Economics

THE WEEK AHEAD

January 22 - 26, 2024

Inflationary buffet

by **Benjamin Tal** benjamin.tal@cibc.com

In the tug of war between a slowing economy and still elevated inflation, it is inflation that will eventually raise the white flag. But at what cost? The Canadian economy is already in a per capita recession. So, the focus will be on the speed at which inflation is getting closer to target. And yes, we can maintain until we are blue in the face that inflation is a lagging indicator, but at the end of the day, what really impacts the psyche of the Bank is the inflation du jour.

But what index is the Bank looking at to assess progress on the inflationary front? The Bank's official mandate is to ensure that annual CPI inflation runs near 2%. But in order to achieve that target, the Bank zooms in on underlying inflationary pressures in order to avoid overreacting to temporary shocks.

Between 1991 and 2001, life was simple. The Bank focused mostly on core inflation defined as all items minus food, energy, and indirect taxes. In 2002, the Bank decided to improve its inflationary measure and introduced the CPIX, which excludes eight historically volatile CPI components along with indirect taxes. In October 2016, the Bank of Canada introduced 3 more measures that were judged to be more persistent and better correlated with the business cycle: CPI-trim, CPI-median, and CPI-common.

Between 2016 and 2020, the Bank was relying heavily on those 3 measures, but in April 2021 the first crack appeared. In its Monetary Policy Report (MPR), the Bank stated that, "Measures of core inflation have remained at or below 2 percent and have diverged since the first wave. Two measures—CPI-median and CPI-trim— likely overstate underlying inflation". And in July 2021, the Bank stated that, "Core measures of inflation have picked up in recent months, likely reflecting some of the same temporary issues driving movements in CPI inflation. CPI-common remains below 2 percent, while CPI-median and CPI-trim have moved above 2 percent."

So, the assessment that the observed inflation at the time was "transitory" was based on the belief that CPI-common was a more reliable indicator. We now know that that was an error. Since then, the Bank has dropped CPI-common from its list of preferred inflationary indicators, but lately has been putting more focus on another inflation measure: services excluding shelter.

The point here is that when you have too many choices of preferred measures, that are themselves moving targets, things can get very confusing. Not only does the Bank look at no less than 6 indices, but also at any point, the focus can be on the y/y rate, the m/m rate, or smoothed versions of them. At this point following any CPI release, the Bank and the market have to look at no less than 30 inflationary numbers to come up with a narrative (see table below). So, you can easily choose your narrative and find the index that supports it, as was the case in 2021. A hawkish central bank might choose to focus on the squares with above 3% inflation, while a less hawkish Bank will focus on those with a 2% handle. In other words, the narrative will determine the data and not the other way around. Therefore, the tone of Governor Macklem's press conference will become increasingly more important than any new data releases because, at the end of the day, the Bank can always find an inflation number to fit its narrative.

Table: CPI matrix

	y/y%	y/y% 3mma	m/m% ann.	3-mo% ann.	6-mo% ann.
CPI	3.4	3.2	3.8	2.3	3.9
Ex. food/energy	3.4	3.4	2.4	3.8	3.7
CPIX	2.6	2.7	1.6	2.6	2.5
Trim	3.7	3.6	4.8	3.8	3.8
Median	3.6	3.6	4.7	3.5	3.7
Services ex. shelter	2.4	2.7	-2.2	4.5	2.2

Source: Statistics Canada, CIBC

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 22	-	-	-	-	-	-	-
Tuesday, January 23	-	-	-	-	-	-	-
Wednesday, January 24	9:45 AM	BANK OF CANADA RATE ANNOUNCE.	(Jan 24)	(H)	5.00%	5.00%	5.00%
Thursday, January 25	-	AUCTION: 10-YR CANADAS $5B	-	-	-	-	-
Thursday, January 25	8:30 AM	PAYROLL EMPLOYMENT, EARNINGS & HRS	(Nov)	-	-	-	-44.6K
Friday, January 26	-	-	-	-	-	-	-

