Economics

THE WEEK AHEAD

October 24-28, 2022

A difficult change in narrative

by **Andrew Grantham** andrew.grantham@cibc.com

The Bank of Canada next week will have to downgrade its forecasts for growth but also, in the near term at least, inflation, relative to where those projections stood back in July. Yet we and financial markets are forecasting another super-sized 75bp interest rate hike. Why?

As they say, the devil is in the detail. While demand is cooling in response to higher interest rates, it may not be doing so any more than the Bank previously expected. A cutting of its GDP forecasts could reflect continued challenges on the supply side relative to the improvement that was expected. On the inflation front, the downside miss relative to July's MPR forecast was entirely a gasoline price story, with domestically driven services inflation (ex-shelter) actually coming in hotter than they anticipated.

However, the central bank can't continue hiking interest rates indefinitely in response to above-target inflationary pressures. Due to the lags involved between interest rates rising, economic activity slowing and finally inflation easing, our forecasts suggest that the annual rate of such services inflation won't peak until March next year, and won't fall below 3% (the top end of the BoC's target bound) until November. Even if the Bank reverted to traditional 25bp increments after next week, the overnight rate would be 6% by that time and the economy would be headed for a deep recession.

So even if it isn't next week, the Bank of Canada will soon face the difficult task of changing its narrative and signaling a pause in this rate hike cycle, at a time when inflation is still very high. Doing so without driving a loosening of financial conditions (i.e through C$ depreciation) or an unwanted move in inflation expectations would be a challenge.

Maintaining a hiking bias even at a meeting where no rate increase is delivered would be the obvious way of doing this. Downgrading forecasts to such an extent that they imply a recession is possible would signal to the public that policymakers will do whatever it takes to bring inflation down. That could help keep inflation expectations under control, but wouldn't prevent any unwanted market reaction.

The Bank should change its view on supply growth, signalling that some of the current headwinds (supply chains, Covid-related illnesses) will be longer lasting than previously forecast. It should alongside this start to educate people that these constraints mean interest rates will likely have to stay above levels we had become accustomed to in the prior cycle to maintain 2% inflation longer term.

The Bank may also want to at least consider revisiting a "conditional commitment", but this time one not to cut interest rates before certain conditions are met. Now, such commitments are admittedly trickier in this direction. Large, unexpected, downside shocks to growth happen more often than upside ones, so policymakers may not want to feel handcuffed into not responding if something unexpected occurred. Moreover, the timing is awkward, given that the commitment not to raise rates before the output gap was closed has been cited as a reason why the Bank fell behind the curve in responding to current inflationary pressures. However, a commitment not to cut interest rates at least until core inflation was within their target range would help make sure that markets didn't prematurely price in an easing, as well as help keep inflation expectations under control.

As for next week though, any change in narrative will be subtle, such as adding the word "likely" between the "will" and "rise further" in its statement. The Bank has a couple more meetings to decide just how to make the larger change in narrative that will soon be required (we forecast that the January meeting will be the first with no interest rate hike), although to borrow a common phrase used by policymakers recently, that window is narrowing.

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 24	-	-	-	-	-	-	-
Tuesday, October 25	-	AUCTION: 3-M BILLS $6.4B, 6-M BILLS $3.4B, 1-YR BILLS $3.4B	-	-	-	-	-
Wednesday, October 26	10:00 AM	BANK OF CANADA RATE ANNOUNCE.	(Oct 26)	(H)	4.00%	3.75%	3.25%
Wednesday, October 26	11:00 AM	Speaker: Tiff Macklem (Governor) & Carolyn Rogers (Sr. Deputy Gov.)	-	-	-	-	-
Thursday, October 27	-	AUCTION: 30-YR CANADAS $2B	-	-	-	-	-
Thursday, October 27	8:30 AM	PAYROLL EMPLOYMENT, EARNINGS & HRS	-	-	-	-	-
Friday, October 28	8:30 AM	GDP M/M	(Aug)	(H)	0.0%	0.0%	0.1%

