THE WEEK AHEAD

March 11 - 15, 2024

Wagers on wages

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

There are two camps among American economists on when the Fed should be cutting the US policy rate. There are those like Paul Krugman who argue that inflation is now low enough that the central bank ought to be easing now. January's CPI blip made a dent in that view, but the week ahead's CPI, and even more so the subsequent core PCE report, are likely to be softer again. The other camp wants more evidence that cooler inflation will be sustained, and puts a lot of weight on the labour market for guidance, particularly on pay rates. Since that group appears to include a majority at the Fed, anyone taking a position at the short end of the US yield curve is, in effect, making a wager on wages.

Today's payroll report undid January's weather distorted spike in average hourly earnings, but still had them up 4.3% over the past year. A bump in productivity helped contain unit labour costs in 2023, but that might have been a one-time lift as supply chains improved. The current pace of pay increases provides Americans with the spending power that could sustain price increases above the Fed's 2% target.

In a quantitative analysis we published last year, we demonstrated that two forces were behind this cycle's escalation in wage rates. The first was a lagged response to higher inflation, as workers hunt more aggressively for pay gains to catch up to living costs. Employers, seeing others raising prices, gain confidence that they can pass on higher labour costs in their own prices. The steep drop in CPI inflation should continue to pull wage growth downward.

A tight labour market was the other factor that compelled employers to ante up higher pay scales. The jobless rate has ticked up to 3.9% in February, but it was never materially lower than in the past cycle. Where the tightness showed up was in the fact that there were far more positions sitting vacant. As job offers went unanswered, employers paid up to fill them. There too, we saw a significant easing in that driver of wage inflation for a while, but of late, job vacancies have stopped falling as a share of the total labour market, and remain elevated compared to the prior cycle.

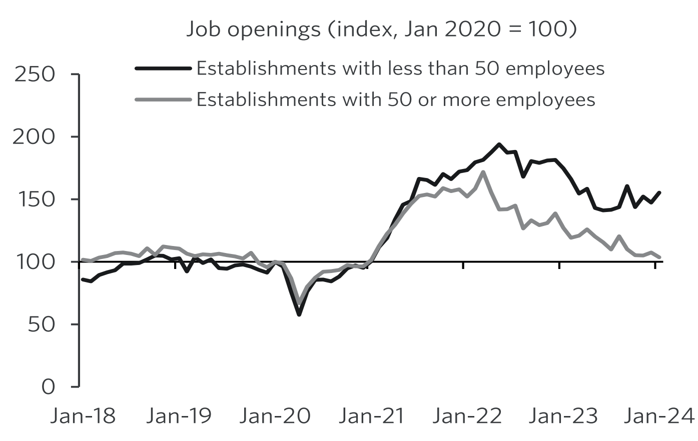
Will those vacant positions push employers to continue to dangle big pay hikes to fill them? Digging into the vacancy data in the JOLTS report suggests that's unlikely. Vacancies at large and medium sized firms continue to decline, and are essentially in line with pre-pandemic norms. The stickiness in total job vacancies is entirely due to a climb in open positions at small businesses with less than 50 employees (Chart).

There's reason to believe that these smaller employers are unlikely to use more aggressive pay hikes to fill such positions, and may opt to leave them open until softer labour markets allow them to find workers. For one, they are less likely to be as well informed about current market wage trends than larger firms. The fact that they are going unfilled month after month suggests that they are being posted at below-market wage rates.

Second, particularly in low skill, lower paying jobs, they're the type of positions for which pay rates have already shot up sharply. That hasn't been sufficient to fill all the vacancies, as low levels of immigration, and jobs available at larger firms in sectors that still pay more, have reduced the availability of workers for these small business jobs. With inflation more subdued, small businesses won't be as confident about passing on further wage hikes in their prices.

For now, bets on the timing of Fed rate cuts are partially tied to the uncertain prospects for wages and their impact on inflation ahead. On our part, we've put our chips on a July cut, with that being deep enough into 2024 to see a turning point for wage inflation as its two drivers point to slower pay gains ahead.

Chart: US job openings by company size



Source: Bureau of Labor Statistics, CIBC calculations

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, March 11	-	-	-	-	-	-	-
Tuesday, March 12	-	AUCTION: 3-M BILLS $14B, 6-M BILLS $5B, 1-YR BILLS $5B	-	-	-	-	-
Tuesday, March 12	-	Quebec Budget	-	-	-	-	-
Wednesday, March 13	-	-	-	-	-	-	-
Thursday, March 14	-	AUCTION: 5-YR CANADAS $5B	-	-	-	-	-
Thursday, March 14	8:30 AM	MANUFACTURING SHIPMENTS M/M	(Jan)	(M)	0.4%	0.4%	-0.7%
Friday, March 15	8:15 AM	HOUSING STARTS SAAR	(Feb)	(M)	240.0K	217.5K	223.6K
Friday, March 15	8:30 AM	WHOLESALE SALES EX PETROLEUM M/M	(Jan)	(M)	-0.6%	-0.6%	0.3%
Friday, March 15	8:30 AM	INT'L. SEC. TRANSACTIONS	(Jan)	(M)	-	-	$10.4B