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 22	10:00 AM	LEADING INDICATORS M/M	(Dec)	(M)	-	-0.3%	-0.5%
Tuesday, January 23	-	AUCTION: 1-YR TREASURIES $46B	-	-	-	-	-
Tuesday, January 23	-	AUCTION: 2-YR TREASURIES $60B	-	-	-	-	-
Tuesday, January 23	8:30 AM	PHILADELPHIA FED	(Jan)	(M)	-	-	6.3
Tuesday, January 23	10:00 AM	RICHMOND FED MANUF. INDEX	(Jan)	(M)	-	-	-11.0
Wednesday, January 24	-	AUCTION: 5-YR TREASURIES $61B	-	-	-	-	-
Wednesday, January 24	-	AUCTION: 2-YR FRN $28B	-	-	-	-	-
Wednesday, January 24	7:00 AM	MBA-APPLICATIONS	(Jan 19)	(L)	-	-	10.4%
Wednesday, January 24	9:45 AM	S&P GLOBAL US SERVICES PMI	(Jan P)	(L)	-	51.0	51.4
Wednesday, January 24	9:45 AM	S&P GLOBAL US COMPOSITE PMI	(Jan P)	(L)	-	-	50.9
Wednesday, January 24	9:45 AM	S&P GLOBAL US MANUFACTURING PMI	(Jan P)	(L)	-	47.7	47.9
Thursday, January 25	-	AUCTION: 7-YR TREASURIES $41B	-	-	-	-	-
Thursday, January 25	8:30 AM	INITIAL CLAIMS	(Jan 20)	(M)	-	200K	187K
Thursday, January 25	8:30 AM	CONTINUING CLAIMS	(Jan 13)	(L)	-	-	1806K
Thursday, January 25	8:30 AM	CHICAGO FED NAT.ACTIVITY INDEX	(Dec)	(M)	-	-	0.0
Thursday, January 25	8:30 AM	GDP (annualized)	(4Q A)	(H)	2.5%	2.0%	4.9%
Thursday, January 25	8:30 AM	GDP DEFLATOR (annualized)	(4Q A)	(H)	2.1%	2.3%	3.3%
Thursday, January 25	8:30 AM	ADVANCE GOODS TRADE BALANCE	(Dec)	(H)	-	-$88.5B	-$89.3B
Thursday, January 25	8:30 AM	WHOLESALE INVENTORIES M/M	(Dec P)	(L)	-	-0.2%	-0.2%
Thursday, January 25	8:30 AM	DURABLE GOODS ORDERS M/M	(Dec P)	(H)	1.0%	1.0%	5.4%
Thursday, January 25	8:30 AM	DURABLE GOODS ORDERS EX-TRANS M/M	(Dec P)	(H)	0.0%	0.2%	0.4%
Thursday, January 25	8:30 AM	RETAIL INVENTORIES M/M	(Dec)	(H)	-	-	-0.1%
Thursday, January 25	10:00 AM	NEW HOME SALES SAAR	(Dec)	(M)	625K	650K	590K
Thursday, January 25	10:00 AM	NEW HOME SALES M/M	(Dec)	(M)	6.0%	10.2%	-12.2%
Friday, January 26	8:30 AM	PCE DEFLATOR Y/Y	(Dec)	(H)	2.4%	2.6%	2.6%
Friday, January 26	8:30 AM	PCE DEFLATOR Y/Y (core)	(Dec)	(H)	3.0%	3.0%	3.2%
Friday, January 26	8:30 AM	PERSONAL INCOME M/M	(Dec)	(H)	0.2%	0.3%	0.4%
Friday, January 26	8:30 AM	PERSONAL SPENDING M/M	(Dec)	(H)	0.7%	0.4%	0.2%
Friday, January 26	10:00 AM	PENDING HOME SALES M/M	(Dec)	(M)	-	1.5%	0.0%

Week Ahead's market call

by Ali Jaffery

In the **US**, all attention will be on the GDP release next week as there are no Fed speakers lined up. We're above consensus on 23Q4 GDP as we expect domestic demand to be stronger than what the market likely thinks. Coming off a 5% outturn in 23Q3, another GDP report above potential will vindicate the many Fed speakers who have come out arguing that it is far too premature to expect policy easing in the near-term. The December PCE data will also provide another inflation report and we expect the FOMC to be pleased once again with core PCE inflation coming in at target.

