Economics

THE WEEK AHEAD

December 25 - 29, 2023 and Jan 1 - 5, 2024

A New Year's resolution for central banks

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

It has become fashionable in recent years to criticize central banks for their actions during and after the pandemic. However, in many cases this is an example of throwing stones in glass houses, as very few of those commentators pointed out the mistakes at the time. Moreover, simply pointing out a mistake now, but not trying to understand why it came about, doesn't help spot or prevent future errors. Most of the missteps that we now realise were made by central banks in recent years had one common element — treating fluctuations in supply as if they were changes in demand.

The pandemic itself was a supply shock, particularly after governments stepped in to protect incomes lost due to shutdown measures. Ultra-low interest rates therefore caused excess demand in areas that were still open, particularly housing. The stall in the recovery during 2021 stemmed from supply disruptions, particularly in the auto industry, rather than a weakening in demand and thereby a widening of the output gap. For all the criticism it has received, the Bank of Canada was actually a frontrunner globally in recognising this and changing its approach to measuring slack within the economy. However, more recently the BoC's rate hikes this summer were possibly an overreaction to a temporary acceleration in growth driven by the partial easing of earlier supply constraints in the auto sector. The New Year's resolution of central banks should be to better understand the supply side of the economy.

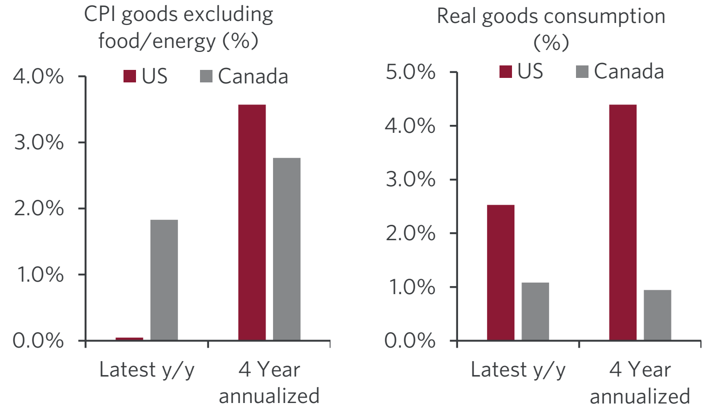
Unfortunately, New Year's resolutions are often broken, including my own yearly pledge to lose weight. So, what mistakes could be made in 2024 if policymakers continue to confuse trends in supply for those in demand?

In the US, the Federal Reserve needs to avoid the temptation of cutting interest rates too early or quickly. Inflation could well touch 2% briefly over the summer, as goods prices continue to fall from their earlier peaks. The larger spike in goods prices in the US, in part because of the higher weight for used cars, always created more room for disinflation as supply issues faded. However, this is a largely supply-driven and possibly temporary source of disinflation. Demand for consumer goods in the US has continued to rise, despite already being elevated relative to its pre-pandemic trend (Chart). Cutting interest rates as early and quickly as financial markets are currently expecting, before demand materially slows, could spark the return of inflation come 2025.

For Canada, a premature easing of interest rates should not be a concern, as household consumption has already slowed materially. Most of the inflation that we are now witnessing is supply driven, notably the inability of housing supply to keep up with population growth. While policymakers recently acknowledged that excess demand has faded, in reality most areas of domestic demand have not been excessive relative to their pre-pandemic trend for over a year, with the notable exception of government spending. The risk for Canada is that the Bank hangs onto a hawkish stance for too long, creating a prolonged period of sluggish economic activity and eventually below-target inflation by 2025.

Both central banks should be well aware of these risks, and if they stick to a New Year's resolution of not overacting to supply-driven trends in growth and inflation we should see more interest rate cuts from the Bank of Canada in 2024 than the Federal Reserve.

