Economics

# THE WEEK AHEAD

February 20-24, 2023

## Time to throw in the towel?

by Avery Shenfeld avery.shenfeld@cibc.com

Nobody can accuse bond market players of stubbornly sticking to their views. Only a couple of weeks ago, investors were ignoring what members of the US Fed were telling them, and for reasons we couldn't fathom, pricing in a series of rate cuts in the back half of the year. Reports on January payrolls and retail sales, and upward revisions to the seasonally-adjusted track for core CPI in Q4 of last year, threw all of that out the window. Two-year Treasury yields are up more than 55 basis points since early February lows as a result. Canadian two year yields, having climbed on their own in the back half of January, also tacked a further half point or so in the month to date.

What investors wanted to see, of course, were signs that the rate hikes delivered last year were showing up in a stall in growth in 2023, thereby adding to the downtrend in inflation. Our own forecast was admittedly looking for that, and we've had to push back expectations for a negative quarter in either the US or Canada further into the year. But it's too soon to throw in the towel on the idea that existing interest rates in Canada, and where we'll be after another half percent climb stateside, might prove to be enough.

For one, there are signs that interest rates are starting to bite, if you look closely enough. In the US, homebuilding — always a rate sensitive sector — has been in a steep slide. Odds are that residential construction will continue to be a significant negative in the first quarter GDP figures. Canadian existing home sales are moribund, with January the weakest start to a year in nearly a decade and half. Owners are opting to not even bother listing their houses because at today's mortgage rates, those who would typically be thinking of moving up, simply can't get enough credit to do so.

Manufacturing tends to be another sector where the first hits from higher rates show up. Here the signals are mixed, as retail sales stateside indicated a surprising rebound in goods purchases, while the last US ISM manufacturing reading was weak, and orders were only on a generally flat trend for the last half of 2022. We don't yet have indications for Canadian consumption in January, but goods spending was soft for most of the second half of last year.

The jobs data, of course, haven't seen any dent at all from higher interest rates, and there's no hope for growth to moderate if we don't get a deceleration in hiring. Gains in hours worked go hand in hand with output, and also generate the labour income needed to sustain consumer demand.

But one indicator we don't yet have is the degree to which January's hiring boom on both sides of the border made headway in filling all those vacant positions. If that was the driver, we could chalk up the hiring to the lagged impact of last year's demand growth, and might expect a lighter pace of additional payrolls gains ahead. Moreover, central bankers understand that either a rise in the unemployment rate, or a drop in the job vacancy rate, can help dampen wage gains, and it was notable that US payrolls gains in January didn't trigger an acceleration in hourly wages that month.

So while bond investors weren't stubbornly sticking to their pre-existing views in the last two weeks, we're going to keep a bit more of a stiff upper lip in the face of data that has gone against our forecast. We added a quarter point hike for the Fed in May, but are resisting the temptation to pile on still more, and are leaving our call for the Bank of Canada to stay on hold this year. We'll need the lagged impacts of earlier rate hikes to spread across more of the economy by the end of Q2, or we too will have to go back to the drawing board.

## 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, February 20 | - | Markets Closed (Ontario Family Day) | - | - | - | - | - |
| Tuesday, February 21 | 8:30 AM | RETAIL TRADE TOTAL M/M | (Dec) | (H) | 0.5% | - | -0.1% |
| Tuesday, February 21 | 8:30 AM | RETAIL TRADE EX-AUTO M/M | (Dec) | (H) | - | - | -0.6% |
| Tuesday, February 21 | 8:30 AM | CPI M/M | (Jan) | (H) | 0.8% | 0.6% | -0.6% |
| Tuesday, February 21 | 8:30 AM | CPI Y/Y | (Jan) | (H) | 6.3% | 6.1% | 6.3% |
| Tuesday, February 21 | 8:30 AM | Consumer Price Index | (Jan) | (M) | - | - | 153.1 |
| Tuesday, February 21 | 8:30 AM | CPI Core- Median Y/Y% | (Jan) | (M) | - | - | 5.0% |
| Tuesday, February 21 | 8:30 AM | CPI Core- Trim Y/Y% | (Jan) | (M) | - | - | 5.3% |
| Wednesday, February 22 | - | - | - | - | - | - | - |
| Thursday, February 23 | - | AUCTION: 10-YR CANADAS $4B | - | - | - | - | - |
| Thursday, February 23 | - | PAYROLL EMPLOYMENT, EARNINGS & HRS | (Dec) | - | - | - | - |
| Friday, February 24 | - | - | - | - | - | - | - |

