Focus

Feature Article

U.S. Inflation: A Tale of Two Indices

Our Thoughts

- America's Inflation, Everyone's Problem
- What Are Americans Still Buying?
- Canada: True North Strong

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America's Inflation, Everyone's Problem

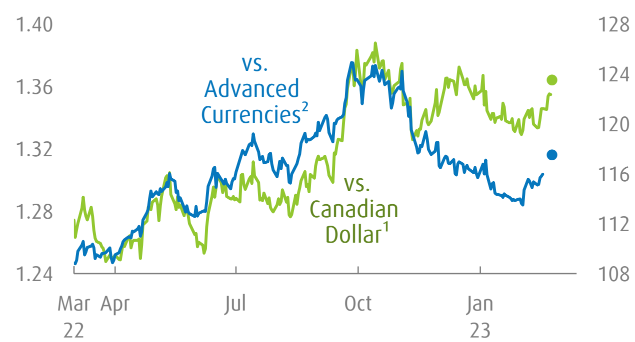
Douglas Porter, CFA
Chief Economist
douglas.porter@bmo.com

Last week we opined that the U.S. economic data pointed to higher for longer, and this week the markets said "yep", with bonds, stocks and currencies selling off. **Adding some serious spice to the mix on Friday, January's core PCE deflator—aka the Fed's preferred inflation measure—**jumped 0.6% m/m and 4.7% y/y. The latter was a full four ticks above expectations, juiced also by upward revisions to earlier months. It actually gets worse when we dig into Chair Powell's supercore measure (services ex energy and housing), where the 3-month trend popped to an annualized 5.4% clip, flagging no let-up in underlying pressures whatsoever. The core results were notably concerning since they came in above what had already been surprisingly perky CPI and PPI figures.

Financial markets were already struggling to digest the recent run of robust U.S. economic data to start the year, and the PCE deflator only added to the discomfort. Ten-year Treasury yields pushed above 3.95% for the first time this year, while 2-year yields flared above 4.8% for the first time since the Global Financial Crisis blew open in 2007. **Markets are now fully priced for three more 25 bp rate hikes from the Fed, which would take the terminal rate to 5.25%-to-5.50%.** But some are now muttering about even more, with non-trivial odds of fed funds hitting 6% beginning to emerge. Stocks have naturally greeted this development as warmly as a skunk at a picnic, with the S&P 500 retreating for the third week in a row, and now down more than 5% from the early February high.

Chart 1
Dollar Daze

U.S. Dollar (as of February 24, 2023)



[1] (lhs : C$/US$); [2] Trade-Weighted Dollar (rhs : Jan. 2006 = 100)
Sources: BMO Economics, Haver Analytics

The re-re-pricing on the Fed outlook has given the U.S. dollar yet another charge. After retreating steadily from the 20-year high hit last fall, the greenback has snapped back up since early February lows to reach its highest levels of 2023. For example, the **euro** has pulled back by more than 4% after nearly touching $1.10 at the start of this month. The **yen** is also on its back heels again, sagging more than 6% in a month to above ¥136. And the **Canadian dollar** has certainly not escaped the broader downdraft, weakening below 73.5 cents (or $1.362/US$), down two cents so far this month. In the 15 years prior to the pandemic, the loonie was only weaker for one brief spell—when oil prices crashed below $30 in late 2015.

The Canadian dollar is being undercut by the broader strength of the U.S. dollar, a related risk-off move, but also by some specific home-grown factors. The sudden reassessment of the potential for even more Fed rate hikes follows soon after the Bank of Canada rather publicly planted its flag in the on-pause field. True, the pause was billed as "conditional" on the inflation performance. But just as U.S. inflation surprised to the high side in January, Canada delivered a rare downside surprise in this week's CPI. Headline inflation cracked below 6% (at 5.9%) for the first time in nearly a year, **leaving Canada with one of the lowest inflation rates in the industrialized world**. Even Japan's rate is now not that much lower at 4.3%, and the BoJ is sticking with *negative* interest rates. Moreover, Canada's core inflation displayed some encouraging signals, with ex food & energy prices rising only 0.1% m/m in seasonally adjusted terms. That's the smallest monthly rise in nearly two years, clipping the 3-month trend to a manageable 3.1% (the similar measure in the U.S. was 4.6%).

The not-terrible domestic inflation reading temporarily calmed some of the more aggressive expectations for the Bank of Canada later this year. The blow-out January jobs report, and a run of reasonably good growth figures to start 2023, had convinced markets that the Bank would hike yet again by summer. Those expectations have been revived by the strong U.S. inflation result, as well as by the sagging Canadian dollar.

The main arguments for why the Bank could consider deviating meaningfully from the Fed are two-pronged: 1) Canadian households are much more indebted than their U.S. counterparts, and mortgages are on a shorter cycle than stateside, leaving **the economy much more sensitive to higher rates**; and 2) **wage and price pressures are a bit less intense in Canada**. The latest CPI results highlighted some of that gap, and so too did job openings. The job vacancy rate in Canada has dipped below 5% in recent months, while the U.S. rate picked back up to 6.7% in December. And most major measures of wages are running consistently stronger than in Canada.

True, the BoC can deviate a bit from the Fed, but the currency will act as a limiter on the extent of that deviation. That is, the Bank may not have the luxury of staying on the sidelines if the Fed is still busily marching rates down the field, driving the loonie lower (and thereby sending imported costs flaring higher). Import prices were up 13% y/y in Q4, outpacing export prices for the first time in two years. At least some of that import price inflation has been sparked by a 5% drop in the Canadian dollar in the past year.

Alongside recent surprisingly solid growth results, this has prompted the market to again nearly fully price in one additional 25 bp hike from the BoC, pushing GoC yields higher across the curve. **The five-year yield—important for the housing market—has vaulted above 3.6%, up by more than 70 bps just since the Bank signalled its pause less than a month ago.** While still roughly 25 bps below the extreme peaks reached last October, yields had not previously been in this zone since 2007. Note that, in inflation-adjusted terms, home prices were 40% lower than current levels back then. While we're not looking for a pullback of that magnitude, it's safe to say that the back-up in bond yields will put a further chill in a frosty domestic housing market.

