Economics

THE WEEK AHEAD

June 6-10, 2022

Avoiding the hobgoblin of small minds

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

If, as they say, consistency is the hobgoblin of small minds, then it's a good thing that central bankers feel free to change their minds when the facts also change. So it's not entirely surprising that, in the face of upside surprises in inflation, the Bank of Canada, which started its rate hike cycle with a traditional quarter point move, has now made 50 basis point tightenings the new normal.

Nor was it unreasonable for Deputy Governor Beaudry, in a speech this past week, to open the door to a 75 bp hike at some point, and to warn that instead of stopping at 2.5%, the midpoint estimate for neutral, there was now greater likelihood of reaching 3% or even higher. He underscored that this was a change in the Bank's view that had taken place only since April, based on less than two months of economic news.

Markets had already been pricing in something similar, so should you be building that into your forecast? Before doing so, we'd draw your attention to another comment from the Bank that you may have missed, which pointed out that even with the latest increase in rates "monetary policy remains stimulative. In fact, the policy rate today is still negative in real terms, that is, once you adjust for inflation. The policy rate will need to rise to neutral to achieve our inflation target."

Those were the words of then BoC Governor Stephen Poloz, speaking just after a rate hike to 1.75% in October 2018. He went on to say that the neutral rate was a range centred on 3%, and left no doubt that rates would continue to rise ahead.

Yet only weeks later, the Bank passed on an opportunity to hike in the face of concerns over trade wars and falling oil prices, and by March, it had dropped the warning about the need to take rates higher. In the end, Poloz ended up delivering none of the hikes he had seen coming. That willingness to change his mind proved judicious, given that the Fed, which pressed on to higher rates, was forced to reverse some of that in 2019, before the Covid shock.

What would it take for Macklem, Beaudry and their colleagues to again change their minds, and revert to their April viewpoint? We would need a similar surprise to the downside on inflation or its drivers. Inflation won't look any better in the next month or two, so a 50 basis point hike is a lock for the July meeting, and a follow-up hike of some scale is an odds on bet for September. But by October, four months of new data will be in the books, covering twice as much time as it took to drive this most recent change of view.

By then, a deep retreat in housing activity, sluggish global growth, and inflation's squeeze on consumer spending power will, in our view, have growth indicators pointing to a significant second half slowdown, one much sharper than the BoC's last projection. Inflation won't be cured, but the Bank will have more comfort that its domestic drivers will be contained enough to see a tamer CPI in 2023. It might therefore not be so obvious that a rate above 2.5% will be needed to do the job.

All that says that when it comes to developing your own central bank forecast, beyond the next meeting, you can't just go with the latest Bank of Canada speech, or the Fed's "dot plot" projection. Remember that in early 2021, the Fed was still expecting no hikes until 2024. Central bankers can and should change their minds, and their rate forecast is, at any point in time, designed to be consistent with their economic view. If the facts change, so will they.

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, June 6	-	AUCTION: 2-YR CANADAS $4B	-	-	-	-	-
Tuesday, June 7	-	AUCTION: 3-M BILLS $, 6-M BILLS $, 1-YR BILLS $	-	-	-	-	-
Tuesday, June 7	8:30 AM	MERCHANDISE TRADE BALANCE	(Apr)	(H)	$2.5B	-	$2.49B
Tuesday, June 7	10:00 AM	IVEY PMI	(May)	(L)	-	-	66.3
Wednesday, June 8	-	AUCTION: 5-YR CANADAS $4B	-	-	-	-	-
Thursday, June 9	-	BoC Financial System Review	-	-	-	-	-
Thursday, June 9	11:00 AM	Speaker: Tiff Macklem (Governor) & Carolyn Rogers (Sr. Deputy Gov.)	-	-	-	-	-
Friday, June 10	8:30 AM	EMPLOYMENT CHANGE	(May)	(H)	30.0K	-	15.3K
Friday, June 10	8:30 AM	UNEMPLOYMENT RATE	(May)	(H)	5.2%	-	5.2%
Friday, June 10	8:30 AM	CAPACITY UTILIZATION	(Q1)	(L)	-	-	82.9%

