Economics

THE WEEK AHEAD

May 30-June 3, 2022

Defining "excess"

by **Andrew Grantham** andrew.grantham@cibc.com

In the coming week, we should get confirmation that the Canadian economy grew at a brisk pace in Q1, despite Omicron-related restrictions. A day later, the Bank of Canada will, correctly, respond by raising interest rates by a further 50bp, and in doing so continue to describe an economy that is in an "excess demand" phase. That's all pretty clear cut. However, defining exactly what excess means in the current environment is key to determining just how much demand growth needs to cool, and the role future interest rate hikes play in that, to return inflation to its 2% target.

In the US, the excess in demand is very clear cut. While GDP is currently 2.8% higher than its pre-pandemic (Q4 2019) level, that represents a slight shortfall relative to its pre-pandemic trend. However, final sales to domestic buyers (basically household spending and business investment) is 5.4% higher than in Q4 2019 and above it's pre-pandemic run rate. American households and businesses have been buying more than the domestic economy can produce, resulting in lower inventory levels and a surge in imports. Actual demand is of course even higher, due to the fact that some sales cannot be completed because of supply chain issues.

Even in service industries, where sales have yet to return to pre-Covid levels, demand has rebounded faster than supply given the slow recovery in labour force participation. The bottom line is that, if these supply issues don't resolve as most forecasters are counting on over the coming 12-18 months, the US economy almost needs a mild recession to realign demand with available supply and achieve its 2% inflation target.

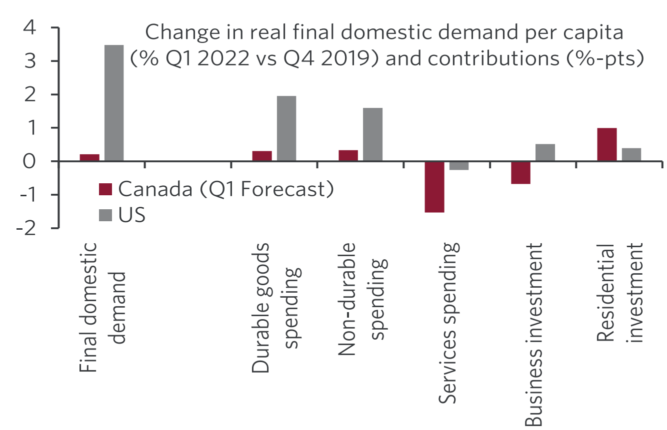
That is not, however, the case for Canada. Unless we are thrown a big curveball by the statisticians next week, the levels of both headline GDP and final demand from the private sector should both be around 1½% above their Q4 2019 level as of Q1 2022, but below their pre-pandemic trends.

Now, we should not take that to mean that there is no excess demand in the Canadian economy at all. The recovery in demand for services is now starting to exceed supply in some areas. Canadian households are continuing to spend more on goods per capita than before Covid struck, although that excess consumption is nowhere near as excessive as in the US.

But by and large excess demand in Canada is much more concentrated in one area — housing (Chart). That also just happens to be the area of the economy that is the most sensitive to interest rate increases, and an area that recent home resale data suggests is already starting to slow from the "exceptionally high" levels that the Bank of Canada described in its last policy statement. Due to the differing ways housing is included in Canadian and US inflation baskets, a moderation in house prices will also have a direct impact on CPI.

In terms of next week's decision and policy statement, the Bank will have to sound hawkish. After all, non-standard 50bp hikes don't happen every day, particularly back-to-back. Moreover, inflation has continued to surprise to the upside. However, any admission that the housing market is already responding to higher interest rates should also be seen as an admission that excess demand is about to become less excessive. That is one of the key reasons why we think that, after another 50bp hike in July, the pace of hikes will slow down, and the Bank won't need to take rates any higher than the 2.5% mid-point of its neutral band to achieve 2% inflation sometime in 2023.

