

Economics

THE WEEK AHEAD

June 19 - 23, 2023

What would an AI-based central bank do?

by Benjamin Tal benjamin.tal@cibc.com

Question: as a central banker, how do you know that you are overshooting? Answer: you don't know. You realize it only in retrospect — when it's way too late.

The history of economic recessions is the history of monetary policy errors. In fact, it would not be a stretch to suggest that the majority of economic recessions in the post-war era were helped, if not caused, by policy errors. And we currently might be in the midst of another overshooting episode.

After all, central bankers are human, they have fears and doubts. Deep inside, Macklem and Powell know that monetary policy works with a lag, and if they just wait and let what's in the pipeline materialize, things should be ok. But for this you need monetary guts, or you need to be emotionless. An AI-based Bank of Canada would have probably elected to pause last week.

Such a robotic central banker would zoom-in on a number of important ongoing disinflationary forces: The level of food prices remains elevated but, on a year-over-year basis, food inflation is decelerating; ditto for energy inflation. So at least until September, CPI inflation on both sides of the border will benefit from favorable base effects. The Canadian dollar is no longer an inflationary driver, in fact the opposite is the case. At its current level, the loonie is a modest disinflationary force. Supply chain conditions have improved notably, helping inflation in 3 ways: price pressures on goods are softening; the effectiveness of monetary policy is improving due to the reduced contribution of supply-based inflation, and retail gross margins are facing significant downward pressure as retailers can no longer hide behind the fog of supply chain pressures.

What's more, the direction of rent inflation in the US is easy to predict — it's going down as rent inflation of new leases is approaching zero — notably lower than the 8% inflation seen in the stock of all leases (which is used in calculating shelter inflation in the CPI). In Canada, shelter inflation, which is now rising by just under 5% (y/y), includes interest payments that

are rising fast, but not principal payments that are falling. An AI-based central banker would have an issue with that.

But perhaps the most important factor behind the decision of an AI-based Bank of Canada to pause is the weight it would assign to different variables based on their predictive power. The main reason behind past overshooting is the fact that inflation is, in many ways, a lagging indicator, but still it is used as the main reason to justify monetary policy decisions in real time.

The US Conference Board has developed 3 indicators: lagging, coincident and leading. A quick look at the list of variables in those indicators reveals a few interesting observations: service inflation — central banks' chief antagonist — is a proud member of the lagging indicators family, while employment is a coincident indicator. As for the seven non-financial variables that compose the index of leading indicators, all but one currently show negative contributions to future growth. In fact, at current readings, that index is now falling at a year-over-year rate that was seen during the Covid and 2001 recessions.

We will take a human over an AI-based central bank any day. But what makes central banks human is also behind the increased risk that we are already in, or fast approaching, overshooting territory.

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 19	8:30 AM	INDUSTRIAL PROD. PRICES M/M	(May)	(M)	-	-	-0.2%
Monday, June 19	8:30 AM	RAW MATERIALS M/M	(May)	(M)	-	-	2.9%
Tuesday, June 20	-	AUCTION: 3-M BILLS \$11.6B, 6-M BILLS \$4.2B, 1-YR BILLS \$4.2B	-	-	-	-	-
Wednesday, June 21	8:30 AM	RETAIL TRADE TOTAL M/M	(Apr)	(H)	0.4%	-	-1.4%
Wednesday, June 21	8:30 AM	RETAIL TRADE EX-AUTO M/M	(Apr)	(H)	0.6%	-	-0.3%
Wednesday, June 21	1:30 PM	Publication: Summary of Deliberations	-	-	-	-	-
Thursday, June 22	-	AUCTION: 30-YR CANADAS \$3B	-	-	-	-	-
Friday, June 23	-	-	-	-	-	-	-

