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ECONOMICS

# THE WEEK AHEAD

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## The least bad

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Three major economies got fresh news on inflation in the last week and a half, but judging by how two-year yields reacted, the one with the worst news was the most blessed, and the one that looked the least bad is in the most trouble. That alone suggests that market participants need to look beyond their own backyard to gain bit more perspective on where things actually sit in their own country.

In the UK, there was some good cheer at the local pub after the latest inflation numbers showed that CPI (including housing) was only, yes only, 6.3%. Not to worry, because excluding food and energy, it was a tepid 5.9%. Brilliant, as the say across the pond. And good enough for the Bank of England to stand pat, albeit in as close a vote as you can get.

In the US, the last inflation report helped cement the case for the Fed to take a pass on a rate hike this month. Its August CPI printed at 3.7%, but a 0.3% seasonally adjusted climb left the 12 month ex-food/energy pace at 4.3%. God bless American disinflation, right? While the FOMC's "dot plot" outlook for rates in 2024/25 showed fewer cuts, it also decided that enough progress was being seen on the inflation front to project that it would need a lower peak unemployment rate (4.1%, versus 4.5% previously) to reach its inflation target.

Now cast your eyes north in Canada, where August's CPI reading was apparently enough to convince many that the Bank of Canada's decision to pause on rates had been too hasty. And where did it stand? At 4.0%, and 3.6% excluding food and energy. Scorching, eh?

So in fact, inflation excluding food and energy, the most commonly cited core measure in the industrialized world, is actually the least bad of these three countries in Canada. True, that's not the Bank of Canada's favourite benchmark. But the Cleveland Fed's trimmed mean for the US CPI is at 4.5%, about a half point above Canada's trimmed mean, one of the BoC's two preferred indicators.

When it comes to overall inflation, the UK CPI doesn't include mortgage interest costs, which as in the case in Canada, will rise as mortgages get renewed. The US inflation rate doesn't include mortgage payments, like the UK, opting to track the costs of renting a house. And it wouldn't really matter if it did, because when rates are rising, Americans can sit on their existing 30-year fixed rate mortgages if they choose not to move.

Canada is not only the least bad in underlying inflation, it's also not the best in recent economic performance, a reason to be patient in delivering any further monetary tightening. The UK picture isn't steller, and it's suffered a larger climb in the jobless rate from its lows than Canada. But certainly, the US has seen much less evidence of a growth slowdown. It's miles ahead of Canada in per capita GDP gains this year, and has seen a smaller bump in its jobless rate.

For markets, being the least bad in underlying inflation, and not the best in recent growth, should mean that the odds of another hike in the Canada, or a more protracted wait for the first rate cuts, are lower than than they are in the US. That's all the more so since a given level for rates would be much more punitive north of the border as we move into 2025, when Canadians who took on ultra-cheap mortgages at the lows in rates in 2020 face a nasty refinancing hit.

Sure, Canada's inflation numbers, like those elsewhere, are too high to completely rule out a further rate hike, should upcoming employment and CPI data surprise us on the upside. But we shouldn't assume that either a further hike, or the pace of rate cuts, will be glued to whatever proves to be the right approach for the US if Canada's economy continues to look not quite as resilient as its American neighbour.

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