

THE WEEK AHEAD

January 15 - 19, 2024

Grading on an easier curve

by Avery Shenfeld avery.shenfeld@cibc.com

Students know that there are two ways to get an “A”. You can study hard and breeze through a tough test. Or you can find a prof that grades on an easier curve, perhaps at a university that hands out A’s to nearly all comers. The result is that two students with the same transcript might actually be quite different in terms of their knowledge and abilities. It’s much the same story for central banks, and the Fed is actually grading its inflation progress on an easier curve than the Bank of Canada.

Chairman Powell is aiming to get the PCE price index back to a sustainable 2% pace, and is grading his success by tracking that benchmark, as well as PCE excluding food and energy. For his part, Governor Macklem is aiming at a sustainable 2% CPI inflation rate and is eying several underlying trend measures for Canada’s CPI.

But if you’re aiming to get an “A” in your price stability exam, “Professor” Powell is the one that’s using an easier benchmark. The core PCE price index has tumbled to a lower level than its CPI counterpart. That’s largely because PCE inflation puts only a 15% weight on one of the hottest items, shelter, versus 35% in the CPI. That divergence was key to our decision to add to our forecast for Fed rate cuts this year.

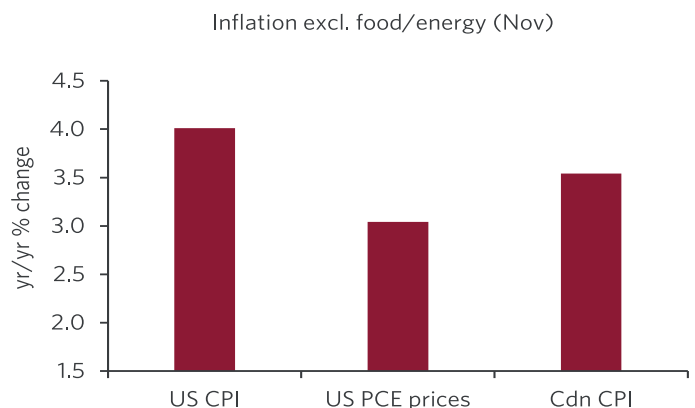
“Professor” Macklem might seem like a tougher grader, since Canada tracks the CPI rather than PCE prices, and the CPI currently puts a 28% weight on shelter, which, as in the US, is still overheated. Canada’s inflation measure includes the upward pressure from rising mortgage interest costs that aren’t captured in either US inflation benchmark. Like the Fed, the BoC also looks at “underlying” inflation measures. But in recent years it downplayed CPI-X, an earlier core indicator that stripped out mortgage interest and thereby reduced the weighting for shelter.

As a result of the BoC’s tougher grading scheme, and the greater progress seen in US PCE (versus its CPI), markets expect the Fed to keep pace or perhaps even exceed the Bank of Canada in terms of rate cuts this year. That’s despite the fact that Canada’s economic growth has virtually stalled with a material rise in the jobless rate, while the US has motored along nicely.

But that might be the wrong interpretation of where we’re headed. Students that earned an easy-A can run into employers and grad schools that will adjust for the differences in grading schemes. And interest rate outcomes might not really be that dependent on these distinctions in current measures of inflation. Remember that what the Bank of Canada targets isn’t today’s inflation rate, or any particular core benchmark. Given the lags in how rate hikes or cuts impact economic slack and prices, the Bank is aiming at steering total inflation a year or so out to its 2% target.

A weaker Canadian economy should continue to put downward pressure on non-shelter components of inflation. And Canada’s heavier weight for shelter in the CPI versus the US PCE index might also not matter as much by then. A likely slowing in inflows of students and temporary foreign workers by 2025 should ease rent inflation, while interest rate cuts will cap the inflation contribution from mortgage interest. So, in terms of the real target, which is where inflation will be a year from now, Canada might not be grading on a tougher curve after all, and facing a weaker economy, the Bank of Canada should therefore end up cutting at a faster pace than its US counterpart.