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, March 11	-	AUCTION: 3-YR TREASURIES $56B	-	-	-	-	-
Tuesday, March 12	-	AUCTION: 10-YR TREASURIES $39B	-	-	-	-	-
Tuesday, March 12	8:30 AM	CPI M/M	(Feb)	(H)	0.3%	0.4%	0.3%
Tuesday, March 12	8:30 AM	CPI M/M (core)	(Feb)	(H)	0.3%	0.3%	0.4%
Tuesday, March 12	8:30 AM	CPI Y/Y	(Feb)	(H)	3.1%	3.1%	3.1%
Tuesday, March 12	8:30 AM	CPI Y/Y (core)	(Feb)	(H)	3.7%	3.7%	3.9%
Tuesday, March 12	2:00 PM	TREASURY BUDGET	(Feb)	(L)	-	-	-$21.9B
Wednesday, March 13	-	AUCTION: 30-YR TREASURIES $22B	-	-	-	-	-
Wednesday, March 13	7:00 AM	MBA-APPLICATIONS	(Mar 8)	(L)	-	-	9.7%
Thursday, March 14	8:30 AM	INITIAL CLAIMS	(Mar 9)	(M)	-	-	217K
Thursday, March 14	8:30 AM	CONTINUING CLAIMS	(Mar 2)	(L)	-	-	1906K
Thursday, March 14	8:30 AM	RETAIL SALES M/M	(Feb)	(H)	0.6%	0.7%	-0.8%
Thursday, March 14	8:30 AM	RETAIL SALES (X-AUTOS) M/M	(Feb)	(H)	0.4%	0.5%	-0.6%
Thursday, March 14	8:30 AM	RETAIL SALES CONTROL GROUP M/M	(Feb)	(H)	0.4%	0.2%	-0.4%
Thursday, March 14	8:30 AM	PPI M/M	(Feb)	(M)	0.2%	0.3%	0.3%
Thursday, March 14	8:30 AM	PPI M/M (core)	(Feb)	(M)	0.1%	0.2%	0.5%
Thursday, March 14	8:30 AM	PPI Y/Y	(Feb)	(M)	-	-	0.9%
Thursday, March 14	8:30 AM	PPI Y/Y (core)	(Feb)	(M)	-	-	2.0%
Thursday, March 14	10:00 AM	BUSINESS INVENTORIES M/M	(Jan)	(L)	-	0.3%	0.4%
Friday, March 15	8:30 AM	NEW YORK FED (EMPIRE)	(Mar)	(M)	-	-7.0	-2.4
Friday, March 15	8:30 AM	IMPORT PRICE INDEX M/M	(Feb)	(L)	-	0.2%	0.8%
Friday, March 15	8:30 AM	EXPORT PRICE INDEX M/M	(Feb)	(L)	-	0.1%	0.8%
Friday, March 15	9:15 AM	INDUSTRIAL PRODUCTION M/M	(Feb)	(H)	-0.1%	0.0%	-0.1%
Friday, March 15	9:15 AM	CAPACITY UTILIZATION	(Feb)	(M)	78.3%	78.4%	78.5%
Friday, March 15	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Mar P)	(H)	-	77.0	76.9

Week Ahead's market call

by Avery Shenfeld

In the **US**, weather distorted the prior month's retail sales figures to the downside, while a statistical quirk acted to lift CPI data to the high side. As a result, February data seem likely to tilt a bit softer on inflation, and firmer on retailing. Given the gap between the two measures, a CPI pace of 0.3% per month can be consistent with 2% inflation in the Fed's PCE price benchmark. But a rebound in February retailing would be generally in line with our forecast for Q1 growth a bit above 2%, healthy enough that the Fed isn't being pushed into a quick move to ease up on rates

In **Canada**, we don't build as many homes in the winter, but when winter seems a bit like spring in parts of the country, that can help lift seasonally-adjusted starts. We might see a pop in February housing starts figures as a result. Manufacturing and wholesaling data are likely to present a mixed picture of economic activity in January. Overall, it's a fairly light week for potential market impacts, as we await the CPI figures later this month.