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 19	-	Markets Closed (Juneteenth)	-	-	-	-	-
Monday, June 19	10:00 AM	NAHB HOUSING INDEX	(Jun)	(L)	-	51.0	50.0
Tuesday, June 20	8:30 AM	BUILDING PERMITS SAAR	(May)	(H)	1400K	1428K	1417K
Tuesday, June 20	8:30 AM	PHILADELPHIA FED	(Jun)	(M)	-	-	-16
Tuesday, June 20	8:30 AM	HOUSING STARTS SAAR	(May)	(M)	1365K	1403K	1401K
Tuesday, June 20	6:30 AM	Speaker: James Bullard (St Louis)	-	-	-	-	-
Tuesday, June 20	11:45 AM	Speaker: John C. Williams (Vice Chairman, New York) (Voter)	-	-	-	-	-
Wednesday, June 21	-	AUCTION: 20-YR TREASURIES \$12B	-	-	-	-	-
Wednesday, June 21	7:00 AM	MBA-APPLICATIONS	(Jun 16)	(L)	-	-	7.2%
Wednesday, June 21	10:00 AM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Wednesday, June 21	12:25 PM	Speaker: Austan D. Goolsbee, Chicago (Voter)	-	-	-	-	-
Thursday, June 22	-	AUCTION: 5-YR TIPS \$19B	-	-	-	-	-
Thursday, June 22	8:30 AM	INITIAL CLAIMS	(Jun 17)	(M)	-	-	262K
Thursday, June 22	8:30 AM	CONTINUING CLAIMS	(Jun 10)	(L)	-	-	1775K
Thursday, June 22	8:30 AM	CHICAGO FED NAT.ACTIVITY INDEX	(May)	(M)	-	-	0.1
Thursday, June 22	8:30 AM	CURRENT ACCOUNT BALANCE	(1Q)	(L)	-	\$218.6B	-\$206.8B
Thursday, June 22	10:00 AM	EXISTING HOME SALES SAAR	(May)	(M)	-	4.3M	4.3M
Thursday, June 22	10:00 AM	EXISTING HOME SALES M/M	(May)	(M)	-	-0.7%	-3.4%
Thursday, June 22	10:00 AM	LEADING INDICATORS M/M	(May)	(M)	-	-0.8%	-0.6%
Thursday, June 22	4:00 AM	Speaker: Christopher J. Waller (Governor) (Voter)	-	-	-	-	-
Thursday, June 22	9:55 AM	Speaker: Michelle W Bowman (Governor) (Voter)	-	-	-	-	-
Thursday, June 22	10:00 AM	Speaker: Jerome H Powell (Chairman) (Voter)	-	-	-	-	-
Thursday, June 22	10:00 AM	Speaker: Loretta Mester (Cleveland) (Non-Voter)	-	-	-	-	-
Thursday, June 22	4:30 PM	Speaker: Thomas I. Barkin (Richmond) (Non-Voter)	-	-	-	-	-
Friday, June 23	9:45 AM	S&P GLOBAL US SERVICES PMI	(Jun P)	(L)	-	54.0	54.9
Friday, June 23	9:45 AM	S&P GLOBAL US COMPOSITE PMI	(Jun P)	(L)	-	-	54.3
Friday, June 23	9:45 AM	S&P GLOBAL US MANUFACTURING PMI	(Jun P)	(L)	-	48.5	48.4
Friday, June 23	5:15 AM	Speaker: James Bullard (St Louis)	-	-	-	-	-
Friday, June 23	1:40 PM	Speaker: Loretta Mester (Cleveland) (Non-Voter)	-	-	-	-	-

Week Ahead's market call

by Katherine Judge and Andrew Grantham

In the **US**, it's a light week for economic data, with housing market indicators taking center stage. While not typically a market mover, a decline in the pace of homebuilding would show that one of the most interest-sensitive sectors of the economy is responding to higher interest rates. Fed speakers will likely echo the message from the June announcement that signaled that higher interest rates are likely in the cards in the near future.

In **Canada**, the minutes from the BoC's latest policy meeting, in which it surprised forecasters with another 25bp hike, will be important to watch for clues as to what conditions will need to be seen to bring (or prevent) a further hike next month. Retail sales data is likely to show consumer spending on goods continuing to struggle in real terms.