Chart: US PCE prices closer to 2% target



Source: 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, January 15	8:30 AM	WHOLESALE SALES EX. PETROLEUM M/M	(Nov)	(M)	-	-	-0.5%
Monday, January 15	8:30 AM	MANUFACTURING SHIPMENTS M/M	(Nov)	(M)	1.0%	0.6%	-2.8%
Monday, January 15	9:00 AM	EXISTING HOME SALES M/M	(Dec)	(M)	-	-	-0.9%
Monday, January 15	10:30 AM	BUSINESS OUTLOOK SURVEY	(4Q)	(L)	-	-	-3.5
Monday, January 15	10:30 AM	Release: Canadian Survey of Consumer Expectations	-	-	-	-	-
Tuesday, January 16	-	AUCTION: 3-M BILLS \$12.2B, 6-M BILLS \$4.4B, 1-YR - BILLS \$4.4B	-	-	-	-	-
Tuesday, January 16	8:15 AM	HOUSING STARTS SAAR	(Dec)	(M)	220.0K	-	212.6K
Tuesday, January 16	8:30 AM	CPI M/M	(Dec)	(H)	-0.3%	-0.3%	0.1%
Tuesday, January 16	8:30 AM	CPI Y/Y	(Dec)	(H)	3.4%	3.2%	3.1%
Tuesday, January 16	8:30 AM	Consumer Price Index	(Dec)	(M)	-	158.3	158.8
Tuesday, January 16	8:30 AM	CPI Core- Median Y/Y%	(Dec)	(M)	3.3%	3.4%	3.4%
Tuesday, January 16	8:30 AM	CPI Core- Trim Y/Y%	(Dec)	(M)	3.4%	3.4%	3.5%
Wednesday, January 17	8:30 AM	INT'L. SEC. TRANSACTIONS	(Nov)	(M)	-	-	-\$15.8B
Wednesday, January 17	8:30 AM	INDUSTRIAL PROD. PRICES M/M	(Dec)	(M)	-	-	-0.4%
Wednesday, January 17	8:30 AM	RAW MATERIALS M/M	(Dec)	(M)	-	-	-4.2%
Thursday, January 18	-	AUCTION: 5-YR CANADAS \$5B	-	-	-	-	-
Friday, January 19	8:30 AM	RETAIL TRADE TOTAL M/M	(Nov)	(H)	0.1%	0.0%	0.7%
Friday, January 19	8:30 AM	RETAIL TRADE EX-AUTO M/M	(Nov)	(H)	-0.1%	-	0.6%

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 15	-	-	-	-	-	-	-
Tuesday, January 16	8:30 AM	NEW YORK FED (EMPIRE)	(Jan)	(M)	-	-2.9	-14.5
Tuesday, January 16	11:00 AM	Speaker: Christopher J. Waller (Governor) (Voter)	-	-	-	-	-
Wednesday, January 17	-	AUCTION: 20-YR TREASURIES \$13B	-	-	-	-	-
Wednesday, January 17	7:00 AM	MBA-APPLICATIONS	(Jan 12)	(L)	-	-	9.9%
Wednesday, January 17	8:30 AM	RETAIL SALES M/M	(Dec)	(H)	0.1%	0.4%	0.3%
Wednesday, January 17	8:30 AM	RETAIL SALES (X-AUTOS) M/M	(Dec)	(H)	0.0%	0.2%	0.2%
Wednesday, January 17	8:30 AM	RETAIL SALES CONTROL GROUP M/M	(Dec)	(H)	0.1%	0.2%	0.4%
Wednesday, January 17	8:30 AM	IMPORT PRICE INDEX M/M	(Dec)	(L)	-	-0.7%	-0.4%
Wednesday, January 17	8:30 AM	EXPORT PRICE INDEX M/M	(Dec)	(L)	-	-0.7%	-0.9%
Wednesday, January 17	9:15 AM	INDUSTRIAL PRODUCTION M/M	(Dec)	(H)	0.0%	-0.1%	0.2%
Wednesday, January 17	9:15 AM	CAPACITY UTILIZATION	(Dec)	(M)	79.0%	78.7%	78.8%
Wednesday, January 17	10:00 AM	BUSINESS INVENTORIES M/M	(Nov)	(L)	-	-0.1%	-0.1%
Wednesday, January 17	10:00 AM	NAHB HOUSING INDEX	(Jan)	(L)	-	39.0	37.0
Wednesday, January 17	2:00 PM	FED'S BEIGE BOOK	-	-	-	-	-
Wednesday, January 17	9:00 AM	Speaker: Michael S Barr (Governor) (Voter) & Michelle W Bowman (Governor) (Voter)	-	-	-	-	-
Wednesday, January 17	3:00 PM	Speaker: John C. Williams (Vice Chairman, New York) (Voter)	-	-	-	-	-
Thursday, January 18	-	AUCTION: 10-YR TIPS \$18B	-	-	-	-	-
Thursday, January 18	8:30 AM	INITIAL CLAIMS	(Jan 13)	(M)	-	207K	202K
Thursday, January 18	8:30 AM	CONTINUING CLAIMS	(Jan 6)	(L)	-	-	1834K
Thursday, January 18	8:30 AM	BUILDING PERMITS SAAR	(Dec)	(H)	1450K	1480K	1467K
Thursday, January 18	8:30 AM	HOUSING STARTS SAAR	(Dec)	(M)	1460K	1418K	1560K
Thursday, January 18	7:30 AM	Speaker: Raphael W. Bostic (Atlanta) (Non-Voter)	-	-	-	-	-
Thursday, January 18	11:30 AM	Speaker: Raphael W. Bostic (Atlanta) (Non-Voter)	-	-	-	-	-
Friday, January 19	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Jan P)	(H)	-	69.0	69.7
Friday, January 19	10:00 AM	EXISTING HOME SALES SAAR	(Dec)	(M)	-	3.8M	3.8M
Friday, January 19	10:00 AM	EXISTING HOME SALES M/M	(Dec)	(M)	-	0.3%	0.8%
Friday, January 19	4:00 PM	NET CAPITAL INFLOWS (TICS)	(Nov)	(L)	-	-	\$3.3B
Friday, January 19	1:00 PM	Speaker: Michael S Barr (Governor) (Voter)	-	-	-	-	-
Friday, January 19	4:15 PM	Speaker: Mary C. Daly (San Francisco) (Non-Voter)	-	-	-	-	-

