Economics

THE WEEK AHEAD

January 9-13, 2023

Keeping it real

by **Avery Shenfeld** avery.shenfeld@cibc.com

In thinking about the right course for Canadian monetary policy in the wake of December job gains, it's important to keep in mind that low inflation is not really an end unto itself. Yes, price stability increases the utility of money as a store of value, but who other than an economics nerd has ever had that at the top of their economic wish list?

We value tame and predictable inflation as a means to more important objectives for real rather than nominal variables: real per capita incomes, stable real growth rates with smaller downturns, low unemployment and fewer people in poverty. Sustained and particularly escalating inflations have often proven detrimental to an economy's ability to achieve these real side objectives. Buenos días Argentina.

But the cure for escalating inflation involves putting a dent into real economic activity in the near term. Keeping it real at the central bank means that policy should follow the course that entails the smallest sacrifice to real incomes and employment necessary to achieve the desired inflation deceleration.

Models based on historical sensitivities suggest that much of the impact of 2022 rate hikes in Canada and abroad will only reveal itself over the course of 2023. Higher mortgage rates have stalled housing demand, but given the lag between sales of new units and their completion, the construction sector bite will come later. Higher mortgage rates will hit those with fixed rates only as their contracts come due. Manufacturing seems to be decelerating in the US, which along with higher costs for capital will spill over into Canadian business spending plans.

The strength shown in December hiring in part reflected the need to add staff to make up for so many hours being lost due to viral illnesses. Still, the Bank of Canada will view the resulting 5% jobless rate, and the associated wage inflation, as reason to hike again in January, making our prior call for a pause seem unlikely.

But the real side perspective makes a strong case that the Bank of Canada should only nudge rates up by a quarter point, and then pause to see how the economy actually fares. Rates are no longer at rock bottom levels. Overshooting, and causing a deeper economic contraction than needed to get inflation back to earth, is a serious risk given the lags in monetary policy impacts. As a case in point, the last time we really tightened the policy screws to deal with elevated inflation, in the early 1990s, central banks got a bigger downturn than they were likely bargaining for.

In Canada, inflation targeting was adopted in February 1991, when the CPI stood at over 6%, and the Bank set interim goals of reaching 3% by the end of 1992, and 2.5% for mid-1994. Instead, a sharp global downturn saw inflation dive to 1% by mid-92, and sit at zero in mid-94. Presumably, since it was willing to live with a more gradualist reduction in inflation, the central bank, or Canadians more broadly, might have been happier suffering a shallower downturn in the economy.

The benefits of waiting and seeing how much bite previous rate hikes have built in, before taking things too far, are in avoiding that sort of nasty surprise this time. Once a sharp downturn is fully visible in the data, it's often too late for a course correction, particularly since mild downturns and steep recessions can initially look quite similar until all the numbers, and all the revisions to them, are in. Larger rate hikes at each meeting add to the risk that the policy levers will be much too tight before we can recognize that's the case.

What about the costs of doing too little, and seeing inflation get more intractable? Yes, there are "real" consequences of that sort of error, but it should be relatively easy to pick out the absence of a slowdown by late spring, and to then resume more significant rate hikes if need be. We also have some factors pulling in the right way on inflation expectations, including softer energy prices. Add in the fact that interest rates are no longer so tempting to borrowers, and the Bank of Canada should have room to, at a minimum, switch to bite sized rate hikes at this point.

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 9	8:30 AM	BUILDING PERMITS M/M	(Nov)	(M)	-	-	-1.4%
Tuesday, January 10	5:10 PM	Speaker: Tiff Macklem (Governor)	-	-	-	-	-
Wednesday, January 11	-	AUCTION: 5-YR CANADAS $4B	-	-	-	-	-
Thursday, January 12	-	AUCTION: 2-YR CANADAS $4B	-	-	-	-	-
Friday, January 13	9:00 AM	EXISTING HOME SALES M/M	(Dec)	(M)	-	-	-3.3%