Chart: US goods inflation had more room to ease (L), but demand remains excessive (R)



Source: Statistics Canada, BEA, 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, December 25	-	Markets Closed (Christmas Day)	-	-	-	-	-
Tuesday, December 26	-	Markets Closed (Boxing Day)	-	-	-	-	-
Wednesday, December 27	-	-	-	-	-	-	-
Thursday, December 28	-	-	-	-	-	-	-
Friday, December 29	-	-	-	-	-	-	-

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, December 25	-	Markets Closed (Christmas Day)	-	-	-	-	-
Tuesday, December 26	-	AUCTION: 1-YR TREASURIES $44B	-	-	-	-	-
Tuesday, December 26	-	AUCTION: 2-YR TREASURIES $57B	-	-	-	-	-
Tuesday, December 26	8:30 AM	CHICAGO FED NAT.ACTIVITY INDEX	(Nov)	(M)	-	-	-0.5
Tuesday, December 26	8:30 AM	PHILADELPHIA FED	(Dec)	(M)	-	-	-11
Tuesday, December 26	9:00 AM	HOUSE PRICE INDEX M/M	(Oct)	(M)	-	0.5%	0.6%
Tuesday, December 26	9:00 AM	S&P CORELOGIC CS Y/Y	(Oct)	(H)	-	5.0%	3.9%
Wednesday, December 27	-	AUCTION: 5-YR TREASURIES $58B	-	-	-	-	-
Wednesday, December 27	-	AUCTION: 2-YR FRN $26B	-	-	-	-	-
Wednesday, December 27	10:00 AM	RICHMOND FED MANUF. INDEX	(Dec)	(M)	-	-	-5.0
Thursday, December 28	-	AUCTION: 7-YR TREASURIES $40B	-	-	-	-	-
Thursday, December 28	8:30 AM	INITIAL CLAIMS	(Dec 23)	(M)	-	210K	205K
Thursday, December 28	8:30 AM	CONTINUING CLAIMS	(Dec 16)	(L)	-	-	1865K
Thursday, December 28	8:30 AM	ADVANCE GOODS TRADE BALANCE	(Nov)	(M)	-$90.0B	-$89.5B	-$89.6B
Thursday, December 28	8:30 AM	WHOLESALE INVENTORIES M/M	(Nov P)	(L)	-	-0.2%	-0.4%
Thursday, December 28	8:30 AM	RETAIL INVENTORIES M/M	(Nov)	(H)	-	0.2%	0.0%
Thursday, December 28	10:00 AM	PENDING HOME SALES M/M	(Nov)	(M)	-	1.0%	-1.5%
Friday, December 29	8:30 AM	CHICAGO PMI	(Dec)	(M)	-	50.0	55.8

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, January 1	-	Markets Closed (New Years Day)	-	-	-	-	-
Tuesday, January 2	-	-	-	-	-	-	-
Wednesday, January 3	-	AUCTION: 3-M BILLS $8.7B, 6-M BILLS $3.2B, 1-YR BILLS $3.2B (Preliminary)	-	-	-	-	-
Thursday, January 4	-	-	-	-	-	-	-
Friday,January 5	8:30 AM	EMPLOYMENT CHANGE	(Dec)	(H)	10.0K	-	24.9K
Friday, January 5	8:30 AM	UNEMPLOYMENT RATE	(Dec)	(H)	5.9%	-	5.8%
Friday, January 5	10:00 AM	IVEY PMI	(Dec)	(L)	-	-	54.7