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 24	8:30 AM	CHICAGO FED NAT.ACTIVITY INDEX	(Sep)	(M)	-	-	0.0
Monday, October 24	9:45 AM	S&P GLOBAL US SERVICES PMI	(Oct P)	(L)	-	49.4	49.3
Monday, October 24	9:45 AM	S&P GLOBAL US COMPOSITE PMI	(Oct P)	(L)	-	-	49.5
Monday, October 24	9:45 AM	S&P GLOBAL US MANUFACTURING PMI	(Oct P)	(L)	-	51.0	52.0
Tuesday, October 25	-	AUCTION: 2-YR TREASURIES $42B	-	-	-	-	-
Tuesday, October 25	9:00 AM	HOUSE PRICE INDEX M/M	(Aug)	(M)	-	-0.7%	-0.6%
Tuesday, October 25	9:00 AM	S&P CORELOGIC CS Y/Y	(Aug)	(H)	-	14.0%	16.1%
Tuesday, October 25	10:00 AM	CONF.BOARD CONSUMER CONFIDENCE	(Oct)	(H)	105.8	105.5	108.0
Tuesday, October 25	10:00 AM	RICHMOND FED MANUF. INDEX	(Oct)	(M)	-	-5	0
Tuesday, October 25	1:55 PM	Speaker: Christopher J. Waller (Governor) (Voter)	-	-	-	-	-
Wednesday, October 26	-	AUCTION: 5-YR TREASURIES $43B	-	-	-	-	-
Wednesday, October 26	-	AUCTION: 2-YR FRN $24B	-	-	-	-	-
Wednesday, October 26	7:00 AM	MBA-APPLICATIONS	(Oct 21)	(L)	-	-	-4.5%
Wednesday, October 26	8:30 AM	ADVANCE GOODS TRADE BALANCE	(Sep)	(M)	-$88.0B	-$87.8B	-$87.3B
Wednesday, October 26	8:30 AM	RETAIL INVENTORIES M/M	(Sep)	(H)	-	-	1.4%
Wednesday, October 26	8:30 AM	WHOLESALE INVENTORIES M/M	(Sep P)	(L)	-	1.1%	1.3%
Wednesday, October 26	10:00 AM	NEW HOME SALES SAAR	(Sep)	(M)	575K	580K	685K
Wednesday, October 26	10:00 AM	NEW HOME SALES M/M	(Sep)	(M)	-16.1%	-15.3%	28.8%
Thursday, October 27	-	AUCTION: 7-YR TREASURIES $35B	-	-	-	-	-
Thursday, October 27	8:30 AM	INITIAL CLAIMS	(Oct 22)	(M)	-	-	214K
Thursday, October 27	8:30 AM	CONTINUING CLAIMS	(Oct 15)	(L)	-	-	1385K
Thursday, October 27	8:30 AM	DURABLE GOODS ORDERS M/M	(Sep P)	(H)	0.4%	0.6%	-0.2%
Thursday, October 27	8:30 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Sep P)	(H)	-0.2%	0.2%	0.3%
Thursday, October 27	8:30 AM	GDP (annualized)	(3Q A)	(H)	2.0%	2.3%	-0.6%
Thursday, October 27	8:30 AM	GDP DEFLATOR (annualized)	(3Q A)	(H)	5.3%	5.3%	9.0%
Friday, October 28	8:30 AM	PCE DEFLATOR Y/Y	(Sep)	(H)	6.3%	6.3%	6.2%
Friday, October 28	8:30 AM	PCE DEFLATOR Y/Y (core)	(Sep)	(H)	5.2%	5.2%	4.9%
Friday, October 28	8:30 AM	PERSONAL INCOME M/M	(Sep)	(H)	0.4%	0.3%	0.3%
Friday, October 28	8:30 AM	PERSONAL SPENDING M/M	(Sep)	(H)	0.5%	0.4%	0.4%
Friday, October 28	8:30 AM	EMPLOYMENT COST INDEX	(3Q)	(M)	-	1.2%	1.3%
Friday, October 28	10:00 AM	PENDING HOME SALES M/M	(Sep)	(M)	-	-5.3%	-2.0%
Friday, October 28	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Oct F)	(H)	-	59.6	59.8

Week Ahead's market call

by Katherine Judge and Andrew Grantham

In the **US** this week, we'll likely receive confirmation that GDP expanded in the third quarter, causing some convergence with the GDI figures that showed growth in the first half of the year. The outlook ahead isn't as encouraging, however, as higher interest rates will weigh more heavily on activity, even if the alleviation of supply chain issues and the related inventory restocking prevents a contraction in growth in Q4. We'll also likely see evidence in the consumer confidence data that households are feeling the weight of higher rates and the slowdown in the labor market. With the Fed in its pre-FOMC blackout period, that leaves equity earnings reports as the other main focus.

In **Canada**, we suspect that still hot inflation (even excluding food/energy) will tip the Bank into another 75bp interest rate hike, rather than the 50bp move that we had previously anticipated. However, policymakers will soon have to find a creative way to pause this rate hike cycle, without damaging its inflation-fighting credibility, while they wait to assess how the economy is coping with the rate hikes that have already been delivered. Monthly GDP data on Friday is likely to signal little/no growth again in August and September, with the advance forecast for the quarter likely to come in at just below a 1% annualized pace.