The title of this piece is certainly not meant to imply that it's only the U.S. economy dealing with a serious inflation issue. In fact, European price trends have long since overtaken their American counterparts. The Euro Area's inflation rate was confirmed at 8.6% in January, down 2 ppts from October's peak, but now more than 2 ppts north of the U.S. tally. Britain is even loftier at 10.1%. However, a much larger share of Europe's inflation has been driven by energy costs—even with core CPI hitting a new high of 5.3%, it's still below the 5.5% U.S. pace. And, **the recent melt in natural gas should help cool headline Euro Area CPI aggressively in the months ahead**. Gas prices in the Netherlands are now down 60% from a year ago, and back to levels last seen in the summer of 2021. The war in Ukraine is regrettably still grinding on at its one-year anniversary today, but Mother Nature did her part for the right side this winter.

What Are Americans Still Buying?

Sal Guatieri
Senior Economist
sal.guatieri@bmo.com

Despite rising loan costs and high inflation, **U.S. consumers turned on the jets in January**, stoked by unusually temperate weather and a spike in after-tax income. The 1.1% sprint in real spending, following declines the prior two months, has consumers on track for a roughly 3% annualized gain in Q1, double the prior pace. Yet, given that special factors (weather, seasonal adjustment) likely played some role, it's hard to take the pulse of underlying demand. A look at **what people are still buying (or not) might shed some light on the outlook for both spending and the economy**. We tracked spending over the past six months to iron out the September-October gains that were juiced by early holiday discounting, the November-December losses that marked some payback, and the January spike that was partly due to warmer weather. On this basis, real spending looks to have picked up moderately from an earlier downshift. Here is the breakdown by key categories:

Still going strong:

- **services:** notably hotel stays (travel related), personal care, health care (doctor and dentist visits are still going strong amid catch up from the pandemic), air travel, and recreation (such as sports and live entertainment)
- **public transportation** including taxis and ride-sharing services (reflecting the return to office)

Rising more modestly:

- **goods:** notably furniture and appliances (basically, anything housing-related)
- **food services**: prior to the January spike, people were cutting back on restaurant visits, which is likely a sign of waning discretionary demand by lower-income groups that have largely exhausted excess savings
- laundry services and clothing, both supported by the return to office
- **autos:** seeing through part of the January spike and noting that preliminary data suggest new vehicle sales fell by one million in February

Stalled:

- **gasoline**, oddly, despite lower prices and a thirst for travel
- **recreational goods and vehicles**, which were hot in the early days of the pandemic

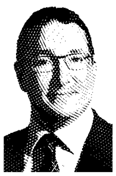
Cutting back:

- **groceries:** notably, egg consumption has plunged due to soaring prices and worsening shortages due to avian flu ravaging the supply of hens
- **household supplies**, **personal care products**, and (surprisingly) **jewellery** (given that upper-income earners still have substantial excess savings)

What can we take away from this mix of strength in some areas but weakness in others? Three things stand out. **First**, consumers remain keen on buying services, especially anything related to travel or the return to office. And, there is still some “revenge” spending for recreational services. **Second**, there is less pent-up demand for goods, especially the recreational kind. And **third**, households are cutting back on things that have become much more expensive, such as food.

The key message is that **American consumers continue to chug along on the back of previously deferred services in the pandemic**. Excess savings and sturdy job markets are taking the sting out of the rising cost of credit and most other items. So long as two-thirds of the economy continues to plod forward, it should remain on course for either a mild downturn or even a soft landing. But its ultimate fate will be decided by the path for inflation and the Fed.

Canada: True North Strong



Benjamin Reitzes
Canadian Rates & Macro Strategist
benjamin.reitzes@bmo.com

The Canadian economy ended 2022 in surprisingly good shape, with retail sales rebounding from softness in the prior two months, home sales climbing (though they fell back in January), and service sectors likely continuing their solid run. December GDP, out next week, is expected to be flat-to-slightly higher. While that might not sound like much, it comes after the most aggressive Bank of Canada rate hike campaign in a generation. If in February 2022 someone said that the Canadian economy would still be holding up well after 425 bps of rate hikes, we would have been politely skeptical.

The early data suggest momentum held firm into 2023. Employment exploded higher in January, though it's always best to take any individual month of the Labour Force Survey with a grain of salt. The early estimate for January retail sales was positive as well, while wholesale trade surged 3% and manufacturing activity jumped 3.9%. That points to a solid start to the year for GDP, suggesting Q1 growth could be far stronger than our call for a modest 0.5% increase (which is in line with the BoC's latest forecast). **If GDP growth clocks in at anything close to potential** (estimated to be around 2%), the positive output gap won't shrink, and **there will be renewed pressure on the BoC to resume tightening policy**.

January inflation figures were a step in the right direction, supporting the BoC's "conditional pause", but there's still plenty of work to be done before inflation gets back to 2%. The smaller-than-expected headline increase was certainly welcome, though the details of the report were mixed, with a few categories seeing unusual weakness. We'll be watching to see if that becomes a trend. The yearly headline and core inflation rates are likely to keep falling given the base effects (prices rose sharply in the first half of 2022), **but that won't be enough to satisfy policymakers that inflation is headed to target**. They'll want to see the shorter-term metrics (e.g. 3-month annualized per cent change) for core inflation continue to decelerate. Unfortunately, that will take consistent monthly prints of 0.2% or lower… something we haven't seen since 2020.

Key Takeaway: The Canadian economy is holding firm despite the 425 bps in rate hikes over the past year. Unless the data do another U-turn weaker over the next month or two, the Bank of Canada might be forced to jump back into action and push rates to levels not seen in over 20 years.

Priscilla Thiagamoorthy
Senior Economist
priscilla.thiagamoorthy@bmo.com

Indications of stronger growth and a move toward price stability are ***good news*** *for the economy.*

Canada

- Short-term inflation metrics continue to improve
- C$ weakens as BoC's conditional policy pause deviates from a hawkish Fed

Good News

Consumer Prices slowed to +5.9% y/y (Jan) —lowest inflation rate since last Feb.

