

Economics

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"Perhaps moving gingerly at first, investors would do well to begin to lean back into equities"

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ECONOMIC INSIGHTS

October 15, 2014

Lean In

by Avery Shenfeld

Market timing is not for the faint of heart. After all, the winning asset allocation strategy will, by definition, involve buying what others are in the final throes of worrying about, and selling what the masses have been turning to. While the pull-back pales against some past ones, investors have been turning away from equities, and in particular, those most cyclically-levered, including energy stocks. We were timely in having advised investors to downweight cyclical equities in our early August issue of this publication. But having sat back since then, it looks to be time to lean in again.

To be sure, the concerns about global growth that are behind the recent correction have merit, and are supported by the evidence on the ground. Europe has stalled, with oncestalwart Germany now caught in the torpor. China looks to have run a bit cooler than its 71/2% target, and will likely be a bit slower still in terms of overall growth come 2015. Japan's sales tax hike more than reversed the momentum seen when consumers rushed to shop ahead of it, and the country has seen no evidence that the weaker yen is powering an export lift. If all of that wasn't enough, the world is suffering from a modern version of the ten plagues, from Ebola in West Africa, armed conflicts in Syria and Iraq, to a return of cold war sentiments in Russia's relations with the West.

But while those geopolitical issues could linger, policy makers have options to address growth shortfalls. In Europe, Germany has elbow room to ease fiscal policy, which would no doubt give France and others license to also step away from growth-denting restraint. The ECB could still expand QE to include sovereign debt if inflation

slides further, and its announcements to date have moved the euro to a more tradecompetitive level. China is easing interest rates, has softened restraints on mortgages, and also launched a moderate-scaled fiscal stimulus effort.

If global growth returns, it will address one side of the recent supply-demand imbalance in oil. Either an OPEC decision in November, or geopolitical hits to production in Iraq, Iran or Libya, could do the same on the supply side.

In North America, the major growth disappointments were back in a weather-affected first quarter. The US is still powering towards healthy labour markets, and the latest jobs surge in Canada suggests prior months may have partly been a statistical undercount. Canada still needs to shift more of its growth from housing and consumption to exports, but the weaker loonie is just what Dr. Poloz ordered in that regard. Our analysis of household debt markets shows that concerns of instability on that front are overblown (see pages 3-5), allowing the central bank to continue to dangle low rates for a while longer than the Fed.

The TSX is currently trading a very reasonable 14 times forward earnings, which one could argue is in fact cheap given we're in an era of lower bond yields. True, earnings expectations may still be in the process of adjusting to economic events of recent weeks, but the softening of the Canadian dollar has also not likely been fully factored in on the plus side. Perhaps moving gingerly at first, investors would do well to begin to lean back into equities, including cyclically levered energy stocks, in the weeks ahead.

MARKET CALL

- Markets are moving more quickly to our FX targets than we envisaged, but have further undershot our yield projections in the wake of growth concerns. We'll revisit US dollar targets against other majors in our Monthly FX Outlook, but note that the big dollar has now come a long way in a hurry.
- We are seeing a bit more of the weakness in the C\$ that we had contemplated for Q1 2015. If oil rebounds towards year end, we could see a period of C\$ stability, but we still expect the loonie to weaken again when the Fed moves to hike much earlier than the Bank of Canada.
- A global growth rebound, and continued progress towards full employment in the US, will quickly reverse the recent drop in yields. The first Fed hikes will feel like a replay of the market jitters when QE tapering was first proposed, leading to an overreaction that will create a buying opportunity at the long end next year. We have slightly trimmed our 30-year Treasury targets in anticipation that with continued moderate inflation, there will be ample demand at a 4% yield from lifecos and pension funds.

