Canada in its policy setting deliberations.

Other Canadian releases: Retail sales—August

(Friday, 8:30 am)

Following a sharp decline in the prior month, retail sales likely rebounded modestly in August with a 0.2% increase. That should look slightly better in volume terms, with a drop in gasoline prices during the month weighing on the nominal figure. Excluding autos, sales are expected to be flat on the month.

Chart: Canadian Consumer price index



Source: Statistics Canada, Haver Analytics, CIBC

Forecast implications — Inflation in Canada will continue to show greater signs of deceleration compared to the US figures, in large part due to the way shelter costs are calculated. However, a rebound in oil prices and widening of refining margins have seen gasoline prices increase again in October which will see headline inflation accelerate again for one month at least.

Week Ahead's key US number: Housing starts—September

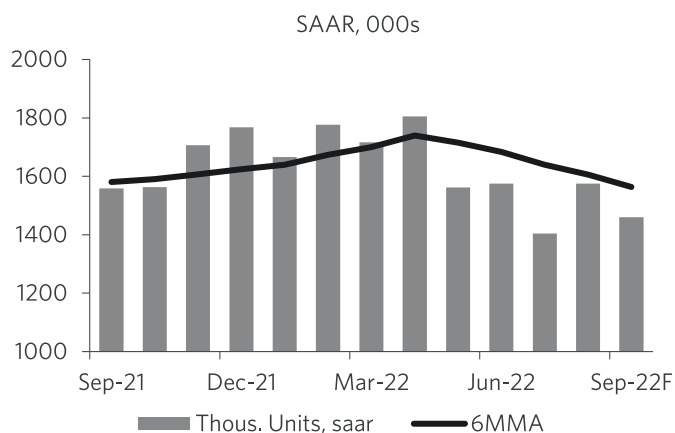
(Wednesday, 8:30 am)

Katherine Judge katherine.judge@cibc.com

Variable	CIBC	Mkt	Prior
Housing starts	1460K	1464K	1575K
Building permits	1530K	1549K	1542K

Mortgage rates reached levels not seen since 2001 in September, which weighed on home purchase intentions, and likely resulted in a drop in the pace of homebuilding to 1460K. That weakness was likely compounded by a reversal in the volatile multi-family segment's strength seen in the prior month, and the expected drop in single-family building is also consistent with plummeting homebuilder confidence. That also suggests a further easing in building permit issuance, to a 1530K pace.

Chart: US Housing starts



Source: Census Bureau, Haver Analytics, CIBC

Forecast implications — With the Fed now on a more aggressive rate hiking path than previously thought, there will be more pain felt in the housing market in the next few quarters as mortgage rates remain elevated in 2023.

Other US Releases: Industrial production—September

(Tuesday, 9:15 am)

A respectable advance in hours worked for production employees in manufacturing, combined with some fading of supply chain disruptions, looks to have supported factory activity in September. However, that was likely negated by weakness in the mining sector, as oil rig counts fell, in line with hurricane-related disruptions and demand worries. Overall, that likely resulted in industrial production flatlining in September.

Contacts:

Avery Shenfeld
[416 594-7356](tel:416-594-7356)
avery.shenfeld@cibc.com

Benjamin Tal
[416 956-3698](tel:416-956-3698)
benjamin.tal@cibc.com

Andrew Grantham
[416 956-3219](tel:416-956-3219)
andrew.grantham@cibc.com

Karyne Charbonneau
[613 552-1341](tel:613-552-1341)
karyne.charbonneau@cibc.com

Katherine Judge
[416 956-6527](tel: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

CIBC World Markets Inc., CIBC World Markets Corp., CIBC World Markets Plc., CIBC Australia Limited and certain other corporate banking and capital markets activities of Canadian Imperial Bank of Commerce operate under the brand name CIBC Capital Markets.

This report is issued and approved for distribution by (a) in Canada, CIBC World Markets Inc., a member of the Investment Industry Regulatory Organization of Canada, the Toronto Stock Exchange, the TSX Venture Exchange and a Member of the Canadian Investor Protection Fund, (b) in the United Kingdom, CIBC World Markets plc, which is regulated by the Financial Services Authority, and (c) in Australia, CIBC Australia Limited, a member of the Australian Stock Exchange and regulated by the ASIC (collectively, "CIBC") and (d) in the United States either by (i) CIBC World Markets Inc. for distribution only to U.S. Major Institutional Investors ("MII") (as such term is defined in SEC Rule 15a-6) or (ii) CIBC World Markets Corp., a member of the Financial Industry Regulatory Authority. U.S. MIIs receiving this report from CIBC World Markets Inc. (the Canadian broker-dealer) are required to effect transactions (other than negotiating their terms) in securities discussed in the report through CIBC World Markets Corp. (the U.S. broker-dealer).

This report 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.

This report does not take into account the investment objectives, financial situation or specific needs of any particular client of CIBC. Before making an investment decision on the basis of any information contained in this report, the recipient should consider whether such information is appropriate given the recipient's particular investment needs, objectives and financial circumstances. CIBC suggests that, prior to acting on any information contained herein, you contact one of our client advisers in your jurisdiction to discuss your particular circumstances. Since the levels and bases of taxation can change, any reference in this report to the impact of taxation should not be construed as offering tax advice; as with any transaction having potential tax implications, clients should consult with their own tax advisors. Past performance is not a guarantee of future results.

The information and any statistical data contained herein were obtained from sources that we believe to be reliable, but we do not represent that they are accurate or complete, and they should not be relied upon as such. All estimates and opinions expressed herein constitute judgments as of the date of this report and are subject to change without notice. This report may provide addresses of, or contain hyperlinks to, Internet web sites. CIBC 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.

© 2022 CIBC World Markets Inc. All rights reserved. Unauthorized use, distribution, duplication or disclosure without the prior written permission of CIBC World Markets Inc. is prohibited by law and may result in prosecution.

The CIBC logo and "CIBC Capital Markets" are trademarks of CIBC, used under license.