Retail Sales Volumes +1.3% (Dec.)—StatCan estimates January nominal sales grew 0.7%

New Housing Price Index +2.7% y/y (Jan.) —slowing

SEPH Employment +91,428 (Dec.)

Wholesale Trade +3.0% (Jan. A)

Manufacturing Sales +3.9% (Jan. A)

Bad News

Ottawa budget deficit $2.0 bln (Dec.) —vs. $3.6 bln surplus last year

United States

- Rising inflation puts more pressure on the Fed
- Stocks fall; 2-yr yield hits highest since 2007
- FOMC Minutes signal at least two more 25 bp hikes

Good News

Real Personal Spending +1.1% (Jan.)

Personal Income +0.6% (Jan.)

Chicago Fed National Activity Index 0.23 (Jan.)

New Home Sales +7.2% to 670,000 a.r. (Jan.)

U of M Consumer Sentiment revised up to 67.0 (Feb.)—and year-ahead inflation expectations revised down a tick to 4.1%

Bad News

Core PCE Deflator accelerated to +0.6% (Jan.) —and Fed's supercore +0.6%

Existing Home Sales -0.7% to 4.0 mln a.r. (Jan.)

Real GDP revised down to +2.7% a.r. (Q4 S)—but a still-healthy 2022 finish

Japan

- Inflation hits a fresh 40-year high…
- …will the BoJ step away from the sidelines soon?

Good News

Department Store Sales +15.1% y/y (Jan.)

Services PMI +1.3 pts to 53.6 (Feb. P)

Bad News

Consumer Prices +4.3% y/y (Jan.)

Manufacturing PMI -1.5 pts to 47.4 (Feb. P)

Europe

- ECB President Lagarde: what comes after March's 50 bp hike "*will be data dependent*"

Good News

Euro Area—Services PMI +2.2 pts to 53.0 (Feb. P)
Euro Area—Consumer Confidence +1.7 pts to -19.0 (Feb. P)

Germany—GfK Consumer Confidence +3.3 pts to -30.5 (Mar.)

Germany—ZEW Survey +11.2 pts to 28.1 (Feb.)

Germany—ifo Business Climate +1.0 pts to 91.1 (Feb.)

France—Business Confidence +1 pt to 103 (Feb.)

U.K.—Manufacturing PMI +2.2 pts to 49.2; **Services PMI** +4.6 pts to 53.3 (Feb. P)

U.K.—GfK Consumer Confidence +7 pts to -38 (Feb.)

Bad News

Euro Area—Consumer Prices revised up to +8.6% y/y (Jan.)—and **core** +5.3% y/y

Euro Area—Manufacturing PMI -0.3 pts to 48.5 (Feb. P)

Germany—Real GDP revised down to -0.4% q/q (Q4)

France—Retail Sales -2.6% y/y (Jan.)

France—Consumer Confidence -1 pts to 82 (Feb.)

Other

- RBNZ raises rates by 50 bps; signals more hikes to come

Good News

Mexico—Real GDP revised up to +0.5% q/q (Q4)

U.S. Inflation: A Tale of Two Indices

Michael Gregory, CFA
Deputy Chief Economist
michael.gregory@bmo.com

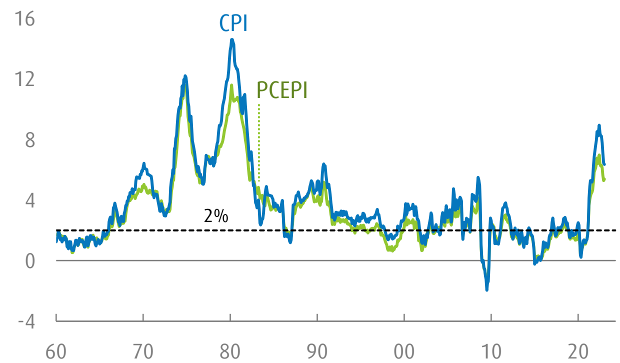
There are two official measures of inflation facing American households, the **Consumer Price Index** (CPI) and the **Personal Consumption Expenditures price index** (PCE price index or PCEPI). This week, the PCE price index increased 0.6% in January, lifting the annual change a tenth to 5.4% y/y. Despite drifting up, it is still down from June's 40-year high of 7.0% *(Chart 1)*. Last week, the CPI rose 0.5% in January, lowering the annual change by a tenth to a 15-month low of 6.4% y/y. This is down from the four-decade high of 9.1% also reached last June.

These two measures display different inflation rates, as they typically do, and we discuss the reasons why below. **The PCE price index has been the Fed's preferred price metric** since 2000 (before, it tracked the CPI), with a 2% annual change in the PCEPI becoming the FOMC's formal inflation target in January 2012. Despite the policy status, the CPI remains more popular; its results regularly make the media headlines. The affinity partly reflects the fact that the CPI is released earlier (e.g., by 10 days this month), has been around longer and is more comparable with international inflation measures. The CPI is also widely followed because it's used for making cost-of-living adjustments (COLAs) to wages and benefits, and for escalating other contract prices and costs.

As mentioned above, the CPI and PCEPI show different inflation rates, 6.4% and 5.4% respectively in January, for a divergence of 1.0 ppts. Since (monthly) PCEPI inflation figures started in 1960, the difference has ranged from 3.9 ppts in June 1980 to -1.7 bps in August 1983 with a median of 39 bps *(Chart 2)*. The latest spread has narrowed from the 40-year high of 2.1 ppts hit in July. Casual observation notes that the most extreme divergences occur when the inflation rates themselves are at extremes, which is a good segue into the discussion on why these two metrics generate different results.