INTEREST & FOREIGN EXCHANGE RATES												
	2014		2015				2016					
END OF PERIOD:	14-0ct	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec		
Overnight target rate 98-Day Treasury Bills 2-Year Gov't Bond 10-Year Gov't Bond 30-Year Gov't Bond	1.00	1.00	1.00	1.00	1.25	1.50	1.50	1.50	1.50	1.50		
	0.85	0.95	1.00	1.05	1.20	1.45	1.45	1.45	1.40	1.45		
	1.01	1.20	1.65	1.90	2.20	2.20	1.95	1.85	1.95	2.00		
	1.94	2.20	2.70	3.00	3.05	2.80	2.75	2.70	2.75	2.80		
	2.50	2.75	3.40	3.45	3.50	3.35	3.25	3.20	3.25	3.35		
U.S. Federal Funds Rate91-Day Treasury Bills2-Year Gov't Note10-Year Gov't Note30-Year Gov't Bond	0.10	0.10	0.25	0.75	1.25	1.25	1.25	1.25	1.25	1.50		
	0.01	0.10	0.40	0.60	0.85	1.10	1.35	1.25	1.20	1.40		
	0.39	0.60	1.05	1.60	1.80	1.70	1.65	1.65	1.70	1.90		
	2.22	2.60	3.10	3.60	3.45	3.25	3.25	3.30	3.35	3.45		
	2.97	3.35	3.65	4.00	3.90	3.70	3.65	3.70	3.75	3.80		
Canada - US T-Bill Spread	0.84	0.85	0.60	0.45	0.35	0.35	0.10	0.20	0.20	0.05		
Canada - US 10-Year Bond Spread	-0.29	-0.40	-0.40	-0.60	-0.40	-0.45	-0.50	-0.60	-0.60	-0.65		
Canada Yield Curve (30-Year — 2-Year)	1.49	1.55	1.75	1.55	1.30	1.15	1.30	1.35	1.30	1.35		
US Yield Curve (30-Year — 2-Year)	2.59	2.75	2.60	2.40	2.10	2.00	2.00	2.05	2.05	1.90		
EXCHANGE RATES CADUSD USDCAD USDJPY EURUSD GBPUSD AUDUSD USDCHF USDBRL USDMXN	0.89	0.90	0.88	0.85	0.85	0.86	0.87	0.87	0.87	0.86		
	1.12	1.11	1.14	1.17	1.18	1.16	1.15	1.15	1.15	1.16		
	107	109	108	112	110	109	108	110	110	109		
	1.27	1.26	1.24	1.23	1.24	1.27	1.28	1.29	1.29	1.30		
	1.59	1.62	1.60	1.60	1.62	1.65	1.64	1.64	1.63	1.63		
	0.87	0.86	0.84	0.83	0.82	0.84	0.86	0.87	0.88	0.90		
	0.95	0.96	0.98	0.99	0.98	0.97	0.97	0.96	0.97	0.96		
	2.40	2.48	2.56	2.52	2.53	2.45	2.35	2.30	2.33	2.40		
	13.42	13.25	13.15	13.18	13.26	13.18	13.20	13.35	13.35	13.29		

Resisting Temptation

Benjamin Tal

Canadian households deserve credit for not taking credit. And despite being lured by low borrowing rates, they in fact pay back principal at a rate much faster than officially estimated by the Bank of Canada. Stronger than perceived credit quality means that any increase in rates would have only limited direct impact on defaults.

Paying on Time

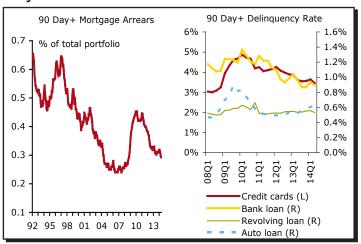
It's almost too good to be true. Despite a mediocre labour market and an unemployment rate that is still too high for the liking of the Bank of Canada, debt service performance in Canada has almost never been better. The number of personal bankruptcies has been on a clear downward trajectory over the past five years, while arrear rates in the mortgage market and in any other consumer credit portfolio are at, or near, record lows (Chart 1).

Sure, shock the system with a healthy dose of 200-300 basis points of monetary tightening and the picture will not be as rosy. But the recent trajectory in the credit market suggests that Canadian households, faced with record-low borrowing rates, acted responsibly in a way that reduced the risk of an abrupt and measurable rise in defaults when rates eventually increase.

