Economics

THE WEEK AHEAD

December 19-23, 2022

Noisy signals

by **Karyne Charbonneau** karyne.charbonneau@cibc.com

In a World Cup stadium, the crowd can be, quite literally, a noisy signal of what is happening on the pitch. The noise level is usually a very clear signal that the action is approaching the penalty area, but an imprecise predictor of an impending goal. Similarly, while Canadian and US inflation tend to follow the same trend, US CPI, which as usual was released earlier, is a noisy signal for next week's Canadian numbers.

In a simple statistical model, where monthly growth for seasonally adjusted Canadian core inflation is predicted by its recent trend, the latest US core number does have some added explanatory power. But this signal is not economically meaningful. That means that a statistical software would tell you your predictions are slightly more accurate, but you would be unlikely to produce a different forecast in any given month. Case in point, this simple model would predict 0.2 percent monthly core growth in November, with or without the US number. Incidentally, that is in line with our expectations.

If there is any valuable signal from US inflation, then one would naturally think that, given the lag between the two releases, forecasters would use it when forming their expectations for Canadian CPI. Statistically, it appears that forecasters use most, but not all, of the information in US CPI. Once again, however, this is mainly a statistical story, at least over most of history. Things look a little different over the pandemic, a period when forecasters may have benefitted from paying closer attention to the US numbers, particularly earlier in 2022.

Given the close link between the two economies, why is the US CPI not more informative about its Canadian counterpart? For one, there can be considerable volatility in the month-to-month measurement of certain prices such as autos and airfares. But there are also more fundamental reasons: differences in how similar things are measured (e.g. shelter costs) and differences in how the prices of regulated sectors are determined (e.g. medical costs).

Due to their large weight in CPI, shelter costs tend to drive core inflation. But shelter costs are measured completely differently on either side of the border. The US Bureau of Labor Statistics views owned housing units as an investment good and therefore excludes all costs related to it. In order to capture the "shelter service" associated with a house, the price of owned accommodation is imputed using the concept of owner occupied rent. This is, by definition, tightly linked to the rental market. Statistics Canada, on the other hand, seeks to capture the payments related to owning a house. That means that things like mortgage interest costs, repairs and property taxes are all included. These two methods lead to vastly different shelter costs estimates.

Researchers at the San Francisco Fed found that as of July 2022, if the BLS had used a payment approach similar to that of Statistics Canada, annual owned accommodation inflation would have been 1.5p.p. lower. And the two methods have led to different trends. Given that rent prices in the US CPI only capture market conditions with a lag, shelter inflation has been rising steadily and should continue to do so until well into 2023. Meanwhile, the drop in house prices showed up in the Canadian index for owned accommodation much faster. Next year could see the two countries swap places. Once the cooling in the rental market is captured in US CPI data, the price of owned accommodation should start falling, but mortgage interest costs will push the Canadian index up for some time after that.

This week's data showed that US CPI growth decelerated more than anticipated. But the downside surprise came mainly from airfares, used cars, and medical costs. The first two are volatile components for which monthly changes don't match across countries, and the last really has no direct comparison within the Canadian data. So, while noise during Sunday's game may help gauge whether the action is heating up, the noisy signal from this week's US CPI data is not enough to conclude that the BoC scored on inflation in November.

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, December 19	8:30 AM	INDUSTRIAL PROD. PRICES M/M	(Nov)	(M)	-	-	2.4%
Monday, December 19	8:30 AM	RAW MATERIALS M/M	(Nov)	(M)	-	-	1.3%
Tuesday, December 20	-	AUCTION: 3-M BILLS $9.2B, 6-M BILLS $3.4B, 1-YR BILLS $3.4B	-	-	-	-	-
Tuesday, December 20	8:30 AM	RETAIL TRADE TOTAL M/M	(Oct)	(H)	1.5%	1.5%	-0.5%
Tuesday, December 20	8:30 AM	RETAIL TRADE EX-AUTO M/M	(Oct)	(H)	-	1.3%	-0.7%
Wednesday, December 21	8:30 AM	CPI M/M	(Nov)	(H)	0.2%	-0.1%	0.7%
Wednesday, December 21	8:30 AM	CPI Y/Y	(Nov)	(H)	6.8%	6.5%	6.9%
Wednesday, December 21	8:30 AM	Consumer Price Index	(Nov)	(M)	-	-	153.8
Wednesday, December 21	8:30 AM	CPI Core- Median Y/Y%	(Nov)	(M)	-	-	4.8%
Wednesday, December 21	8:30 AM	CPI Core- Trim Y/Y%	(Nov)	(M)	-	-	5.3%
Thursday, December 22	-	AUCTION: 10-YR CANADAS $4B	-	-	-	-	-
Thursday, December 22	8:30 AM	PAYROLL EMPLOYMENT, EARNINGS & HRS	(Oct)	-	-	-	-
Friday, December 23	8:30 AM	GDP M/M	(Oct)	(H)	0.0%	0.1%	0.1%