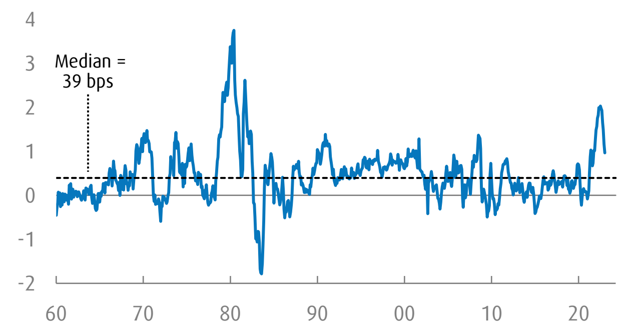
The CPI and PCEPI are constructed differently and any consequent divergence in calculated inflation rates can be dissected into a formula effect, a scope effect, a weight effect and an 'other effects' remainder. In Table 1,

Chart 1
Inflation, Two Ways
United States (y/y % chng)



Sources: BMO Economics, Haver Analytics

Chart 2
Faster-Running CPI
United States (ppts)
Annual Change in CPI less PCEPI



Sources: BMO Economics, Haver Analytics

Table 1
Reconciliation of PCEPI Inflation with CPI Inflation
2022Q4 (y/y % chng)

PCE Price Index	5.7
Formula Effect	0.11 ppts
Scope Effect	-0.35 ppts
Weight Effect	1.51 ppts
Other Effects	0.18 ppts
CPI	7.2

Figures do not add due to rounding
Sources: BMO Economics, author's calculations, BEA

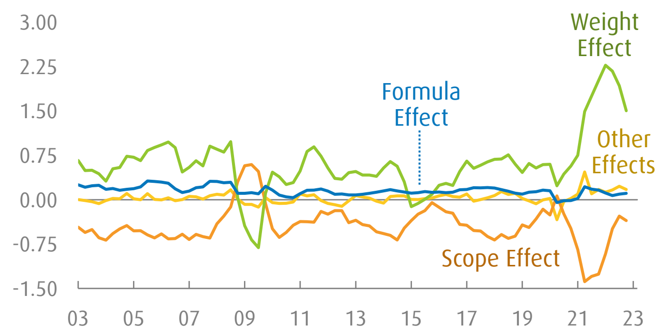
we show the reconciliation between the annual changes in the CPI and PCE price index for 2022Q4.

Formula effect: Calculated by the Bureau of Labor Statistics (BLS), the CPI measures the prices of items in a representative basket of goods and services for urban households. When comparing two periods and determining an inflation rate, the basket may not change. Technically, this is a Laspeyres index formula. Note that beginning January 2023, the basket is being updated annually instead of biennially but the BLS smooths the impact of basket updates to avoid distorting year-on-year inflation rates.

Calculated by the Bureau of Economic Analysis (BEA... the GDP folks), the PCEPI includes the prices of all goods and services purchased or used by all households. This time, when comparing two periods and determining an inflation rate, what was bought or used is the 'basket' and it changes each period. Technically, this is a Fisher Ideal index formula.

Chart 3
Special Effects

United States (% : s.a.a.r. : 4-qtr m.a.)
Contributions to CPI-PCEPI Divergence



Sources: BMO Economics, Haver Analytics

For both the CPI and PCEPI, these are essentially weighted averages of prices with the relative importance or weights of items based on surveys. When prices rise, households tend to purchase less of the more expensive goods and services and substitute them for more affordable alternatives, given their budget constraints. By construction, this gets reflected in the PCEPI but not in the CPI (that's why the PCEPI is considered to be closer to a true COLA index). The lack of substitution biases up the CPI relative to the PCEPI. In 2022Q4, the formula effect alone contributed 11 bps to the divergence between CPI and PCEPI yearly inflation rates. And, it typically averages around 16 bps (*Chart 3*).

Scope effect: The PCE price index is a much broader concept than the CPI. It includes the prices of all items, not just the expenditures paid for 'out of pocket'. The CPI includes only the latter. As such, the PCEPI includes the prices of goods and services bought on behalf of households by governments and businesses, along with final consumption expenditures of non-profit institutions serving households (think of a service club). For example, along with the prices of medical goods and services paid directly by consumers, the costs of such things such as Medicare and employer-sponsored health insurance are also included. Education prices include the cost of public education along with tuition. About 25% of PCE outlays are not covered by the CPI.

However, a more complete and comprehensive spending picture comes with a consequence. Roughly 20% of PCEPI prices or costs are unobservable (e.g. financial services furnished without payment), or are infrequently observed, and must be estimated by the BEA on a monthly basis. In 2022Q4, the scope effect contributed -35 bps to the discrepancy between CPI and PCEPI yearly inflation rates, and it typically stays on the negative side of the ledger (it tends to bias up PCEPI inflation relative to the CPI).

Weight effect: The source for the CPI's relative importance of items, or spending weights, is the BLS's Consumer Expenditure Survey. However, the source for the PCEPI's weights are all business surveys such as the Quarterly Services Survey and the Census Bureau's other surveys on retail sales. Different surveys can give rise to different weights, but it's the broader scope of the PCEPI that impacts weights the most.

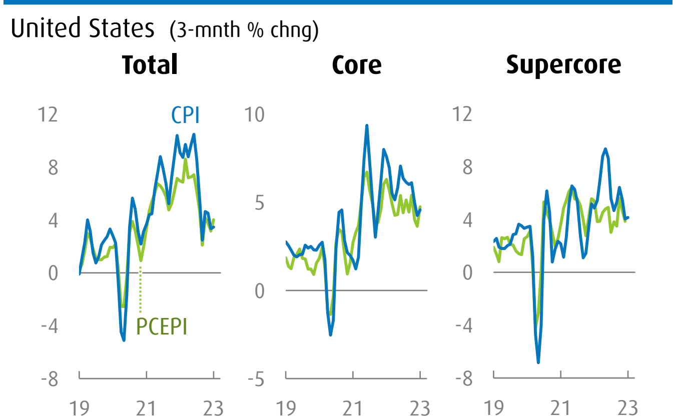
The weights of most items that both indices share will necessarily be smaller in the PCEPI. And, in an area like medical goods and services, that includes large outlays not covered in the CPI, the PCEPI weights will be noticeably larger. Meantime, in determining the contribution to the discrepancy between CPI and PCEPI inflation rates, the largest-weighted CPI items end up having the most influence, such as rent of shelter and energy. In 2022Q4, the weight effect alone (151 bps) could account for all the discrepancy.