Paying Back

What's interesting in Chart 2 is not that non-auto consumer credit has slowed down dramatically over the

Chart 1
Very Little Bad Debt



Source: CBA, Equifax Canada, CIBC

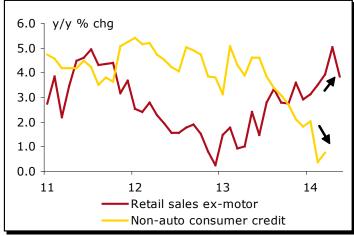
past year, but that it occurred in an environment in which non-auto retail sales have risen strongly. In the past, this kind of sales performance was accompanied by credit growth five times stronger than what we see today. Simply put, with the notable exception of auto sales, leverage is currently playing a negligible role in financing consumer spending.

The mortgage market tells a similar tale. Chart 3 clearly illustrates the decoupling between housing sales and mortgage activity. Unit sales are still running at a pace of between 35,000 and 40,000 per month. But if in the past this level of activity required a double-digit rise in mortgages outstanding, today it is supported by less than half that pace.

An important force behind the slowing pace of mortgage activity in the face of healthy unit sales is the increased propensity of Canadian borrowers to pay back principal. Taking advantage of low rates, an estimated 30%-40% of households with mortgages now accelerate payments in a way that de-facto shortens their amortization. And between 40%-50% of borrowers are estimated to face an amortization period of less than twenty years.

And it shows: over the past year principal payments rose four times faster than new mortgages. Today, for every mortgage dollar taken, a record high 90 cents of principal are being paid back (Chart 4).

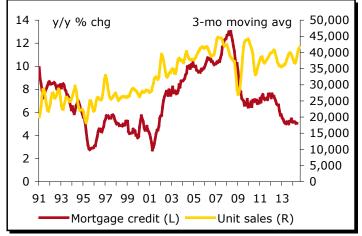
Chart 2 Rise in Non-Auto Sales Not Financed by Debt



Source: BoC, CBA, Statistics Canada/Haver Analytics, CIBC

Chart 3

Housing Sales Stable, Mortgage Activity Slowing



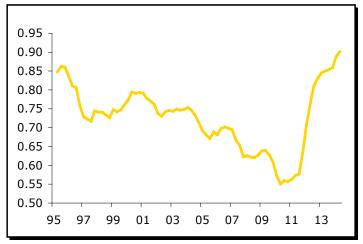
Source: BoC, CREA, CIBC

You can see it even better when you zoom in on the trajectory of the debt service ratio in the mortgage market. This ratio, derived by the Bank of Canada, estimates, at the aggregate level, the cost of carrying a mortgage as a share of disposable income. As can be seen in Chart 5 (left), this ratio has been relatively flat over the past few years. But in an environment of falling interest payments, this stability means that principal payments are rising faster than incomes (Chart 5, right).

Unaccounted For: \$11 billion of Principal Payments

The good news does not end here. We believe that households have been paying principal back at an even more impressive pace. As it stands now, the Bank of Canada's estimate suggests that the debt service ratio currently stands at 6.3%.

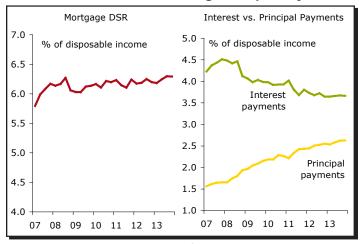
Chart 4
Ratio: Principal Payments to New Mortgages



Source: BoC, CIBC

Chart 5

Stable DSR Ratio Masks Rising Principal Payments



Source: Bank of Canada, Statistics Canada, CIBC

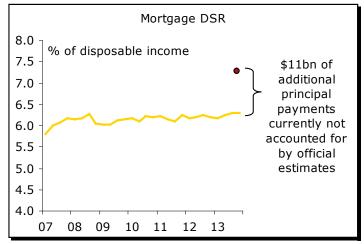
But buried deep in the calculations is the implicit assumption that the average amortization period in the overall mortgage market is 25 years. While that might have been the case in the past, it is certainly not the case in the here and now. Based on various sources, we estimate that the average amortization period in the Canadian mortgage market is around 20 years.

Applying this amortization period to the calculations yields a mortgage debt service ratio of 7.3%—a full percentage point higher than officially stated by the Bank of Canada. Translating percentage points into dollars, you get that Canadian households are paying \$11 billion a year in principal payments more than officially estimated (Chart 6).