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, January 1	-	Markets Closed (New Years Day)	-	-	-	-	-
Tuesday, January 2	9:45 AM	S&P GLOBAL US MANUFACTURING PMI	(Dec)	(L)	-	48.4	48.2
Tuesday, January 2	10:00 AM	CONSTRUCTION SPENDING M/M	(Nov)	(M)	-	0.6%	0.6%
Wednesday, January 3	7:00 AM	MBA-APPLICATIONS	(Dec 29)	(L)	-	-	-
Wednesday, January 3	10:00 AM	ISM - MANUFACTURING	(Dec)	(H)	48.0	47.2	46.7
Wednesday, January 3	10:00 AM	JOLTS Job Openings	(Nov)	-	8900K	8850K	8733K
Wednesday, January 3	2:00 PM	FOMC Meeting Minutes	(Dec 13)	-	-	-	-
Wednesday, January 3	8:30 AM	Speaker: Thomas I. Barkin (Richmond) (Non-Voter)	-	-	-	-	-
Thursday, January 4	8:15 AM	ADP EMPLOYMENT CHANGE	(Dec)	(M)	-	113K	103K
Thursday, January 4	8:30 AM	INITIAL CLAIMS	(Dec 30)	(M)	-	-	-
Thursday, January 4	8:30 AM	CONTINUING CLAIMS	(Dec 23)	(L)	-	-	-
Thursday, January 4	9:45 AM	S&P GLOBAL US SERVICES PMI	(Dec)	(L)	-	51.3	51.3
Thursday, January 4	9:45 AM	S&P GLOBAL US COMPOSITE PMI	(Dec)	(L)	-	-	51.0
Friday, January 5	8:30 AM	NON-FARM PAYROLLS	(Dec)	(H)	180K	168K	199K
Friday, January 5	8:30 AM	UNEMPLOYMENT RATE	(Dec)	(H)	3.8%	3.8%	3.7%
Friday, January 5	8:30 AM	AVERAGE HOURLY EARNINGS ALL EMPLOYEES M/M	(Dec)	(H)	0.2%	0.3%	0.4%
Friday, January 5	8:30 AM	AVERAGE WEEKLY HOURS ALL EMPLOYEES	(Dec)	(H)	-	34.4	34.4
Friday, January 5	8:30 AM	MANUFACTURING PAYROLLS	(Dec)	(H)	-	-	28K
Friday, January 5	8:30 AM	GOODS & SERVICES TRADE BALANCE	(Nov)	(H)	-$65.0B	-	-$64.3B
Friday, January 5	10:00 AM	FACTORY ORDERS M/M	(Nov)	(M)	1.5%	1.6%	-3.6%
Friday, January 5	10:00 AM	ISM - SERVICES	(Dec)	(M)	53.0	52.5	52.7
Friday, January 5	10:00 AM	DURABLE GOODS ORDERS M/M	(Nov)	(H)	-	-	-
Friday, January 5	10:00 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Nov)	(H)	-	-	-
Friday, January 5	1:30 PM	Speaker: Thomas I. Barkin (Richmond) (Non-Voter)	-	-	-	-	-

Week Ahead's market call

by Andrew Grantham

In the **US**, there still appears to be plenty of demand within the economy, which suggests to us that job openings and payrolls employment may be a bit stronger than current consensus expectations. The ISM surveys may also beat low expectations, although the correlation between these figures and the hard economic data appears to have weakened further post-pandemic.

In **Canada**, we expect more of the same from the labour force survey, namely weak hiring that results in a further tick up in the unemployment rate, but as yet no outright decline in employment. Wage growth will still appear strong, but with the jobless rate continuing to move higher and job-switching at low levels, that inflationary pressure should ease as we progress through next year.

Week Ahead's key Canadian number: Employment—December

(January 5, Friday, 8:30 am)

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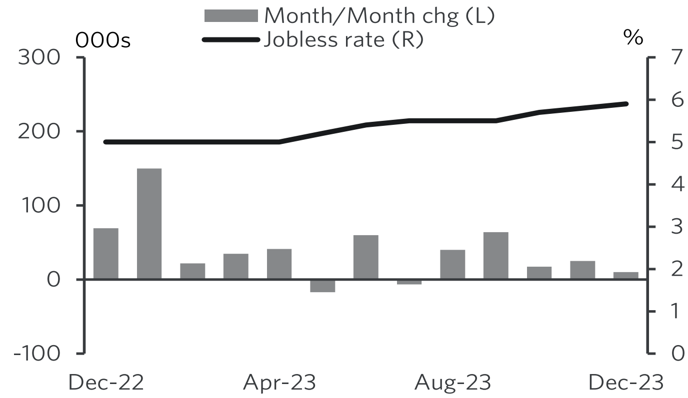
Variable	CIBC	Mkt	Prior
Employment change	10.0K	-	24.9K
Unemployment rate	5.9%	-	5.8%

