Economics

THE WEEK AHEAD

January 24-28, 2022

False precision

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

There's near unanimity among economists and market participants that an interest rate cycle will soon be upon us in Canada and the US. Both countries face excessive inflation pressures, both are nearing full employment, and given that the major driver for growth (a diminishing Covid pandemic here and abroad) will be similar, there's little reason to expect a significant policy divergence.

How far that will take us is a matter of some debate, but there are at least a few principles we can apply to take a stab at that question. If we're zeroing in on full employment and don't face any new headwinds, the tightening cycle should take rates into the vicinity of the so-called neutral rate.

Evidence from the prior cycle puts that in the 2½% range stateside, and likely something perhaps just a hair below that in Canada, assuming inflation gets back to its 2% target as growth decelerates and Covid disruptions fade. Past cycles also see occasional pauses along a tightening path, as economies are often buffeted by developments that force a pause or a back step. When inflation cooperates, as we expect it will after 2022, central banks like to see how the economy has digested the first round of hikes before moving rates even higher.

This cycle will also see the use of quantitative tightening, which could help lift longer term rates, and thereby raise term borrowing costs, even during those periods in which short rates are paused. We see no reason why the Bank of Canada should continue to reinvest maturing bonds into fresh government bond purchases once it starts hiking rates, so that QT process will begin very soon here, and likely not very far into a US rate hike cycle that could commence as early as March.

But high frequency traders aren't typically satisfied with a projection that tells them to brace for 200 basis points or so in rate hikes over the next two and a half years. They want to know exactly which meetings each central bank will use to lift rates, a question we face now as the Bank of Canada prepares to reveal such a decision in the week ahead.

Any such forecasts suffer from a degree of false precision. Put yourself in a meeting room in, say, June 2024, looking back on how the Canadian economy evolved over the prior 10 quarters. Just how much difference would it have made to the outcome on growth or inflation if you moved the timing of each rate hike forward or backward by a couple of months? Not much.

Since the Bank of Canada's rate decisions are really based on steering the economy over that sort of horizon, so as to attain its inflation objectives, it can follow its own tastes on exactly when to pull the trigger. It could opt to do its first hike now, counting on Omicron's wrath to fade out, and assuming that it's not followed closely by an immunity-escaping "pi" or "rho" variant with the same infectiousness but even greater punch.

Or it could, as we've assumed, signal that, prior to Omicron, the economy had reached the conditions it previously had laid out for rate hikes to begin. But it has likely slipped back from that status during this wave, and the Bank could clarify that hikes are in the offing once we have more assurance that Omicron has departed and that no serious new wave is replacing it. That would lay the groundwork for a hike in March or no later than April, and still leave ample time to get rates into the 2% range in 2024.

For investors, that makes it unwise to put on trades that will only work if a particular timing is followed. Instead, the opportunities lie in thinking about where the curve is headed under any gradualist path that sees inflation return to the 2% range in 2023, gets both Canadian and US short rates through 2% in 2024, and is combined with a reversal of quantitative easing that pares back the Fed's and Bank of Canada's bond holdings. We'll steer the details on such trades to our FICC strategy team, which has some excellent ideas to consider.

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 24	-	-	-	-	-	-	-
Tuesday, January 25	-	Government Bond Purchase Program (GBPP): 5-YR	-	-	-	-	-
	-	AUCTION: 3-M BILLS $, 6-M BILLS $, 1-YR BILLS $	-	-	-	-	-
Wednesday, January 26	8:30 AM	BANK OF CANADA RATE ANNOUNCE.	(Jan 26)	(H)	0.25%	0.25%	0.25%
Wednesday, January 26	11:00 AM	Speaker: Tiff Macklem (Governor) & Carolyn Rogers (Sr. Deputy Gov.)	-	-	-	-	-
Thursday, January 27	-	Government Bond Purchase Program (GBPP): 30-YR	-	-	-	-	-
Thursday, January 27	-	AUCTION: 30-YR CANADAS $2B	-	-	-	-	-
Thursday, January 27	8:30 AM	PAYROLL EMPLOYMENT, EARNINGS & HRS	(Nov)	-	-	-	-
Friday, January 28	-	-	-	-	-	-	-