Other effects: While item weights are derived from different sources, usually the CPI and PCEPI use the same item price. However, in some case, different prices are used. For example, the CPI figure for airline fares is based on a sampling of routes. The PCEPI figure is based on airlines' passenger revenues and miles flown.

Data revision is another issue. The seasonally unadjusted CPI is nearly never revised, with only the seasonal adjustment factors getting re-estimated annually (this had a noticeable impact this year in turning the 'tenth dial' on some monthly moves). The BEA doesn't publish seasonally unadjusted PCE price data, and the published figures get revised often (monthly back two periods, annually for up to five years). In 2022Q4, these other effects contributed 18 bps to the divergence between CPI and PCEPI yearly inflation rates.

As a final note, markets were recently focussing more than normal on how the CPI and PCEPI were constructed as they scrambled to create a CPI version of **the Fed's new favourite inflation metric, the PCEPI's core services excluding housing costs**, also known as 'supercore'. In January, it increased 0.6% which lifted the annual change by four tenths to 4.6% y/y. The version the market seems to have settled on is the CPI's core services excluding tenant and owners' equivalent rents. In January, it increased 0.4% which kept the annual change at 6.2% y/y. From a technical perspective, this could have been made even more comparable. While food services are included in the food component of the CPI, they are not in the PCEPI. So, excluding food, energy and other goods still leaves food services in the PCEPI but not the CPI. Adding food services back into the CPI version has it increasing 0.4% in January which lifted the annual change by a tenth to 6.6% y/y. However, the refinement does little to change the general conclusion… **underlying inflation is still appearing stubborn no matter how you measure it** *(Chart 4)*.

Chart 4
Short-term Trends Start to Bend



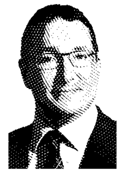
Sources: BMO Economics, Haver Analytics

Economic Forecast Summary for February 24, 2023

	2022				2023				Annual		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2021	2022	2023
CANADA											
Real GDP (q/q % chng : a.r.)	2.8	3.2	2.9	1.5	0.5	-1.0	-1.0	1.0	5.0	3.6	0.7
Consumer Price Index (y/y % chng)	5.8	7.5	7.2	6.7	5.5 ↓	3.8	3.5	3.2 ↑	3.4	6.8	4.0
Unemployment Rate (percent)	5.7	5.1	5.1	5.1	5.1	5.4	5.6	5.8	7.5	5.3	5.5
Housing Starts (000s : a.r.)	241	271	281	258	233	242	225	220	274	263	230
Current Account Balance ($blns : a.r.)	3.7	10.6	-44.4	-44.0 ↑	-37.5 ↑	-36.5 ↑	-36.5 ↑	-37.5 ↑	-6.7	-18.5 ↑	-37.0 ↑
Interest Rates	(average for the quarter : %)										
Overnight Rate	0.33	1.17	2.75	3.92	4.50	4.50	4.50	4.50	0.25	2.04	4.50
3-month Treasury Bill	0.39	1.43	2.91	3.96	4.40 ↑	4.45 ↑	4.45 ↑	4.45 ↑	0.11	2.17	4.45 ↑
10-year Bond	1.92	2.98	3.01	3.16	3.10 ↑	3.20 ↑	3.10	3.05	1.36	2.77	3.10 ↑
Canada-U.S. Interest Rate Spreads	(average for the quarter : bps)										
90-day	9	33	16	-22	-36 ↓	-53 ↑	-60 ↑	-60 ↑	7	9	-53 ↑
10-year	-2	5	-10	-67	-57 ↑	-54 ↑	-53	-51	-8	-18	-54 ↑
UNITED STATES											
Real GDP (q/q % chng : a.r.)	-1.6	-0.6	3.2	2.7	0.5	-1.0	-1.0	0.8	5.9	2.1	0.7
Consumer Price Index (y/y % chng)	8.0	8.6	8.3	7.1	6.0 ↑	4.5	3.9	3.5	4.7	8.0	4.5 ↑
Unemployment Rate (percent)	3.8	3.6	3.5	3.6	3.5	4.0	4.6	4.8	5.4	3.6	4.2
Housing Starts (mlns : a.r.)	1.72	1.65	1.45	1.41	1.34	1.33	1.34	1.37	1.61	1.56	1.34
Current Account Balance ($trlns : a.r.)	-1.13	-0.95	-0.87	-0.87	-0.86 ↓	-0.87 ↓	-0.87	-0.88 ↓	-0.85	-0.95 ↑	-0.87 ↓
Interest Rates	(average for the quarter : %)										
Fed Funds Target Rate	0.21	0.96	2.63	3.79	4.63	5.04	5.13	5.13	0.13	1.90	4.98
3-month Treasury Bill	0.30	1.10	2.75	4.18	4.80 ↑	5.00 ↑	5.05	5.05	0.05	2.08	5.00 ↑
10-year Note	1.94	2.93	3.10	3.83	3.65 ↑	3.75 ↑	3.65	3.55	1.44	2.95	3.65 ↑
EXCHANGE RATES	(average for the quarter)										
US¢/C$	79.0	78.4	76.6	73.7	74.7	75.4	76.0	76.7	79.8	76.9	75.7
C$/US$	1.27	1.28	1.31	1.36	1.34	1.33	1.32	1.30	1.25	1.30	1.32
¥/US$	116	130	138	141	132	132	130	129	110	131	130
US$/Euro	1.12	1.06	1.01	1.02	1.08	1.09	1.10	1.11	1.18	1.05	1.09
US$/£	1.34	1.26	1.18	1.17	1.22	1.23	1.24	1.26	1.38	1.24	1.24

Blocked areas mark BMO Capital Markets forecasts; up and down arrows (↑↓) indicate forecast changes; spreads may differ due to rounding

Canada



Benjamin Reitzes
Canadian Rates & Macro Strategist
benjamin.reitzes@bmo.com

Shelly Kaushik
Economist
shelly.kaushik@bmo.com

Current Account Balance

Monday, 8:30 am

Q4 (e)	**-$11.0 bln (-$44.0 bln a.r.)**
Consensus	*-$11.0 bln (-$44.0 bln a.r.)*
Q3	-$11.1 bln (-$44.4 bln a.r.)

