Economics

THE WEEK AHEAD

October 10-14, 2022

Can you hedge against inflation, or disinflation?

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

There's a whole generation of economic participants that weren't even alive the last time inflation was an issue, way back in the early 1980s. Some of them might be asking, what's so bad about higher inflation that it's worth risking a recession to cure it? After all, both wages and prices are now escalating together, so if you're not on a fixed income, why worry? One fear is that it's a slippery slope that could land you in much higher inflation that reduces the utility of money as a store of value.

But another part of the answer is that high inflation is also uncertain inflation. When it's running at 2%, you might see it edge up to 3% or down to 1%, but at 8%, the range of future outcomes is likely wider. Indeed, many of the clients we speak to are grappling with inflation-related questions about their business or investment plans that they hadn't needed to think about in the past.

CEOs of commodity-related companies have always faced major uncertainties about the direction of their product prices, which can double or drop in half in the space of a year, unlike, say, the selling prices of a typical services firm, or finished goods that are well downstream from resources. The commodities companies can use hedges in which they give up some upside in prices for protection against downside moves. A chain of shoe stores doesn't have that option.

Businesses can hedge against the risk that a broad drop in inflation leaves them locked into a labour contract paying wage gains that can no longer be offset by year to year price hikes. Instead of pledging a contract paying hikes of, say 6% a year for the next two years with a view that wages and prices will be generally hot, a more modest pay plus a cost of living clause can give comfort to workers while reducing employer risks should inflation melt away. A contract with limited locked-in raises but a profit sharing arrangement can serve the same purpose.

Should inflation rocket or remain stubbornly high, and interest rates climb along with them, companies that have locked in more of their debt or used derivatives to put a cap on future bond refinancing rates can have a bit less risk. Being careful about the use of leverage to finance expansions at this point in the cycle also helps pare back the risk that inflation or central banks' battle against it will raise future refinancing costs.

Investors also have some options for inflation protection, but most of these work only on surprises in one direction. Neither gold nor cryptocurrencies have done well of late as an inflation hedge for those living in countries not seeing a collapse in their foreign exchange rate. Industrial commodities or related equities worked well early in this inflation upturn when they were a big part of the inflation story, but price momentum has since shifted elsewhere, into services.

Real return bonds are the most direct hedge against still higher or more persistent inflation than the market is allowing for, while nominal bonds will be the winner in a downside surprise for inflation. You have to pick sides in that investment decision.

History suggests that, in terms of capital gains, equities might not do well should inflation persists. The Dow traded at roughly the same level in 1982 as it had in 1968, a huge drop in after-inflation terms given the steep escalation in prices over that span. True, that would look better on a total return basis adding in the dividends clipped over that time. But stocks at this point in the cycle are more likely to behave like long-dated nominal bonds, being a winner if inflation melts away, but only if that doesn't entail a deep recession to make that happen.

All of these and other tricky decisions about ensuring your investments or businesses against sharply higher or lower inflation might have your head spinning. And that's exactly why central banks are so eager to take such uncertainties out of the picture by getting inflation back down to lower, and generally more stable, waters.

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, October 10	-	Markets Closed (Thanksgiving)	-	-	-	-	-
Tuesday, October 11	-	AUCTION: 3-M BILLS $9.2B, 6-M BILLS $3.4B, 1-YR BILLS $3.4B	-	-	-	-	-
Wednesday, October 12	-	-	-	-	-	-	-
Thursday, October 13	-	AUCTION: 2-YR CANADAS $4B	-	-	-	-	-
Friday, October 14	8:30 AM	MANUFACTURING SHIPMENTS M/M	(Aug)	(M)	-1.8%	-1.2%	-0.9%
Friday, October 14	8:30 AM	WHOLESALE TRADE M/M	(Aug)	(M)	0.8%	0.1%	-0.6%
Friday, October 14	9:00 AM	EXISTING HOME SALES M/M	(Sep)	(M)	-	-	-1.0%

Week Ahead Calendar And Forecast—United States

H, M, L = High, Medium or Low Priority
SAAR = Seasonally Adjusted Annual Rate
Consensus Source: Bloomber