Week Ahead's key Canadian number: Housing starts—February

(Friday, 8:15 am)

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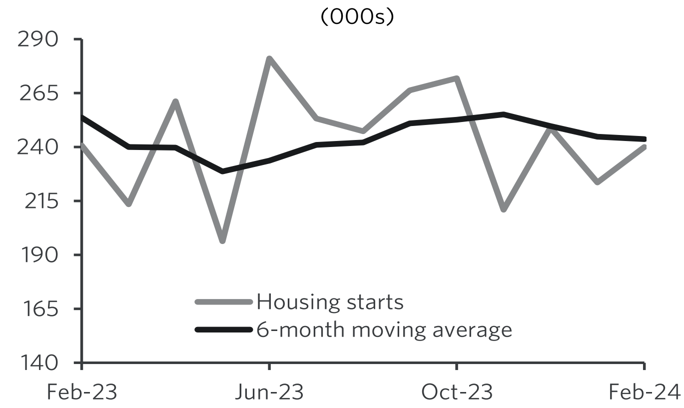
Variable (K)	CIBC	Mkt	Prior
Housing starts SAAR	240.0	217.5	223.6

Chart: Canadian housing starts



Source: CMHC, Haver Analytics, CIBC

Housing activity in the resale market has perked up lately, with unit sales rising in December and January, possibly reflecting optimism for Bank of Canada rate cuts later in 2024, and an atypically mild winter. That could have translated into a pickup in housing starts in February to a 240K pace, likely concentrated in the single-family segment of the market, as condo starts will be limited by weakness in the pre-sale space and the fact that there is already ample supply in the pipeline from previously started projects.

Forecast implications — Homebuilding is likely to show a deceleration in Q1 as a whole, but the drag on GDP growth from residential investment looks likely to have been limited by increased activity in the resale market. We expect housing starts to accelerate in H2, when the BoC will likely be cutting interest rates.

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

(Tuesday, 8:30 am)

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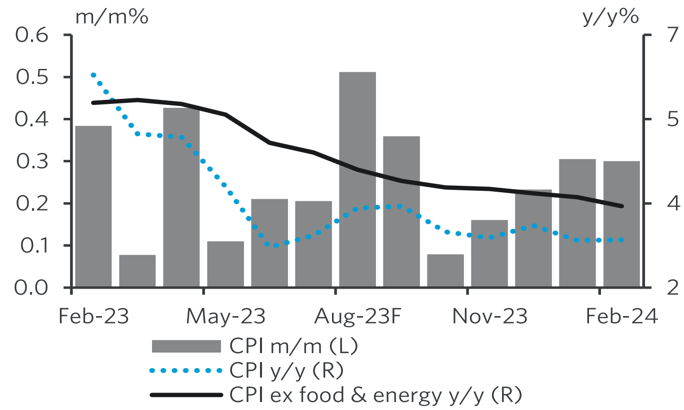
Variable (%)	CIBC	Mkt	Prior
Headline CPI (m/m)	0.3	0.4	0.3
Headline CPI (yr/yr)	3.1	3.1	3.1
Core CPI (m/m)	0.3	0.3	0.4
Core CPI (yr/yr)	3.7	3.7	3.9

Chart: US consumer price index



Source: BLS, Haver Analytics, CIBC

Are we on the cusp of a second inflation surge? We don't think so. Our expectation for the February CPI print is a headline and core reading of 0.3% m/m. Underpinning this assumption is that the January wage and price resetting that occurred throughout the economy — which may have been juiced by the strength of the economy and residual seasonality — is done. That should mean a cooler non-housing services print in the month. Shelter could remain hot but goods prices will stay in deflationary territory. That's not the composition Chair Powell would love, but with the economy humming along and the overall level of core inflation in a reasonable range, the Fed has time on the clock to get a more sustainable composition of inflation.

Forecast implications — BLS recently explained in seminar that the increase OER was due to a variety of factors, but primarily higher weights on firming underlying prices for single family homes. Shelter costs will remain hot, leaving PCE inflation, where they carry a lower weight, running unusually far below the CPI.

Market implications — Our view on inflation is mostly aligned with the market's. But in the event of another upside surprise, that would likely send markets into a bit of frenzy. However, we're not so sure the Fed would need to panic. They would wait for the dust to settle with the PCE data given the different weights and methodologies for some components. And with the labor market coming into better balance and a deflationary trend in goods still intact, the forward looking view suggests that the broader forces affecting inflation remain favorable.

Other US Releases: Retail sales—February

(Thursday, 8:30 am)

After a pullback in January which was also perhaps influenced by bad weather, we expect the US consumer to bounce back in February, with the control group of retail sales growing by 0.4% in the month. High frequency credit card suggests that retail consumption should rebound in the month. Firm job gains and strong real wage growth, combined with a shift towards goods consumption, should continue to support strong demand for retailing.

Forecast implications — Assuming another month of subdued core goods prices, the rebound retail sales should keep consumption and GDP growth on track for around a 2% annualized in 24Q1. The weakness in the January retail sales is offset partly by the strong momentum from the prior quarter.

Industrial production—February

(Friday, 9:15 am)

Industrial production is expected to modestly contract in February by 0.1% and capacity utilization should edge down to 78.3%. We expect the downward drift in manufacturing production to continue and an unwinding of the weather-induced surge in utilities to be a drag in the month.

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