Put differently, that extra cushion is sufficient to absorb the first 100 basis point increase in the effective mortgage

Chart 6

Principal Payments Rising Faster Than Perceived



Source: BoC, Statistics Canada, CIBC

rate, with households simply extending amortizations, reducing principal payments to offset the interest payment increase.

Tail Risk

What looks good on average does not look as good at the margin—where losses actually occur. However, a closer look at the distribution of high ratio mortgages based on their loan-to-value (LTV) position reveals very little change over the past few years with the share of mortgages with LTV larger than 80%, in fact, falling by five percentage points since 2009.

Staying at the margins and zooming in on the other potential predictor of defaults, the debt service ratio, we learn from Chart 7 that this tail risk has remained relatively unchanged over the years with just over 6% of households allocating more than 40% of their income to debt financing.

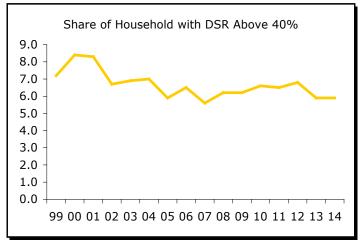
Loan-to-value and debt service indicators are important predictors of future default, but none of them is more powerful than the old fashioned credit score. Recent analysis by CIBC Risk Management suggests that during the past six years, credit score was the strongest predictor of mortgage default.

And here again the picture is encouraging. The average credit score in Canada has trended upward over the past five years, with the improvement seen in all regions and age groups (Chart 8).

Again looking for better insight at the margins, we zoom in on the trajectory and distribution of the different risk

Chart 7

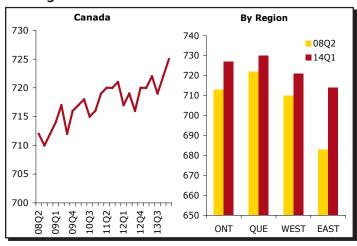
Stable Tail Risk



Source: Financial Monitor, CIBC

Chart 8

Average Credit Score



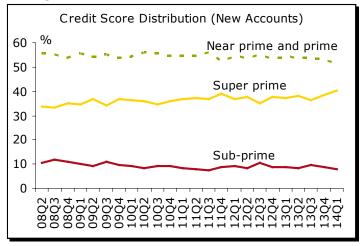
Source: Equifax Canada, CIBC

categories and the picture that emerges is rather dull (Chart 9).

Most importantly, the share of sub-prime credit (defined here as individuals with a credit score of less than 620) at close to 10% of new accounts has been little changed in recent years. Looking at the sub-prime component in the mortgage market alone reveals a share of only 3.5% of total new mortgages.

The picture that emerges from all of the above is encouraging. So far, it appears that not only have many households resisted the temptation of low rates but, in fact, they used those rates to pay down debt at a rate not seen before. But it is not over yet. The Bank of Canada is determined to keep low rates for as long as possible—further testing the willpower of Canadians.

Chart 9 **Boring....**



Source: Equifax Canada, CIBC

US Housing — No Market For Young Men

Andrew Grantham

This time last year it looked like easy going for the US housing recovery. Household formation, starts and sales were on the up, and prices were rising. Fast forward a year and that has seemingly stalled. Sure, the weather played a big role earlier in the year. But net household formation of less than 500K (March 2014 vs. March 2013) has also placed a question mark over the demographics that will underpin US housing demand.

We still see cyclical factors—particularly the poor finances of young people—at play in holding back household formation, while some aspects of US demographics will become more supportive in the years ahead. However, a continued leaning towards multiples, rather than single-family housing, could take a slice from the upside of home-building to the US economy and demand for Canadian lumber producers.

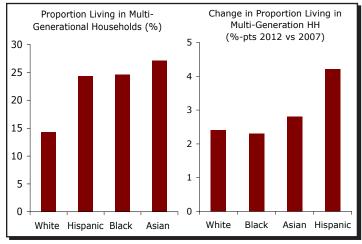
The Long...

A variety of long-run explanations have been forwarded for the sluggishness of household formation. One such factor is the increase in ethnic diversity. The population of minority groups in the US has been rising faster than that of white households in recent years, and the former typically have a greater propensity to live in multigenerational households (Chart 1, left).