Week Ahead's market call

by Avery Shenfeld

In the **US**, we expect retail sales to come in a bit weaker than consensus, but all of the fourth quarter consumer data has to be put into the context of a correction from a barnburner gain in Q3. Industrial production will see some benefit from a pick-up at auto plants, but perhaps a drag from utilities in the face of mild weather. Housing starts look to ease, but lower mortgage rates portend a pick-up as we move deeper into 2024. Remarks from Fed speakers could be the thing to watch this week, as we'll get their take on the latest CPI data and perhaps some clues on how soon we can expect a truly dovish pivot.

In **Canada**, the headline inflation data will mislead in two directions. StatsCan gives prominence to the monthly non-seasonally adjusted change, so December's CPI drop (NSA) will actually mask a 0.3% seasonally adjusted rise in prices, while the rise in the 12-month inflation rate reflects a steeper drop in gasoline prices dropping out from 12 months ago. What's important is that the two core measures that look for the underlying trend are likely to continue their gradual softening, with more of the inflation now narrowly based in the shelter component. We're hoping to also see a modest reduction in inflation expectations in the Bank of Canada's consumer survey, where what's happening to gasoline prices is often influential. Their Business Outlook Survey needs to be interpreted carefully, since some of the questions ask respondents to compare the coming year to the one gone by, and that base of comparison is now a pretty low bar, suggesting that the survey may not show a further darkening even if the economic picture isn't all that positive.

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

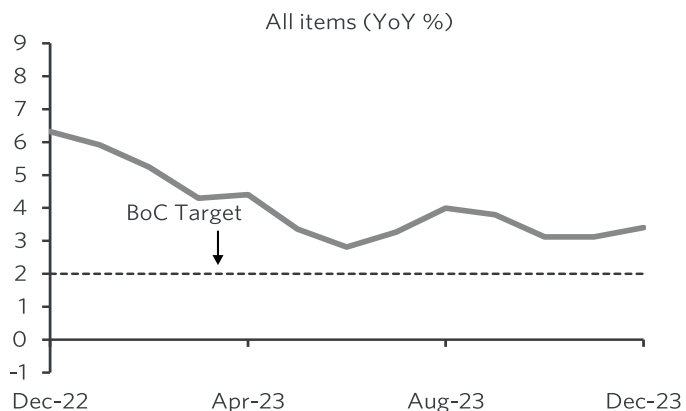
(Tuesday, 8:30 am)

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Variable (%)	CIBC	Mkt	Prior
CPI NSA (m/m)	-0.3	-0.3	0.1
CPI (y/y)	3.4	3.2	3.1

The annual rate of inflation likely accelerated modestly in December, albeit largely because gasoline prices fell less than they did during the same month of 2022. Elsewhere, rents and mortgage interest costs will keep shelter prices rising quickly, although there should be further signs that food price inflation is easing. Airline fares weren't as weak as normal in November, which could mean that they didn't rise as much as they typically do in December. With overall inflationary pressures becoming less broad-based, we should see a further deceleration in the Bank of Canada's preferred CPI-trim and CPI-median measures of inflation.