Week Ahead's key Canadian number: Gross domestic product—August

(Friday, 8:30 am)

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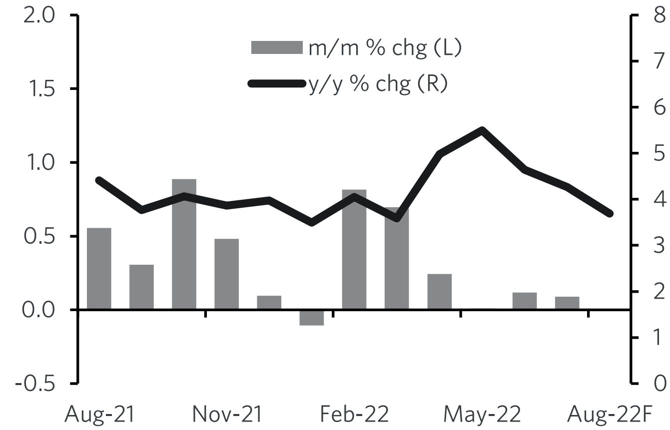
Variable	CIBC	Mkt	Prior
GDP m/m (August)	0.0%	0.0%	0.1%

Chart: Canadian GDP at basic prices



Source: Statistics Canada, Haver Analytics, CIBC

It's been slow going for the Canadian economy in recent months, and momentum could well have ground to a halt completely at the end of Q3. August GDP is expected to be flat, which would be in line with the advance estimate from Statistics Canada. For September, the early indicators released so far also point to a stagnating economy, albeit not one that is necessarily already in reverse. Added up, annualized growth during Q3 should be in the 0.5-1.0% range, which would be roughly half the long-run potential growth rate of the economy.

Forecast implications — Growth has certainly cooled in Canada, although the economy hasn't shifted into reverse gear. A pace of growth that is below the long run potential for the economy (around 1.5-2.0%) should eventually start to relieve some of the domestically driven inflationary pressures within the services sector. However, a longer period of sluggish growth, and some help from global supply chains, will be needed to bring inflation back down to the Bank of Canada's 2% target.

Week Ahead's key US number: Real GDP—Q3 (Advance)

(Thursday, 8:30 am)

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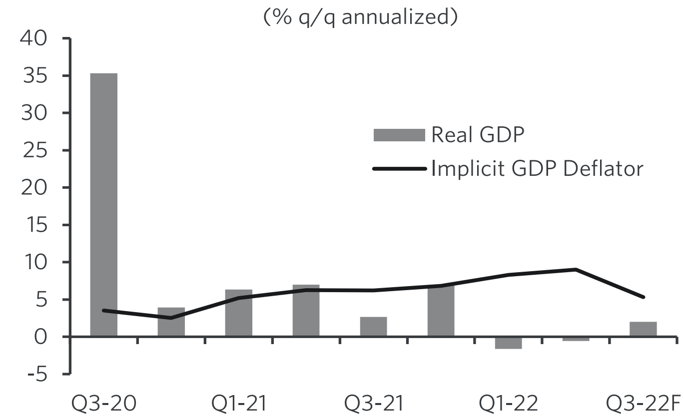
GDP (%)	CIBC	Mkt	Prior
GDP q/q annualized	2.0	2.3	-0.6
GDP deflator	5.3	5.3	9.0

Chart: US GDP



Source: BEA, Haver Analytics, CIBC

After two consecutive quarterly declines in GDP, the US economy looks to have rebounded in the third quarter. A climb in exports of industrial supplies, namely petroleum products, will be a key driver of growth. Consumer spending on services will be another growth driver, offsetting a likely drag from goods consumption as higher interest rates and the slowdown in the housing market limited spending on related goods, and unit auto sales dropped off. There will also be support from business investment in equipment, particularly computer equipment, and investment in mining structures.

Forecast implications — Our forecast for a 2.0% annualized advance in GDP in Q3 is partly representative of that series playing catchup with the GDI data that showed growth in the first half of the year. However, the slowing trend in the labor market suggests a moderation in growth ahead, as interest rates continue on a sharply higher trajectory. Still, the restocking of inventories as supply chain issues fade will help prevent a contraction in growth in the final quarter of the year.

Market impact — We're broadly in line with the consensus forecast and market reaction should therefore be limited.

Other US Releases: Advance trade in goods—September

(Wednesday, 8:30 am)

Although supply chain issues continued to fade in September, disruptions from Hurricane Ian could have held back some US exports, resulting in a widening of the advance trade deficit to $88.0bn. While slower global growth will limit demand for US exports ahead, there will likely be pockets of strength within the industrial supplies category, on demand to replace Russian petroleum products, while auto exports could improve along with supply chains. At the same time, weaker domestic demand for goods will hold back US imports.

Durable goods orders—September

(Thursday, 8:30 am)

The deterioration in the outlook for demand portends weakness in orders of the ex. transportation durable goods group, which could have fallen by 0.2% in September. In particular, the core capital goods group, which is a leading indicator of business investment in equipment, could have weakened. Adding the volatile transportation group back into the mix could have shown a more respectable 0.4% increase in orders, helped by demand to restock auto inventories as supply chain issues ease.

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