## 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, February 20 | - | Markets Closed (President's Day) | - | - | - | - | - |
| Tuesday, February 21 | - | AUCTION: 1-YR TREASURIES $34B | - | - | - | - | - |
| Tuesday, February 21 | - | AUCTION: 2-YR TREASURIES $42B | - | - | - | - | - |
| Tuesday, February 21 | 9:45 AM | S&P GLOBAL US SERVICES PMI | (Feb P) | (L) | - | 47.3 | 46.8 |
| Tuesday, February 21 | 9:45 AM | S&P GLOBAL US COMPOSITE PMI | (Feb P) | (L) | - | 47.5 | 46.8 |
| Tuesday, February 21 | 9:45 AM | S&P GLOBAL US MANUFACTURING PMI | (Feb P) | (L) | - | 47.2 | 46.9 |
| Tuesday, February 21 | 10:00 AM | EXISTING HOME SALES SAAR | (Jan) | (M) | - | 4.11M | 4.02M |
| Tuesday, February 21 | 10:00 AM | EXISTING HOME SALES M/M | (Jan) | (M) | - | 2.1% | -1.5% |
| Wednesday, February 22 | - | 5-YR AUCTION: $43B | - | - | - | - | - |
| Wednesday, February 22 | - | AUCTION: 2-YR FRN $22B | - | - | - | - | - |
| Wednesday, February 22 | 7:00 AM | MBA-APPLICATIONS | (Feb 17) | (L) | - | - | -7.7% |
| Wednesday, February 22 | 2:00 PM | FOMC Meeting Minutes | (Feb 1) | - | - | - | - |
| Thursday, February 23 | - | AUCTION: 7-YR TREASURIES $35B | - | - | - | - | - |
| Thursday, February 23 | 8:30 AM | INITIAL CLAIMS | (Feb 18) | (M) | - | 200K | 194K |
| Thursday, February 23 | 8:30 AM | CONTINUING CLAIMS | (Feb 11) | (L) | - | - | 1696K |
| Thursday, February 23 | 8:30 AM | CHICAGO FED NAT.ACTIVITY INDEX | (Jan) | (M) | - | - | -0.49 |
| Thursday, February 23 | 8:30 AM | GDP (annualized) | (4Q S) | (H) | 2.9% | 2.9% | 2.9% |
| Thursday, February 23 | 8:30 AM | GDP DEFLATOR (annualized) | (4Q S) | (H) | - | 3.5% | 3.5% |
| Thursday, February 23 | 10:50 AM | Speaker: Raphael W. Bostic (Atlanta) (Non-Voter) | - | - | - | - | - |
| Thursday, February 23 | 2:00 PM | Speaker: Mary C. Daly (San Francisco) (Non-Voter) | - | - | - | - | - |
| Friday, February 24 | 8:30 AM | PCE DEFLATOR Y/Y | (Jan) | (H) | 4.9% | 4.9% | 5.0% |
| Friday, February 24 | 8:30 AM | PCE DEFLATOR Y/Y (core) | (Jan) | (H) | 4.3% | 4.3% | 4.4% |
| Friday, February 24 | 8:30 AM | PERSONAL INCOME M/M | (Jan) | (H) | 1.3% | 0.9% | 0.2% |
| Friday, February 24 | 8:30 AM | PERSONAL SPENDING M/M | (Jan) | (H) | 1.0% | 1.3% | -0.2% |
| Friday, February 24 | 10:00 AM | NEW HOME SALES SAAR | (Jan) | (M) | 620K | 620K | 616K |
| Friday, February 24 | 10:00 AM | NEW HOME SALES M/M | (Jan) | (M) | 0.6% | 0.7% | 2.3% |
| Friday, February 24 | 10:00 AM | MICHIGAN CONSUMER SENTIMENT | (Feb F) | (H) | - | 66.4 | 66.4 |
| Friday, February 24 | 10:15 AM | Speaker: Philip N Jefferson (Governor) (Voter) | - | - | - | - | - |
| Friday, February 24 | 1:30 PM | Speaker: Susan M. Collins (Boston) | - | - | - | - | - |
| Friday, February 24 | 1:30 PM | Speaker: Christopher J. Waller (Governor) (Voter) | - | - | - | - | - |

# Week Ahead's market call

by Avery Shenfeld

In the **US**, brisk January gains in hours worked, wages and social security payments all point to a healthy climb in personal income, and retail sales suggest that also fueled a hefty jump in consumption. Core PCE inflation might have edged down a tick that month, the only slight bright spot from the Fed's perspective. The Fed minutes will look predictably hawkish, since despite the ambiguity of Powell's press conference remarks that day, the committee's statement suggested that there was a strong consensus that at least two more hikes were in the offing.

In **Canada**, healthy job gains in the past two months might explain why December's retail sales will show reasonably good volume gains, and some further growth likely extended into January. A monthly 0.8% increase in the CPI might raise eyebrows, but remember that in Canada the headlines are in not-seasonally-adjusted terms. While that would still be a 0.5% gain after seasonal adjustment, much of that will come from an uptick in gasoline and yet another increase in mortgage interest costs (MIC). We're keeping tabs on CPI excluding food, energy and MIC, and expect that underlying inflation measure will remain more moderate, as it has in the prior three months.