Chart: Change in real final domestic demand per capita and contributions



Source: FRED, Statistics Canada, CIBC

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, May 30	8:30 AM	CURRENT ACCOUNT BAL.	(Q1)	(M)	$3.5B	-	-$0.8B
Tuesday, May 31	8:30 AM	GDP M/M	(Mar)	(H)	0.5%	0.5%	1.1%
Tuesday, May 31	8:30 AM	GDP (annualized)	(Q1)	(H)	5.2%	5.5%	6.7%
Wednesday, Jun 1	10:00 AM	BANK OF CANADA RATE ANNOUNCE.	(Jun 1)	(H)	1.50%	1.50%	1.00%
Thursday, Jun 2	8:30 AM	BUILDING PERMITS M/M	(Apr)	(M)	-	-	-9.3%
Thursday, Jun 2	11:00 AM	Speaker: Paul Beaudry (Deputy Gov.)	-	-	-	-	-
Friday, Jun 3	8:30 AM	LABOUR PRODUCTIVITY Q/Q	(Q1)	(M)	-	-	-0.5%

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, May 30	-	Markets Closed (Memorial Day)	-	-	-	-	-
Monday, May 30	11:00 AM	Speaker: Christopher J. Waller (Governor) (Voter)	-	-	-	-	-
Tuesday, May 31	9:00 AM	HOUSE PRICE INDEX M/M	(Mar)	(M)	-	2.00%	2.10%
Tuesday, May 31	9:00 AM	S&P CORELOGIC CS Y/Y	(Mar)	(H)	-	19.70%	20.20%
Tuesday, May 31	9:45 AM	CHICAGO PMI	(May)	(M)	-	55.7	56.4
Tuesday, May 31	10:00 AM	CONF.BOARD CONSUMER CONFIDENCE	(May)	(H)	102.5	103.7	107.3
Wednesday, Jun 1	7:00 AM	MBA-APPLICATIONS	(May 27)	(L)	-	-	-1.20%
Wednesday, Jun 1	10:00 AM	ISM - MANUFACTURING	(May)	(H)	54.5	54.9	55.4
Wednesday, Jun 1	10:00 AM	CONSTRUCTION SPENDING M/M	(Apr)	(M)	-	0.70%	0.10%
Wednesday, Jun 1	10:00 AM	JOLTS Job Openings	(Apr)	-	-	11400K	11549K
Wednesday, Jun 1	2:00 PM	FED'S BEIGE BOOK	-	-	-	-	-
Wednesday, Jun 1	-	NEW VEHICLE SALES	(May)	(M)	-	14.50M	14.29M
Wednesday, Jun 1	11:30 AM	Speaker: John C. Williams (Vice Chairman, New York) (Voter)	-	-	-	-	-
Wednesday, Jun 1	1:00 PM	Speaker: James Bullard (President, St Louis) (Voter)	-	-	-	-	-
Thursday, Jun 2	8:15 AM	ADP EMPLOYMENT CHANGE	(May)	(M)	-	295K	247K
Thursday, Jun 2	8:30 AM	INITIAL CLAIMS	(May 28)	(M)	-	210K	210K
Thursday, Jun 2	8:30 AM	CONTINUING CLAIMS	(May 21)	(L)	-	-	1346K
Thursday, Jun 2	8:30 AM	NON-FARM PRODUCTIVITY	(Q1 F)	(M)	-	-7.50%	-7.50%
Thursday, Jun 2	10:00 AM	FACTORY ORDERS M/M	(Apr)	(M)	0.2%	0.7%	1.80%
Thursday, Jun 2	12:00 PM	Speaker: Lorie K. Logan (Executive VP, New York)	-	-	-	-	-
Thursday, Jun 2	1:00 PM	Speaker: Loretta Mester (President, Cleveland) (Voter)	-	-	-	-	-
Friday, Jun 3	8:30 AM	NON-FARM PAYROLLS	(May)	(H)	300K	325K	428K
Friday, Jun 3	8:30 AM	UNEMPLOYMENT RATE	(May)	(H)	3.5%	3.5%	3.6%
Friday, Jun 3	8:30 AM	AVERAGE HOURLY EARNINGS ALL EMPLOYEES M/M	(May)	(H)	0.3%	0.4%	0.3%
Friday, Jun 3	8:30 AM	AVERAGE WEEKLY HOURS ALL EMPLOYEES	(May)	(H)	-	34.6	34.6
Friday, Jun 3	8:30 AM	MANUFACTURING PAYROLLS	(May)	(H)	-	39K	55K
Friday, Jun 3	10:00 AM	ISM - SERVICES	(May)	(M)	57.4	56.6	57.1
Friday, Jun 3	10:30 AM	Speaker: Lael S Brainard (Governor) (Voter)	-	-	-	-	-