Date	Time	Economic Releases, Auctions and Speakers	Month	Priority	CIBC	Consensus	Prior
Monday, October 10	-	Treasury Markets Closed (Columbus Day)	-	-	-	-	-
Monday, October 10	9:00 AM	Speaker: Charles L. Evans (Chicago) (Non-Voter)	-	-	-	-	-
Monday, October 10	1:00 PM	Speaker: Lael S Brainard (Governor) (Voter)	-	-	-	-	-
Tuesday, October 11	-	AUCTION: 3-YR TREASURIES $40B	-	-	-	-	-
Tuesday, October 11	2:00 PM	TREASURY BUDGET	(Sep)	(L)	-	-	$219.6B
Tuesday, October 11	12:00 PM	Speaker: Loretta Mester (Cleveland) (Voter)	-	-	-	-	-
Wednesday, October 12	-	10-YR AUCTION: $32B	-	-	-	-	-
Wednesday, October 12	7:00 AM	MBA-APPLICATIONS	(Oct 7)	(L)	-	-	-14.2%
Wednesday, October 12	8:30 AM	PPI M/M	(Sep)	(M)	0.2%	0.2%	-0.1%
Wednesday, October 12	8:30 AM	PPI M/M (core)	(Sep)	(M)	0.3%	0.3%	0.4%
Wednesday, October 12	8:30 AM	PPI Y/Y	(Sep)	(M)	-	8.4%	8.7%
Wednesday, October 12	8:30 AM	PPI Y/Y (core)	(Sep)	(M)	-	7.3%	7.3%
Wednesday, October 12	2:00 PM	FOMC Meeting Minutes	(Sep 21)	-	-	-	-
Wednesday, October 12	10:00 AM	Speaker: Neel Kashkari (Minneapolis) (Non-Voter)	-	-	-	-	-
Wednesday, October 12	1:45 PM	Speaker: Michael S Barr (Governor) (Voter)	-	-	-	-	-
Wednesday, October 12	6:30 PM	Speaker: Michelle W Bowman (Governor) (Voter)	-	-	-	-	-
Thursday, October 13	-	30-YR AUCTION: $18B	-	-	-	-	-
Thursday, October 13	8:30 AM	INITIAL CLAIMS	(Oct 8)	(M)	-	-	219K
Thursday, October 13	8:30 AM	CONTINUING CLAIMS	(Oct 1)	(L)	-	-	1361K
Thursday, October 13	8:30 AM	CPI M/M	(Sep)	(H)	0.2%	0.2%	0.1%
Thursday, October 13	8:30 AM	CPI M/M (core)	(Sep)	(H)	0.4%	0.4%	0.6%
Thursday, October 13	8:30 AM	CPI Y/Y	(Sep)	(H)	8.1%	8.1%	8.3%
Thursday, October 13	8:30 AM	CPI Y/Y (core)	(Sep)	(H)	6.5%	6.5%	6.3%
Friday, October 14	8:30 AM	RETAIL SALES M/M	(Sep)	(H)	0.3%	0.2%	0.3%
Friday, October 14	8:30 AM	RETAIL SALES (X-AUTOS) M/M	(Sep)	(H)	0.1%	-0.1%	-0.3%
Friday, October 14	8:30 AM	RETAIL SALES CONTROL GROUP M/M	(Sep)	(H)	0.0%	-	0.0%
Friday, October 14	8:30 AM	IMPORT PRICE INDEX M/M	(Sep)	(L)	-	-1.1%	-1.0%
Friday, October 14	8:30 AM	EXPORT PRICE INDEX M/M	(Sep)	(L)	-	-1.2%	-1.6%
Friday, October 14	10:00 AM	BUSINESS INVENTORIES M/M	(Aug)	(L)	-	0.9%	0.6%
Friday, October 14	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Oct P)	(H)	-	58.8	58.6
Friday, October 15	10:30 AM	Speaker: Lisa D Cook (Governor) (Voter)	-	-	-	-	-

Week Ahead's market call

by Avery Shenfeld

In the **US**, the news on inflation is likely to be better, but not by nearly enough. We're in line with the consensus in seeing a headline reading of 0.2% for the monthly CPI change, but the core rate remaining well above target with a 0.4% advance. Where there will be a bit better news, in these days of bad-news-is-good-news, is on retail sales, if we're right about a flat reading for the control group measure. Q3 GDP growth will still be on target for a moderate gain, but remember that's after a negative first half, and might include a bounce-back related to an understatement of actual growth in those first two quarters.