Canada's **current account** deficit was likely little changed in Q4; we look for a slightly narrower shortfall of about $11 bln (or $44 bln a.r.) from $11.1 bln ($44.4 bln a.r.) in the third quarter. This would be the second straight deficit on the back of much smaller goods trade surpluses, primarily from lower commodity prices, which stepped down again in Q4. Meantime, the services deficit was little changed as travel flows have returned to more normal patterns. Our estimate would put the current account deficit at about a manageable 1.6% of GDP, which would put limited pressure on the Canadian dollar given relatively healthy financial flows.

Real GDP

Tuesday, 8:30 am

	Real GDP	Chain Prices
Q4 (e)	**+1.5% a.r.**	**-1.9% a.r.**
Consensus	*+1.5% a.r.*	*n.a.*
Q3	+2.9% a.r.	-5.4% a.r.

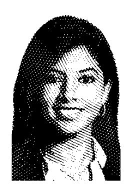
	Monthly Real GDP
Dec. (e)	**unch**
Consensus	*unch*
Nov.	+0.1%

The economy has held up surprisingly well in the face of the most aggressive rate hike campaign in a generation. **GDP growth** held in positive territory in Q4, though slowed to about half the pace of the prior quarter. We're expecting growth to clock in at 1.5%, in line with StatCan's flash estimate. Retail sales rebounded from their steepest non-pandemic quarterly drop since the GFC, though the increase in services spending likely decelerated. Consumption looks to add to growth in Q4 after being a drag in Q3. Business investment was likely mixed, with falling machinery/electrical import volumes pointing to another drop in machinery and equipment spending, while non-residential construction is expected to see a decent gain. The latter contrasts with the residential sector which looks to see a third consecutive steep quarterly contraction. Home sales and housing starts slumped, while renovation activity likely provided a small positive offset. Following back-to-back large inventory builds, we anticipate a smaller increase will be a drag on growth. However, net exports should provide an offset as export volumes contracted less than imports in the quarter.

For **December GDP**, we're looking for a flat reading, in line with the flash estimate, with a decent chance of a +0.1% print. Services drove growth in the prior two months, and that was likely the case once again, with retail and home sales firming. Wholesale and manufacturing activity fell according to earlier data, while StatCan flagged a pullback in mining/oil/gas. Despite a big employment gain, hours worked dipped in December, suggesting broader activity likely struggled. Looking ahead to January, hours worked surged, retail activity looks to have turned higher and wholesale trade rebounded, pointing to a decent start to the year for monthly GDP.

United States

Sal Guatieri
Senior Economist
sal.guatieri@bmo.com



Priscilla Thiagamoorthy
Senior Economist
priscilla.thiagamoorthy@bmo.com

Durable Goods Orders

Monday, 8:30 am

	Durable Orders	Core Orders
Jan. (e)	**-4.0%**	**-0.3%**
Consensus	*-3.9%*	*-0.1%*
Dec.	+5.6%	-0.1%

Durable goods orders look to decline 4.0% in January, wiping out most of the prior month's jump, as Boeing orders lost altitude after soaring to multi-year highs in December. Excluding aircraft and defense items, capital goods orders likely extended a downward trend to four of the past five months, as ISM factory orders plumbed their lowest ebb since the 2020 shutdowns. Fewer purchases of business machinery should more than offset an upturn in the auto space. You wouldn't know it from the payrolls data, but the sector is struggling to make headway, as January's weather-related bounce in production merely retraced half of the prior month's slide and was still the second-weakest level of activity in the past year.

ISM Manufacturing PMI
Wednesday, 10:00 am

Feb. (e)	**47.4**
Consensus	*48.0*
Jan.	47.4

After sliding for five straight months to the lowest level since the onset of the pandemic, the **ISM manufacturing PMI** looks to hold steady at 47.4 in February. New orders are expected to shrink again as higher borrowing costs continue to weigh on sales, though production could edge up amid the still-expanding employment picture. Meantime, the prices sub-index likely climbed again as producer costs showed some vigour more recently. With the Fed on track to raise rates at least a couple more times, the ISM's manufacturing gauge will likely continue to lose steam, falling deeper into contractionary terrain.

ISM Services PMI
Friday, 10:00 am

Feb. (e)	**54.2**
Consensus	*54.5*
Jan.	55.2

The **ISM services PMI** report for January raised a few eyebrows, with the gauge unexpectedly rebounding well into expansionary terrain, up 6 pts to 55.2. We expect to see some reversal in February, with the index likely falling a point to 54.2. Business activity and new orders likely retraced some of the prior month's surge but are expected to remain robust in the expansion zone. Meanwhile, employment has held relatively steady, oscillating around the 50-mark. The prices sub-index remains high, much to the dismay of the Fed. Looking ahead, momentum for the still-strong services sector will depend on labour market conditions. Robust services demand could keep inflation sticky, putting more pressure on the Fed to keep going with rate hikes.