Chart: Canadian consumer price index



Source: Statistics Canada, Haver Analytics, CIBC

Forecast implications — Headline inflation will likely be stuck just above 3% until the spring, largely due to continued increases in shelter costs (including mortgage interest payments) and some lingering food price inflation. However, with the drivers of inflation becoming narrower, the CPI-trim and CPI-median measures of price pressures should continue to decelerate, which will provide comfort for the Bank of Canada to start cutting interest rates in Q2.

Other Canadian releases: Retail sales—November

(Friday, 8:30 am)

After posting a solid increase in October, retail sales likely stagnated in November which would represent a slight decline in inflation-adjusted and per-capita terms. More discretionary areas of spending likely struggled as households continue to make cutbacks due to higher interest rates. The advance estimate for December could look weak in nominal terms, partly due to the impact of lower gasoline prices.

Week Ahead's key US number: Retail sales—December

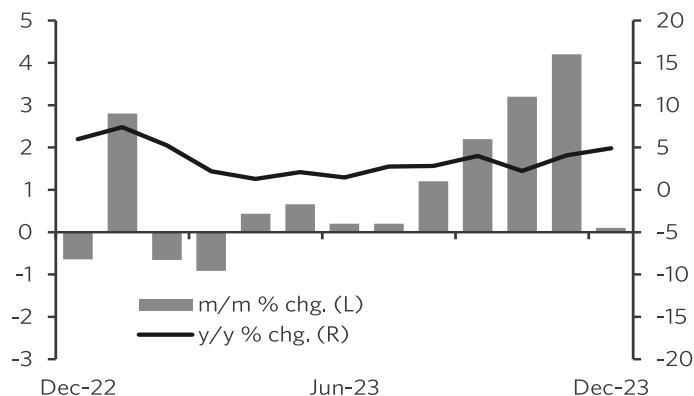
(Wednesday, 8:30 am)

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Variable (%)	CIBC	Mkt	Prior
Retail sales (m/m)	0.1	0.4	0.3
Retail sales - ex auto	0.0	0.2	0.2
Retail sales - control group	0.1	0.2	0.4

High-frequency credit card spending suggests retail sales likely ended 2023 not with a bang, but a whimper. Despite the solid labour market conditions, consumers are coming off a splurge in Q3 which would have pulled forward some consumption for durables. Combined with a saving rate that has started to drift up over the past few months, these signals add up to a US consumer due for a much needed breather. Our expectation is a modest 0.1% m/m growth for both headline sales and the control group.

Chart: US retail sales (%)



Source: Census Bureau, Haver Analytics, CIBC

Forecast implications — Despite the soft expected control group reading, the December CPI inflation in core goods excluding used cars came in at -0.1% m/m implying solid real goods consumption in the month. Our GDP tracking remains just under 2% annualized for 23Q4.

Market implications — Our views on retail sales are somewhat below consensus but that should not mean too much. The FOMC has been very tolerant of the past strength in consumption which was mostly a surprise. Powell has repeatedly emphasized supply-side improvements in the labour market and stronger potential output as reasons for the strength in activity. Implicitly, they seem to view the past surge in spending as temporary given it coincided with a rebalancing of the labour market. Hence, surprises in retail sales — in either direction — likely have modest consequences for monetary policy in the near-term.

Other US Releases: Industrial production—December

(Wednesday, 9:15 am)

We expect flat industrial production in December, whereas consensus expects a contraction in the month. Our view is based on the expectation that auto manufacturers will slowly ramp up production, offsetting a drop in utilities.

Housing starts—December

(Thursday, 8:30 am)

The pace of home building should pullback by 100K to 1460K after the surge in November. However, with mortgage rates have dropped by over a 100bps since October, housing demand is likely to gradually heat up again.

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