In **Canada**, all eyes will be on the Bank of Canada for its January decision and the release of a fresh new set of projections. Not much has changed over the past few months. Growth in the Canadian remains weak and inflation, as judged by the Bank's preferred core measures, has showed some but not enough progress. We expect that to be the main message of the press conference will be to draw a line in the sand that we need to see further progress on the inflation before discussing rate cuts. There will likely be another token reference to the possibility of further monetary restraint, but that should be balanced by an acknowledgement of flexibility to get back to target and the outsized role of shelter costs. What we would like to see is the Bank putting greater weight on a broader set of inflation measures (cough ...*CPIX*...cough) as a guidepost to monetary policy.

There are no major Canadian data releases next week.

Week Ahead's key US number: Gross domestic product—Q4 (Advance)

(Thursday, 8:30 am)

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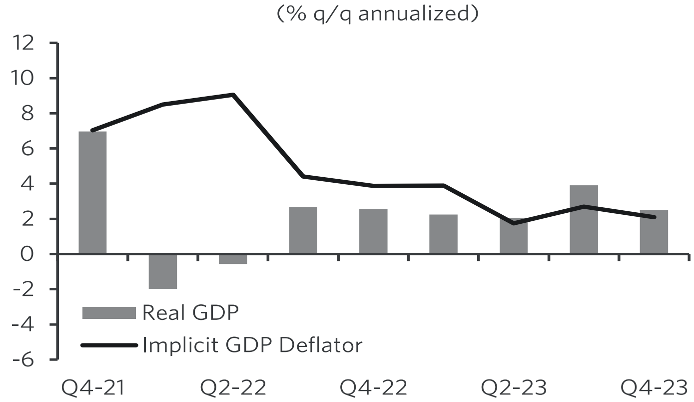
Variable (%)	CIBC	Mkt	Prior
GDP q/q annualized	2.5	2.0	4.9
GDP deflator	2.1	2.3	3.3

Chart: US GDP



Source: BEA, Haver Analytics, CIBC

The main event in the US data lineup this week will be the 23Q4 GDP print, and it should be another strong one. Our forecast calls for 2.5% Q/Q SAAR, above the current consensus number of 2.0% but in line with the Atlanta Fed Nowcast (2.4%). Once again, most of the strength in GDP will come from the sizzling consumption prints we've seen. But other components of domestic demand should also be solid in the quarter. However, with consumers continuing to pull goods off the shelves quickly and imports weak, downside risks to inventory accumulation are fairly high.

Forecast implications — 23Q4 will set the stage for the momentum heading into 24Q1, and the December retail sales print suggests the hand-off to consumption will be strong. Absent a material pullback in January spending, modest assumptions of monthly consumption imply consumption growth north of 2% in the upcoming quarter. If that all turns out to be true, our expectation of annual growth in 2024 will likely be at or above 2%.

Market impact — Markets are overly optimistic on how much the Fed will ease and the GDP print will likely be an opportunity to recalibrate. The source data indicate another strong outturn for domestic demand and that will likely be enough for some pullback in market pricing despite potential volatility from inventories and net exports that could push down the headline number.

Other US Releases: Durable goods order—December

(Thursday, 8:30 am)

Durable orders growth should slow to 1.0% as the volatile transportation category cools down. But excluding transportation, we expect momentum to continue fading with flat growth as restrictive monetary policy continues to weigh on the global economy.

Personal income & outlays—December

(Friday, 8:30 am)

Based on the December CPI report and the wider gap between CPI and PCE, we expect the core PCE deflator to be 0.2% m/m and 3.0% y/y in December. Real consumption should be strong at 0.5% consistent with the surge in retail sales. Income growth should come in more modestly at 0.2% which will mean most of the spending once again will come from a dip in saving. We estimate the saving rate will fall below 4% once again.

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