Financial Markets Update for February 24, 2023

		Feb 24 [1]	Feb 17	Week Ago	4 Weeks Ago	Dec 31, 2022
					(basis point change)	
Canadian Money Market	Call Money	4.50	4.50	0	0	25
	Prime Rate	6.70	6.70	0	0	25
U.S. Money Market	Fed Funds (effective)	4.75	4.75	0	25	25
	Prime Rate	7.75	7.75	0	25	25
3-Month Rates	Canada	4.51	4.50	1	16	28
	United States	4.81	4.79	3	15	47
	Japan	-0.14	-0.16	2	4	4
	United Kingdom	4.16	4.20	-4	6	29
	Australia	3.51	3.47	5	13	25
2-Year Bonds	Canada	4.29	4.15	14	61	24
	United States	4.82	4.62	20	61	39
10-Year Bonds	Canada	3.42	3.29	13	53	12
	United States	3.95	3.82	13	44	7
	Japan	0.50	0.50	0	2	9
	Germany	2.54	2.44	10	30	-3
	United Kingdom	3.65	3.51	14	33	-1
	Australia	3.82	3.82	0	27	-23
Risk Indicators	VIX	22.6	20.0	2.6 pts	4.1 pts	0.9 pts
	Inv. Grade CDS Spread [2]	76	74	1	5	-6
	High Yield CDS Spread [2]	459	454	6	29	-25
					(percent change)	
Currencies	US¢/C$	73.38	74.22	-1.1	-2.3	-0.5
	C$/US$	1.363	1.347	—	—	—
	¥/US$	136.31	134.15	1.6	5.0	4.0
	US$/€	1.0545	1.0695	-1.4	-3.0	-1.5
	US$/£	1.194	1.204	-0.8	-3.5	-1.2
	US¢/A$	67.27	68.79	-2.2	-5.3	-1.3
Commodities	CRB Futures Index	266.94	267.57	-0.2	-3.9	-3.9
	Oil (generic contract)	75.03	76.55	-2.0	-5.8	-6.5
	Natural Gas (generic contract)	2.40	2.28	5.6	-22.7	-46.3
	Gold (spot price)	1,811.26	1,842.36	-1.7	-6.1	-0.7
Equities	S&P/TSX Composite	20,013	20,515	-2.5	-3.4	3.2
	S&P 500	3,950	4,079	-3.2	-3.0	2.9
	Nasdaq	11,356	11,787	-3.7	-2.3	8.5
	Dow Jones Industrial	32,730	33,827	-3.2	-3.7	-1.3
	Nikkei	27,453	27,513	-0.2	0.3	5.2
	Frankfurt DAX	15,240	15,482	-1.6	0.6	9.5
	London FT100	7,877	8,004	-1.6	1.4	5.7
	France CAC40	7,207	7,348	-1.9	1.5	11.3
	S&P ASX 200	7,307	7,347	-0.5	-2.5	3.8