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, December 19	10:00 AM	NAHB HOUSING INDEX	(Dec)	(L)	-	34	33
Tuesday, December 20	8:30 AM	HOUSING STARTS SAAR	(Nov)	(M)	1410K	1400K	1425K
Tuesday, December 20	8:30 AM	BUILDING PERMITS SAAR	(Nov)	(H)	1490K	1485K	1512K
Wednesday, December 21	-	20-YR AUCTION: $12B	-	-	-	-	-
Wednesday, December 21	7:00 AM	MBA-APPLICATIONS	(Dec 16)	(L)	-	-	3.2%
Wednesday, December 21	8:30 AM	CURRENT ACCOUNT BALANCE	(3Q)	(L)	-	-$224.0B	-$251.1B
Wednesday, December 21	10:00 AM	EXISTING HOME SALES SAAR	(Nov)	(M)	-	4.21M	4.43M
Wednesday, December 21	10:00 AM	EXISTING HOME SALES M/M	(Nov)	(M)	-	-5.0%	-5.9%
Wednesday, December 21	10:00 AM	CONF.BOARD CONSUMER CONFIDENCE	(Dec)	(H)	99.5	101.0	100.2
Thursday, December 22	-	AUCTION: 5-YR TIPS $19B	-	-	-	-	-
Thursday, December 22	8:30 AM	INITIAL CLAIMS	(Dec 17)	(M)	-	225K	211K
Thursday, December 22	8:30 AM	CONTINUING CLAIMS	(Dec 10)	(L)	-	-	1671K
Thursday, December 22	8:30 AM	GDP (annualized)	(3Q T)	(H)	-	2.9%	2.9%
Thursday, December 22	8:30 AM	GDP DEFLATOR (annualized)	(3Q T)	(H)	-	4.3%	4.3%
Thursday, December 22	8:30 AM	CHICAGO FED NAT.ACTIVITY INDEX	(Nov)	(M)	-	-	-0.05
Thursday, December 22	10:00 AM	LEADING INDICATORS M/M	(Nov)	(M)	-	-0.4%	-0.8%
Friday, December 23	8:30 AM	DURABLE GOODS ORDERS M/M	(Nov P)	(H)	-0.5%	-1.0%	1.1%
Friday, December 23	8:30 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Nov P)	(H)	-0.2%	0.1%	0.5%
Friday, December 23	8:30 AM	PCE DEFLATOR Y/Y	(Nov)	(H)	5.5%	5.5%	6.0%
Friday, December 23	8:30 AM	PCE DEFLATOR Y/Y (core)	(Nov)	(H)	4.6%	4.6%	5.0%
Friday, December 23	8:30 AM	PERSONAL INCOME M/M	(Nov)	(H)	0.3%	0.3%	0.7%
Friday, December 23	8:30 AM	PERSONAL SPENDING M/M	(Nov)	(H)	0.2%	0.1%	0.8%
Friday, December 23	10:00 AM	NEW HOME SALES SAAR	(Nov)	(M)	605K	600K	632K
Friday, December 23	10:00 AM	NEW HOME SALES M/M	(Nov)	(M)	-4.3%	-5.1%	7.5%
Friday, December 23	10:00 AM	MICHIGAN CONSUMER SENTIMENT	(Dec F)	(H)	-	59.1	59.1

Week Ahead's market call

by Katherine Judge and Andrew Grantham

In the **US**, we'll likely receive confirmation that consumers became markedly more cautious in spending in November, even when adding in some growth in services spending to what was implied by the goods side in the retail sales report. Expectations around future growth have been dimmed by the prospect of even higher interest rates, which will also likely dent consumer confidence. Orders of durable goods could also look soft, given the deterioration in goods demand that's underway, while the pullback in homebuilding could have been limited by the easing in mortgage rates in November.

In **Canada**, inflation may have eased slightly due to falling gasoline prices, but we will have to wait until next spring to see more notable decelerations that bring inflation closer to target. October's jump in retail sales appears to be primarily a price story, and anecdotal evidence suggests that sales were not particularly stellar to start the holiday season, which could show up in November's advance estimate. Monthly GDP is likely to show the economy stagnating, albeit not yet slipping into reverse, at the start of the fourth quarter.

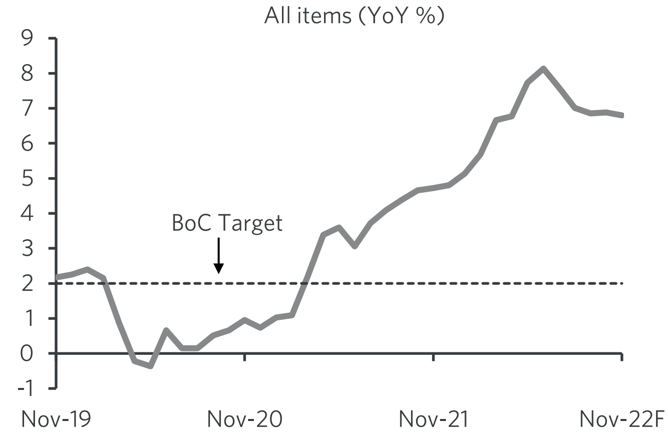
Week Ahead's key Canadian number: Consumer price index—November