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

(Tuesday, 8:30 am)

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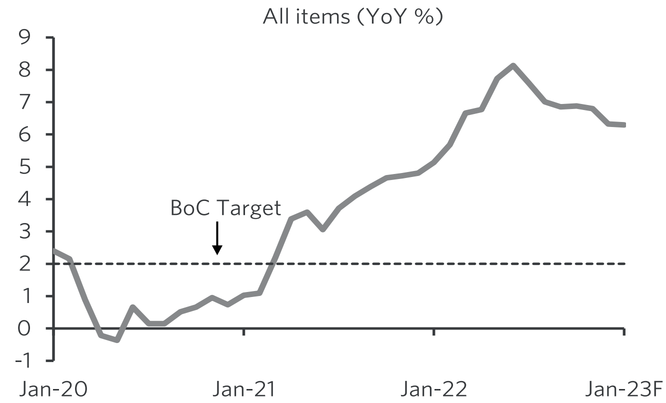
| Variable (%) | CIBC | Mkt | Prior |
|---|---|---|---|
| CPI NSA (m/m) | 0.8 | 0.6 | -0.6 |
| CPI (y/y) | 6.3 | 6.1 | 6.3 |

Chart: Canadian consumer price index




Source: Statistics Canada, Haver Analytics, CIBC

No one said that returning inflation back to 2% was going to be easy and would happen in a straight line, and that fact will be on full display in January's data. A slight rebound in gasoline prices, coupled with a further rapid increase in mortgage interest costs, could have seen prices rise by 0.8% on the month and the annual rate of inflation hold steady at 6.3%. However, further moderation in imported goods prices should mean that core inflation excluding food, energy and mortgage interest likely rose at a monthly pace which is broadly consistent with a 2% inflation target.

**Forecast implications** — Even though it may have taken a minor detour in January, inflation is still likely to be on a sharp downward path over the spring as some of the biggest monthly increases from 2022 drop out of the annual calculation. Indeed, headline inflation is likely to fall below 3% by June, although the final leg from there back to the 2% target will drag into 2024.

## Other Canadian releases: Retail sales—December

(Tuesday, 8:30 am)

Retail sales appear to have been surprisingly strong in December, with a 0.5% increase expected despite a sharp drop in gasoline prices over the month. While autos were likely a driver behind that advance, even excluding that volatile element the flat reading we expect would still represent a healthy gain in volume terms. The advance estimate for January could be an opposite story, however, with a healthy looking gain in nominal terms representing a more modest one in volumes.

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

(Friday, 8:30 am)

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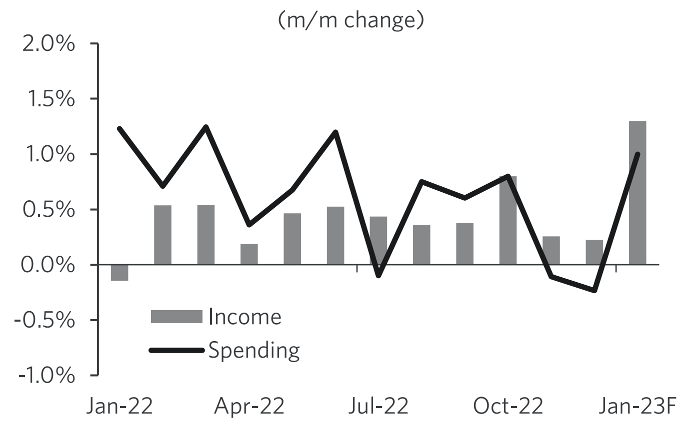
| Variable (%) | CIBC | Mkt | Prior |
|---|---|---|---|
| Personal income (m/m) | 1.3 | 0.9 | 0.2 |
| Personal spending (m/m) | 1.0 | 1.3 | -0.2 |
| Core PCE price index (y/y) | 4.3 | 4.3 | 4.4 |

Chart: US Personal income and spending




Source: BEA, Haver Analytics, CIBC

Labor income gains provided a catalyst for strong household spending in January, which likely rebounded by 1.0%. An impressive advance in goods spending will have been joined by a healthy rise in spending on services, with still strong demand for discretionary goods and services bolstered by the strong jobs market. However, unseasonably warm temperatures in January will cut into spending on utilities. The 1.3% expected gain in incomes implies that consumers didn't have to dip into savings to fund spending in January. The Fed's preferred gauge of inflation, core PCE prices, likely maintained a 0.3% monthly pace, slightly slower than its CPI counterpart given the lower weight of shelter in the index, causing the annual rate to subside to 4.3%.

**Forecast implications** — Although the savings rate has dropped, the resilient labor market continues to bolster optimism and aggregate incomes. The strong start to the year solidifies the need for at least two further 25bp rate hikes ahead, and for interest rates to remain at terminal for the rest of the year thereafter.

**Market impact** — The consensus is also expecting strength in income and consumption, which should limit any market reaction.

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