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 9	3:00 PM	CONSUMER CREDIT	(Nov)	(L)	-	-25.0B	$27.1B
Monday, January 9	12:30 PM	Speaker: Raphael W. Bostic (Atlanta)	-	-	-	-	-
Tuesday, January 10	-	AUCTION: 3-YR TREASURIES $40B	-	-	-	-	-
Tuesday, January 10	4:30 AM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Tuesday, January 10	9:00 AM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Wednesday, January 11	-	AUCTION: 10-YR TREASURIES $32B	-	-	-	-	-
Wednesday, January 11	7:00 AM	MBA-APPLICATIONS	(Jan 6)	(L)	-	-	-10.3%
Thursday, January 12	-	30-YR AUCTION: $18B	-	-	-	-	-
Thursday, January 12	8:30 AM	INITIAL CLAIMS	(Jan 7)	(M)	-	-	204K
Thursday, January 12	8:30 AM	CONTINUING CLAIMS	(Dec 31)	(L)	-	-	1694K
Thursday, January 12	8:30 AM	CPI M/M	(Dec)	(H)	-0.1%	0.0%	0.1%
Thursday, January 12	8:30 AM	CPI M/M (core)	(Dec)	(H)	0.2%	0.3%	0.2%
Thursday, January 12	8:30 AM	CPI Y/Y	(Dec)	(H)	6.3%	6.6%	7.1%
Thursday, January 12	8:30 AM	CPI Y/Y (core)	(Dec)	(H)	5.6%	5.7%	6.0%
Thursday, January 12	2:00 PM	TREASURY BUDGET	(Dec)	(L)	-	-	-$248.5B
Thursday, January 12	7:30 AM	Speaker: Patrick Harker (Philadelphia) (Non-Voter)	-	-	-	-	-
Thursday, January 12	11:30 AM	Speaker: James Bullard (St Louis) (Voter)	-	-	-	-	-
Friday, January 13	8:30 AM	IMPORT PRICE INDEX M/M	(Dec)	(L)	-	-0.9%	-0.6%
Friday, January 13	8:30 AM	EXPORT PRICE INDEX M/M	(Dec)	(L)	-	-0.7%	-0.3%
Friday, January 13	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Jan P)	(H)	-	60.5	59.7

Week Ahead's market call

by Andrew Grantham

In the **US**, inflation data should show a further easing in core price pressures, albeit to a 12-month rate still well above that consistent with the Fed's 2% PCE target. With health services expected to remain a dampener like it was in the prior two months, Fed officials will be looking for further signs that wage growth is easing to become more confident that CPI inflation is on a sustainable downward trajectory.

In **Canada**, we get another week to digest the December employment reports, with only lower tier data on tap.

There are no major Canadian data releases next week.

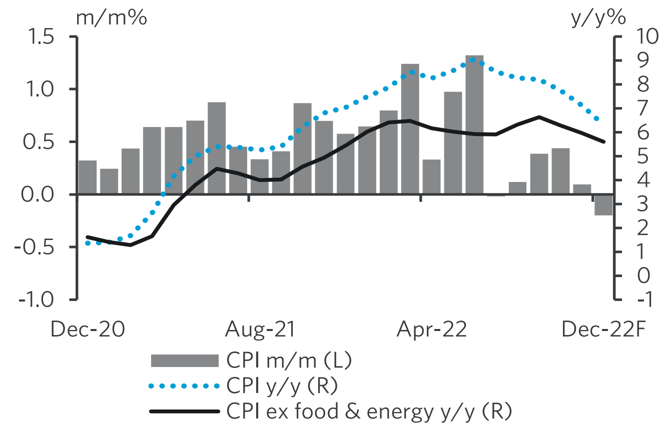
Week Ahead's key US number: Consumer price index—December

(Thursday, 8:30 am)

Katherine Judge katherine.judge@cibc.com

Variable	CIBC	Mkt	Prior
Headline CPI m/m	-0.1%	0.0%	0.1%
Headline CPI (y/y)	6.3%	6.6%	7.1%
Core CPI m/m	0.2%	0.3%	0.2%
Core CPI y/y	5.6%	5.7%	6.0%

Chart: US consumer price index



Source: BLS, Haver Analytics, CIBC

There was more relief in the form of lower gasoline prices for households in December, which will be behind the expected 0.1% monthly decline in total prices. That retrenchment will have been limited by pressure in food prices and an expected 0.2% advance in the core group (excluding food and energy), with the latter likely showing strength in core services tied to the tight labor market, against an easing in core goods prices on weaker demand and the improvement in supply chains and inventories.

An easing in monthly hotel prices was behind the deceleration in shelter costs in December, but rent and owners' equivalent rent reaccelerated and are likely to show continued, strong pressure in December, before peaking in early 2023 in terms of monthly increases. Outside of shelter, other core services are the main areas of concern for the Fed, given ties to the tightness in the labor market, and still strong demand for services. A measurement quirk has been behind the downward pressure on core prices from medical care lately, with airfares also adding to the downside; both areas that aren't indicative of underlying demand, and therefore did little to assuage the Fed's concern.

Forecast implications — With core goods prices continuing to ease on supply chain improvements, and momentum in shelter prices likely waning in early 2023, the Fed will be focused on the impact of past rate hikes in cooling the labor market and demand for services. We expect there to be enough evidence in hand of a slowdown in those areas for the Fed to stop hiking after delivering another 50bps of hikes in early 2023.

Market impact — We are a tick below consensus for both total and core inflation, which could nudge bond yields and the USD lower, but be a plus for equities.

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

Karyne Charbonneau
613 552-1341
karyne.charbonneau@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