Week Ahead's market call

by Andrew Grantham

In the **US**, a busy week for data should show that domestic growth is holding up fairly well despite the obvious headwinds from inflation and rising interest rates. We expect solid readings for payrolls and the services ISM, although we are a bit below consensus for the manufacturing survey where supply chain issues could be once again slowing production. The detail of the conference board's sentiment survey will hopefully show that spending intentions are still fairly solid, despite the impact that inflation is having on overall consumer confidence.

In **Canada**, the Bank is set to deliver another 50bp hike, with Q1 GDP (released Tuesday) likely joining CPI readings and printing above the BoC's prior forecasts. A big positive contribution from residential investment is expected and signal an increase in excess demand in that area (see cover). However, the advance estimate for April GDP could show growth starting to ease, partly due to housing responding to higher interest rates, and placing some downside risk to the Bank's previous Q2 GDP forecast.

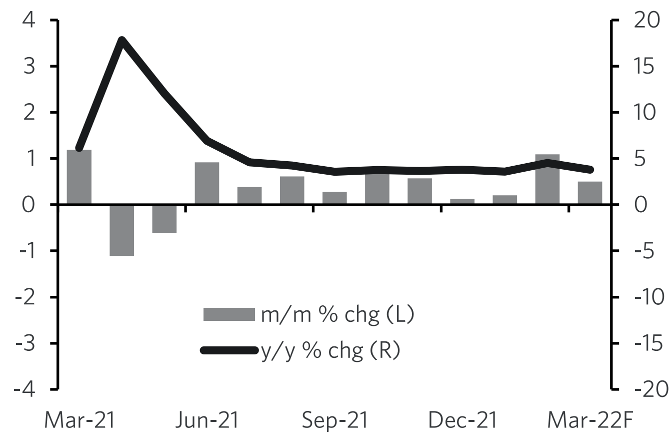
Week Ahead's key Canadian number: GDP—March & Q1

(Tuesday, 8:30 am)

Andrew Grantham andrew.grantham@cibc.com

GDP (%)	CIBC	Mkt	Prior
GDP Mar (m/m)	0.5	0.5	1.1
GDP Q1 (q/q SAAR)	5.2	5.5	6.7

Chart: Canadian real GDP at basic prices



Source: Statistics Canada, Haver Analytics, CIBC

Previously released monthly GDP by industry data suggest that Q1 growth should be in the 5½%-6% range. However, allocating such strong growth by expenditure breakdown is a bit of a headscratcher. Consumer spending will be a fairly modest positive, judging by the fact that retail sales volumes were unimpressive and that services spending was hampered early on by Omicron-related restrictions. While exports were up handsomely in value terms during the quarter, volumes were down to represent a drag on GDP. That will likely leave growth dependent on inventory rebuilding and residential investment, the latter of which saw a re-acceleration in activity as prospective buyers and renovators looked to get ahead of rising interest rates.

For March's monthly GDP print, upside revisions to the manufacturing and wholesale advance estimates likely outweigh a weaker than previously expected retail print. As such, we expect monthly GDP for March to be in line with its advance estimate, at 0.5%. Advance data for manufacturing, wholesale and retail for April indicate little in terms of volume gains on aggregate, but further growth in recovering service industries should still drive a 0.2% increase in overall GDP.