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 24	-	AUCTION: 2-YR TREASURIES $54B	-	-	-	-	-
Monday, January 24	8:30 AM	CHICAGO FED NAT.ACTIVITY INDEX	(Dec)	(M)	-	-	0.37
Monday, January 24	9:45 AM	MARKIT US SERVICES PMI	(Jan P)	(L)	-	-	57.6
Monday, January 24	9:45 AM	MARKIT US COMPOSITE PMI	(Jan P)	(L)	-	-	57.0
Monday, January 24	9:45 AM	MARKIT US MANUFACTURING PMI	(Jan P)	(L)	-	57.0	57.7
Tuesday, January 25	-	AUCTION: 1-YR TREASURIES $34B	-	-	-	-	-
Tuesday, January 25	-	AUCTION: 5-YR TREASURIES $55B	-	-	-	-	-
Tuesday, January 25	9:00 AM	HOUSE PRICE INDEX M/M	(Nov)	(M)	-	1.1%	1.1%
Tuesday, January 25	9:00 AM	S&P CORELOGIC CS Y/Y	(Nov)	(H)	-	-	18.4%
Tuesday, January 25	10:00 AM	CONF.BOARD CONSUMER CONFIDENCE	(Jan)	(H)	111.0	112.0	115.8
Tuesday, January 25	10:00 AM	RICHMOND FED MANUF. INDEX	(Jan)	(M)	-	14.0	16.0
Wednesday, January 26	-	AUCTION: 2-YR FRN $26B	-	-	-	-	-
Wednesday, January 26	7:00 AM	MBA-APPLICATIONS	(Jan 21)	(L)	-	-	2.3%
Wednesday, January 26	8:30 AM	ADVANCE GOODS TRADE BALANCE	(Dec)	(M)	-$97.5B	-$95.5B	-$98.0B
Wednesday, January 26	8:30 AM	RETAIL INVENTORIES M/M	(Dec)	(H)	-	-	2.0%
Wednesday, January 26	8:30 AM	WHOLESALE INVENTORIES M/M	(Dec P)	(L)	-	1.4%	1.4%
Wednesday, January 26	10:00 AM	NEW HOME SALES SAAR	(Dec)	(M)	750K	770K	744K
Wednesday, January 26	10:00 AM	NEW HOME SALES M/M	(Dec)	(M)	0.8%	3.5%	12.4%
Wednesday, January 26	2:00 PM	FOMC RATE DECISION (UPPER BOUND)	(Jan 26)	(H)	0.25%	0.25%	0.25%
Wednesday, January 26	2:00 PM	FOMC RATE DECISION (LOWER BOUND)	(Jan 26)	(H)	0.00%	0.00%	0.00%
Wednesday, January 26	2:30 PM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Thursday, January 27	-	AUCTION: 7-YR TREASURIES $53B	-	-	-	-	-
Thursday, January 27	8:30 AM	INITIAL CLAIMS	(Jan 22)	(M)	-	260K	286K
Thursday, January 27	8:30 AM	CONTINUING CLAIMS	(Jan 15)	(L)	-	-	1635K
Thursday, January 27	8:30 AM	GDP (annualized)	(4Q A)	(H)	5.3%	5.8%	2.3%
Thursday, January 27	8:30 AM	GDP DEFLATOR (annualized)	(4Q A)	(H)	6.7%	5.9%	6.0%
Thursday, January 27	8:30 AM	DURABLE GOODS ORDERS M/M	(Dec P)	(H)	-0.5%	-0.5%	2.6%
Thursday, January 27	8:30 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Dec P)	(H)	0.2%	0.4%	0.9%
Thursday, January 27	10:00 AM	PENDING HOME SALES M/M	(Dec)	(M)	-	-0.3%	-2.2%
Friday, January 28	8:30 AM	EMPLOYMENT COST INDEX	(Q4)	(M)	-	1.1%	1.3%
Friday, January 28	8:30 AM	PCE DEFLATOR Y/Y	(Dec)	(H)	5.8%	5.8%	5.7%
Friday, January 28	8:30 AM	PCE DEFLATOR Y/Y (core)	(Dec)	(H)	4.8%	4.8%	4.7%
Friday, January 28	8:30 AM	PERSONAL INCOME M/M	(Dec)	(H)	0.7%	0.5%	0.4%
Friday, January 28	8:30 AM	PERSONAL SPENDING M/M	(Dec)	(H)	-0.9%	-0.6%	0.6%
Friday, January 28	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Jan F)	(H)	-	68.8	68.8

Week Ahead's market call

by Avery Shenfeld

In the **US**, the Fed will still keep rates on hold, but might ramp up the rhetoric enough to make a March hike more likely than a wait for the meeting after that. A move in March would more readily open the door to four quarter point hikes, rather than our last official projection for three, so stay tuned on that front. Clues on how quickly the Fed might transition to quantitative tightening after rate hikes commence likely won't be available in the statement, but we'll see if the subsequent press conference adds some colour. The consensus for Q4 GDP growth has dropped of late, but is still somewhat above our 5.3% projection. That's a strong quarter, but its soft finish, and the dent from the Omicron wave, suggest a sub-2% first quarter pace. The trade deficit should narrow after being hit by a prior-month import surge, while core durable orders will have trouble building much after a steep prior month climb. The Russia-Ukraine border situation is one that also now bears close watching these days.