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, June 6	-	-	-	-	-	-	-
Tuesday, June 7	-	AUCTION: 3-YR TREASURIES $44B	-	-	-	-	-
Tuesday, June 7	8:30 AM	GOODS & SERVICES TRADE BALANCE	(Apr)	(H)	-$90.4B	-$89.4B	-$109.8B
Tuesday, June 7	3:00 PM	CONSUMER CREDIT	(Apr)	(L)	-	$34.0B	$52.44B
Wednesday, June 8	-	AUCTION: 10-YR TREASURIES $33B	-	-	-	-	-
Wednesday, June 8	7:00 AM	MBA-APPLICATIONS	(Jun 3)	(L)	-	-	-2.%
Wednesday, June 8	10:00 AM	WHOLESALE INVENTORIES M/M	(Apr F)	(L)	-	2.1%	2.1%
Thursday, June 9	-	30-YR AUCTION: $19B	-	-	-	-	-
Thursday, June 9	8:30 AM	INITIAL CLAIMS	(Jun 4)	(M)	-	210K	200K
Thursday, June 9	8:30 AM	CONTINUING CLAIMS	(May 28)	(L)	-	-	1309K
Friday, June 10	8:30 AM	CPI M/M	(May)	(H)	0.7%	0.7%	0.3%
Friday, June 10	8:30 AM	CPI M/M (core)	(May)	(H)	0.5%	0.5%	0.6%
Friday, June 10	8:30 AM	CPI Y/Y	(May)	(H)	8.2%	8.2%	8.3%
Friday, June 10	8:30 AM	CPI Y/Y (core)	(May)	(H)	5.9%	5.9%	6.2%
Friday, June 10	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Jun P)	(H)	-	58.9	58.4
Friday, June 10	2:00 PM	TREASURY BUDGET	(May)	(L)	-	-	$308.2B

Week Ahead's market call

by Avery Shenfeld

In the **US**, the inflation data will take centre stage, and we don't think anyone will draw much comfort from a drop in 12-month CPI metrics, since they will reflect a large gain dropping out of the data from a year earlier. The monthly core CPI pace will remain much too hot for the Fed's liking, as it's too soon for higher interest rates to work their way into tamer prices.

In **Canada**, we're a week behind the US in reporting employment data, although these are only household survey numbers in this case. Job gains in our forecast would be still running a bit above the pace that the Bank of Canada needs to see to be assured that the jobless rate has bottomed. An appearance by the Bank of Canada Governor and his Senior Deputy will focus on the financial system, and could address the linkage between rate hikes and what's happening in housing and mortgage markets.

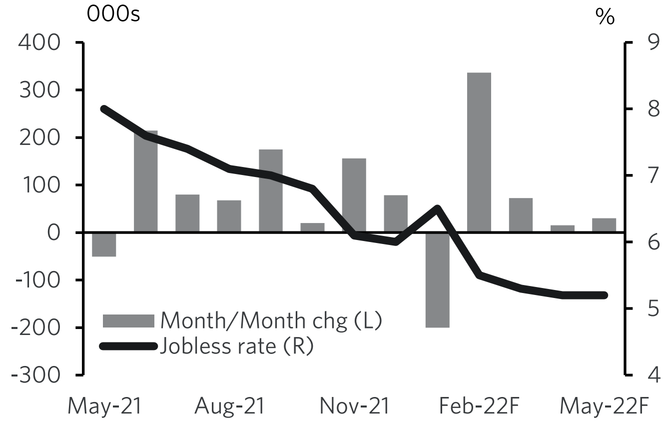
Week Ahead's key Canadian number: Labour force survey—May

(Friday, 8:30 am)

Andrew Grantham andrew.grantham@cibc.com

Variable	CIBC	Mkt	Prior
Employment (m/m)	30.0K	-	15.3K
Unemployment rate	5.2%	-	5.2%

Chart: Canadian employment



Source: Statistics Canada, Haver Analytics, CIBC

Employment likely continued to move higher in May, albeit at a much more muted pace than seen earlier in the year. Hiring in rebounding service areas such as food & accommodation and transportation likely drove the increase, but sectors such as construction and real estate, which appear to already be slowing down due to higher interest rates, may have stalled or moved in the opposite direction. A 30K gain in jobs overall would be close to the pace of population growth and leave the unemployment rate unchanged at 5.2%, assuming no move in labour force participation.