[1] = as of 11:20 am *[2] = One day delay*

Global Calendar — February 27–March 3

China

Monday February 27

Tuesday February 28

Wednesday March 1

PMI	Mfg.	Non-mfg.
Feb. (e)	**50.7**	**55.0**
Jan.	50.1	54.4

Caixin Manufacturing PMI

Feb. (e)	**51.3**
Jan.	49.2

Thursday March 2

Friday March 3

Caixin Services PMI

Feb. (e)	**54.8**
Jan.	52.9

Japan

Monday February 27

Tuesday February 28

Industrial Production

Jan. P (e)	**-2.9%**	**-0.7% y/y**
Dec.	+0.3%	-2.4% y/y

Retail Sales

Jan. (e)	**+0.7%**	**+4.1% y/y**
Dec.	+1.1%	+3.8% y/y

Wednesday March 1

Manufacturing PMI

Feb. F (e)	**47.4**
Jan.	48.9

Thursday March 2

Capital Spending

Q4 (e)	**+7.1% y/y**
Q3	+9.8% y/y

Consumer Confidence

Feb. (e)	**32.0**
Jan.	31.0

Friday March 3

Jobless Rate

Jan. (e)	**2.5%**
Dec.	2.5%

Services PMI

Feb. F (e)	**53.6**
Jan.	52.3

Europe

Monday February 27

EURO AREA

Adjusted Private Sector Credit

Jan.	
Dec.	+5.3% y/y

Consumer Confidence

Feb. F (e)	**-19.0**
Jan.	-20.7

Economic Confidence

Feb. (e)	**101.0**
Jan.	99.9

ITALY

Consumer Confidence

Feb. (e)	**101.4**
Jan.	100.9

Tuesday February 28

FRANCE

Consumer Price Index

Feb. P (e)	**+0.9%**	**+7.1% y/y**
Jan.	+0.4%	+7.0% y/y

Consumer Spending

Jan. (e)	**+0.4%**	**-4.6% y/y**
Dec.	-1.3%	-5.6% y/y

Real GDP

Q4 F (e)	**+0.1%**	**+0.5% y/y**
Q4 P	+0.1%	+0.5% y/y
Q3	+0.2%	+1.0% y/y

Wednesday March 1

EURO AREA

Manufacturing PMI

Feb. F (e)	**48.5**
Jan.	48.8

GERMANY

	Unemploy.	Jobless Rate
Feb. (e)	**-10,000**	**5.5%**
Jan.	-22,000	5.5%

Consumer Price Index

Feb. P (e)	**+0.7%**	**+9.0% y/y**
Jan.	+0.5%	+9.2% y/y

UNITED KINGDOM

Nationwide House Prices

Feb. (e)	**-0.6%**	**-1.0% y/y**
Jan.	-0.6%	+1.1% y/y

Manufacturing PMI

Feb. F (e)	**49.2**
Jan.	47.0

Thursday March 2

EURO AREA

Consumer Price Index

Feb. P (e)	**+0.5%**	**+8.2% y/y**
Jan.	-0.2%	+8.6% y/y

Core CPI

Feb. P (e)	**+5.3% y/y**
Jan.	+5.3% y/y

Jobless Rate

Jan. (e)	**6.6%**
Dec.	6.6%

ITALY

Jobless Rate

Jan. (e)	**7.8%**
Dec.	7.8%

Consumer Price Index

Feb. P (e)	**-0.3%**	**+9.5% y/y**
Jan.	-1.5%	+10.7% y/y

Friday March 3

EURO AREA

Services PMI

Feb. F (e)	**53.0**
Jan.	50.8

Producer Price Index

Jan. (e)	**-0.3%**	**+17.7% y/y**
Dec.	+1.1%	+24.6% y/y

GERMANY

Trade Surplus

Jan. (e)	**€11.0 bln**
Dec.	€10.0 bln

FRANCE

Industrial Production

Jan. (e)	**-0.2%**	**+0.3% y/y**
Dec.	+1.1%	+1.4% y/y

ITALY

Real GDP

Q4 F (e)	**-0.1%**	**+1.7% y/y**
Q4 P	-0.1%	+1.7% y/y
Q3	+0.5%	+2.7% y/y

UNITED KINGDOM

Services PMI

Feb. F (e)	**53.3**
Jan.	48.7

Other

Monday February 27

Tuesday February 28

AUSTRALIA

Retail Sales

Jan. (e)	**+1.5%**
Dec.	-3.9%

INDIA

Real GDP

Q4 (e)	**+4.6% y/y**
Q3	+6.3% y/y

Wednesday March 1

AUSTRALIA

Real GDP

Q4 (e)	**+0.7%**	**+2.7% y/y**
Q3	+0.6%	+5.9% y/y

Consumer Price Index

Jan. (e)	**+8.1% y/y**
Dec.	+8.4% y/y

Thursday March 2

AUSTRALIA

Building Approvals

Jan. (e)	**-7.5%**
Dec.	+18.5%

BRAZIL

Real GDP

Q4 (e)	**-0.3%**	**+2.9% y/y**
Q3	+0.4%	+3.6% y/y

Friday March 3

D = date approximate

Upcoming Policy Meetings | Bank of England: Mar. 23, May 11, June 22 | European Central Bank: Mar. 16, May 4, June 15

North American Calendar — February 27–March 3

Canada

Monday February 27	Tuesday February 28	Wednesday March 1	Thursday March 2	Friday March 3
8:30 am Current Account Balance **Q4 (e) -$11.0 bln (-$44.0 bln a.r.)** *Consensus -$11.0 bln (-$44.0 bln a.r.)* Q3 -$11.1 bln (-$44.4 bln a.r.)	**8:30 am Real GDP / Chain Prices** **Q4 (e) +1.5% a.r. / -1.9% a.r.** *Consensus +1.5% a.r. / n.a.* Q3 +2.9% a.r. / -5.4% a.r. **8:30 am Monthly Real GDP** **Dec. (e) unch** *Consensus unch* Nov. +0.1% **Capital Expenditures Survey (2023)** **Alberta Budget** **British Columbia Budget** 10:30 am 3-, 6- & 12-month bill auction $18.0 bln (new cash $2.4 bln)	**9:30 am S&P Global Manufacturing PMI** **Feb.** Jan. 51.0 **Auto Sales[D]** **Feb.** Jan. +7.5% y/y Noon 2-year bond auction $3.5 bln		**8:30 am Labour Productivity** **Q4 (e) unch** Q3 +0.5% **8:30 am Building Permits** **Jan. (e) +1.0%** Dec. -7.3%

United States

Monday February 27	Tuesday February 28	Wednesday March 1	Thursday March 2	Friday March 3
8:30 am Durable Orders / Core Orders **Jan. (e) -4.0% / -0.3%** *Consensus -3.9% / -0.1%* Dec. +5.6% / -0.1% **10:00 am Pending Home Sales** **Jan. (e) +1.5%** *Consensus +1.0%* Dec. +2.5% **10:30 am Dallas Fed Mfg. Activity** **Feb. (e) -9.5[C]** Jan. -8.4 Fed Speaker: Governor Jefferson (10:30 am) 11:30 am 13- & 26-week bill auctions $108 bln	**8:30 am Goods Trade Deficit** **Jan. A (e) $91.0 bln[C]** Dec. $89.7 bln **8:30 am Wholesale and Retail Inventories (Jan. A)** **9:00 am S&P CoreLogic Case-Shiller Home Price Index (20 city)** **Dec. (e) -0.6% / +4.7% y/y** *Consensus -0.5% / +4.8% y/y* Nov. -0.5% / +6.8% y/y **9:00 am FHFA House Price Index** **Dec. (e) -0.4% / +6.4% y/y** *Consensus -0.2% / +6.5% y/y* Nov. -0.1% / +8.2% y/y **9:45 am Chicago PMI** **Feb. (e) 45.0[C]** Jan. 44.3 **10:00 am Conf. Board Consumer Confidence Index** **Feb. (e) 108.5[C]** Jan. 107.1 **10:00 am Richmond Fed Mfg Index** **Feb. -5[C]** Jan. -11 Fed Speaker: Chicago's Goolsbee (2:30 pm) 11:00 am 4-, 8- & 17-week bill auction announcements	**7:00 am MBA Mortgage Apps** **Feb. 24** Feb. 17 -13.3% **9:45 am S&P Global Manufacturing PMI (Feb. F)** **10:00 am ISM Manufacturing PMI** **Feb. (e) 47.4** *Consensus 48.0* Jan. 47.4 **10:00 am Construction Spending** **Jan. (e) +0.2%[C]** Dec. -0.4% **Autodata Total Vehicle Sales[D]** **Feb. (e) 14.8 mln a.r.** Jan. 16.2 mln a.r. 11:30 am 17-week bill auction	**8:30 am Initial Claims** **Feb. 25 (e) 197k (+5k)[C]** Feb. 18 192k (-3k) **8:30 am Continuing Claims** **Feb. 18 (e) 1,675k (+21k)[C]** Feb. 11 1,654k (-37k) **8:30 am Productivity / Unit Labour Costs** **Q4 F (e) +1.8% a.r. / +2.5% a.r.** *Consensus +2.6% a.r. / +1.4% a.r.* Q4 P +3.0% a.r. / +1.1% a.r. Q3 +1.4% a.r. / +2.0% a.r. Fed Speaker: Governor Waller (4:00 pm) 11:00 am 13- & 26-week bill, 3-, 10[R]-year note, 30[R]-year bond auction announcements 11:30 am 4- & 8-week bill auctions	**9:45 am S&P Global Services/ Composite PMI (Feb. F)** **10:00 am ISM Services PMI** **Feb. (e) 54.2** *Consensus 54.5* Jan. 55.2 Fed Speakers: Dallas' Logan (11:00 am); Atlanta's Bostic (noon); Governor Bowman (3:00 pm); Richmond's Barkin (4:15 pm)

[C] = consensus [D] = date approximate [R] = reopening

Upcoming Policy Meetings | Bank of Canada: Mar. 8, Apr. 12, June 7 | FOMC: Mar. 21-22, May 2-3, June 13-14

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