However, that trend certainly doesn't explain all of the change towards multi-generational living. Within the different ethnic groups themselves, the proportion of multi-generation families has risen since before the recession (Chart 1, right), suggesting cyclical factors are also prominent for the rise in families sharing one roof. Meanwhile, there are also long-term trends still at play which are supportive for stronger household formation, such as people marrying later in life and a higher divorce rate, which lead to more single people living on their own than in the past.

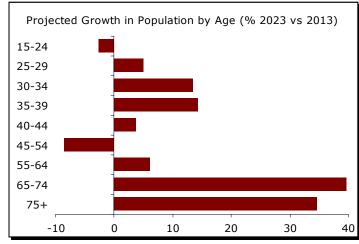
Trends in population growth could turn to be supportive of higher household formation going forwards as well. Much has been written about the impact of retiring baby-boomers on the US economy. But their children, the echo-boomers, are also getting older and moving towards the prime age for setting up house on their own. Outside of the 65+ category, the sharpest growth in population over the next 10 years will be in people aged 30-40 years (Chart 2).

Chart 1
Minorities More Likely to Live Together (L),
But Proportion Has Also Risen (R)



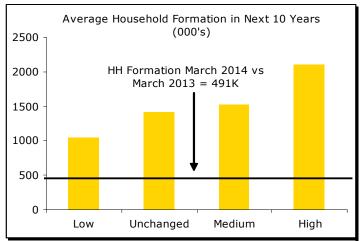
Source: US Census, PEW Institute, CIBC

Chart2
Echo-Boomers Enter Moving-Out Age



Source: Census Bureau, CIBC

Chart 3
Household Formation Stronger Even on Pessimistic
Assumption For Headship Rate



Source: US Census, CIBC

These demographic trends mean that even if headship rates in different age groups (the proportion of those groups that are heads of their household) fall to their lows of the past 20 years, an average of around 1 mn new households would be created each year for the next decade (Chart 3).

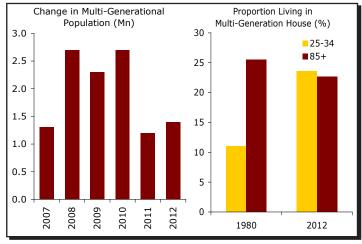
But that appears to be a pessimistic assumption, given that the lows in headship rates were generally recorded either in the most recent recessionary period or that of the 1990s. Assuming headship rates return to their average level for each age group or remain at current levels, household formation would average closer to 1.5 mn a year. A return to the highest levels of headship rates, generally recorded just before the recession, would yield 2 mn a year. That, in turn, appears overly optimistic.

...and Short of it

The recession led to an acceleration in the population living in multi-generational homes—a trend that has yet to reverse (Chart 4, left). And that trend has been most dramatic for young people who, despite the aging population and rising life expectancy, have now overtaken the elderly as the age group most likely to live with relatives (Chart 4, right).

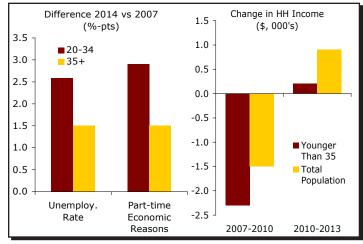
That's not because it's cool to live with Mom and Dad. It's because for many in that age group the recession and sluggish recovery has left them with no other choice. Relative to pre-recession levels, young people are still suffering the most not just from unemployment but also underemployment (Chart 5, left), which has resulted in incomes not just falling more during the recession but also recovering slower thereafter (Chart 5, right). The median income of a household headed by someone below 35 is only \$35K, while the average rent for a 1-bedroom city-centre apartment is around \$12K a year.