Even though employment growth is slowing, wage inflation is likely to pick up fairly significantly over the next few months. That's largely due to base effects, as the rehiring of low wage service workers in the late spring/early summer last year lowered the average earnings figures. That's something which will start to flatter the year-over-year wage numbers starting this month. A reacceleration in Omicron related absenteeism helped drive a decline in hours worked during April, which is something that should have rebounded in May.

Forecast implications — More modest hiring growth should signal more modest economic expansion as well, and come as little surprise with the economy already mostly fully recovered from the pandemic-driven downturn. Hiring difficulties should see wage inflation pick up in services sectors, although one area where pay growth has already been strong (construction) should start to ease as demand cools thanks to higher interest rates.

Other Canadian releases: Merchandise trade—April

(Tuesday, 8:30 am)

Oil exports appear to have taken a temporary step back in April, both in terms of prices and volumes. However, auto exports should have been firmer, while some of the pop in imports in the prior month reflected companies stockpiling certain materials due to supply chain concerns emanating from the war in Ukraine and sanctions imposed on Russia. Taking all of those moving parts into consideration, we expect that the trade surplus will be broadly unchanged at $2.5bn in April, before likely improving again in May.

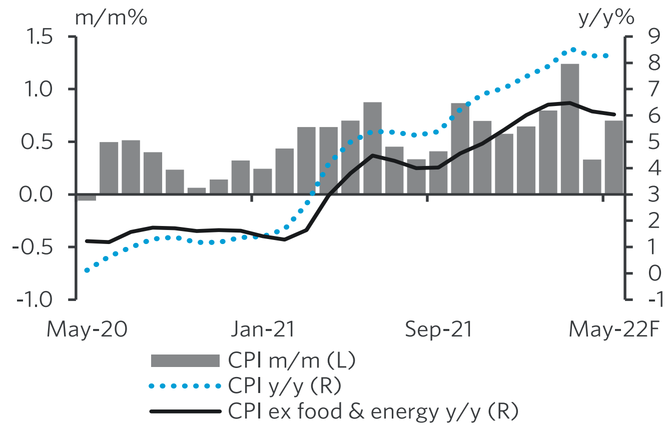
Week Ahead's key US number: Consumer price index—May

(Friday, 8:30 am)

Katherine Judge katherine.judge@cibc.com

Consumer price index (%)	CIBC	Mkt	Prior
Headline CPI m/m	0.7	0.7	0.3
Headline CPI (y/y)	8.2	8.2	8.3
Core CPI m/m	0.5	0.5	0.6
Core CPI y/y	5.9	5.9	6.2

Chart: US Consumer price index



Source: BLS, Haver Analytics, CIBC

With gasoline prices higher in May, total monthly inflation likely accelerated to 0.7%. However, that would still leave the annual rate slightly slower at 8.2%, given base effects. Excluding energy and food prices, core monthly inflation could have decelerated but remained lofty at 0.5%, as high-frequency indicators showed that demand for flights and dining out were held back by the rise in Omicron cases. Higher goods prices tied to the lockdowns in China, and further upside in the shelter component that's playing catch up to earlier increases in home prices will therefore be behind the monthly increase. Still, base effects will result in a deceleration in the annual rate to 5.9%.

Forecast implications — Base effects will help annual inflation slow further in June, but that will be limited by the climb in oil prices and upside in service prices. That should compel the Fed to raise rates by 50bps at each of the next two FOMC meetings. Thereafter, the pace of tightening could slow as consumer demand will be thwarted ahead by sky-high prices eating into real households incomes, while the construction and real estate sectors are already responding to higher rates.

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

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