In **Canada**, a light week for economic news could see a mixed bag, with early readings pointing to a drop in August manufacturing shipments but a rebound in wholesale trade. Softness in existing home sales relative to a year ago is at this point well priced-in, with the next shoe to drop in that sector coming when weaker new home sales starts to feed into construction activity in 2023.

There are no major Canadian data releases next week.

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

(Thursday, 8:30 am)

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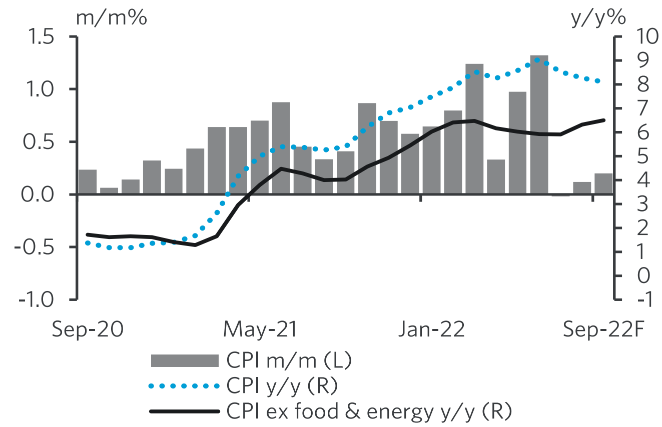
Variable (%)	CIBC	Mkt	Prior
Headline CPI m/m	0.2	0.2	0.1
Headline CPI (y/y)	8.1	8.1	8.3
Core CPI m/m	0.4	0.4	0.6
Core CPI y/y	6.5	6.5	6.3

Chart: US Consumer price index



Source: BLS, Haver Analytics, CIBC

The relief from higher prices at the pump extended into September, but continued pressure in food prices, where a labor shortage in the transportation industry and extreme weather conditions remain issues, could have resulted in a 0.2% monthly advance in total prices, leaving annual inflation at 8.1%.

That would also include pressure in components outside of food and energy, which likely rose by 0.4% m/m, as the shelter component is still picking up the impact of leases resetting at higher rates, reflecting the housing market strength seen last year. Leaning against that could be some weakness in used car prices, in line with marginal improvement in supply chains. All told, core annual inflation is set to accelerate by two ticks, to 6.5%, magnified by base effects.

Forecast implications — Oil prices have risen in recent days on the OPEC+ announcement to cut supply, which will boost total inflation ahead if sustained, and we have yet to see signs of a levelling off in food prices as implied by broader commodity indices. There could be better news in core price categories ahead, however, if the alleviation in supply chain issues starts to feed through more meaningfully into goods prices, offsetting some pressure from shelter costs. Annual core inflation is set to descend over the rest of the year as that index will be lapping some strong year-ago readings that are unlikely to be repeated, but the Fed will be focused on the monthly core readings, which should look strong enough to justify another 100bps of hikes.

Market impact — We are in line with the consensus and market reaction should therefore be limited.

Other US Releases: Retail sales—September

(Friday, 8:30 am)

Higher unit auto sales and receipts at restaurants could have offset lower gasoline prices to result in a moderate 0.3% advance in total retail sales in September. However, that would represent only modest growth in volume terms, likely owing to food services, which exemplifies the ongoing shift away from goods consumption and towards services that is underway. Indeed, it's likely that the control group of sales (ex. autos, gasoline, building materials, and restaurants) flatlined again, representing a negative in real terms, and confirming that the consumption of goods contracted over Q3.

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