Chart 4
Multi-Generation Living Accelerated During
Recession (L), Young Overtake the Elderly (R)



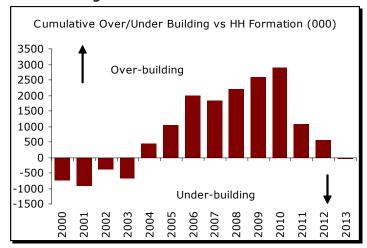
Source: US Census, PEW Institute, CIBC

Chart 5
Young People Suffer Most From Labour Weakness
(L), Denting Incomes (R)



Source: BLS, BEA, CIBC

Chart 6
Overbuilding No More



Source: US Census Bureau, CIBC

Too Old to Stay...Too Broke to Buy

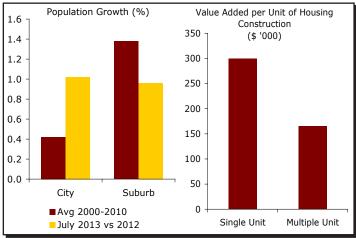
So as echo-boomers become older, household formation in the US is expected to pick up notably. And that should keep builders busier as well—justifying the recent resurgence in homebuilder confidence. Even though there was a massive amount of overbuilding prior to the recession (Chart 6), the large retrenchment subsequently means that there aren't as many newly built homes sitting idle. And as we have shown in the past, many houses that are sitting unsold have been doing so for some time, and as such are not suitable for occupancy without substantial renovation.

But what kind of properties will these people be living in, and are they more likely to be buying or renting? Since the recession, there's been a renewed tendency towards city living (Chart 7, left) and towards renting rather than buying. Those rental units, usually in condo developments, typically add far less to GDP in terms of building than single units (Chart 7, right). And to support those heavier structures, steel, rather than good-old Canadian lumber, is often the building material of choice.

Unfortunately for those lumber producers, renting a condo is likely to remain the new American dream. The struggles in recent years finding well-paid work, combined with higher levels of student debt, has left most under-35 year-olds with little in terms of savings. A mere \$10K would give you the same net worth as the average under-35 year-old in the US in 2013. That's around 6.5% of the average house price at the end of the year. Back in 2004, when house prices were roughly equal to 2013, median net worth was some 9% of the price. And with tighter lending conditions now as well, buying will remain out of reach for many.

Demographic forces, as well as the continued recovery in the US economy, will lead to greater household formation in the coming years. However, those 30-40 year-olds finally primed to move out from their family homes still face difficulties buying such houses themselves, and as a result renting a condo could remain the new American dream for some years, cutting into some of the upside of the housing recovery stateside on the US economy and Canadian lumber producers.

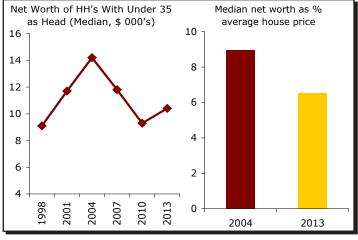
Chart 7
City Population Growing Faster Now (L) Multiples
Add Less to GDP (R)



Source: US Census Bureau, BEA, CIBC

Chart 8

Low Net Worth of Young People (L), Makes Home
Purchase Less Likely (R)



Source: S&P, BEA, CIBC

What to Make of Canada's Inflation Upturn

Avery Shenfeld

Investors ignore inflation at their peril, particularly in Canada where the CPI is the sole monetary policy target. So what are we to make of the most recent news, which has core CPI tracking a hair above the Bank of Canada's 2% target? Some are beginning to argue that the data belie the very dovish message that Governor Poloz's team has been emphasizing, and such calls could grow louder if, as we expect, there are further elevated readings in the months ahead.

Do I Hear an Echo?

While the run-up in prices has jumped ahead of the central bank's forecast, it sounds more like an echo than a new trumpeting call for tighter policy. An echo, that is, of the very low CPI readings that prevailed in the latter half of 2013.

Back then, both headline and core inflation were hovering near 1%, and there was chatter about a potential policy ease. But our detailed analysis of the micro data at the time (see "How Persistent is Canadian Disinflation", Economic Insights, January 2014) found that random noise in some of the less stable components, rather than a persistent disinflationary trend, was behind the deceleration.

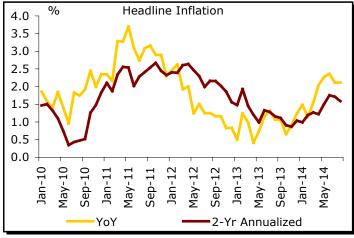
With hindsight, that call looks right on the money, as inflation subsequently drifted higher. When noise rather than signal pushes inflation below its trend run rate, a year later, one should expect to see a period of above-trend CPI readings. For one, a 12-month rate will be measured against those unusually low year-ago prices. In addition, there will be a catch-up to price hikes that were skipped or delayed in the earlier period, creating momentum in monthly inflation as well. The result is that while the 12-month rate looks elevated due to these echo effects, inflation looks mild when assessed by the annualized two-year climb since late summer 2013 (Chart 1).