In **Canada**, the central bank will shift from forward guidance to a mission mostly accomplished message by saying that, prior to an Omicron pull back, the economy had essentially met some key conditions for tightening to commence. Aside from some elbow room on total hours worked, we were nearing full employment at the last reading. The issue is that we've likely taken a step back from that precipice due to Omicron, and with some uncertainty on where that story is going, the Bank could still opt to set the stage for a hike in March or April when there's greater clarity (See our cover story). The Bank's growth forecast will be marked down to make room for a weak Q1, but of greater interest is whether there's much of a change in their inflation outlook. If its revised upwards for the latter half of the year, that might portend a slightly firmer pace for rate hikes in 2022. Otherwise, it's a very light week for data.

There are no major Canadian data releases next week

Week Ahead's key US number: Real GDP - Q4 (Advance)

(Thursday, 8:30 am)

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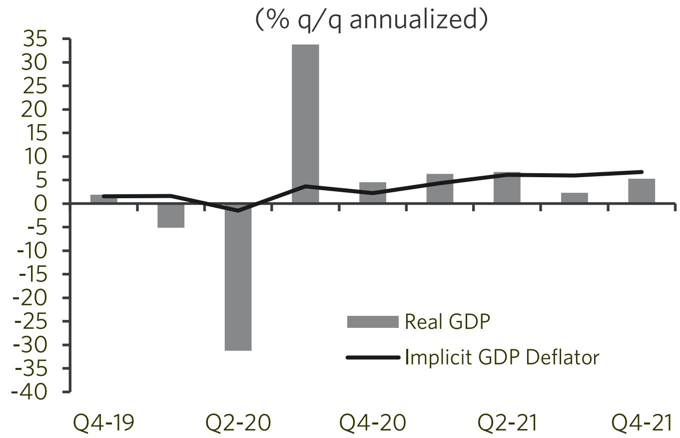
GDP (%)	CIBC	Mkt	Prior
GDP q/q annualized	5.3	5.8	2.3
GDP deflator	6.7	5.9	6.0

Chart: US Real gdp



Source: Bureau of Economic Analysis, Haver Analytics, CIBC

Growth in the US economy appears to have accelerated to 5.3% annualized in the fourth quarter as consumer spending jumped at the start of the quarter, while the fading of some supply chain bottlenecks supported inventory replenishment. The restocking of inventories coincided with a pickup in imports as some major US ports moved to 24-hour shifts for workers, but an acceleration in exports will provide an offset in the GDP calculation. Excluding inventories, the advance in final sales would be a less robust 2.8% annualized.

Residential investment will also be a growth driver as existing home sales and housing starts gained momentum. With capital goods import volumes lower through November, and domestic shipments of such goods showing only modest progress in nominal terms, business investment in equipment will likely have been a drag on growth again, with investment in IP products providing an offset.

Forecast implications — With the spread of Omicron accelerating in January, the first quarter of 2022 is set to see a marked deceleration in growth on soft consumer spending and renewed supply chain bottlenecks. It won't be until the spring months when the Omicron wave will likely have passed that the economy will see a sharp services-led rebound in growth, prompting the Fed to hike rates as early as March.

Market impact — We're below the consensus forecast, which could weigh on the greenback and see bond yields fall.

Other US Releases:
Durable goods orders—December

(Thursday, 8:30 am)

Durable goods orders likely fell by 0.5% in December as the surge in transportation orders from the prior month could have reversed. Excluding transportation, orders likely advanced by 0.2% as US businesses continued to look to automation-related equipment amidst the worker shortage.

Personal income & outlays—December

(Friday, 8:30 am)

Along with the spread of Omicron and the retreat in spending on goods, services demand also tapered off in December as suggested by high-frequency indicators, implying a 0.9% drop in total consumer spending. The weak handoff to Q1 combined with a further pull back in services activity in January sets the stage for a soft first quarter. Incomes likely rose by 0.7% in December on employment compensation gains, while prices could have heated up by a tick, with core PCE inflation reaching 4.8%, validating the Fed's increasingly hawkish rhetoric.

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