(Wednesday, 8:30 am)

Andrew Grantham andrew.grantham@cibc.com

Variable (%)	CIBC	Mkt	Prior
CPI NSA (m/m)	0.2	-0.1	0.7
CPI (y/y)	6.8	6.5	6.9

Chart: Canadian consumer price index



Source: Statistics Canada, Haver Analytics, CIBC

After increasing in the prior month, gasoline prices dropped throughout November and will be the primary factor holding CPI to a muted 0.2% monthly increase. That would see the annual rate tick down, albeit only slightly, to 6.8%. Some positive signs of an easing in goods prices within the US CPI data could also show up in the Canadian data. However, food price inflation appears to have remained stubborn, and rising rates will continue to impact the mortgage interest payment part of the inflation basket.

Forecast implications — Headline inflation won't drop meaningfully until next spring, when the biggest monthly increases from 2022 start to fall out of the annual calculation. However, it is clear that the underlying trend in inflation has already slowed noticeably, with the 3-month annualized pace of ex food/energy inflation expected to be around 3 ½% after this month's release. While that's still above the 2% target, it is well below the 8% peak reached in May.

Other Canadian releases: Retail trade—October

(Tuesday, 8:30 am)

Following a decline in the prior month, retail sales appear set to have rebounded by 1.5% in October. However, with much of that increase in nominal sales likely driven by higher gasoline prices during that month, the increase in volume terms will be much less impressive. Moreover, the advance reading for November is likely to see spending decline again.

Gross domestic product—October

(Friday, 8:30 am)

Advance figures for manufacturing, wholesale and retail all appeared positive for October, although more detailed data released subsequently highlighted that those gains were largely due to higher prices rather than volumes. Because of that, and given evidence that the recovery in consumer services has started to stall, we expect monthly GDP to be flat in October. The advance figure for November is also likely to be similarly uninspiring.

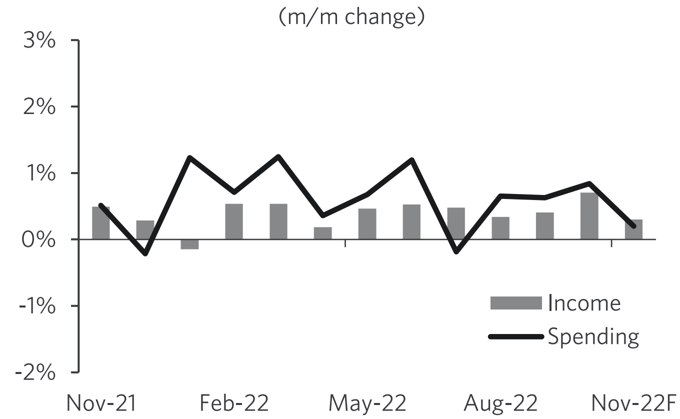
Week Ahead's key US number: Personal income and outlays—November

(Friday, 8:30 am)

Katherine Judge katherine.judge@cibc.com

Personal income and outlays (%)	CIBC	Mkt	Prior
Personal income (m/m)	0.3	0.3	0.7
Personal spending (m/m)	0.2	0.1	0.8
Core PCE price index (y/y)	4.6	4.6	5.0

Chart: US Personal income and spending



Source: BEA, Haver Analytics, CIBC

Personal incomes were bolstered by strong wage growth in November, and some states were still issuing tax refunds, suggesting moderate growth of 0.3% in aggregate household income. Dismal spending on goods, combined with a stronger showing in services, likely resulted in a modest 0.2% advance in total spending, showing that consumers became more cautious and added to savings. The Fed's preferred measure of prices, core PCE prices, could have risen more modestly on a monthly basis than its CPI counterpart, given the lower weighting of shelter in the index, leaving the annual pace at 4.6%.

Forecast implications — Consumers are becoming more cautious about spending as hiring is slowing and interest rates are headed higher. We expect to see a more marked deterioration in spending in Q1, as the impact of past rate hikes materializes more fully, which could see the Fed stop hiking after it delivers another 50bps in early 2023.

Market impact— We are roughly in line with the consensus, which should limit any market reaction.

Other US Releases: Housing starts—November

(Tuesday, 8:30 am)

Mortgage rates slid in November, supporting home purchase intentions and mortgage applications, which rose for the first time since June. However, plummeting homebuilder confidence and the pullback in permit issuance in prior months still suggests that housing starts likely eased off to a 1410K pace in November. Building permit issuance also likely softened, in line with the declining homebuilder sentiment, to 1490K.

Durable goods orders—November

(Friday, 8:30 am)

Orders of durable goods likely retreated by 0.5% in the US in November, including a 0.2% decline in the ex. transportation group, as the ISM's new orders gauge fell further into contractionary territory. That's also in line with the easing in capacity utilization in the industrial sector over the last two months, suggesting softer orders of capital goods.

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