Mind the Gap

Even so, some will be tempted to use the run of firmer core inflation to reassess the output gap—the degree of slack in the economy that protects against a lasting acceleration in inflation. In theory, accelerating inflation is *prima facie* evidence that slack has disappeared.

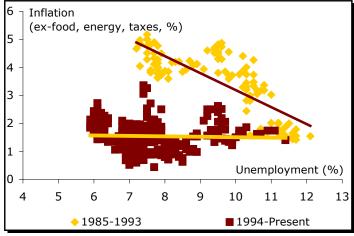
But there are reasons to doubt that interpretation in this case. We are in an era in which inflation readings barely budge over the course of the cycle, and therefore provide no such help. The Philips Curve, which tracks the

Chart 1
Canadian CPI Mirrors Year-ago Drop



Source: Statistics Canada, CIBC

Chart 2 Inflation No Longer Swings With Unemployment



Source: Statistics Canada, CIBC

relationship between inflation and unemployment, is flat as a pancake (Chart 2). Even the "common component" measure of inflation, designed by the Bank of Canada to extract its underlying trend most efficiently, fails to show a strong correlation with the output gap.

That insensitivity captures two effects. First, if the central bank is doing its job, it tightens or eases to head inflation off at the pass, leaving it in a random walk around the 2% target. Second, that success dulls the response in inflation expectations to observed swings in CPI, helping to ground wage demands and pricing policies. Note that measures of inflation expectations have not excessively heated up in recent months, despite the upswing in actual inflation (Chart 3).

The Stand in Targets

While market players don't all "get it", and might respond to a few months of elevated core or headline inflation, none of this will come as a surprise to the Bank of Canada. While it raised eyebrows over last year's low CPI readings, enough to warn that its next move might be a rate cut rather than a hike, it has shrugged off the more recent CPI rebound, retaining its neutral stance.

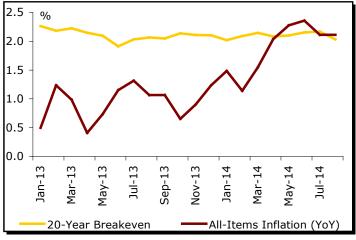
That largely reflects the nuanced approach to inflationtargeting highlighted in former Deputy Governor Tiff Macklem's final speech before his departure from the Bank. In it, he asserted that policy would respond to inflation pressures emanating from insufficient slack in the Canadian economy, but look through price hikes tied to other factors. In that sense, one can think of the output gap as the stand-in target for CPI in attempting to assess the timing of future interest rate moves.

But, in turn, there's a stand-in for the stand-in: unemployment. The BoC Governing Council's output gap measure is nudged up or down to better fit the overall economic picture. A run of GDP above the BoC's estimates of potential growth can be interpreted as either 1) narrowing the output gap, or 2) evidence that potential growth is faster than previously thought. The latter has been the case in recent quarters for the Bank's model-based estimate of the output gap, which has not narrowed by as much as the difference between actual GDP and the previously estimated potential would have dictated (Chart 4).

How does the Bank choose between the two options in its more subjective Governing Council measure? It would appear it looks at direct measures of labour and output market slack, or the wage and cost pressures that signal its absence. In effect, then, measures like the unemployment rate stand in for the output gap, which in turn stands in for CPI, as the guide on whether to tighten or not.

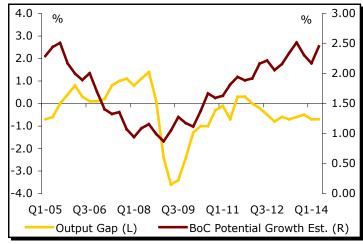
Of late, while both GDP growth and core inflation have beaten BoC forecasts, employment gains have been

Chart 3 Inflation Expectations Still Contained



Source: Statistics Canada, Bloomberg, CIBC

Chart 4
Recent Growth Raised Potential,
Leaving Output Gap Flat



Source: Haver Analytics, Bank of Canada

meagre, and the jobless rate has been glued to 7%. That makes it hard to argue, at least for now, that slack is being absorbed, and that the inflation pressures we're seeing can be tied to an overheated economy. As a result, while Poloz hasn't followed the Fed's lead in taking direct aim at unemployment as a deciding factor in when to tighten, the upturn in inflation won't bump him off the sidelines unless it's confirmed by diminishing labour market slack.