Week Ahead's key Canadian number: Retail sales—April

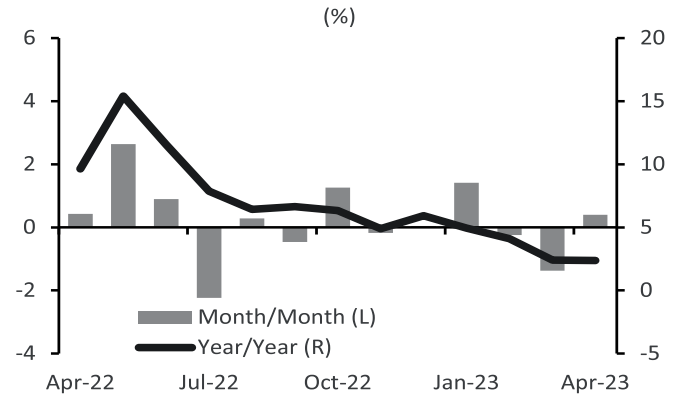
(Wednesday, 8:30 am)

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Variable (%)	CIBC	Mkt	Prior
Retail sales total m/m	0.4	-	-1.4
Ex-autos m/m	0.6	-	-0.3

Retail sales appear to have rebounded modestly in April, although much of that appears to have been driven by higher prices including at the pumps. The 0.4% gain that we forecast would be slightly ahead of the advance estimate, but would represent no growth in inflation-adjusted terms. The advance estimate for May would show a further very modest advance in retail sales, albeit one that is again partly linked to higher prices.

Chart: Canadian retail sales



Source: Statistics Canada, Haver Analytics, CIBC

Forecast implications— Gains in retail sales earlier in the year were largely driven by a rebound in auto sales linked to the easing of past supply chain issues. Retail sales volumes excluding autos have seen very little change over the past year, which would represent a decline in per-capita terms after accounting for strong population growth. We suspect that household spending on goods could slip slightly during the second half of this year, with interest rates having risen further and more consumers becoming exposed to those higher rates.

Week Ahead's key US number: Housing starts—May

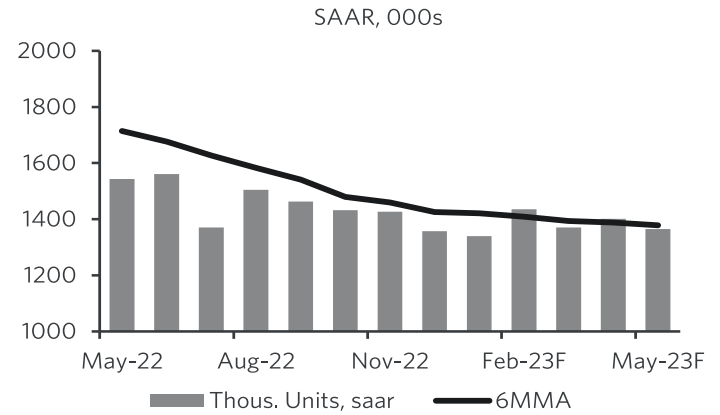
(Tuesday, 8:30 am)

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Variable	CIBC	Mkt	Prior
Housing starts	1365K	1403K	1401K
Building permits	1400K	1428K	1417K

Mortgage rates climbed in May as the fading of banking sector issues lifted bond yields, which weighed on home purchase intentions. Along with the decline in building permit issuance in April, that suggests that the pace of homebuilding could have declined by 2.6% in May, to 1365K annualized. We expect bond yields to ascend further in the third quarter, which will continue to limit demand. In line with that, building permit issuance likely eased off to 1400K annualized in May.

Chart: US Housing starts



Source: Census Bureau, Haver Analytics, CIBC

Forecast implications— Our forecast implies that housing starts were 12% below year-ago levels in May, providing some comfort to the Fed that activity is responding to higher interest rates, even if undersupply in the pre-COVID housing market has limited that response.

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