

Powell and Macklem: Time to Compare Notes

by Avery Shenfeld

They are both fine gentlemen, but they both can't be right. Bank of Canada Governor Macklem and US Fed Chairman Powell have more that they agree on than markets understand, but also some items on which two reasonable people could disagree, on which the facts will have to come down on one side or the other.

Market participants seem to think that the Fed's "Average Inflation Targeting" is a lot different than the Bank of Canada's "Flexible Inflation Targeting". It's not. Underscoring that point, the BoC has forecast CPI inflation overshooting to 2.4% by the end of 2023, pointing out, that after a big undershoot of the 2% target in 2020, they can be flexible on the pace of future rate hikes and allow a rebound over 2% for a while. That elbow room also hints that the Bank of Canada won't find it necessary to actually adopt AIT anytime soon. Both central banks are going to ignore a larger near-term pop in the 12-month CPI as we lap some very weak 2020 prices.

Their guidance on interest rates seems very different, but perhaps not as different as it appears. You may have missed it, but in his Q&A session, Macklem said their guidance was that they wouldn't raise rates before slack had been absorbed, expecting that to occur in the second half of 2022. But, he noted, the guidance didn't say they would mechanically then raise rates when we get there. So again, he's leaving the door open to a more protracted pause should the growth and inflation outlook for 2023 look to be sufficiently in check.

Where these central bankers part company is on just how optimistic they are willing to be on the outlook. The BoC is projecting 7% GDP growth for the US this year, implying roughly 8% growth from Q4 2020 to Q4 2021. The FOMC's median forecast for Q4/ Q4 is only 6.5%. Further out, the BoC has the American economy decelerating to only 1.3% growth in 2023, slowing under the weight of reduced fiscal impetus. But are they also hinting that the US output gap will have closed and the fed funds rate will have been lifted? The Fed sees less of a deceleration, and has suggested that rate hikes won't yet be kicking in.

Who's right? Time, and Covid-19, will tell. But it seems unlikely that with massive fiscal stimulus now in place, and near zero interest rates, the US would chug along for three full years at a pace that would leave price pressures so muted to allow that hands off approach on rates. While the BoC sees US PCE inflation still moderate at 2.4% at the end of 2023, that could include the cushioning impacts of some interest rate hikes.

Powell should compare notes with Macklem before the week ahead's FOMC meeting. Recent Fed speakers, including Richard Clarida who we judge to be its thought leader, are trying to reassure markets that they will have their eye on the ball, hinting that they could hike earlier if need be. If the Bank of Canada's optimistic take on its own economy is correct, and it does need to hike in H2 2022, any reasonable economic scenario will have the Fed in the same boat.

ECONOMIC UPDATE

CANADA	20Q2A	20Q3F	20Q4F	21Q1F	21Q2F	21Q3F	21Q4F	22Q1F	22Q2F	2020F	2021F	2022F
Real GDP Growth (AR)	-38.1	40.5	7.8	-0.9	2.8	7.6	7.2	5.4	4.1	-5.4	4.3	5.0
Real Final Domestic Demand (AR)	-38.4	50.8	2.1	-2.7	3.0	8.4	7.8	4.9	4.9	-4.6	3.8	5.3
Household Consumption (AR)	-44.3	62.8	2.3	-1.6	2.0	11.6	9.7	5.4	6.0	-6.3	4.7	6.1
All Items CPI Inflation (Y/Y)	0.0	0.3	0.8	1.2	2.3	2.1	2.0	2.0	2.0	0.7	1.9	2.0
Unemployment Rate (%)	13.1	10.1	8.8	9.0	8.4	7.3	6.7	6.4	6.2	9.5	7.9	6.1
U.S.	20Q2A	20Q3A	20Q4A	21Q1F	21Q2F	21Q3F	21Q4F	22Q1F	22Q2F	2020A	2021F	2022F
Real GDP Growth (AR)	-31.4	33.4	4.0	1.9	3.7	6.6	5.2	2.9	2.6	-3.5	4.3	3.6
Real Final Sales (AR)	-28.1	25.9	3.0	2.7	3.3	6.2	5.7	3.0	2.4	-2.9	3.8	3.6
All Items CPI Inflation (Y/Y)	0.4	1.2	1.2	1.9	3.1	2.5	2.7	2.6	2.6	1.2	2.6	2.6
Core CPI Inflation (Y/Y)	1.3	1.7	1.6	1.7	2.7	2.2	2.4	2.4	2.4	1.7	2.2	2.4
Unemployment Rate (%)	13.1	8.8	6.8	6.8	6.2	5.4	4.9	4.5	4.3	8.1	5.8	4.0

INTEREST & EXCHANGE RATE FORECAST

END OF PERIOD:	2021		2021		2022			
	8-Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
CDA Overnight target rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50
98-Day Treasury Bills	0.11	0.15	0.10	0.15	0.20	0.25	0.25	0.35
2-Year Gov't Bond	0.30	0.25	0.30	0.35	0.40	0.45	0.60	0.90
10-Year Gov't Bond	1.51	1.50	1.65	1.45	1.65	1.75	1.80	1.85
30-Year Gov't Bond	1.89	2.10	2.00	1.90	1.95	2.10	2.20	2.25
U.S. Federal Funds Rate	0.125	0.125	0.125	0.125	0.125	0.125	0.375	0.625
91-Day Treasury Bills	0.04	0.00	0.05	0.15	0.20	0.25	0.40	0.50
2-Year Gov't Note	0.15	0.15	0.15	0.25	0.40	0.50	0.85	1.15
10-Year Gov't Note	1.58	1.60	1.75	1.50	1.60	1.70	1.80	2.00
30-Year Gov't Bond	2.29	2.30	2.40	2.25	2.30	2.40	2.50	2.70
Canada - US T-Bill Spread	0.07	0.15	0.05	0.00	0.00	0.00	-0.15	-0.15
Canada - US 10-Year Bond Spread	-0.07	-0.10	-0.10	-0.05	0.05	0.05	0.00	-0.15
Canada Yield Curve (10-Year — 2-Year)	1.21	1.25	1.35	1.10	1.25	1.30	1.20	0.95
US Yield Curve (10-Year — 2-Year)	1.44	1.45	1.60	1.25	1.20	1.20	0.95	0.85
EXCHANGE RATES								
CADUSD	0.79	0.81	0.79	0.77	0.76	0.75	0.75	0.75
USDCAD	1.27	1.24	1.27	1.30	1.32	1.33	1.34	1.34
USDJPY	109	102	100	99	99	99	100	101
EURUSD	1.19	1.24	1.26	1.26	1.25	1.25	1.24	1.23
GBPUSD	1.38	1.43	1.46	1.46	1.44	1.43	1.41	1.40
AUDUSD	0.77	0.82	0.82	0.84	0.85	0.86	0.87	0.88
USDCNY	6.52	6.32	6.25	6.15	6.05	5.95	5.85	5.80
USDBRL	5.72	4.80	4.80	4.50	5.00	4.80	5.00	4.50
USDMXN	21.6	20.0	20.0	19.0	19.5	19.8	20.0	20.5

Sources: Statistics Canada, Bank of Canada, CIBC World Markets Inc.

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