Chart: Canadian employment



Source: Statistics Canada, Haver Analytics, CIBC

Job listings have been falling pretty consistently, including in service areas which had earlier in the year still been struggling to rehire staff. That should continue to result in weak employment growth that falls short of the still-strong pace of population growth. The 10K gain in employment we predict for December would result in a further uptick in the jobless rate to 5.9%, which would be towards the higher end of the range seen immediately before the Covid-19 pandemic. However, with a weak figure dropping out of the year-over-year calculation from last December, wage inflation may well accelerate slightly to 5.2%.

Forecast implications — With demand in the economy remaining sluggish, any growth in employment should remain slight and below the pace of population growth in the first half of 2024. That would see the unemployment rate creep up further to nearly 6.5%, although at this jobless rate, wage inflation should ease and make the Bank of Canada feel more comfortable about cutting interest rates.

Week Ahead's key US number: Employment situation—December

(January 5, Friday, 8:30 am)

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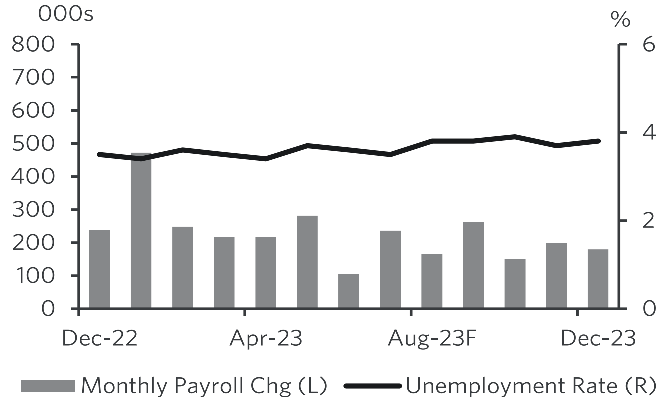
Variable	CIBC	Mkt	Prior
Employment (m/m)	180K	168K	199K
Unemployment rate	3.8%	3.8%	3.7%
Avg hourly earnings (m/m)	0.2%	0.3%	0.4%

Chart: US payroll employment



Source: BLS, Haver Analytics, CIBC

US employment should remain strong in December with an expected 180K payroll jobs gained. Most of the support should continue to come from government and healthcare sectors. These sectors have accounted for an average of 80% of the jobs gained over the past six months and are less influenced by broader business cycle conditions, suggesting job growth should remain solid for some time going forward in the payroll survey. However, the household survey should show a less rosy picture with the unemployment rate edging up to 3.8% in December after dropping two notches to 3.7% in November. Last month's strong number likely reflected a mix of strong labour demand and some residual seasonality. Overall, the key takeaway will be the same over the past few months: a tight labour market that is only gradually rebalancing.

Forecast implications — Looking at Q4 as a whole, the labour market data will likely point to a moderation in income growth and a softening in labour demand with the unemployment rate a notch higher than in Q3. But the participation rate will come in a few shades under 63%, well above the CBO's estimate of the trend participation rate of 62.4% suggesting labour supply is at or near its cycle peak.

Market impact — At this point, the market is most sensitive to the changing attitudes of FOMC officials and we expect will be somewhat less sensitive to turns in the data. With the labour market settling into a more gradual pace of rebalancing, we view the risks around the December report as fairly balanced.

Other US Releases: ISM Manufacturing—December

(January 3, Wednesday, 10:00 am)

ISM manufacturing should improve slightly, in line with other preliminary manufacturing PMI data. This will be the thirteenth consecutive month in contractionary territory for the measure.

JOLTS Job Openings—November

(January 3, Wednesday, 10:00 am)

We expect the November JOLTS data to show job openings increased in the month, consistent with other measures in October that pointed to labour demand picking up. That implies that the vacancy-to-unemployment ratio should edge up a notch to 1.4.

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