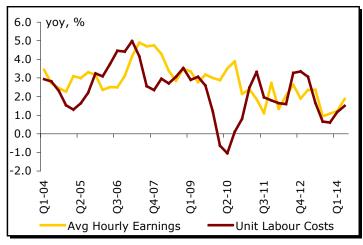
The final leg in the chain takes us to the issue of what constitutes full employment, the so-called Non-Capital Accelerating Inflation Rate of Unemployment (NAIRU). Back in the mid-1990s, a young Stephen Poloz, then in the research department of the Bank of Canada, argued that the NAIRU rate was even higher than the 8% unemployment rate judged to be sustainable without inflation in the late 1980s, perhaps even as high as 9%. Uncertainty about how NAIRU has shifted in recent years has the Bank of Canada eyeing both wages and unit labour costs for signs of momentum. At this point, tame readings on labour costs confirm room for further job gains before inflation pressures will set in (Chart 5).

In sum, there's a reason why the Bank of Canada calls its approach "flexible" inflation targeting. This isn't the ECB,

which took foolish pride in its decision to hike rates in 2008, just as a recession loomed, to show its intolerance of a couple of extra ticks in the CPI.

The Bank of Canada will show the same response to a few months of even 2½% core CPI as it did to a 1% core rate, which is to do nothing at all. So what should markets make of Canada's inflation upturn? Not much.

Chart 5
No Sign of Labour Cost Pressures



Source: Statistics Canada, CIBC

ECONOMIC UPDATE											
CA NA DA	14Q2A	14Q3F	14Q4F	15Q1F	15Q2F	2013A	2014F	2015F	2016F		
Real GDP Growth (AR)	3.1	2.5	1.9	2.9	3.1	2.0	2.3	2.7	2.3		
Real Final Domestic Demand (AR)	3.0	1.5	1.6	1.6	2.3	1.4	1.3	1.9	1.8		
All Items CPI Inflation (Y/Y)	2.2	2.1	2.3	2.2	1.8	0.9	2.0	2.2	2.3		
Core CPI Ex Indirect Taxes (Y/Y)	1.7	2.0	2.3	2.2	2.2	1.2	1.8	2.2	2.0		
Unemployment Rate (%)	7.0	6.9	6.7	6.7	6.6	7.1	6.9	6.6	6.5		
u.s.	14Q2A	14Q3F	14Q4F	15Q1F	15Q2F	2013A	2014F	2015F	2016F		
Real GDP Growth (AR)	4.6	3.0	3.0	2.8	2.8	2.2	2.2	2.9	2.4		
Real Final Sales (AR)	3.2	3.4	3.0	2.8	2.9	2.2	2.1	3.0	2.5		
All Items CPI Inflation (Y/Y)	2.1	1.8	2.2	2.1	1.6	1.5	1.9	2.0	2.1		
Core CPI Inflation (Y/Y)	1.9	1.8	1.9	2.1	2.1	1.8	1.8	2.2	2.1		
Unemployment Rate (%)	6.2	6.1	5.9	5.8	5.7	7.4	6.2	5.7	5.6		

CANADA

We thought that auto-related strength in manufacturing and consumer spending would be enough to push third quarter growth above 3%, but lighter utility usage during a cool summer and a hiccup in oil sands production means that growth is likely to come in closer to 2.5%. A scorching September for jobs, however, has improved the unemployment rate outlook by a touch. Weak year-ago price trends—along with intensified C\$ pass-through effects—are still likely to push the annual CPI readings slightly higher in the near term, offsetting lower oil prices.

UNITED STATES

The US economy appears unfazed by sluggish trends elsewhere in the world, and we expect growth rates around 3% in each of the final two quarters of the year. Crucially for the FOMC, rates of joblessness and underemployment continue to fall, although progress on the former may be slower from here with labour force participation no longer falling.

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