Forecast implications — While Q1 will represent a much stronger start to the year than everyone had anticipated as Omicron spread in January, the expected contributions from inventories and residential construction will be hard to replicate throughout the remainder of the year. Indeed, given signs of a drop off in home sales during April, residential investment is likely to be a drag on growth as early as Q2. Rebounding consumer spending on services will become a bigger driver, although the inflationary pressures on disposable incomes will mean overall consumption throughout the balance of the year isn't as impressive as most expected when 2022 began.

Other Canadian releases: Current account—Q1

(Monday, 8:30 am)

Surging commodity prices will have more than offset a decline in export volumes and a widening services deficit in Q1, seeing the current account balance return to a surplus position. Moreover, the $3.5bn surplus we forecast would be the highest since 2008. Continued strong oil prices into Q2 will help the current account stay in a surplus position, although a return of travel and wider deficits in services as a result will pull in the opposite direction.

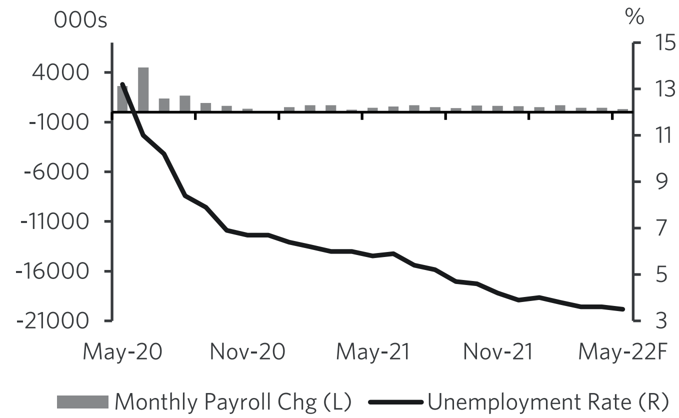
Week Ahead's key US number: Employment situation—May

(Friday, 8:30 am)

Katherine Judge katherine.judge@cibc.com

Variable	CIBC	Mkt	Prior
Employment (m/m)	300K	325K	428K
Unemployment rate	3.5%	3.5%	3.6%
Avg hourly earnings (m/m)	0.3%	0.4%	0.3%

Chart: US payroll



Source: BLS, Haver Analytics, CIBC

With inflation eroding real incomes in the US, labor force participation could have increased in May. However, employers in goods-producing sectors of the economy could have become hesitant to hire as higher interest rates are working to cool activity in the construction and real estate industries, while manufacturers are challenged by supply chain disruptions tied to the lockdowns in China. Overall, headcounts likely increased by 300K, which would still be enough to push the unemployment rate down to 3.5%. With hiring likely tilted towards lower value-added services, wage growth likely slowed to 0.3% on the month.

Forecast implications — The slowdown expected in hiring will do little to assuage the Fed's fears of inflation as the gain will still be large enough to push the unemployment rate down to its pre-pandemic low.

Market impact — We're below the consensus which could see the USD and bond yields fall.

Other US Releases: ISM Manufacturing—May

(Wednesday, 10:00 am)

Key regional PMIs declined in the US in May, suggesting that the ISM's gauge of manufacturing activity could have eased off to 54.5. Supply chain issues related to the lockdowns in China could have weighed on production growth and employment, with the expected drops in those components likely only partly offset by any rise in the supplier deliveries sub-index.

Contacts:

Avery Shenfeld
416 594-7356
avery.shenfeld@cibc.com

Benjamin Tal
416 956-3698
benjamin.tal@cibc.com

Andrew Grantham
416 956-3219
andrew.grantham@cibc.com

Karyne Charbonneau
613 552-1341
karyne.charbonneau@cibc.com

Katherine Judge
416 956-6527
katherine.judge@cibc.com

CIBC Capital Markets
PO Box 500
161 Bay Street, Brookfield Place
Toronto, Canada, M5J 2S8
Bloomberg @ CIBC

economics.cibccm.com